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Pakistan: Request for Stand-By Arrangement—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Pakistan

In the context of the request for Stand-By Arrangement, the following documents have been released and are included in this package:

- The staff report for Request for Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on October 30, 2008, with the officials of Pakistan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 20, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of November 20, 2008, on the assessment of the risks to the Fund and the Fund's liquidity position.

- A Press Release summarizing the views of the Executive Board as expressed during its November 24, 2008 discussion of the staff report that completed the review.

- A statement by the Executive Director for Pakistan.

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

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INTERNATIONAL MONETARY FUND

PAKISTAN

Request for Stand-By Arrangement

Prepared by the Middle East and Central Asia Department
(In consultation with other departments)

Approved by Masood Ahmed and Adnan Mazarei

November 20, 2008

Discussions on a potential Stand-By Arrangement (SBA) in support of the authorities' program were initiated at the time of the Annual Meetings in Washington DC and continued in Dubai during October 21–29, 2008. The staff held discussions with Advisor to the Prime Minister Tarin, State Bank of Pakistan (SBP) Governor Akhtar, Finance Secretary Khan, and senior government and SBP officials.

IMF staff team. Mr. Di Tata (Head), Mr. Kramarenko, Mr. Bartsch, Ms. Morsy (all MCD), Mr. Geadah (MCM), and Mr. Sun (SPR). Mr. Ross (Resident Representative in Pakistan) assisted the mission. Mr. Ahmad (OED) also participated in the discussions.

Access. The authorities have requested a 23-month SBA for SDR 5.169 billion ($7.6 billion, 500 percent of quota), which constitutes exceptional access. SDR 2.067 billion ($3.1 billion, 200 percent of quota) will become available upon Board approval, and the remainder will be phased thereafter subject to quarterly reviews. The authorities' request is being considered under the Emergency Financing Mechanism (EFM).

The program. In the attached Memorandum of Economic and Financial Policies (MEFP), the authorities describe the two key objectives of their program: (i) restoring macroeconomic stability and confidence through a significant tightening of macroeconomic policies; and (ii) ensuring social stability and adequate support for the poor. Program policies seek to strike an appropriate balance between these two objectives.

Article IV Consultation. The last Article IV consultation was completed by the Executive Board on December 17, 2007.

Exchange rate regime. Pakistan has accepted the obligations of Article VIII, Sections 2, 3, and 4. It maintains an exchange restriction arising from a limit on advance payments for imports. The authorities plan to eliminate this restriction by January 31, 2010. Pakistan's exchange rate regime has been classified as a managed float since January 2008.

Data. Pakistan has participated in the General Data Dissemination Standard (GDDS) since 2003. Economic data are broadly adequate for surveillance and program monitoring.

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Executive Summary

Pakistan's macroeconomic situation deteriorated significantly during 2007/08 (fiscal year starts July 1) and in the first four months of 2008/09. A robust macroeconomic performance through mid-2007 was affected by adverse security developments, large increases in import prices (oil and food), and the global financial turmoil. Delays in passing through higher energy prices to consumers led to an increase in the fiscal deficit to 7.4 percent of GDP in 2007/08, from 4.3 percent in 2006/07. Monetization of the higher fiscal deficit fueled inflation, which reached 25 percent in October 2008. Against this background, real GDP growth slowed to 5.8 percent in 2007/08, the current account deficit widened to 8.4 percent of GDP, and gross international reserves fell to a critically low level of $3.4 billion (less than one month of imports) at end-October 2008.

The authorities have requested a 23-month Stand-By Arrangement for SDR 5.169 billion ($7.6 billion, 500 percent of quota) in support of their macroeconomic stabilization program for 2008/09 and 2009/10. The authorities' program envisages a tightening of fiscal and monetary policies to bring down inflation and reduce the external current account deficit to more sustainable levels. The pace of adjustment seeks to balance the need to address the current macroeconomic imbalances with protecting social stability.

Key elements of the program:

- **The fiscal program seeks to reduce the deficit from 7.4 percent of GDP in 2007/08 to 4.2 percent in 2008/09, and to 3.3 percent in 2009/10, while allowing for increased spending on the social safety net**. This fiscal adjustment will be achieved primarily by phasing out energy subsidies, better prioritizing development spending, and implementing tax policy and administration measures. The authorities are seeking additional donor support for funding the expanded social safety net and for increasing development spending (the program includes adjustors for this purpose). The program envisages important reforms in tax policy and administration and public financial management.

- **Monetary policy will be tightened, and potential financial sector vulnerabilities will be addressed**. The State Bank of Pakistan (SBP) recently increased its discount rate by 200 basis points to 15 percent and stands ready to further tighten monetary conditions, as needed, to protect the country's reserves position, bring down inflation, and eliminate SBP financing of the government. The program also envisages the design of contingency plans to address problem banks, and measures to improve monetary management and strengthen the SBP's bank resolution capacity.

The program faces considerable risks. These risks arise from security and implementation uncertainties, a more severe-than-anticipated slowdown in economic activity in trading partners, and lower-than-expected private capital inflows. There is an urgent need to mobilize additional donor support to strengthen Pakistan's resilience to potential shocks, help finance the expanded social safety net, and allow for higher spending on development programs.

I. INTRODUCTION

1. **From the early 2000s to mid-2007, Pakistan's macroeconomic performance was robust**. During the period 2000/01–2004/05, when Pakistan successfully implemented two Fund-supported programs (an SBA and a three-year arrangement under the Poverty Reduction and Growth Facility), real GDP growth averaged 5 percent a year with relative price stability.[1] The improved macroeconomic performance enabled the country to re-enter international capital markets in the mid-2000s. During 2005/06–2006/07, higher foreign direct investment (FDI) and portfolio inflows financed a strengthening of the international reserves position, despite a widening current account deficit. The external debt declined to 27 percent of GDP, and gross official reserves rose to $14.3 billion (3.8 months of imports) at end-2006/07. At the same time, real GDP grew by more than 7 percent a year owing to a significant policy stimulus and the foreign-financed increase in investment, while inflation remained at around 7 percent.

2. **The macroeconomic situation, however, deteriorated significantly in 2007/08 and the first four months of 2008/09 on account of domestic and external factors**. Adverse security developments, large exogenous price shocks (oil and food), and global financial turmoil buffeted the economy. These shocks, combined with policy inaction during the political transition to a new government and large central bank financing of the growing fiscal deficit led to slower growth, higher inflation, and a sharp deterioration of the external position.

3. **Against this background, the Pakistani authorities have embarked upon a program to restore macroeconomic stability while protecting the poor and vulnerable during the process of adjustment**. To support this program, they have requested a 23-month SBA in an amount equivalent to 500 percent of quota, with front-loaded access. The exceptional access is consistent with the size of Pakistan's balance of payments need, while the front-loading is justified by the necessity to bolster the country's international reserve position at the outset of the program.

II. RECENT DEVELOPMENTS

4. **Economic activity has slowed**. Real GDP growth decelerated to 5.8 percent in 2007/08, from 6.8 percent in 2006/07, as both investment and consumption were negatively affected by weakened confidence, reduced foreign exchange inflows, and adverse security developments (Table 1 and Figure 1). Available indicators suggest that growth in the manufacturing sector decelerated markedly in the first quarter of 2008/09.

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[1] For a more detailed assessment of Pakistan's performance during this period see *Pakistan—Ex Post Assessment of Longer-Term Program Engagement* (Country Report No. 05/408).

5. **Inflation has been on the rise since early 2008**. Twelve-month headline CPI inflation rose to 25 percent in October 2008 owing to strong domestic demand growth, rising fuel and food import prices, and a depreciation of the rupee of more than 30 percent since end-March 2008. Core inflation (excluding energy and food) increased to 18.3 percent in October.

6. **The external position has deteriorated significantly**. The external current account deficit widened to 14 billion or 8½ percent of GDP in 2007/08, from 4.8 percent in 2006/07, reflecting higher oil import prices and continued strong aggregate demand growth. This, combined with a sharp decline in capital inflows, in particular portfolio investment (Figure 2), led to a drop in gross international reserves from $14.3 billion at end-June 2007 to a critically low level of $3.4 billion (less than 1 month of imports) at end-October 2008.

7. **The fiscal deficit (excluding grants) is estimated to have risen to 7.4 percent of GDP in 2007/08, from 4.3 percent in 2006/07**. This deterioration in the fiscal position is mainly attributable to a substantial increase in energy and food subsidies (in a context of rising international prices that were not passed through to consumers), higher than envisaged interest payments, and additional security-related expenditures (Tables 3a–3b and Figure 3).

8. **Increases in interest rates were insufficient in light of the rise in inflation, and the State Bank of Pakistan (SBP) accommodated the government's large domestic financing needs**. The SBP increased its discount rate in several steps by 350 basis points starting in June 2007, to 13 percent in July 2008. Cut-off interest rates in the bi-weekly auctions of treasury bills largely followed the changes in the discount rate, but were not sufficiently attractive to commercial banks. As a result, commercial banks reduced their holdings of treasury bills, and SBP financing of the government reached PRs 950 billion ($12 billion) during July 2007–October 2008 (Table 4 and Figure 4). Negative real interest rates resulted in a slowdown in rupee deposit growth and an increase in foreign currency deposits, while credit growth to the private sector accelerated to 20 percent by September 2008.

9. **The banking system was well capitalized and liquid based on the latest data available as of end-June 2008, but liquidity problems emerged recently**. Some small and mid-sized banks have recently experienced serious liquidity problems because of deposit withdrawals, which prompted the authorities to reduce the cash reserve requirement by 4 percentage points in two steps during October–November, and to broaden the range of assets that can be used to meet the statutory liquidity requirement. The SBP also facilitated mergers of some non-viable banks with sound banks.

Pakistan: Financial Soundness Indicators for the Banking System, 2005–08

	Dec. 2005	Dec. 2006	Dec. 2007	Jun. 2008
Capital adequacy				
Regulatory capital to risk-weighted assets	11.3	12.5	13.2	12.1
Asset composition and quality				
Provisions to NPLs	76.7	66.5	75.0	75.0
NPLs net of provisions to capital	14.3	13.5	8.3	10.2
Earnings and profitability				
Return on assets (after tax)	1.9	2.1	1.5	1.7
Return on equity (after tax)	25.8	24.2	15.5	16.7
Liquidity				
Liquid assets to total assets	33.7	32.0	33.6	31.6

Source: Pakistani authorities.

10. **Financial market indicators have also deteriorated markedly**. The EMBIG spread of Pakistani sovereign bonds has risen to above 2,000 basis points, and the Karachi KSE-100 stock index, after climbing to record highs by end-April 2008, dropped by 40 percent by late August 2008. In response, on August 27, 2008, the authorities imposed a price floor on all stock prices, which has led to a virtual halt in trading.

11. **Faced with increasing pressures in the foreign exchange market, in May 2008, the authorities adopted several exchange measures** consisting of: (i) a 25 percent limit on advance payments for imports of goods (an exchange restriction subject to Fund approval under Article VIII, Section 2(a)); (ii) the requirement for exchange bureaus to repatriate foreign exchange from their accounts abroad and to sell 25 percent of any foreign exchange receipts in the interbank market; (iii) prior SBP consent for outward remittances of more than $50,000 upon verification of the bona fide nature of the payment; and (iv) a margin requirement of 35 percent for the opening of letters of credit for non-essential imports. With regard to this latter measure, which was introduced at a later date, staff is obtaining additional information from the authorities in order to assess its jurisdictional implications. In addition, the government recently imposed regulatory duties on imports of luxury items.

III. The Authorities' Program

12. **The authorities' economic program for 2008/09–2009/10 seeks to restore the confidence of international and domestic investors by addressing the current macroeconomic imbalances while preserving social stability by protecting the poor**. The program envisages a significant tightening of fiscal and monetary policies to bring down inflation and strengthen the external position, as well as several structural measures in the

fiscal and financial sectors. The pace of adjustment seeks to balance the need to quickly restore macroeconomic stability with mobilizing the required domestic political support for the program, which is an essential precondition for its success.

A. Macroeconomic Framework

13. **The authorities' policies for the remainder of 2008/09 and for 2009/10 are aimed at stabilizing the macroeconomic situation; strengthening the international reserves position, including by stopping and ultimately reversing portfolio outflows; and easing the burden of adjustment on the poor**. Real GDP growth is projected to slow to 3–3½ percent in 2008/09 in response to weaker aggregate demand growth and a deceleration in economic activity in Pakistan's trading partners. The 12-month inflation rate is targeted to decline to 20 percent by June 2009, even after taking into account the impact of significant increases in administered prices (Table 1).

14. **The external position is expected to strengthen significantly in 2008/09 in response to tighter financial policies, improved confidence, lower commodity prices, and higher disbursements from international financial institutions**. The external current account deficit is projected to decline to 6½ percent of GDP in 2008/09 owing mainly to lower oil import prices and slower non-oil import growth. In the financial account of the balance of payments, the program envisages an increase in disbursements to the government by multilateral and bilateral creditors to $4.8 billion in 2008/09 ($2.5 billion in 2007/08), which includes $1.4 billion from the World Bank and $2.2 billion from the Asian Development Bank, of which $500 million was already disbursed in September. This increase will be more than offset, however, by sluggish FDI performance and significant outflows of portfolio and other investments. Given the need to rebuild reserves to at least $8.6 billion (the level prevailing at end-June 2008), an external financing gap of $4.7 billion is projected for 2008/09 (Table 2). This gap will be fully covered by access to Fund resources.

15. **The program envisages further gains in macroeconomic stabilization in 2009/10**. Real GDP growth would pick up to 4½–5 percent in 2009/10 owing to a recovery of confidence and investment. With further fiscal adjustment, the continuation of a tight monetary policy, and falling oil and food import prices, CPI inflation is projected to decline to 6 percent by June 2010. The external current account deficit would narrow further to 5.7 percent of GDP in 2009/10, while higher FDI and a resumption of portfolio flows would more than offset a decline in official disbursements. With a further targeted increase in international reserves to $11.3 billion by end-June 2010, a financing gap of $3.6 billion would remain in 2009/10. This gap will be filled with Fund resources and privatization proceeds, including from Global Depository Receipts (GDRs).

16. **Successful implementation of the authorities' program will lay the foundation for a significant improvement in macroeconomic conditions over the medium term**. Real GDP growth is projected to increase gradually to 6½–7 percent a year by 2012/13, with inflation declining to 5 percent. Further fiscal consolidation by substantially raising tax revenue (a key condition for fiscal viability) and the continuation of a tight monetary policy stance should contribute to a gradual decline in the external current account deficit to about 3½ percent of GDP over the medium term.[2] As a result of this improvement and increased capital inflows, international reserves would increase gradually to about $14.5 billion (2.6 months of imports) by end-June 2013 (Tables 5–7).

B. Fiscal Policy

17. **The fiscal program envisages a reduction in the fiscal deficit to 4.2 percent of GDP in 2008/09, from 7.4 percent in 2007/08, to help reduce the external current account deficit and move toward a more sustainable fiscal position**. At the same time, the authorities are committed to eliminating SBP financing of the government during October 1, 2008–June 30, 2009. Although the fiscal effort could arguably be more ambitious, the envisaged pace of adjustment is justified by the need to provide an appropriate level of poverty-related spending. Tax revenue is programmed to increase by ½ percentage point of GDP in 2008/09 on account of tax administration measures (MEFP, ¶9 and 15) and an increase of one percentage point in the general sales tax (GST) rate implemented when the budget was approved. Expenditure measures (2¾ percent of GDP) include the phasing out of energy subsidies and a better prioritization of development spending. The authorities have already raised domestic fuel prices, which, in combination with declining international fuel prices, has led to the elimination of fuel subsidies. They have also increased electricity tariffs by an average of 18 percent on September 5, and in close collaboration with the World Bank will prepare a plan, by end-December 2008, to complete the elimination of electricity subsidies by end-June 2009 (structural benchmark).

18. **The program targets a further reduction in the fiscal deficit to 3.3 percent of GDP in 2009/10**. On the revenue side, tax administration measures, an increase in excises on tobacco, and a reduction in exemptions are expected to yield an additional 0.8 percent of GDP (MEFP, ¶15). Total expenditure is programmed to remain broadly constant at about 19 percent of GDP in 2009/10, but the full-year effect of the elimination of energy subsidies will create room for increasing development spending by 0.9 percent of GDP (MEFP, ¶14) and for maintaining an adequate level of social safety net spending.

[2] While the projected current account deficits for 2008/09 and 2009/10 are high, the adjustment scenario envisaged in the program is expected to reduce the deficit to slightly below the current account norm under the macroeconomic balance approach over the medium term (implying broad alignment of the exchange rate with fundamentals). However, the medium-term deficit would still be above the NFA-stabilizing current account deficit, implying a 12 percent overvaluation under the external sustainability approach.

19. **A strengthening and better targeting of social assistance constitute an essential element of the program**. Specifically, the authorities intend to increase social safety net spending by 0.6 percentage points of GDP in 2008/09, to 0.9 percent of GDP, in order to protect the poor and cushion the impact of the elimination of subsidies on vulnerable groups (MEFP, ¶10). To this end, in close collaboration with the World Bank, the authorities will develop, by end-March 2009, a strategy and a time-bound action plan to strengthen the social safety net and improve targeting to the poor, including under the newly introduced Benazir Income Support Program. They will also implement short-term social support measures by scaling up other existing programs (structural benchmark, MEFP, ¶11). In addition, electricity tariffs already incorporate a "lifeline" minimum tariff that will shield low-income households consuming small amounts of electricity from a steep increase in tariffs. The authorities are seeking additional external assistance from bilateral donors in order to cover the cost of the expanded social safety net.

20. **The authorities' program incorporates a number of fiscal reforms that are critical to the achievement of the fiscal objectives**. In the area of public financial management, the transition to a single treasury account will be completed by end-June 2009 (structural benchmark), which will help improve control on cash disbursements and overall cash management. Moreover, a better coordination among various government agencies on the design and implementation of the public investment program will strengthen project selection and execution (MEFP, ¶17). The authorities also intend to prepare a plan by end-March 2009 (structural benchmark, MEFP, ¶12) for addressing the large inter-corporate debt in the energy sector, with a view to proceeding with a gradual settlement of this debt with limited use of budgetary resources (MEFP, ¶12).

21. **Medium-term fiscal consolidation will be supported by strong tax policy and administration measures, while allowing for higher spending in infrastructure and the social sectors**. Specifically, the authorities' medium-term fiscal framework assumes a further increase in tax revenue of at least 2½ percentage points of GDP (MEFP, ¶15). This revenue effort, along with declining interest payments, will make it possible to significantly increase development and social spending while reducing the fiscal deficit to 2.0–2.5 percent of GDP by 2012/13 (Table 6).

22. **The authorities are committed to moving ahead with substantive tax policy and administration reform during the program period**. Initially, the focus will be on tax administration measures, with an action plan expected to be finalized by end-December 2008 (structural benchmark, MEFP, ¶15). Subsequently, the government will reduce exemptions under the GST and harmonize the income and GST laws in the context of the 2009/10 budget discussions (performance criterion). Finally, a new draft VAT law will be submitted for public debate by end-2009. The full revenue impact of this law will materialize over the medium term.

C. Monetary and Exchange Rate Policy

23. **The program envisages a tightening of monetary policy**. As a first step in this direction, on November 12, 2008, the SBP raised the discount rate by 200 basis points, to 15 percent. The authorities believe that this action, together with further interest rate flexibility going forward, will be sufficient to protect the country's reserve position and ensure that the domestic financing requirement of the government will be met entirely through market placements of government securities, without further recourse to SBP financing. The authorities are committed to increasing the discount rate further at the time of the Monetary Policy Statement at end-January 2009, or earlier, as needed, if the SBP's actual net foreign assets fall short of monthly benchmarks established under the program.

24. **The SBP will pursue a flexible exchange rate policy, with intervention in the foreign exchange market geared to achieving the program's monthly NFA targets and smoothing excessive exchange rate volatility**. To facilitate this task, the SBP will phase out the provision of foreign exchange for oil imports, which will be shifted to the interbank market starting with the foreign exchange for furnace oil by February 1, 2009 (structural benchmark). The authorities will also eliminate the exchange restriction arising from the existing limit on advance payments for imports by January 31, 2010, and are committed not to impose or intensify existing restrictions or impose or modify multiple currency practices subject to Fund approval during the program period (MEFP, ¶21).

25. **Several measures will be taken to improve liquidity management and monetary policy implementation**. In particular, the coordination between the SBP and the treasury on forecasting the government cash flow requirements will be strengthened. To this end, quarterly volumes of treasury bill placements consistent with zero SBP financing of the budget during October 1, 2008–June 30, 2009 have been agreed between the two institutions. In addition, the SBP will adopt a more transparent liquidity management framework by end-June 2009. In line with Fund technical assistance and the recommendations made by a recent FSAP update mission (September 2008), this framework envisages the establishment of an interest rate corridor (MEFP, ¶19) and an increase in the frequency of the SBP's policy meetings to enhance the responsiveness of monetary policy.

26. **The authorities also intend to set up an inter-agency committee to review and strengthen the legal provisions relating to the operational independence of the SBP**. By the time of the second program review, this committee will determine the steps to be taken in order to align SBP legislation with best international practices (MEFP, ¶24). The authorities intend to request Fund technical assistance for this purpose.

27. **In the financial sector, some small and mid-sized banks are vulnerable to shocks**. The authorities broadly agreed with the conclusions of stress tests conducted recently by Fund staff in the context of the FSAP update mission. These tests suggest that while large

banks appear resilient to potential shocks (e.g., higher interest rates and exchange rate depreciation), some small and mid-sized banks are vulnerable to large interest rate increases and a related deterioration in credit quality. Recognizing these risks, the SBP is preparing a contingency plan for dealing with problem private banks, which will be ready by end-December 2008 (structural benchmark, MEFP, ¶22). Moreover, the SBP's enforcement powers will be strengthened by submitting the necessary legislative amendments to parliament by end-June 2009 (performance criterion, MEFP, ¶23).

28. **The floor on stock prices will be retained until macroeconomic conditions have improved**. The authorities explained that if the floor on stock prices were to be maintained, Pakistan would most likely be removed from the MSCI (Morgan Stanley Capital International) emerging markets index, which would limit the ability of institutional investors to invest in Pakistan. They recognized, however, that it would be premature to remove the floor on stock prices before the macroeconomic situation stabilizes and investor confidence improves, as such a decision could lead to significant portfolio outflows and pressures on the reserves position. The authorities also indicated that they were considering to support the market through (i) a fund to be established by four state-owned financial institutions (with borrowing guaranteed by the government) to buy shares in seven large state-owned companies; and (ii) government guarantees of 12-month put options to insure investors against possible stock price declines. The staff argued against the use of public funds to support the market. At the end, the authorities agreed that the timing and terms under which the floor will be removed, including any use of public funds to support the market, will be decided after reaching understandings with Fund staff.

IV. Program Modalities

A. Program financing

29. **Pakistan faces very sizeable financing needs during the program period**. As noted above, staff estimates that even with the envisaged narrowing of the external current account deficit, the overall gross external financing needs would remain large (Table 8), particularly during the first year of the program, owing to continued pressures on the financial account. Notwithstanding the large commitments from multilateral sources already identified, private financial flows are expected to be insufficient to meet the balance of payments financing requirements. Privatization proceeds and additional support from bilateral donors would help reduce Pakistan's external financing needs, but a sizable financing gap would remain taking into account the need to build up reserves from the current low levels.

30. **The authorities have requested a 23-month SBA in the amount of SDR 5.169 billion (500 percent of quota)**. Fund support will help meet the balance of payments need. Following the first Fund disbursement of $3.1 billion (200 percent of quota), a limited portion of these resources is expected to be used for intervention to ensure orderly conditions in the foreign exchange market. Subsequently, increased donor support, a

reduction in financial account pressures, and the remaining Fund disbursements will contribute to a significant increase in international reserves to a more comfortable level. The arrangement is subject to exceptional access policy. Box 1 contains an evaluation of the four criteria for exceptional access.[3]

Box 1. Exceptional Access Criteria

Presently, Pakistan is mainly a current account case, but the situation is increasingly becoming aggravated by capital account pressures. Below is an evaluation of Pakistan's situation in light of the four substantive criteria for exceptional access:

Criterion 1—exceptional balance of payments pressure in the capital account. In addition to the widening of the current account, the loss of investor confidence following the deterioration in Pakistan's fiscal position, domestic political instability, and the decline in risk appetite in the wake of the global financial turmoil have resulted in a significant decline in capital inflows. (The decrease in capital inflows in 2007/08 compared with 2006/07 amounted to $2.5 billion or 163 percent of quota). Given Pakistan's dependence on foreign capital inflows to finance its relatively large current account deficit, the reduction in these inflows contributed to a large loss of international reserves. Rebuilding the reserves position requires Fund financing beyond the normal access levels.

Criterion 2—sustainable debt position. Despite relatively large current account deficits in recent years, Pakistan's external debt amounted to 27 percent of GDP at end-2007/08. This is mainly explained by the preponderance of FDI and low-interest official financing in the structure of capital inflows. Public and publicly-guaranteed debt, however, amounted to 58 percent of GDP at end-2007/08. The financing of the program would be consistent with a decline in debt ratios over the medium term, provided that the authorities fully implement the appropriate stabilization policies.

Criterion 3—access to private capital markets. Until recently, Pakistan had access to international financial markets by issuing Eurobonds, GDRs, and exchangeable bonds, as well as through nonresidents' portfolio investment in domestic securities. However, FDI, which is the primary source of external inflows, appears to be holding up despite the recent sharp slowdown in other flows. It is expected that Pakistan can regain access to international capital markets and see a significant pickup in FDI in two to three years, provided the adjustment effort is successfully implemented.

Criterion 4—strong policy reform program. The government's recent steps toward reducing the fiscal deficit in 2008/09 and its efforts to prepare a home-grown stabilization program demonstrate the authorities' intent to address the current macroeconomic imbalances. The staff believes that Pakistan has sufficient institutional capacity to deliver the required adjustment, as evidenced by the successful implementation of Fund-supported programs during 2000/01–2004/05. However, while there are reasonable prospects for success if the authorities' proposed policies are implemented, the risks to the program remain very high, as implementation can be affected by the difficult political, security, and economic conditions.

[3] Management informed the Executive Board about a potential need for exceptional access and its intention to invoke the exceptional financing mechanism on October 20, 2008, and the staff updated the Board on progress on exceptional access on October 29, 2008 and November 14, 2008.

31. **It is proposed that exceptional access be provided on SBA terms**. The presumption is that exceptional access in capital account crises will be provided with resources of the Supplemental Reserve Facility (SRF), where SRF conditions apply. The SRF is geared toward "large *short-term* financing needs resulting from a sudden and disruptive loss of confidence reflected in pressure on the capital account and the member's reserves." However, as noted above, Pakistan is mainly a current account case and the balance of payments needs are unlikely to be short-lived. The country will have to undergo a prolonged current account adjustment, while facing capital account pressures that are likely to subside only gradually, particularly taking into account the prevailing global financial conditions. Therefore, the staff proposes a 23-month SBA arrangement with exceptional access under "upper credit tranche" terms.

B. Financial Risks to the Program and Capacity to Repay the Fund

32. **Downside risks to the program are significant**:

- **The political and security situation remains challenging**. Program adjustment measures could further intensify existing social tensions associated with the difficult security situation, high inflation, frequent power outages, and increasing poverty. An escalation of these tensions may lead to a reversal of policies and a further sharp deterioration of political and economic conditions. Under these circumstances, a vigorous implementation of the measures aimed at strengthening the social safety net and reducing inflation is essential to address these risks and increase the chances of program success.

- **External sector developments are highly uncertain**. A worse-than-expected economic downturn in trading partners, lower remittances from the Gulf Cooperation Council (GCC) countries, and a delayed resumption of foreign portfolio investment in Pakistan would lead to a larger-than-projected financing gap. The authorities' commitment to adjust policies in response to these shocks (MEFP, ¶27) and the possible mobilization of additional concessional donors' assistance (see below) should mitigate these risks.

- **The external and fiscal debt sustainability analyses (DSA) highlight a number of additional risk factors**. The external DSA indicates that debt ratios will remain well contained in the medium term under the baseline scenario, with the external debt peaking at 33 percent of GDP in 2009/10 and gradually declining to below 29 percent by 2012/13 (Table 12). The fiscal DSA also projects that under the baseline scenario public debt ratios will decline from 58 percent of GDP in 2007/08 to 44 percent in 2013/14 (Table 13). However, an exchange rate overshooting could negatively affect the outlook for external and public debt sustainability (Figures 5–6). Other risk factors (e.g., higher interest rates, slower real GDP growth, a higher current account deficit, or lower FDI) and possible use of public funds to support the banking system would have a moderate impact on debt ratios. The external DSA also estimated the impact of a combined shock including lower growth, a higher current account deficit, lower FDI, and a 30 percent real depreciation, while the fiscal DSA estimated the effects of a combined shock including lower growth, a higher real interest rate, and a lower primary surplus. In both cases, debt ratios remain sustainable.

- **Notwithstanding the preponderance of downside risks, there are also a number of upside factors**. These include a stronger-than-expected decline in commodity prices, a faster return of investor confidence, and larger-than-expected donor assistance. The realization of these upside factors could lead to a better balance of payments outcome, a higher reserve buildup, potentially stronger growth, and faster improvement in social indicators. If larger than expected external budget support becomes available, the first $500 million (0.3 percent of GDP per year) will be used to replace noncentral bank domestic government borrowing assumed in the program to cover additional social safety net spending. Any additional external financing beyond the first $500 million per year can be used to increase government spending, in particular development spending and security related outlays, up to a fiscal deficit of 4.7 percent of GDP in 2008/09 and 3.8 percent of GDP in 2009/10. This would result in somewhat higher growth and external current account deficits. Beyond those limits, any additional external financing will be assigned to retire government debt with the SBP and strengthen the SBP's international reserves position.

33. **Given its relatively moderate initial external debt burden, the staff believes that Pakistan will be able to discharge its obligations to the Fund in a timely manner, provided the authorities' adjustment program is fully implemented.** Fund credit outstanding will peak at SDR 5.5 billion in 2010/11 (67 percent of gross reserves), while debt service payments will reach about 22 percent of gross reserves and 8 percent of exports of goods and services in 2012/13 (Tables 9–10). The authorities' past record of servicing Fund obligations has been very satisfactory and provides additional comfort.

C. Program Phasing and Monitoring

34. **The SBA will cover 23 months and will be subject to quarterly reviews**. As noted earlier, access will be frontloaded given the large financing needs at the beginning of the program; the remaining tranches will be disbursed according to the schedule presented in Table 11. In line with the procedures on the EFM, the staff intends to inform the Executive Board on implementation and market response to the program within one to two months after its approval.

35. **Performance under the program will be monitored based on quarterly quantitative performance criteria (PC) and structural PCs and benchmarks (MEFP, Tables 1–2)**. Key quantitative PCs include floors on the SBP's net foreign assets, ceilings on

the SBP's net domestic assets, ceilings on the budget deficit, and limits on SBP's net credit to the government for end-December 2008, end-March 2009, and end-June 2009.[4] Structural PCs and benchmarks focus on areas of macroeconomic relevance that are considered critical for achieving the program's objectives, including the social safety net, tax reform, public financial management, monetary and exchange rate policy, and the SBP's supervisory enforcement capacity and contingency planning (Box 2).

36. **Safeguards**. An updated safeguards assessment will be completed no later than at the time of the first review. In this context, the authorities are providing the required documentation and a Fund safeguards mission is expected to take place in January 2009.

Box 2. Rationale for the Proposed Structural Conditionality under the SBA

Monetary and exchange rate policy
Subordinating foreign exchange intervention policy to the achievement of the SBP's NFA targets is a key program commitment ensuring sufficient exchange rate flexibility, which is critical for achieving the program's reserve targets and promoting current account adjustment. To fulfill this commitment, the SBP's provision of foreign exchange for oil imports will be phased out according to a schedule (MEFP, ¶20), with the elimination of provisions for furnace oil by February 1, 2009 being the first step (structural benchmark, MFEP, ¶20).

Banking sector issues
The SBP and the government need to be fully prepared to address any potential strains in the banking system. To ensure an appropriate response, the SBP will finalize a contingency plan for handling problem private banks by end-December 2008 (structural benchmark, MEFP, ¶22). In addition, submitting amendments to the banking legislation to Parliament by end-June 2009 is essential to enhance the effectiveness of SBP enforcement powers in the areas of banking supervision (performance criterion, MEFP, ¶23).

Fiscal structural issues
To ensure the targeted reduction in the fiscal deficit and to help eliminate SBP financing of the government—key objectives under the program-- a number of structural performance criteria and benchmarks relating to expenditure and revenue measures, as well as fiscal management, have been introduced. A strong **revenue effort** is essential to significantly increase the tax-to-GDP ratio, which is low by international standards. To this end, a full description of required reforms in the area of tax administration, including an action plan for harmonizing the GST and income tax administration, will be finalized by end-December 2008 (structural benchmark, MFEP, ¶15); and the government will submit, by end-June 2009, draft legislative amendments to parliament to harmonize the income tax and GST laws and reduce exemptions (performance criterion, MFEP, ¶15). Regarding **expenditure,** in close collaboration with the World Bank, the government will finalize, by end-December 2008, the schedule for further electricity tariff adjustments during 2008/09 with a view to eliminating tariff differential subsidies by end-June 2009 (structural benchmark, MFEP, ¶9). With respect to **fiscal management,** the government will prepare a plan for eliminating the inter-corporate circular debt by end-March 2009 (structural benchmark, MFEP, ¶12; and the transition to a single treasury account will be completed by end-June 2009 (structural benchmark, ¶17).

Social protection measures
The design and implementation of a comprehensive system of targeted social assistance is an integral part of the program. In close collaboration with the World Bank, the government will develop a strategy and a time-bound action plan, by end-March 2009, for the adoption of specific measures to strengthen the social safety net and improve targeting to the poor (structural benchmark, MFEP, ¶11).

[4] The establishment of performance criteria for a 12-month period is not proposed because of substantial uncertainties on economic trends.

V. STAFF APPRAISAL

37. **Pakistan's economy has reached a critical juncture. It has been severely affected by adverse security developments, large exogenous shocks, and policy inaction during the political transition to a new government**. During this transition, there was a long delay in passing through to consumers the large increases in international oil and food prices, which resulted in a marked deterioration of the external and fiscal positions. Monetization of the fiscal deficit fueled inflationary pressures and contributed to a significant widening of the external current account deficit. At the same time, weakening investor confidence and the global financial turmoil resulted in a slowdown of capital inflows and, subsequently, a reversal of portfolio flows and capital flight. As a result, gross official reserves have declined sharply to a precarious level of less than one month of imports, even after a substantial depreciation of the rupee.

38. **The authorities' program for the remainder of 2008/09 and for 2009/10 seeks to address the current macroeconomic imbalances while preserving social stability and protecting the poor**. The envisaged fiscal and monetary tightening will help bring down inflation and reduce the external current account deficit. At the same time, scaled up donor support associated with the program and a restoration of investor confidence are expected to help strengthen Pakistan's weak international reserves position. A forceful and sustained implementation is key to the success of the program.

39. **Fiscal consolidation is essential to put the public finances on a sustainable path and eliminate SBP financing of the government**. The authorities have prepared a comprehensive package of revenue and expenditure measures to support a substantial fiscal adjustment effort in 2008/09 and 2009/10. The fiscal program focuses on phasing out energy subsidies and significantly strengthening tax revenue, which is exceptionally low by international standards, while accommodating an expanded and more effective social safety net. The government already implemented a significant adjustment in domestic fuel prices that led to the elimination of fuel subsidies. Completing the elimination of electricity subsidies would help achieve the program budget targets, while reducing distortions and providing a supportive environment for needed investment in the power sector. Implementing the tax policy and administration measures envisaged in the program will require sustained efforts and strong political determination. These reforms are critical to reduce the fiscal deficit while allowing for sufficient resources for social and development spending.

40. **Putting in place a comprehensive and effective social safety net is a key priority of the program**. In particular, there is an urgent need to improve targeting and delivery mechanisms. While a more comprehensive and well-targeted social safety net is being designed with World Bank assistance, other existing social support programs could usefully be scaled up.

41. **Public financial management reforms should also be pursued decisively**. Efforts in this area are necessary to ensure transparency and accountability in the use of public funds, and improve budget cash management. A plan for addressing the inter-corporate circular debt in the energy sector should be developed without further delay.

42. **Fiscal efforts should continue beyond the program period by focusing primarily on further strengthening revenue mobilization**. This will permit reducing the fiscal deficit to 2–2½ percent of GDP, while allowing for significantly higher spending in infrastructure and the social sectors. In particular, strong measures will be necessary to broaden the GST base, significantly reduce income tax exemptions, and further improve tax enforcement.

43. **A tighter monetary policy is essential to protect the country's international reserves position, help bring down inflation, and avoid further central bank financing of the government**. The recent increase in the SBP's discount rate is a step in the right direction, and the authorities should be ready to raise the discount rate further if the monthly program benchmarks for reserves are not achieved or the results of the treasury bill auctions prove insufficient to eliminate SBP financing of the government. In addition, the SBP and the treasury should improve coordination in forecasting the government's cash flow and domestic debt management in order to ensure the targeted placement of treasury bills with commercial banks and non-banks. A decisive implementation of reforms aimed at strengthening the SBP's operational independence and improving liquidity management will increase the credibility and agility of monetary policy.

44. **Moreover, exchange rate flexibility is needed for achieving the program's reserves targets**. As part of efforts in this area, the schedule for eliminating the SBP's allocation of foreign exchange for oil imports should be adhered to. Given the authorities' intention to eliminate the exchange restriction related to advance payments for imports by end-January 2010, the staff proposes the approval of this restriction, which is temporary, nondiscriminatory among Fund members, and was imposed for balance of payments reasons.

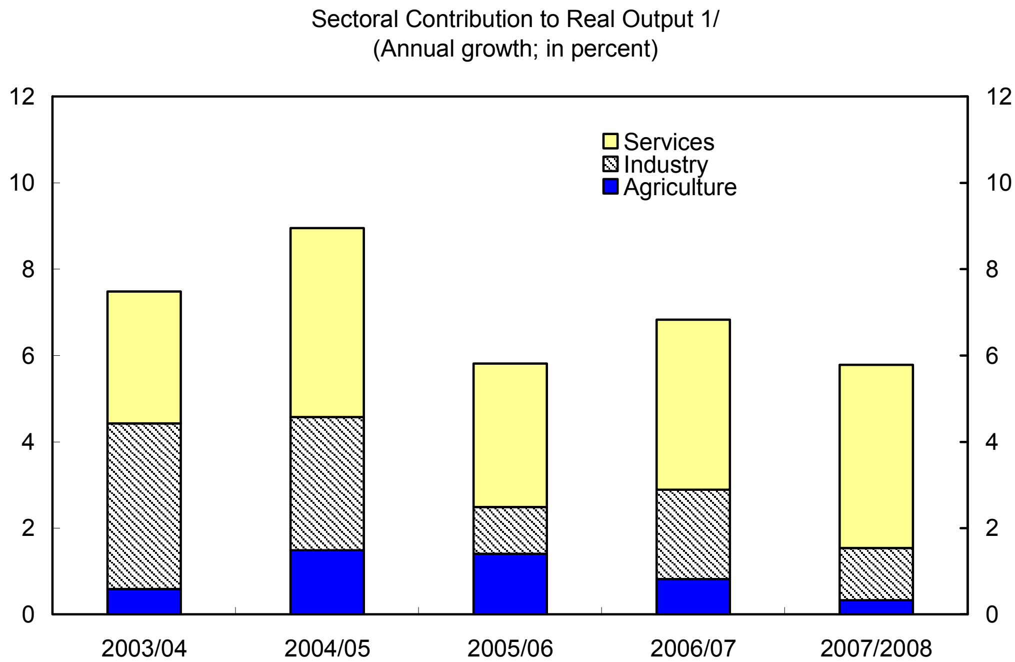
45. **Financial sector vulnerabilities need to be monitored closely and an appropriate crisis management framework should be put in place without delay**. In particular, the SBP should finalize promptly contingency plans for handling problem banks and its enforcement powers should be strengthened by amending the present legislation. If liquidity pressures reoccur, the SBP should focus on providing targeted support to solvent banks and to seek the resolution of insolvent banks, rather than resorting to generalized injections of liquidity. Given the weak external position, it is important that the removal of the current floor on stock prices take place only after the macroeconomic situation has stabilized and investor confidence has improved. In addition, the authorities should avoid using public funds to support stock prices.

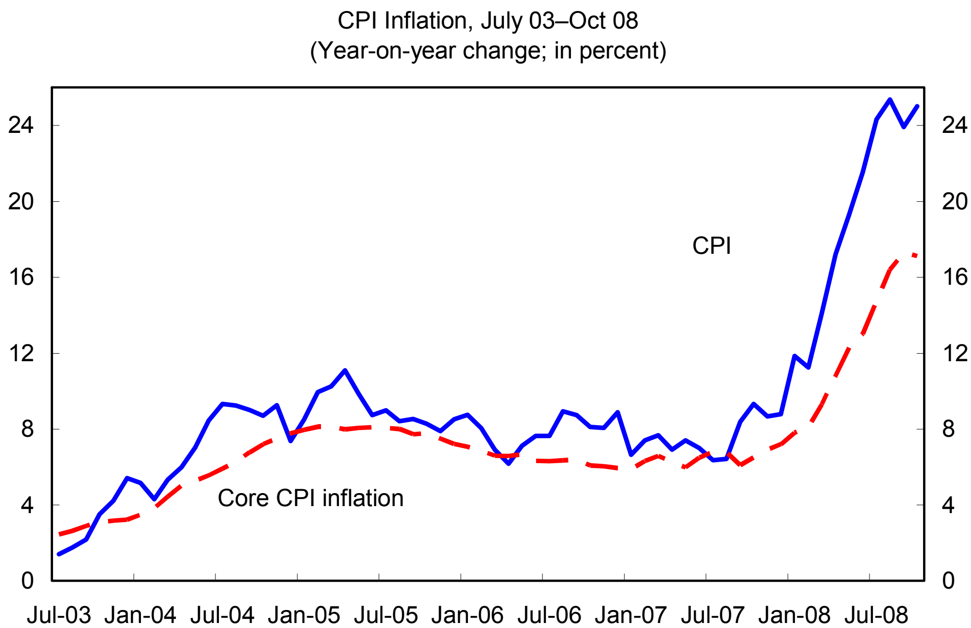
46. **The exceptional level of access under the proposed arrangement (500 percent of quota) is justified by Pakistan's balance of payments needs**. While there are reasonable prospects for success if the authorities implement the envisaged policies, the risks to the program and financial stability remain high. These risks arise from security uncertainties, possible policy reversals, a more severe-than-anticipated slowdown in trading partners, lower-than-expected private capital inflows, and the possible negative impact of removing the floor on stock prices on portfolio flows. However, in the absence of Fund financing, Pakistan is likely to experience a severe balance of payments crisis, which would impose significant hardship on the population and may have region-wide spillover effects. The proposed level of access is consistent with medium-term external and debt sustainability provided the program is implemented as envisaged and any unforeseen shocks are addressed promptly.

47. **There is an urgent need to mobilize additional donor assistance to strengthen Pakistan's resilience to possible shocks and ease the burden of adjustment on the poor**. Additional concessional financing (preferably in the form of grants) will allow for higher social and development spending, enhancing social stability and the domestic political support for the program. It will also contribute to a faster accumulation of international reserves, thereby bolstering investor confidence and Pakistan's external viability.

48. **In view of Pakistan's balance of payments needs and the comprehensive package of adjustment measures proposed by the authorities, the staff supports the authorities' request for an SBA in the amount of SDR 5.169 billion**.

Figure 1. Pakistan: Output and Inflation Indicators, 2003/04–2007/08



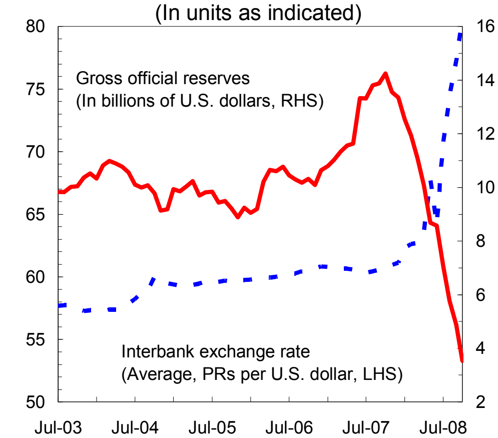


Sources: Pakistani authorities; and Fund staff estimates.

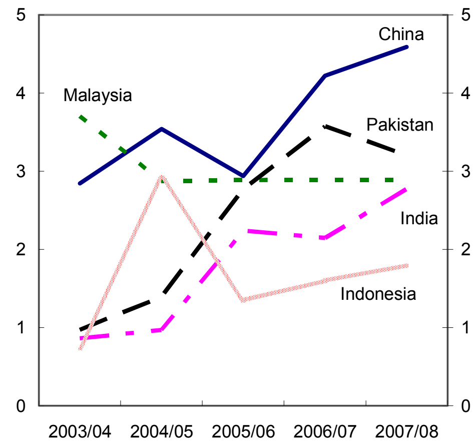
1/ At factor cost.

Figure 2. Pakistan: External Sector Indicators, 2003–08

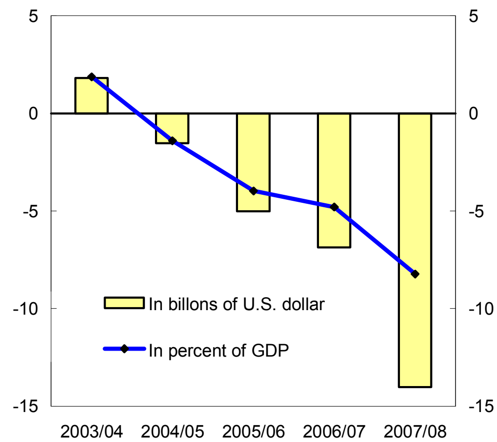
Exchange Rate and Gross Official Reserves,
July 03–Oct 08
(In units as indicated)



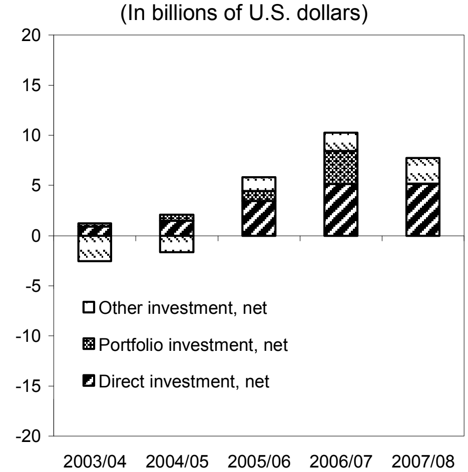
FDI Regional Comparison
(In percent of GDP)



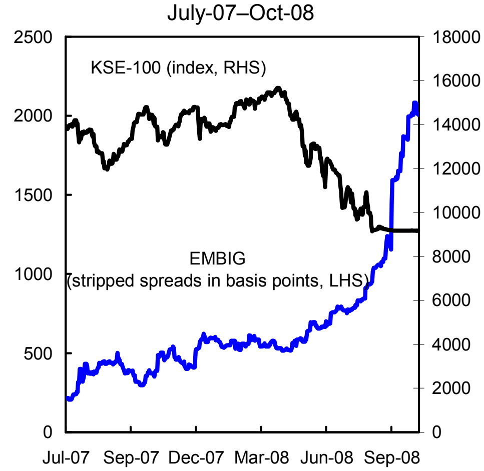
Current Account Balance
(In units as indicated)



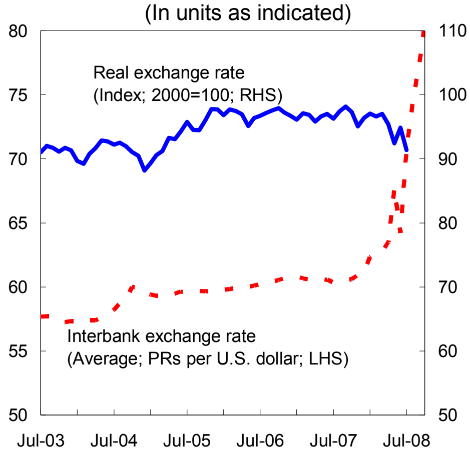
Capital Flows
(In billions of U.S. dollars)



EMBIG and KSE-100 Indices
July-07–Oct-08

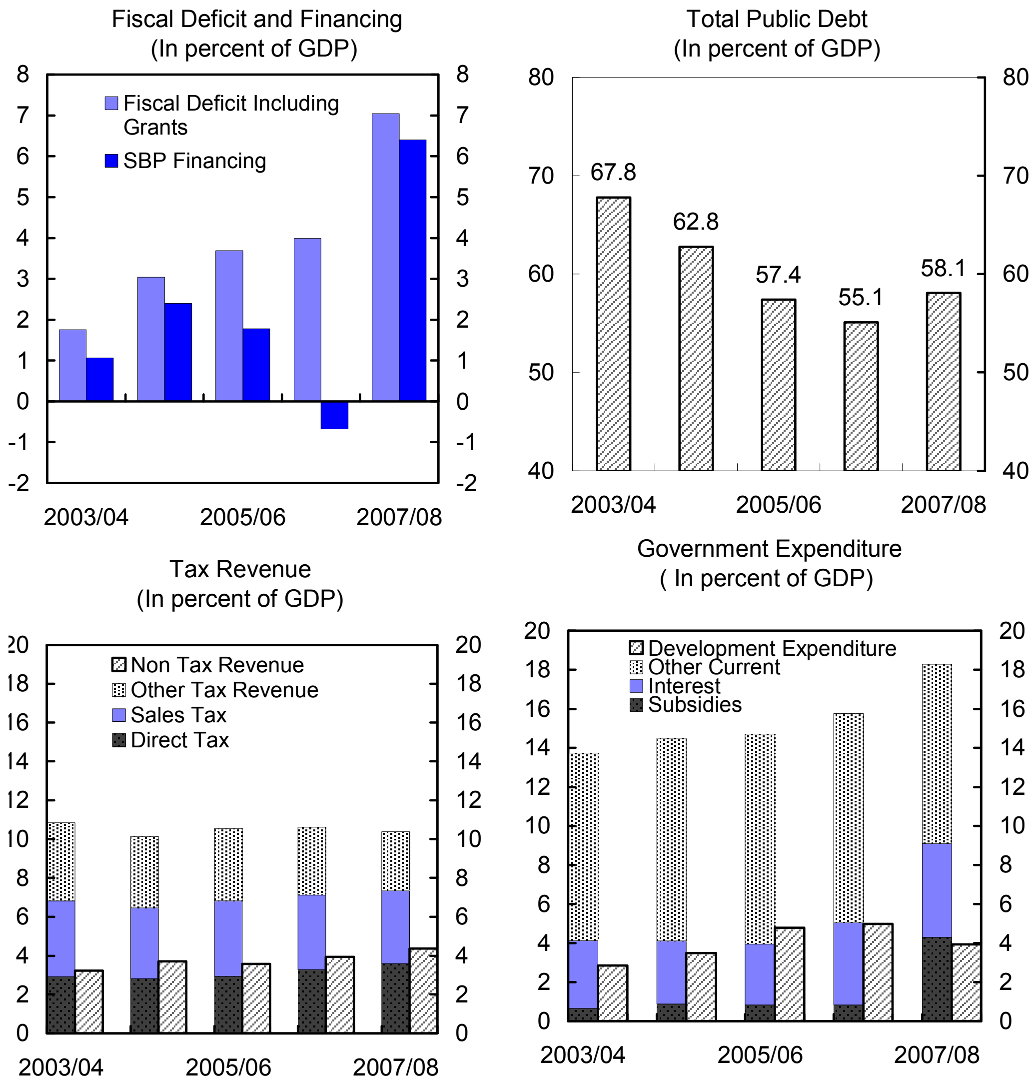


Nominal and Real Exchange Rate,
July 03–Oct 08
(In units as indicated)



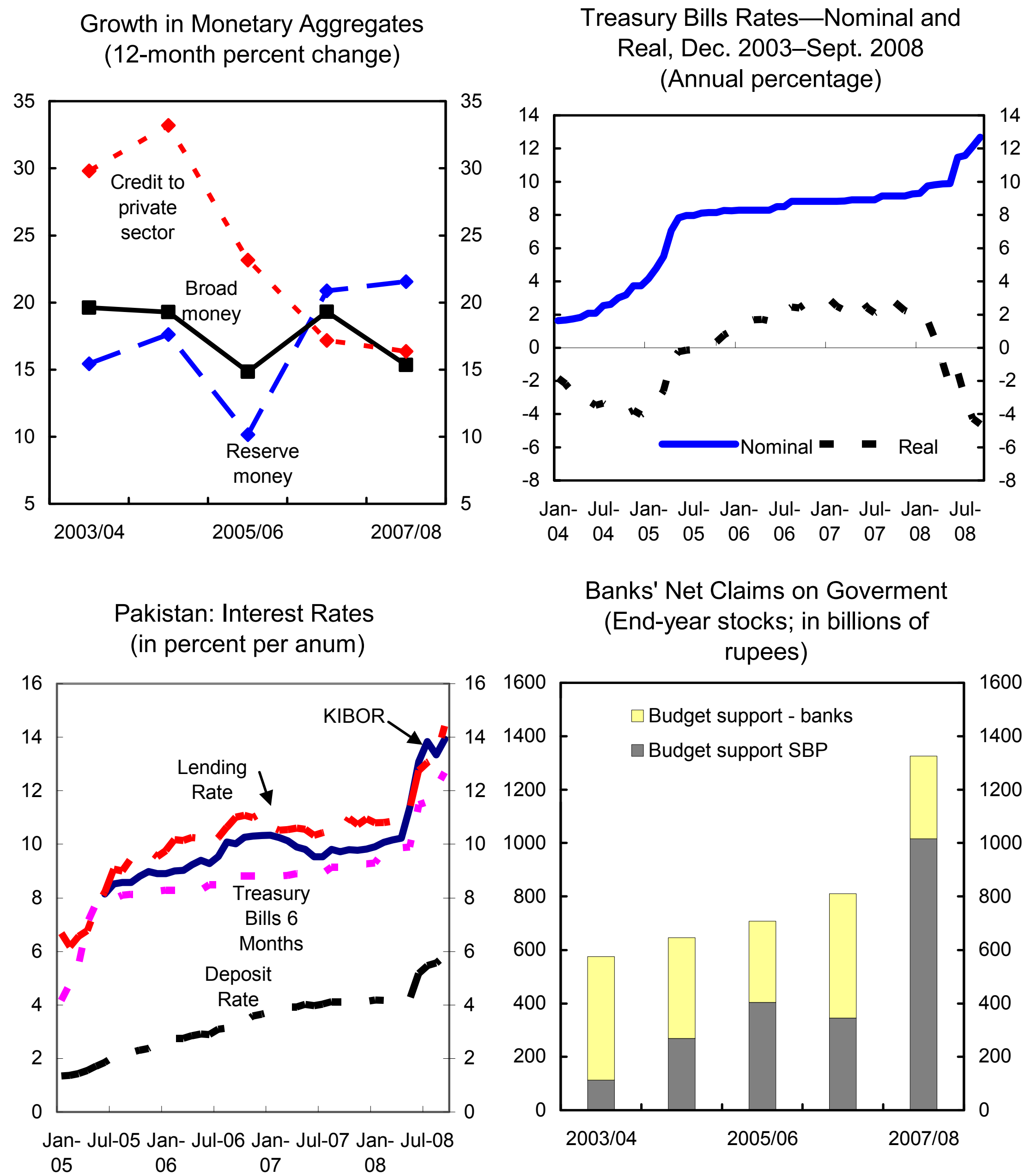
Sources: Pakistani authorities; and Fund staff estimates.

Figure 3. Pakistan: Budget Indicators, 2003/04–2007/08



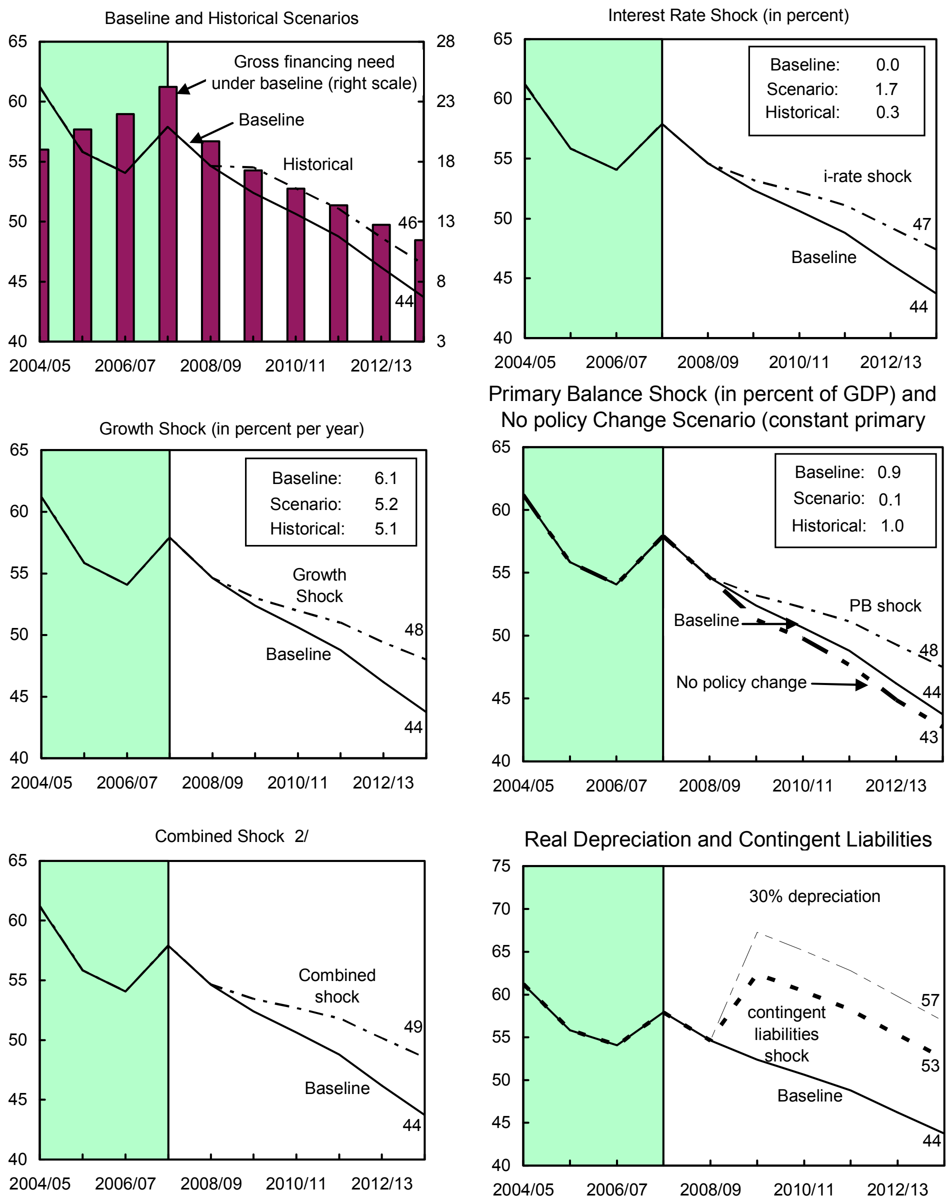
Sources: Pakistani authorities; and Fund staff estimates.

Figure 4. Pakistan: Monetary and Credit Indicators, 2003/04–2007/08



Sources: Pakistani authorities; and Fund staff estimates.

Figure 5. Pakistan: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)

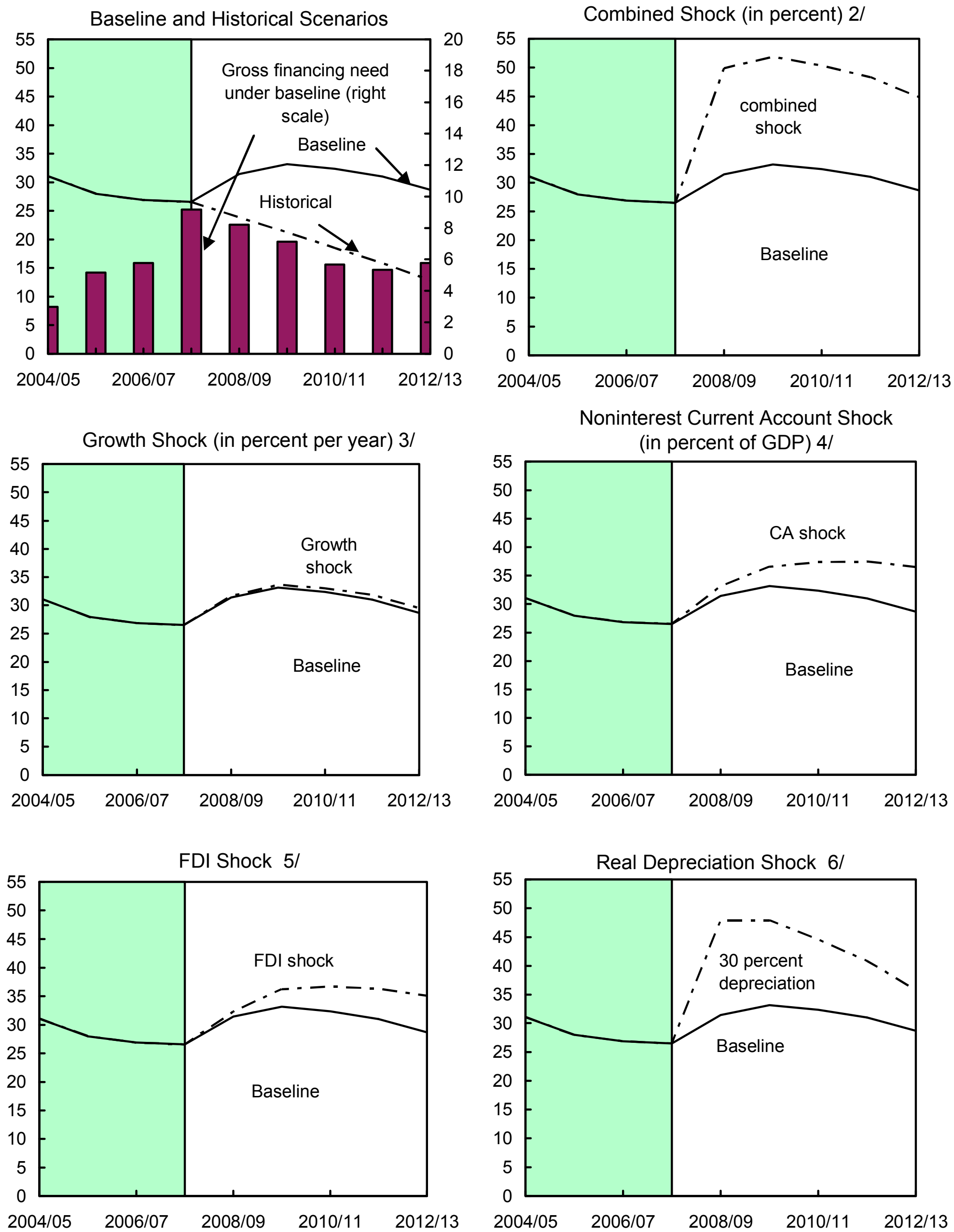


Sources: Pakistani authorities; and Fund staff estimates and projections.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009/10, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 6. Pakistan: External Debt Sustainability—Bound Tests 1/

(External debt in percent of GDP)



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

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks.
2/ Combined impact of shocks to growth, current account, FDI, and real depreciation.
3/ Growth rate lower than the baseline scenarion by half of the ten-year standard deviation.
4/ Current account deficit higher than the baseline scenario by half of the ten-year standard deviation.
5/ Net flows of foreign direct investment are 50 percent lower than in the baseline scenario.
6/ One-time real depreciation of 30 percent occurs in 2008/09.

Table 1. Pakistan: Selected Economic Indicators, 2004/05–2009/10 1/

(Population: 160.9 million (2007/08))
(Per capita GDP: $1,042 (2007/08))
(Poverty rate: 23.9 percent (2004/05))

				Est.	Proj.	
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	(Annual changes in percent)					
Output and prices						
Real GDP at factor cost	9.0	5.8	6.8	5.8	3.4	5.0
Partner country demand (WEO definition)	4.8	4.8	4.5	4.5	…	…
Consumer prices (period average)	9.3	7.9	7.8	12.0	23.0	13.0
Consumer prices (end of period)	8.7	7.6	7.0	21.5	20.0	6.0
Pakistani rupees per U.S. dollar (period average)	3.1	0.8	1.3	…	…	…
	(In percent of GDP)					
Saving and investment						
Gross national saving	17.7	17.8	18.2	12.9	13.5	15.6
Government	0.5	1.1	1.0	-2.8	-1.1	0.8
Nongovernment (including public sector enterprises)	17.2	16.7	17.2	15.8	14.5	14.9
Gross capital formation 2/	19.1	21.7	23.0	21.3	20.0	21.3
Government	3.5	4.8	5.0	4.3	3.0	3.8
Nongovernment (including public sector enterprises)	15.6	16.9	18.0	17.0	17.0	17.5
Public finances						
Revenue and grants	14.1	14.7	15.2	14.6	15.1	16.1
Expenditure (including statistical discrepancy) 3/	17.2	18.4	19.2	21.7	19.1	19.2
Budget balance (including grants)	-3.0	-3.7	-4.0	-7.1	-4.0	-3.1
Budget balance (excluding grants)	-3.3	-4.3	-4.3	-7.4	-4.2	-3.3
Primary balance	0.2	-0.6	0.2	-2.5	0.6	1.6
Total government debt	61.2	55.8	54.1	57.9	54.6	52.4
External government debt	27.7	25.2	24.2	26.2	26.9	27.1
Domestic government debt	33.5	30.7	29.9	31.7	27.7	25.4
	(Annual changes in percent of initial stock of broad money, unless otherwise indicated)					
Monetary sector						
Net foreign assets	2.2	2.5	8.1	-7.8	-4.9	1.8
Net domestic assets	17.1	12.4	11.3	23.1	15.7	14.1
Broad money	19.3	14.9	19.3	15.3	10.8	15.9
Private credit (annual change in percent)	33.2	23.2	17.2	16.4	25.2	19.6
Six-month treasury bill rate (period average, in percent)	4.7	8.2	8.8	…	…	…
External sector						
Merchandise exports, U.S. dollars (growth rate, in percent)	16.2	14.3	4.4	16.5	12.0	11.0
Merchandise imports, U.S. dollars (growth rate, in percent)	38.3	31.6	8.0	31.2	1.1	5.7
Current account including official current transfers (in percent of GDP)	-1.4	-3.9	-4.8	-8.4	-6.5	-5.7
	(In percent of exports of goods and nonfactor services; unless otherwise indicated)					
External public and publicly guaranteed debt	174.6	160.3	164.8	169.7	160.0	154.2
Debt service	15.0	13.1	16.0	14.5	16.9	15.4
Implicit interest rate (in percent) 4/	2.5	2.6	2.8	5.0	2.4	3.2
Gross reserves (in millions of U.S. dollars) 5/	9,805	10,765	14,302	8,591	8,591	11,291
In months of next year's imports of goods and services	3.5	3.7	3.8	2.2	2.1	2.6
Memorandum items:						
Real effective exchange rate (annual average, percentage change)	0.2	5.3	0.5	-0.8	…	…
Terms of trade (percentage change)	0.0	-2.0	-3.7	-10.2	…	…
Real per capita GDP (percentage change)	6.9	3.9	5.0	4.0	1.6	3.3
GDP at market prices (in billions of Pakistani rupees)	6,500	7,623	8,723	10,478	13,384	15,880
GDP at market prices (in billions of U.S. dollars)	109.6	127.5	144.0	167.6	...	...

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

1/ Fiscal year ends June 30.
2/ Including changes in inventories. Investment data recorded by the Federal Bureau of Statistics are said to underreport true activity.
3/ Expenditure on social assistance in 2008/09 is budgeted at 0.6 percent of GDP. The program will target an additional 0.3 percent of GDP.
4/ Calculated as interest payments in percent of the end-of-period debt stock of the previous year.
5/ Excluding gold and foreign deposits of commercial banks held with the State Bank of Pakistan.

Table 2. Pakistan: Balance of Payments, 2006/07–2009/10

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

		Est.	Proj. Sep.	Proj. Dec.	Proj. Mar.	Proj. Jun.	Proj.	
	2006/07	2007/08	2008/09				2008/09	2009/10
Current account	-6,878	-14,036	-3,956	-3,112	-2,333	-1,221	-10,622	-9,738
Balance on goods	-9,711	-15,295	-4,365	-3,597	-3,364	-1,948	-13,273	-12,848
Exports, f.o.b.	17,278	20,122	5,581	5,356	5,589	6,011	22,537	25,016
Imports, f.o.b.	-26,989	-35,417	-9,946	-8,953	-8,953	-7,959	-35,810	-37,864
Services (net)	-4,170	-6,307	-1,238	-1,625	-1,564	-1,737	-6,164	-6,410
Services: credit	4,140	3,590	1,053	943	984	968	3,949	4,331
Services: debit	-8,310	-9,897	-2,291	-2,568	-2,549	-2,705	-10,113	-10,741
Income (net)	-3,582	-3,909	-1,099	-994	-746	-864	-3,704	-4,251
Income: credit	939	1,613	253	472	400	395	1,520	1,626
Income: debit	-4,521	-5,522	-1,352	-1,466	-1,146	-1,259	-5,224	-5,877
Of which: interest payments	-1,416	-2,161	-464	-450	-450	-449	-1,813	-2,167
Balance on goods, services, and income	-17,463	-25,511	-6,702	-6,216	-5,674	-4,548	-23,141	-23,508
Of which: income on direct investment	-1,932	-3,361	-888	-1,016	-696	-810	-3,411	-3,710
Current transfers (net)	10,585	11,475	2,746	3,105	3,342	3,327	12,519	13,770
Current transfers: credit, *of which:*	10,658	11,617	2,775	3,130	3,359	3,360	12,624	13,876
Workers' remittances	5,494	6,451	1,748	1,846	1,958	2,140	7,692	8,538
Other private transfers	4,617	4,666	968	1,254	1,367	1,170	4,759	5,235
Current transfers: debit	-73	-142	-29	-25	-17	-33	-105	-106
Capital account	304	119	0	32	24	52	108	284
Capital transfers: credit	309	126	5	37	25	52	119	295
Of which: official capital grants	267	109	5	38	22	35	100	271
Capital transfers: debit	-5	-7	-5	-6	0	0	-11	-11
Financial account	10,145	7,657	605	193	1,714	3,646	6,158	9,109
Direct investment abroad	-114	-75	-8	-18	-30	-44	-100	-80
Direct investment in Pakistan	5,140	5,153	1,014	899	1,262	1,414	4,589	5,200
Of which: privatization receipts	266	133	0	133	250	256	639	500
Portfolio investment (net), *of which:*	3,283	36	19	-500	-600	1,109	28	378
Eurobond/GDR	-141	-25	0	0	-500	-25	600	-122
Other investment assets	-585	-219	267	-75	-75	-412	-295	-510
General government	0	5	5	0	0	0	5	5
Banks	-463	276	193	-50	-50	-293	-200	-200
Other sectors	-122	-500	69	-25	-25	-119	-100	-315
Other investment liabilities	2,421	2,762	-687	-114	1,158	1,579	1,936	4,121
Monetary authorities	-1	490	-186	0	0	186	0	0
General government, *of which:*	1,308	1,787	76	356	1,361	843	2,636	2,987
Disbursements (medium- and long-term)	2,444	2,549	688	969	1,375	1,114	4,146	4,077
Amortization (medium- and long-term)	-1,031	-1,108	-450	-257	-264	-371	-1,342	-1,075
Banks	152	66	-80	-50	100	230	200	200
Other sectors	962	419	-497	-420	-303	320	-900	934
Net errors and omissions	156	472	0	0	0	0	0	0
Reserves and related items	-3,727	5,788	3,351	2,888	594	-2,478	4,355	345
Reserve assets, *of which:*	-3,708	5,961	3,487	-129	-200	-3,258	-100	-3,000
Foreign exchange (State Bank of Pakistan)	-3,537	5,711	3,420	-229	-300	-2,891	0	-2,700
Foreign exchange (deposit money banks)	-173	250	67	100	100	-367	-100	-300
Use of Fund credit and loans	-119	-173	-36	-49	-49	-62	-197	-230
Exceptional financing	100	0	-100	3,066	843	843	4,652	3,575
Memorandum items:								
Current account (in percent of GDP; including official transfers)	-4.8	-8.4	-2.4	-1.9	-1.4	-0.7	-6.5	-5.7
Current account (in percent of GDP; excluding fuel imports)	0.5	-1.6	...	...	...	...	0.1	0.0
Exports f.o.b. (growth rate, in percent)	4.4	16.5	...	...	...	...	12.0	11.0
Imports f.o.b. (growth rate, in percent)	8.0	31.2	...	...	...	...	1.1	5.7
Imports f.o.b. (growth rate, in percent, excluding oil)	5.6	24.3	...	...	...	...	3.6	12.1
Oil imports (in millions of U.S. dollars, cif)	7,418	11,399	...	...	...	...	10,848	9,710
Crude oil price ($/bbl)	60.7	87.0	...	...	...	...	85.4	72.8
Terms of trade (growth rate, in percent)	-3.7	-10.2	...	...	...	...	...	...
Workers' remittances and other private transfers (growth rate, in percent)	1.7	9.9	...	...	...	...	12.0	10.6
External debt (in millions of U.S. dollars) 1/	38,699	44,467	44,507	47,880	49,678	51,446	51,315	56,820
Gross financing needs (in millions of U.S. dollars) 1/	8,338	15,367	...	...	...	...	13,373	12,210
End-period gross official reserves (millions of U.S. dollars) 2/	14,302	8,591	5,171	5,400	5,700	8,591	8,591	11,291
(In months of next year's imports of goods and services)	3.8	2.2	...	...	...	...	2.1	2.6

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

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

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

Table 3a. Pakistan: Consolidated Government Budget, 2006/07–2009/10

(In billions of Pakistani rupees)

	2007/08	2008/09						2009/10
			Est.	Proj.				
	Est.	Budget	Sep.	Dec.	Mar.	Jun.	Year	Proj.
Revenue and grants	1,530	1,854	397	485	494	642	2,018	2,556
Revenue	1,499	1,832	392	479	490	634	1,995	2,521
Tax revenue	1,086	1,358	285	347	364	472	1,468	1,879
Federal	1,045	1,299	273	332	350	454	1,409	1,809
FBR revenue	1,007	1,250	261	320	338	441	1,360	1,753
Oil and gas surcharges and other	38	49	12	12	12	13	49	56
Provincial	41	59	12	15	14	18	59	70
Nontax revenue	414	474	107	132	126	163	527	642
Federal	336	379	87	107	106	133	432	520
Provincial	78	95	20	25	20	30	95	122
Grants	31	22	5	6	5	7	22	35
Expenditure	2,281	2,408	523	599	634	791	2,546	3,046
Current expenditure	1,858	1,968	462	525	538	623	2,147	2,435
Federal	1,420	1,451	366	391	403	471	1,630	1,771
Interest	490	523	142	166	149	161	618	751
Other 1/	931	928	224	225	253	310	1,012	1,019
Provincial	437	517	96	134	135	152	517	664
Development expenditure and net lending	423	440	61	74	96	168	399	612
Public Sector Development Program	452	439	61	73	96	168	397	610
Federal 1/	238	289	38	40	59	110	247	400
Of which: one-off expenditure (earthquake-related spending in 2005–08)	17	27	7	13	13	27	27	15
Provincial	214	150	23	33	36	58	150	210
Net lending	-28	2	0	1	1	1	2	2
Statistical discrepancy ("+" = additional expenditure)	-3	0	11	0	0	0	11	0
Underlying budget balance (excluding grants and earthquake)	-762	-549	-135	-106	-131	-130	-535	-510
Underlying budget balance (including grants)	-731	-527	-130	-101	-126	-123	-513	-476
Overall Deficit (excluding grants)	-779	-576	-142	-120	-144	-157	-562	-525
Overall Deficit (including grants)	-748	-553	-137	-114	-139	-150	-540	-491
Financing	748	553	137	114	139	150	540	491
External	121	204	6	40	96	187	328	314
Of which: privatization receipts	0	25	0	11	22	115	148	46
Domestic	628	349	131	74	44	-37	211	177
Bank	520	99	105	43	13	-68	91	95
Nonbank	106	250	27	31	31	31	120	82
Privatization receipts	2	0	0	0	0	0	0	0
Memorandum items:								
Expenditure 2/	2,295	2,435	541	612	647	818	2,584	3,061
Primary balance (excluding grants)	-289	-53	0	46	5	4	56	226
Primary balance (including grants)	-259	-30	5	52	10	11	78	261
Defense spending	285	296	77	74	76	82	308	375
Total government debt	6,068	…	…	…	…	…	7,312	8,323
Domestic debt	3,324	…	…	…	…	…	3,710	4,026
External debt	2,744	...	...	…	…	…	3,602	4,297
Nominal GDP (market prices)	10,478	12,556	13,384	13,384	13,384	13,384	13,384	15,880

Sources: Pakistani authorities for historical data; and Fund staff for estimates and projections.

1/ In 2007/08, PRs 23 billion (0.2 percent of GDP) of current expenditure was reclassified as development expenditure.
2/ Includes statistical discrepancy and spending related to the 2005 earthquake.

Table 3b. Pakistan: Consolidated Government Budget, 2006/07–2009/10

(In percent of GDP; unless otherwise indicated)

	Est.	Budget	Est. Sep.	Proj. Dec.	Proj. Mar.	Proj. Jun.	Proj. Year	Proj.
	2007/08	2008/09						2009/10
Revenue and grants	14.6	14.8	3.0	3.6	3.7	4.8	15.1	16.1
Revenue	14.3	14.6	2.9	3.6	3.7	4.7	14.9	15.9
Tax revenue	10.4	10.8	2.1	2.6	2.7	3.5	11.0	11.8
Federal	10.0	10.3	2.0	2.5	2.6	3.4	10.5	11.4
FBR revenue	9.6	10.0	1.9	2.4	2.5	3.3	10.2	11.0
Direct taxes	3.7	4.0	0.7	1.0	0.9	1.4	4.0	4.8
Federal excise duty	0.8	0.9	0.3	0.2	0.2	0.2	0.9	0.9
Sales tax	3.7	3.8	0.8	0.9	1.0	1.2	3.9	3.9
Customs duties	1.4	1.4	0.2	0.3	0.5	0.5	1.4	1.4
Oil and gas surcharges and other	0.4	0.4	0.1	0.1	0.1	0.1	0.4	0.4
Provincial	0.4	0.5	0.1	0.1	0.1	0.1	0.4	0.4
Nontax revenue	3.9	3.8	0.8	1.0	0.9	1.2	3.9	4.0
Grants	0.3	0.2	0.0	0.0	0.0	0.1	0.2	0.2
Expenditure	21.8	19.2	3.9	4.5	4.7	5.9	19.0	19.2
Current expenditure	17.7	15.7	3.4	3.9	4.0	4.7	16.0	15.3
Federal	13.6	11.6	2.7	2.9	3.0	3.5	12.2	11.1
Interest	4.7	4.2	1.1	1.2	1.1	1.2	4.6	4.7
Other1/	8.9	7.4	1.7	1.7	1.9	2.3	7.6	6.4
Provincial	4.2	4.1	0.7	1.0	1.0	1.1	3.9	4.2
Development expenditure and net lending	4.0	3.5	0.5	0.5	0.7	1.3	3.0	3.9
Public Sector Development Program	4.3	3.5	0.5	0.5	0.7	1.3	3.0	3.8
Federal 1/	2.3	2.3	0.3	0.3	0.4	0.8	1.8	2.5
Of which: one-off expenditure (earthquake-related spending)	0.2	0.2	0.0	0.1	0.1	0.2	0.2	0.1
Provincial	2.0	1.2	0.2	0.2	0.3	0.4	1.1	1.3
Net lending	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy ("+" = additional expenditure)	0.0	0.0	0.1	0.0	0.0	0.0	0.1	0.0
Underlying budget balance (excluding grants and earthquake)	-7.3	-4.4	-1.0	-0.8	-1.0	-1.0	-4.0	-3.2
Overall Deficit (excluding grants)	-7.4	-4.6	-1.1	-0.9	-1.1	-1.2	-4.2	-3.3
Overall Deficit (including grants)	-7.1	-4.4	-1.0	-0.9	-1.0	-1.1	-4.0	-3.1
Financing	7.1	4.4	1.0	0.9	1.0	1.1	4.0	3.1
External	1.2	1.6	0.0	0.3	0.7	1.4	2.5	2.0
Of which: privatization receipts	0.0	0.2	0.0	0.1	0.2	0.9	1.1	0.3
Domestic	6.0	2.8	1.0	0.5	0.3	-0.3	1.6	1.1
Bank	5.0	0.8	0.8	0.3	0.1	-0.5	0.7	0.6
Nonbank	1.0	2.0	0.2	0.2	0.2	0.2	0.9	0.5
Privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Expenditure 2/	21.9	19.4	4.0	4.6	4.8	6.1	19.3	19.3
Primary balance (excluding grants)	-2.8	-0.4	0.0	0.3	0.0	0.0	0.4	1.4
Primary balance (including grants)	-2.5	-0.2	0.0	0.4	0.1	0.1	0.6	1.6
Defense spending	2.7	2.4	0.6	0.5	0.6	0.6	2.3	2.8
Total government debt	57.9	…	…	…	…	…	54.6	52.4
Domestic debt	31.7	…	…	…	…	…	27.7	25.4
External debt	26.2	…	…	…	…	…	26.9	27.1
Nominal GDP (market prices, billions of Pakistani rupees)	10,478	12,556	13,384	13,384	13,384	13,384	13,384	15,880

Sources: Pakistani authorities for historical data; and Fund staff for estimates and projections.

1/ In 2007/08, PRs 23 billion (0.2 percent of GDP) of current expenditure was reclassified as development expenditure.
2/ Includes statistical discrepancy and spending related to the 2005 earthquake.

Table 4. Pakistan: Monetary Survey and Analytical Balance Sheet of the State Bank of Pakistan, 2005/06–2009/10

				Est.	Proj.			
				Sep.	Dec.	Mar.	Jun.	Proj.
	2005/06	2006/07	2007/08			2008/09		2009/10
				(In billions of Pakistani rupees)				
Monetary survey								
Net foreign assets (NFA)	710	985	669	486	295	229	438	530
Net domestic assets (NDA)	2,697	3,080	4,021	4,188	4,536	4,638	4,759	5,494
Net claims on government, *of which:*	796	889	1,473	1,522	1,593	1,596	1,535	1,636
Budget support	708	816	1,325	1,430	1,473	1,485	1,417	1,508
Commodity operations	108	99	127	113	100	91	137	147
Credit to nongovernment	2,191	2,576	3,018	3,172	3,410	3,573	3,794	4,528
Private sector	2,130	2,496	2,904	2,995	3,221	3,373	3,636	4,349
Public sector enterprises	61	81	114	177	189	200	159	179
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3
Other items, net	-287	-382	-467	-503	-463	-528	-567	-667
Broad money	3,407	4,065	4,689	4,674	4,831	4,867	5,197	6,024
Currency	740	840	982	1,107	1,168	1,190	1,156	1,301
Rupee deposits	2,471	3,018	3,443	3,282	3,369	3,372	3,737	4,379
Foreign currency deposits	196	207	263	285	295	305	303	343
State Bank of Pakistan (SBP)								
NFA	565	788	481	308	101	57	236	276
NDA	436	422	990	1,250	1,346	1,412	1,314	1,472
Net claims on government	384	325	1,015	1,240	1,273	1,273	1,167	1,167
Of which: budget support	404	339	1,016	1,227	1,274	1,274	1,181	1,181
Claims on nongovernment	-7	-7	-7	-7	-7	-7	-7	-7
Claims on scheduled banks	218	272	219	224	249	249	249	279
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3
Other items, net	-156	-164	-233	-204	-166	-100	-91	37
Reserve money, *of which:*	1,001	1,210	1,471	1,559	1,447	1,469	1,551	1,748
Banks' reserves	208	305	416	381	289	292	321	373
Currency	789	898	1,051	1,174	1,158	1,177	1,225	1,370
				(12-month changes; in percent)				
Broad money	14.9	19.3	15.3	13.4	9.6	10.4	10.8	15.9
NFA, banking system (in percent of broad money) 1/	2.5	8.1	-7.8	-10.2	-11.4	-10.1	-4.9	1.8
NDA, banking system (in percent of broad money) 1/	12.4	11.3	23.1	22.0	20.2	19.6	15.7	14.1
Budgetary support (in percent of broad money) 1/	2.1	3.2	12.5	11.7	9.0	7.5	1.9	1.8
NFA, banking system	11.5	38.7	-32.1	-49.5	-65.1	-68.3	-34.5	20.9
NDA, banking system	15.8	14.2	30.5	32.6	27.3	25.8	18.4	15.4
Budgetary support	9.5	15.2	62.4	61.6	41.8	32.7	6.9	6.5
Private credit	23.2	17.2	16.4	20.2	16.8	18.4	25.2	19.6
Currency	11.2	13.5	16.9	26.6	15.9	21.2	17.7	12.6
Reserve money	10.2	20.9	21.6	27.9	5.8	9.8	5.4	12.7
NFA, SBP (in percent of reserve money) 1/	6.8	22.2	-25.4	-30.7	-43.1	-36.9	-16.6	2.6
NDA, SBP (in percent of reserve money) 1/	3.4	-1.4	46.9	52.5	48.6	45.8	22.0	10.2
Net claims on government (in percent of reserve money) 1/	14.8	-5.8	56.9	59.3	51.7	36.9	10.3	0.0
				(In units as indicated)				
Memorandum items:								
Velocity	2.2	2.1	2.2	...	...	...	2.6	2.6
Money multiplier	3.4	3.4	3.2	3.0	3.3	3.3	3.4	3.4
Currency to broad money ratio (percent)	21.7	20.7	20.9	23.7	24.2	24.5	22.2	21.6
Currency to deposit ratio (percent)	27.8	26.1	26.5	31.0	31.9	32.4	28.6	27.6
Reserves to deposit ratio (percent)	7.8	9.5	11.2	10.7	7.9	7.9	7.9	7.9
Budget bank financing (billions of Pakistani rupees), *of which:*	61	108	509	105	147	160	91	91
By commercial banks	-74	173	-167	-106	-111	-98	-74	91
By SBP	135	-65	677	211	258	258	165	0
NFA of SBP (change from beginning of the year in U.S. dollar billions) 2/	1	4	-4.5	-2.2	-4.4	-5.0	-2.9	0.4
NFA of commercial banks (in billions of Pakistani rupees)	145	197	187	177	193	172	201	254
NDA of commercial banks (in billions of Pakistani rupees)	2,261	2,658	3,030	2,938	3,191	3,226	3,445	4,022
Excess reserves in percent of broad money	0.3	1.0	...	...	...	...	...	...

Sources: Pakistani authorities for historical data; and Fund staff estimates and projections.

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

Table 5. Pakistan: Medium-Term Macroeconomic Framework, 2004/05–2012/13

				Est.	Proj.				
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
	(In percent of GDP)								
Saving and investment									
Current account balance	-1.4	-3.9	-4.8	-8.4	-6.5	-5.7	-4.6	-4.0	-3.6
Gross national saving	17.7	17.8	18.2	12.9	13.5	15.6	19.2	20.5	21.1
Government saving	0.5	1.1	1.0	-2.8	-1.1	0.8	2.8	3.6	4.3
Gross capital formation	19.1	21.7	23.0	21.3	20.0	21.3	23.8	24.5	24.8
	(In billions of U.S. dollars, unless otherwise indicated)								
Balance of payments									
Current account balance	-1.5	-5.0	-6.9	-14.0	-10.6	-9.8	-8.6	-8.0	-7.9
Net capital flows 1/	1.1	6.3	10.6	8.2	6.3	9.5	10.1	10.6	12.3
Of which: foreign direct investment 2/	1.5	3.5	5.1	5.2	4.6	5.2	5.4	5.6	5.9
Gross official reserves	9.8	10.8	14.3	8.6	8.6	11.3	12.3	13.5	14.5
In months of imports 3/	3.5	3.7	3.8	2.2	2.1	2.6	2.6	2.6	2.6
External debt (in percent of GDP)	31.1	28.0	26.9	26.5	31.4	33.2	32.4	31.0	28.7
	(In percent of GDP)								
Public finances									
Revenue and grants	14.1	14.7	15.2	14.6	15.1	16.1	16.9	17.7	18.3
of which: tax revenue	10.1	10.5	10.9	10.4	11.0	11.8	12.7	13.6	14.4
Expenditure (incl. statistical discrepancy)	17.2	17.5	19.2	21.7	19.1	19.2	19.5	20.0	20.3
Of which: Current	14.5	14.3	15.8	17.7	16.0	15.3	14.1	14.1	14.0
Development	3.9	4.3	4.9	4.0	3.0	3.9	5.4	5.9	6.2
Primary balance 4/	0.2	-0.6	0.2	-2.5	0.6	1.6	0.7	0.8	0.8
Overall fiscal balance 4/	-3.0	-3.7	-4.0	-7.1	-4.0	-3.1	-2.6	-2.3	-2.0
Underlying fiscal balance 5/	-3.3	-3.4	-3.9	-7.3	-4.0	-3.2	-3.0	-2.7	-2.3
Total government debt	61.2	55.8	54.1	57.9	54.6	52.4	50.7	48.8	46.2
	(Annual changes in percent)								
Output and prices									
Real GDP at factor cost	9.0	5.8	6.8	5.8	3.4	5.0	5.5	6.0	7.0
Consumer prices (period average)	9.3	7.9	7.8	12.0	23.0	13.0	7.0	6.5	5.0

Sources: Pakistani authorities for historical data; and IMF staff estimates for projections.

1/ Difference between the overall balance and the current account balance.
2/ Including privatization.
3/ Ratio of gross official reserves to next year's imports of goods and services (divided by 12).
4/ Including grants and earthquake-related expenditures.
5/ Excluding grants and earthquake-related expenditures.

Table 6. Pakistan: Medium-Term Fiscal Framework, 2006/07–2012/13 1/

(In percent of GDP; unless otherwise indicated)

		Est.	Proj.				
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Revenue and grants	15.2	14.6	15.1	16.1	16.9	17.7	18.3
Tax revenue	10.9	10.4	11.0	11.8	12.7	13.6	14.4
Of which: Central Board of Revenue	9.7	9.6	10.2	11.0	11.9	12.8	13.6
Nontax revenue	3.9	3.9	3.9	4.0	3.8	3.7	3.6
Grants	0.3	0.3	0.2	0.2	0.4	0.4	0.4
Expenditure	20.6	21.8	19.0	19.2	19.5	20.0	20.3
Current expenditure 2/	15.8	17.7	16.0	15.3	14.1	14.1	14.0
Interest	4.2	4.7	4.6	4.7	3.3	3.1	2.8
Other federal 2/	6.9	8.9	7.6	6.4	6.4	6.4	6.4
Provincial	4.6	4.2	3.9	4.2	4.4	4.6	4.8
Development expenditure 2/	5.0	4.3	3.0	3.8	5.4	5.9	6.2
Of which: one-off outlays 3/	0.5	0.2	0.2	0.1	0.0	0.0	0.0
Net-lending	-0.1	-0.3	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	-1.4	0.0	0.1	0.0	0.0	0.0	0.0
Overall balance							
Underlying (excluding grants and one-off outlays)	-3.9	-7.3	-4.0	-3.2	-3.0	-2.7	-2.3
Excluding grants	-4.3	-7.4	-4.2	-3.3	-3.0	-2.7	-2.3
Including grants	-4.0	-7.1	-4.0	-3.1	-2.6	-2.3	-2.0
Financing	4.0	7.1	4.0	3.1	2.6	2.3	2.0
External	2.0	1.2	2.5	2.0	1.5	1.8	2.6
Of which: privatization receipts	0.6	0.0	1.1	0.3	0.2	0.2	0.1
Domestic	2.0	6.0	1.6	1.1	1.1	0.6	-0.6
Memorandum items:							
Primary balance							
Excluding grants	-0.1	-2.8	0.4	1.4	0.4	0.4	0.4
Including grants	0.2	-2.5	0.6	1.6	0.7	0.8	0.8
Interest payments/revenue (ratio)	28.4	32.7	31.0	29.8	20.2	17.8	15.5
Total government debt	54.1	57.9	54.6	52.4	50.7	48.8	46.2
External	24.2	26.2	26.9	27.1	26.5	26.2	26.0
Domestic	29.9	31.7	27.7	25.4	24.2	22.7	20.2
Nominal GDP (billions of Pakistani rupees)	8,723	10,478	13,384	15,880	17,926	20,237	22,736

Sources: Pakistani authorities for historical data; and Fund staff for estimates and projections.

1/ Projections based on a staff scenario with tighter fiscal and monetary policies.

2/ Projection for 2007/08 includes as development expenditure 0.2 percent of GDP corresponding to items classified as current expenditure in earlier years. Reclassification is maintained in all projection years.

3/ Spending related to the 2005 earthquake.

Table 7. Pakistan: Balance of Payments, 2006/07-2012/13

(In millions of US dollars; unless otherwise indicated)

		Est.			Proj.		
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Current account	-6,878	-14,036	-10,622	-9,738	-8,520	-7,952	-7,853
Balance on goods	-9,711	-15,295	-13,273	-12,848	-13,125	-13,342	-13,706
Exports, f.o.b.	17,278	20,122	22,537	25,016	27,767	30,822	34,212
Imports, f.o.b.	-26,989	-35,417	-35,810	-37,864	-40,893	-44,164	-47,918
Services (net)	-4,170	-6,307	-6,164	-6,410	-6,881	-7,593	-8,258
Services: credit	4,140	3,590	3,949	4,331	4,719	5,131	5,593
Services: debit	-8,310	-9,897	-10,113	-10,741	-11,601	-12,724	-13,851
Income (net)	-3,582	-3,909	-3,704	-4,251	-4,194	-4,631	-5,316
Income: credit	939	1,613	1,520	1,626	1,740	1,862	1,992
Income: debit	-4,521	-5,522	-5,224	-5,877	-5,934	-6,493	-7,308
Of which: interest payments	-1,416	-2,161	-1,813	-2,167	-1,898	-2,064	-2,119
Balance on goods, services, and income	-17,463	-25,511	-23,141	-23,508	-24,201	-25,567	-27,280
Of which: income on direct investment	-1,932	-3,361	-3,411	-3,710	-4,036	-4,429	-5,189
Current transfers (net)	10,585	11,475	12,519	13,770	15,680	17,615	19,427
Current transfers: credit, *of which:*	10,658	11,617	12,624	13,876	15,788	17,723	19,535
Workers' remittances	5,494	6,451	7,692	8,538	9,477	10,614	11,676
Other private transfers	4,617	4,666	4,759	5,235	5,811	6,508	7,159
Current transfers: debit	-73	-142	-105	-106	-108	-108	-108
Capital account	304	119	108	284	277	200	206
Capital transfers: credit	309	126	119	295	288	211	217
Of which: official capital grants	267	109	100	271	179	100	100
Capital transfers: debit	-5	-7	-11	-11	-11	-11	-11
Financial account	10,145	7,657	6,158	9,109	9,462	10,366	11,985
Direct investment abroad	-114	-75	-100	-80	-50	-10	-9
Direct investment in Pakistan	5,140	5,153	4,589	5,200	5,400	5,600	5,900
Of which: privatization receipts	266	133	639	500	300	300	300
Portfolio investment (net), *of which:*	3,283	36	28	378	1,878	2,400	3,300
Eurobond/GDR	-141	-25	600	-122	478	1,000	1,500
Other investment assets	-585	-219	-295	-510	-435	-447	-460
General government	0	5	5	5	5	5	5
Banks	-463	276	-200	-200	-200	-200	-200
Other sectors	-122	-500	-100	-315	-240	-252	-265
Other investment liabilities	2,421	2,762	1,936	4,121	2,669	2,823	3,253
Monetary authorities	-1	490	0	0	0	0	0
General government, *of which:*	1,308	1,787	2,636	2,987	2,008	2,117	1,993
Disbursements (medium- and long-term)	2,444	2,549	4,146	4,077	3,350	3,350	3,350
Amortization (medium- and long-term)	-1,031	-1,108	-1,342	-1,075	-1,142	-1,233	-1,357
Banks	152	66	200	200	200	200	200
Other sectors	962	419	-900	934	460	506	1,060
Net errors and omissions	156	472	0	0	0	0	0
Reserves and related items	-3,727	5,788	4,355	345	-1,218	-2,615	-4,338
Reserve assets, *of which:*	-3,708	5,961	-100	-3,000	-1,300	-1,500	-1,300
Foreign exchange (State Bank of Pakistan)	-3,537	5,711	0	-2,700	-1,000	-1,200	-1,000
Foreign exchange (deposit money banks)	-173	250	-100	-300	-300	-300	-300
Use of Fund credit and loans	-119	-173	-197	-230	-255	-1,115	-3,038
Exceptional financing	100	0	4,652	3,575	337	0	0
Memorandum items:							
Current account (in percent of GDP; including official transfers)	-4.8	-8.4	-6.5	-5.7	-4.6	-4.0	-3.6
Current account (in percent of GDP; excluding fuel imports)	0.5	-1.6	0.1	0.0	1.4	2.2	2.6
Exports f.o.b. (growth rate, in percent)	4.4	16.5	12.0	11.0	11.0	11.0	11.0
Imports f.o.b. (growth rate, in percent)	8.0	31.2	1.1	5.7	8.0	8.0	8.5
Imports f.o.b. (growth rate, in percent, excluding oil)	5.6	24.3	3.6	12.1	6.2	7.1	8.2
Oil imports (in million s of U.S. dollars, cif)	7,418	11,399	10,848	9,710	11,050	12,245	13,406
Crude oil price ($/bbl)	60.7	87.0	85.4	72.8	78.5	82.1	84.0
Terms of trade (growth rate, in percent)	-3.7	-10.2	...	...	...	...	...
Workers' remittances and other private transfers (growth rate, in percent)	1.7	9.9	12.0	10.6	11.0	12.0	10.0
External debt (in millions of U.S. dollars) 1/	38,699	44,467	51,315	56,820	59,628	61,799	62,303
Gross financing needs (in millions of U.S. dollars) 1/	8,338	15,367	13,373	12,210	10,469	10,630	12,577
End-period gross official reserves (millions of U.S. dollars) 2/	14,302	8,591	8,591	11,291	12,291	13,491	14,491
(In months of next year's imports of goods and services)	3.8	2.2	2.1	2.6	2.6	2.6	2.6

Sources: Pakistani authorities; and Fund 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 of commercial banks held with the State Bank of Pakistan (cash reserve requirements) and gold.

Table 8. Pakistan: Gross Financing Requirements and Financing Gaps, 2007/08–2009/10
(In millions of U.S. dollars; unless otherwise specified)

		Projections	
	2007/08	2008/09	2009/10
Gross external financing requirements	15,367	13,373	12,210
Current account deficit (if surplus = -)	14,036	10,622	9,738
Maturing short-term debt	25	713	545
Amortization of medium- and long-term debt	1,306	2,039	1,927
Medium and long-term to external private creditors	25	500	622
Medium and long-term to external official creditors	1,281	1,539	1,305
IMF	173	197	230
To other official creditors	1,108	1,342	1,075
Amortization payments by domestic private sector	0	0	0
Amortization payments by domestic public sector	1,108	1,342	1,075
Of which:			
Paris club	244	178	190
ADB	354	372	446
WB	422	392	398
IDB	20	200	20
Available financing	15,367	8,722	8,635
Net FDI (including privatization receipts)	5,078	4,489	5,120
Roll-over of short-term debt	713	545	530
Medium- and long-term borrowing	2,549	4,146	4,577
GDR	0	1,100	0
Other net capital inflows	1,316	-1,559	1,108
Reserve accumulation (decrease = +)	5,711	0	-2,700
Remaining financing gap	0	4,652	3,575
Of which : use of Fund resources	...	4,752	2,575
Other exceptional financing	...	-100	…
GDRs	...	…	1,000
Memorandum items:			
Gross international reserves in billions of U.S. dollars	8.6	8.6	11.3
in months of imports	2.2	2.1	2.6
in percent of short-term external debt	1,205	1,576	2,130

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

Table 9. Pakistan: Selected Vulnerability Indicators, 2005/06–2012/13

	2005/06	2006/07	Est. 2007/08	Proj. 2008/09	2009/10	2010/11	2011/12	2012/13
Key economic and market indicators								
Real GDP growth (market prices, in percent)	6.2	6.2	5.8	3.4	5.0	5.5	6.0	7.0
CPI inflation (period average, in percent)	7.9	7.8	12.0	23.0	13.0	7.0	6.5	5.0
Short-term (ST) interest rate (in percent)	8.2	8.8	11.5	...	...	...	...	...
Emerging market bond index (EMBI) secondary market spread (basis points, end of period)	251	214	687	...	...	...	...	...
Exchange rate PRs/US$ (end of period)	60.1	60.4	68.2	...	...	...	...	...
External sector								
Exchange rate regime			Managed float since January 2008					
Current account balance (percent of GDP)	-3.9	-4.8	-8.4	-6.5	-5.7	-4.6	-4.0	-3.6
Net FDI inflows (percent of GDP)	2.7	3.5	3.0	2.8	3.0	2.9	2.8	2.7
Exports (percentage change of U.S. dollar value; GNFS)	14.2	5.4	10.7	11.7	10.8	10.7	10.7	10.7
Real effective exchange rate (2000=100, annual average)	96.5	97.1	97.1	...	...	...	...	...
Gross international reserves (GIR) in billions of U.S. dollars	10.8	14.3	8.6	8.6	11.3	12.3	13.5	14.5
GIR in percent of ST debt at remaining maturity (RM) 1/	839.0	1,089.3	440.4	344.7	488.8	791.2	851.5	857.3
GIR in percent of ST debt at RM and banks' foreign exchange (FX) deposits 1/	237.4	301.5	147.8	141.7	190.5	224.4	232.0	232.5
Total gross external debt (ED) in percent of GDP, *of which:*	28.1	27.2	26.5	30.9	32.3	31.2	29.8	27.4
ST external debt (original maturity, in percent of total ED)	0.2	0.4	1.8	1.3	1.1	0.8	0.7	0.7
ED of domestic private sector (in percent of total ED)	4.4	5.8	6.5	5.8	5.8	6.0	6.1	6.1
ED to foreign official sector (in percent of total ED)	95.6	94.2	93.5	94.2	94.2	94.0	93.9	93.9
Total gross external debt in percent of exports	176.6	182.7	187.6	190.2	188.4	177.1	165.1	149.5
Gross external financing requirement (in billions of U.S. dollars) 2/	6.6	8.3	15.5	13.5	12.4	10.6	10.7	12.7
Public sector (PS) 3/								
Overall balance (including grants, in percent of GDP)	-3.7	-4.0	-7.1	-4.0	-3.1	-2.6	-2.3	-2.0
Primary balance (percent of GDP)	-0.6	0.2	-2.5	0.6	1.6	0.7	0.8	0.8
Debt-stabilizing primary balance (percent of GDP) 4/	-6.0	-3.1	-2.2	-3.0	-1.4	-1.8	-1.9	-1.6
Gross PS financing requirement (in percent of GDP) 5/	20.7	21.9	24.3	19.8	17.4	15.8	14.4	12.8
Public sector gross debt (in percent of GDP)	57.4	55.1	58.1	57.3	56.1	53.9	51.0	46.7
Public sector net debt (in percent of GDP) 6/	51.7	49.5	52.5	51.7	50.4	48.2	45.4	41.0
Financial sector (FS) 7/								
Capital adequacy ratio (in percent) 8/	11.3	12.5	12.1	...	...	...	...	...
Nonperforming loans (NPLs) in percent of total loans 8/	14.3	13.5	10.2	...	...	...	...	...
Provisions in percent of NPLs 8/	76.7	66.5	75.0	...	...	...	...	...
Return on average assets (in percent) 8/	1.9	2.1	1.7	...	...	...	...	...
Return on equity (in percent) 8/	25.8	24.2	16.7	...	...	...	...	...
FX deposits held by residents (in percent of total deposits)	7.3	6.4	7.1	7.5	7.3	...	...	...
Government debt held by FS (percent of total FS assets)	23.6	21.9	31.4	29.5	27.2	...	...	...
Credit to private sector (percent change)	23.2	17.2	16.4	25.2	19.5	...	...	...
Memorandum item:								
Nominal GDP (in billions of U.S. dollars)	127.5	144.0	167.6	...	...	...	...	...

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

1/ Debt at remaining maturity is defined as maturing short-, medium-, and long-term external official debt.
2/ Current account deficit plus amortization of external debt.
3/ Public sector covers general (consolidated) government.
4/ Based on the end of period debt stock in year t-1, and the baseline assumptions for the relevant variables (i.e., growth, interest rates, inflation, exchange rates) in year t.
5/ Overall balance plus debt amortization.
6/ Net debt is defined as gross debt minus government deposits with the banking system.
7/ Financial sector includes all commercial and specialized banks; for government debt also includes non-banks, but excludes State Bank of Pakistan.
8/ For 2005/06 data are on a calendar year basis (e.g., the value for 2005/06 denotes the observation for end-December 2005).

Table 10. Pakistan: Indicators of Fund Credit, 2008/09–2016/17
(In millions of SDR unless otherwise specified)

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	Projected Debt Service to the Fund based on Existing and Prospective Drawings:								
PRGF									
Principal 1/	137.7	155.1	172.3	163.7	120.6	51.7	17.2	0.0	0.0
Interest and charges 1/	4.0	3.1	2.2	1.4	0.6	0.2	0.0	0.0	0.0
Stand-by Arrangements									
Principal	0.0	0.0	0.0	587.9	1,927.9	1,967.9	656.4	28.4	0.0
Interest and charges	42.9	128.3	186.3	189.9	140.0	56.8	13.0	0.6	0.0
	Projected Level of Credit Outstanding based on Existing and Prospective Drawings:								
Total	3,885.0	5,466.5	5,521.7	4,770.1	2,721.6	702.0	28.4	0.0	0.0
PRGF Arrangements	680.5	525.4	353.2	189.5	68.9	17.2	0.0	0.0	0.0
Stand-by Arrangements	3,204.5	4,941.1	5,168.5	4,580.6	2,652.7	684.8	28.4	0	0
	Projected Debt Service to the Fund based on Existing and Prospective Drawings:								
Total 1/	184.6	286.4	360.8	942.8	2,189.1	2,076.6	686.7	29.0	0.0
Of which:									
Principal	137.7	155.1	172.3	751.6	2,048.5	2,019.6	673.6	28.4	0.0
Interest and charges	46.9	131.4	188.5	191.2	140.6	57.0	13.0	0.6	0.0
In percent of exports of goods and services	1.0	1.4	1.6	3.9	8.2	7.0	2.1	0.1	0.0
In percent of GDP	0.2	0.2	0.3	0.7	1.5	1.3	0.4	0.0	0.0
In percent of gross international reserves	3.2	3.8	4.4	10.4	22.4	19.0	5.5	0.2	0.0
Memorandum items									
Exports of goods and services (in millions of U.S. dollars)	26,486	29,347	32,486	35,952	39,805	43,904	48,249	53,059	58,394
Quota	1,034								
GDP (in millions of U.S. dollars)	163,220	171,343	184,307	199,199	217,290	229,375	244,912	261,502	286,680
Gross international reserves (in millions of U.S. dollars)	8,591	11,291	12,291	13,491	14,491	16,191	18,591	21,291	21,291

Source: Fund staff projections.

1/ For 2008/09 and 2009/10, debt service includes payments related to the EFF.

Table 11. Pakistan: Access and Phasing under the Proposed Stand-By Arrangement, 2008–10

Review	Available Date	Action	Purchase in millions of SDRs	Purchase in percent of quota
	November 24, 2008	Board approval of SBA	2,067.40	200
First Review	March 15, 2009	Observance of end-December 2008 performance criteria, completion of first review	568.54	55
Second Review	June 15, 2009	Observance of end-March 2009 performance criteria, completion of second review	568.54	55
Third Review	September 15, 2009	Observance of end-June 2009 performance criteria , completion of third review	434.15	42
Fourth Review	December 15, 2009	Observance of end-September 2009 performance criteria, completion of fourth review	434.15	42
Fifth Review	March 15, 2010	Observance of end-December 2009 performance criteria, completion of fifth review	434.15	42
Sixth Review	June 15, 2010	Observance of end-March 2010 performance criteria, completion of sixth review	434.15	42
Seventh Review	September 15, 2010	Observance of end-June 2010 performance criteria, completion of seventh review	227.42	22
	Total		5,168.50	500

Source: Fund staff.

Table 12. Pakistan: Public Sector Debt Sustainability Framework, 2004/05–2013/14

(In percent of GDP, unless otherwise indicated)

	Actual			Est.	Projections						Debt-stabilizing primary balance 9/
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	
Baseline: Public sector debt 1/	61.2	55.8	54.1	57.9	**54.6**	**52.4**	**50.7**	**48.8**	**46.2**	**43.8**	**-0.9**
o/w foreign-currency denominated	28.1	25.4	24.3	26.2	26.9	27.1	26.5	26.2	26.0	25.8	
Change in public sector debt	-6.6	-5.4	-1.8	3.8	-3.3	-2.2	-1.8	-1.8	-2.6	-2.5	
Identified debt-creating flows (4+7+12)	-4.3	-4.9	-3.0	1.7	-3.2	-4.9	-2.9	-3.0	-2.9	-2.8	
Primary deficit	-0.2	0.6	-0.2	2.5	-0.6	-1.6	-0.7	-0.8	-0.8	-0.6	
Revenue and grants	14.1	14.7	15.2	14.6	15.1	16.1	16.9	17.7	18.3	18.3	
Primary (noninterest) expenditure	14.0	15.3	15.0	17.1	14.5	14.5	16.2	16.9	17.5	17.7	
Automatic debt dynamics 2/	-5.0	-5.7	-2.7	-1.7	-2.7	-3.9	-2.7	-2.7	-2.6	-2.7	
Contribution from interest rate/growth differential 3/	-5.7	-5.9	-2.8	-4.4	-8.0	-3.9	-2.7	-2.7	-2.6	-2.7	
Of which contribution from real interest rate	-1.2	-2.7	0.2	-1.8	-6.4	-1.6	-0.1	0.0	0.4	0.2	
Of which contribution from real GDP growth	-4.5	-3.2	-3.0	-2.6	-1.5	-2.3	-2.6	-2.7	-3.0	-2.9	
Contribution from exchange rate depreciation 4/	0.8	0.2	0.1	2.7	5.2	...	...	...	...	...	
Other identified debt-creating flows	0.9	0.2	-0.1	0.9	0.1	0.6	0.5	0.5	0.5	0.5	
Privatization receipts (negative)	-0.4	-1.3	-0.8	0.0	-1.1	-0.3	-0.2	-0.2	-0.1	-0.1	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Build-up of bank deposits	1.3	1.5	0.7	0.9	1.2	0.9	0.6	0.6	0.6	0.6	
Residual, including other asset changes (2-3) 5/	-2.3	-0.5	1.3	2.2	-0.1	2.7	1.2	1.1	0.4	0.3	
Public sector debt-to-revenue ratio 1/	432.7	379.8	355.4	396.6	362.4	325.8	299.4	275.8	252.3	238.8	
Gross financing need 6/	19.0	20.7	22.0	24.2	19.7	17.3	15.8	14.4	12.8	11.5	
in billions of U.S. dollars	20.8	26.4	31.7	40.6	32.2	29.7	29.1	28.6	27.7	26.3	
Scenario with key variables at their historical averages 7/					**54.6**	**54.5**	**52.8**	**51.1**	**48.7**	**46.4**	**-0.4**
Scenario with no policy change (constant primary balance) in 2009/10-2013/14					**54.6**	**51.3**	**49.8**	**47.7**	**44.9**	**42.8**	**-0.7**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline											
Real GDP growth at market prices (in percent)	7.7	6.2	6.2	5.8	3.4	5.0	5.5	6.0	7.0	7.0	
Average nominal interest rate on public debt (in percent) 8/	5.5	6.0	8.7	10.4	10.2	10.3	7.1	6.8	6.4	5.8	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-1.5	-4.5	0.9	-3.2	-13.4	-2.7	0.1	0.3	1.4	0.8	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-2.5	-0.9	-0.5	-11.4	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	7.0	10.5	7.8	13.5	23.6	13.0	7.0	6.5	5.0	5.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	16.5	16.3	4.1	20.6	-12.2	4.7	18.2	10.9	10.6	8.1	
Primary deficit	-0.2	0.6	-0.2	2.5	-0.6	-1.6	-0.7	-0.8	-0.8	-0.6	

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

1/ General government gross debt; excludes external military debt, commercial debt, and short-term loans.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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

Table 13. Pakistan: External Debt Sustainability Framework, 2004/05–2012/13

(In percent of GDP, unless otherwise indicated)

	Actual			Est.	Projections					Debt-stabilizing noninterest current account 8/
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	
Baseline: External debt	31.1	28.0	26.9	**26.5**	**31.4**	**33.2**	**32.4**	**31.0**	**28.7**	**-5.0**
Change in external debt	-3.0	-3.1	-1.1	-0.3	4.9	1.7	-0.8	-1.3	-2.4	
Identified external debt-creating flows (4+8+9)	-3.7	-3.5	-3.6	4.0	2.5	0.9	-0.8	-1.3	-1.9	
Current account deficit, excluding interest payments	0.5	2.9	3.8	7.1	5.4	4.4	3.6	3.0	2.6	
Deficit in balance of goods and services	7.1	10.1	9.6	12.9	11.9	11.2	10.9	10.5	10.1	
Exports	16.2	15.9	14.9	14.1	16.2	17.1	17.6	18.0	18.3	
Imports	23.4	26.0	24.5	27.0	28.1	28.4	28.5	28.6	28.4	
Net non-debt-creating capital inflows (negative)	-1.5	-3.1	-5.2	-3.1	-3.1	-3.3	-3.7	-3.5	-3.5	
Automatic debt dynamics 2/	-2.6	-3.4	-2.2	0.0	0.2	-0.2	-0.7	-0.8	-1.0	
Contribution from nominal interest rate	0.9	1.0	1.0	1.3	1.1	1.3	1.0	1.0	1.0	
Contribution from real GDP growth	-2.3	-1.6	-1.5	-1.3	-0.9	-1.5	-1.7	-1.8	-2.0	
Contribution from price and exchange rate changes 3/	-1.2	-2.7	-1.7	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 4/	0.7	0.4	2.5	-4.3	2.5	0.9	0.0	0.0	-0.4	
External debt-to-exports ratio (in percent)	191.2	175.5	180.7	187.5	193.7	193.6	183.5	171.9	156.5	
Gross external financing need (in billions of US dollars) 5/	3.3	6.6	8.3	15.4	13.4	12.2	10.5	10.6	12.6	
In percent of GDP	3.0	5.2	5.8	9.2	8.2	7.1	5.7	5.3	5.8	
Scenario with key variables at their historical averages 6/				**26.5**	**23.9**	**21.3**	**18.5**	**15.8**	**12.8**	**-1.8**
Key Macroeconomic Assumptions Underlying Baseline										
Real GDP growth (in percent)	7.7	6.2	6.2	5.8	3.4	5.0	5.5	6.0	7.0	
GDP deflator in U.S. dollars (change in percent)	3.8	9.6	6.4	10.0	-5.8	0.0	2.0	2.0	1.9	
Nominal external interest rate (in percent)	3.1	3.7	4.0	5.6	4.1	4.2	3.3	3.5	3.4	
Growth of exports of goods and services (U.S. dollar terms, in percent) 7/	17.9	14.2	5.4	10.7	11.7	10.8	10.7	10.7	10.7	
Growth of imports of goods and services (U.S. dollar terms, in percent) 7/	44.7	29.6	6.3	28.4	1.3	5.8	8.0	8.4	8.6	
Current account balance, excluding interest payments	-0.5	-2.9	-3.8	-7.1	-5.4	-4.4	-3.6	-3.0	-2.6	
Net non-debt-creating capital inflows	1.5	3.1	5.2	3.1	3.1	3.3	3.7	3.5	3.5	

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

1/ Projections based on a staff scenario with tighter fiscal and monetary policies.

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

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

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

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

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

7/ Exports and imports of goods and services

Table 14. Pakistan: External Debt, 2004/05–2015/16

(In millions of U.S. dollars, outstanding as end of each fiscal year)

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Total external debt	34,037	35,655	38,699	44,467	51,315	56,820	59,628	61,799	62,303	62,668	63,965	65,413
Public and public guaranteed debt (excl. IMF)	31,084	32,579	35,290	40,243	42,379	45,244	47,731	50,848	54,341	57,774	60,148	61,690
Medium- and long-term debt	30,813	32,410	35,265	39,530	41,834	44,714	47,401	50,518	54,011	57,444	59,818	61,359
Multilateral creditors	15,358	16,530	18,687	21,583	24,234	26,674	28,851	30,970	32,985	34,958	36,746	38,330
ADB	6,049	6,341	7,151	9,408	11,256	12,168	13,424	14,623	15,783	16,900	17,984	19,050
World Bank	9,057	9,875	10,931	11,532	12,373	13,871	14,825	15,776	16,661	17,547	18,281	18,826
Other	253	315	604	643	605	634	601	570	541	511	482	454
Bilateral creditors	13,819	13,677	13,696	15,117	15,331	15,910	15,943	15,943	15,923	15,884	15,822	15,731
Paris Club	13,014	12,831	12,694	13,927	13,781	13,651	13,512	13,361	13,192	13,002	12,787	12,540
Non-paris club	805	847	1,002	1,190	1,550	2,259	2,431	2,582	2,731	2,882	3,035	3,191
Bonds	1,265	1,908	2,655	2,665	2,165	2,043	2,521	3,521	5,021	6,521	7,171	7,221
of which: Euro bond	1,255	1,900	2,650	2,650	2,165	2,043	2,521	3,521	5,021	6,521	7,171	7,221
Commercial banks and others	370	295	227	165	104	87	86	84	82	80	78	76
Short-term debt	271	169	25	713	545	530	330	330	330	330	330	330
IDB	271	169	25	713	545	530	330	330	330	330	330	330
Private sector debt	1,342	1,585	2,002	2,887	3,175	3,470	3,709	3,878	3,926	3,854	3,774	3,724
Of which:												
Multilateral creditors	297	266	280	322	…	…	…	…	…	…	…	…
Paris Club creditors	695	685	760	1,274	…	…	…	…	…	…	…	…
Non-paris club creditors	5	2	1	9	…	…	…	…	…	…	…	…
Other	345	633	962	1,007	…	…	…	…	…	…	…	…
IMF	1,611	1,491	1,407	1,337	5,761	8,106	8,188	7,074	4,036	1,041	42	0

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

ATTACHMENT I. PAKISTAN: LETTER OF INTENT

November 20, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

The Pakistani authorities have held discussions with Fund staff for a 23-month Stand-By Arrangement in support of the government's program for 2008/09–2009/10. Based on these discussions, the attached Memorandum on Economic and Financial Policies (MEFP) reviews economic developments and policies during 2007/08–2009/10, and discusses the underpinning stabilization and structural policies. In support of the policies in the attached MEFP, the government requests that the Executive Board of the Fund approve a Stand-By Arrangement with exceptional access in an amount of SDR 5.169 billion.

The Government of Pakistan will provide the Fund with such information as the Fund may request in connection with Pakistan's progress in implementing its economic and financial policies. The government believes that the policies set out in the attached MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Pakistan will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations.

Sincerely yours,

/s/
Shaukat Tarin
Advisor to the Prime Minister
on Finance and Economic Affairs

/s/
Shamshad Akhtar
Governor
State Bank of Pakistan

ATTACHMENT II. PAKISTAN: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2008/09–2009/10

The Government of Pakistan has adopted a comprehensive program of macroeconomic stabilization and sustainable development. This memorandum sets out Pakistan's economic and financial policies for November 2008–June 2010, to be supported by the International Monetary Fund (IMF) under a 23-month Stand-By Arrangement (SBA).

VI. RECENT ECONOMIC DEVELOPMENTS

1. **In the last decade, Pakistan's economy witnessed a major economic transformation.** The country's real GDP increased from $60 billion in 2000/01 to $170 billion in 2007/08 (fiscal year starts July 1st), with per capita income rising from under $500 to over $1,000. During the same period, the volume of international trade increased from about $20 billion to nearly $60 billion. For most of this period, real GDP grew at more than 7 percent a year with relative price stability. The improved macroeconomic performance enabled Pakistan to re-enter the international capital markets in the mid-2000s. Large capital inflows financed the current account deficit and contributed to an increase in gross official reserves to $14.3 billion (3.8 months of imports) at end-June 2007. Buoyant output growth, low inflation, and the government's social policies contributed to a reduction in poverty and an improvement in many social indicators.

2. **This strong macroeconomic performance resulted from the implementation of a series of important structural reforms.** In the early 2000s, with financial support from international financial institutions (IFIs), including the IMF, the World Bank, and the Asian Development Bank, the government expanded the role of markets in the economy, privatized a number of large state-owned enterprises, established market-based regulatory bodies, and took steps to reduce the cost of doing business in Pakistan.

3. **The macroeconomic situation, however, deteriorated significantly in 2007/08 and the first four months of 2008/09** owing to adverse security developments, large exogenous price shocks (oil and food), global financial turmoil, and policy inaction during the political transition to the new government. Specifically:

- Real GDP growth slowed to 5.8 percent in 2007/08 (6.8 percent in 2006/07), reflecting weaker performance of the agricultural and manufacturing sectors.

- Headline CPI 12-month inflation rose to 25 percent in October 2008, with core inflation (excluding energy and food) increasing to 18 percent.

- The external current account deficit widened to about $14 billion or 8½ percent of GDP in 2007/08. The growth of exports and workers' remittances recovered, but total imports rose by more than 30 percent owing to an increase of $4 billion

(2½ percent of GDP) in the value of oil imports and strong aggregate demand growth. With the surplus in the financial account of the balance of payments declining to $7.7 billion, from $10.1 billion in 2006/07, this led to a decline in the gross international reserves of the State Bank of Pakistan (SBP) of $5.7 billion, to $8.6 billion at end-June 2008. Reserves dwindled further to $3.4 billion (less than one month of imports) as of end-October 2008.

- The fiscal deficit (excluding grants) is estimated to have risen to 7.4 percent of GDP in 2007/08, from 4.3 percent in 2006/07, mainly because of a substantial increase in energy and food subsidies (in a context of rising international prices that were not passed through to consumers), higher than envisaged interest payments, and additional security-related expenditures. The deficit was largely covered through SBP financing.

- To contain inflationary pressures, between July 2007 and July 2008 the SBP increased its discount rate in several steps by 350 basis points, to 13 percent. Despite these increases, SBP financing of the government continued in July–October 2008.

- The banking system was well capitalized and liquid as of end-June 2008, but liquidity problems have emerged recently. Domestic pressures and the global financial crisis led to rising dollarization and an outflow of deposits from the system during July-October, which contributed to a deterioration of liquidity conditions. In response to an escalation of liquidity pressures in October, the SBP recently reduced the reserve requirement by 4 percentage points and eased liquidity requirements. In addition, the SBP has encouraged the merger of four small banks. These measures have stabilized liquidity conditions in recent weeks.

- Financial market indicators have deteriorated. After climbing to new record highs by end-April 2008, the Karachi KSE-100 index dropped by one third, prompting the Karachi Stock Exchange Board to impose a floor on the decline of all stock prices on August 27, 2008. The EMBIG spread has increased to over 2,000 basis points. The rupee has depreciated by 30 percent since end-March 2008, reflecting growing foreign exchange market pressures. In May 2008, the SBP adopted, on a temporary basis, several exchange measures aimed at reducing these pressures. In addition, the government has recently imposed regulatory duties on imports of luxury items.

VII. Stabilization Policies

A. Macroeconomic outlook and policies

4. **The government's financial policies for the remainder of 2008/09 and for 2009/10 are aimed at stabilizing the macroeconomic situation and restoring investor confidence.** The government's program envisages a significant fiscal consolidation, and the

SBP will tighten monetary policy to lower inflation and strengthen the international reserves position. As a result of these policies, the 12-month inflation rate is projected to decline to 20 percent at end-June 2009, even after taking into account the impact of significant increases in administered energy prices. Real GDP growth would slow further to 3–3½ percent in 2008/09 in response to the tightening of macroeconomic policies and a deceleration of growth in Pakistan's trading partners.

5. **The tighter financial policies, higher disbursements from IFIs, lower commodity prices, and restored confidence are expected to contribute to a significant strengthening of the external position in 2008/09.** Specifically, the external current account deficit is projected to narrow to $10.6 billion (6.5 percent of GDP) owing mainly to slower aggregate demand growth and lower oil import prices. At the same time, the surplus in the financial account would decline to $6.2 billion, as an increase in disbursements from IFIs (to about $4 billion) would be more than offset by weaker FDI and portfolio flows relative to 2007/08, reflecting in part the impact of the global financial turmoil. Given the target to increase gross official reserves to $8.6 billion by end-June 2009 (the level prevailing at end-June 2008), the residual financing gap of $4.7 billion will be covered by drawing on IMF resources. To further bolster confidence, the government is seeking additional financial support from donors.

6. **The government's medium-term strategy seeks to achieve high sustained growth and significantly reduce poverty, while ensuring external and fiscal sustainability.** Following the initial stabilization effort in 2008/09, real GDP growth would increase to 5 percent in 2009/10, and is projected to rise gradually to 6½–7 percent a year by 2012/13, based on a significant increase in investment and further progress in structural reforms. Average inflation is targeted to decline to 13 percent in 2009/10, and to 5 percent by 2012/13. Prudent demand management policies would contribute to a gradual decline in the external current account deficit to 5.7 percent of GDP in 2009/10, and further to 3.6 percent of GDP by 2012/13. This, along with the expected pickup in capital inflows, would help increase gross international reserves to $14.5 billion (2.6 months of projected imports) by 2012/13, while reducing the external debt to 29 percent of GDP. The external financing gap for 2009/10, which is projected at $3.6 billion, will be covered by disbursements from the IMF and GDR proceeds. External financing gaps will be fully eliminated by the end of the SBA.

B. Fiscal policy

7. **The fiscal deficit (excluding grants) is targeted to decline to 4.2 percent of GDP (PRs 562 billion) in 2008/09, from 7.4 percent in 2007/08.** This fiscal effort is necessary to help reduce the external current account deficit, move toward a sustainable fiscal position, and eliminate SBP financing of the government. To achieve the 2008/09 deficit target, the government will increase tax revenue by 0.6 percentage points of GDP and reduce non-interest current expenditure by about 1½ percentage points of GDP, mainly through the

elimination of oil subsidies by December 2008 and electricity subsidies by June 2009. At the same time, domestically-financed development spending will be reduced by about 1 percentage point of GDP through better project prioritization.

8. **The government has already implemented a number of measures consistent with the envisaged fiscal adjustment in 2008/09.** Specifically, petroleum prices have been adjusted three times since June 2008, which has led to the complete elimination of petroleum subsidies. At the same time, electricity tariffs were adjusted by an average of 18 percent effective September 5, 2008. In addition, steps have been taken to slow the pace of development spending, the research and development subsidy for the textile industry has been fully eliminated, wheat procurement prices have been raised to international levels, and the general sales tax (GST) rate has been raised by one percentage point to 16 percent.

9. **The government plans to take additional fiscal measures in 2008/09.** As noted above, electricity tariff differential subsidies will be fully eliminated by end-June 2009. To achieve this objective, the average base tariff will be further increased during 2008/09 according to a schedule to be agreed with the World Bank by end-December 2008 (structural benchmark), and the government will use fuel and other surcharges, as necessary. The implementation of the electricity tariff increases will be followed up in the context of the program reviews. On the revenue side, further steps will be taken during the remainder of the fiscal year to strengthen tax enforcement. Moreover, fuel prices will continue to be adjusted to pass through changes in international prices.

10. **An expanded and effective social safety net constitutes an integral part of the authorities' program.** In this regard, several measures are envisaged to protect vulnerable groups that might be adversely affected by inflation and the economic slowdown. The fiscal program for 2008/09 envisages an increase in social safety net spending of 0.6 percentage points of GDP, to 0.9 percent of GDP. To this end, the government has launched the Benazir Income Support Program (BISP), for which the budget already allocated PRs 34 billion (0.3 percent of GDP). The design of the BISP, in particular the targeting of transfers and the delivery mechanism, will be reviewed in the first half of 2009, in consultation with the World Bank. The government also plans to expand social safety net spending by an additional 0.3 percent of GDP, for which further external assistance (mainly in the form of grants) is being sought from donors. While a more comprehensive and better-targeted social safety net is being designed, these additional funds will be allocated to scale up other existing programs, in particular cash transfers under the Bait-ul-Mal program. Also, part of the additional resources could be used to cover larger than envisaged electricity subsidies for poor households.

11. **Putting in place a more comprehensive and well-targeted social safety net is a key priority under the program.** To that end, in close cooperation with the World Bank, the government will prepare, by end-March 2009, a strategy and a time-bound action plan for the

adoption of specific measures. The first program review will assess progress in this area. The resources allocated to the short-term protection measures described above will be used for funding the newly designed social safety net in 2009/10.

12. **The government will prepare, by end-March 2009, a plan for eliminating the inter-corporate circular debt within the fiscal deficit target.** The plan will clearly identify all elements of circular debt, including (i) the identification of all debts owed and due among the corporations, duly reconciled; (ii) the determination of the validity of the claims; (iii) a schedule by which respective entities will discharge their liabilities to each other; and (iv) a timeframe during which the Federal Adjuster will use his powers to make adjustments, in case of failure, to adhere to the approved schedule.

13. **The targeted reduction in the fiscal deficit in 2008/09 will help eliminate SBP financing of the budget.** The government is committed to limiting SBP financing of the budget to zero on a cumulative basis during October 1, 2008–June 30, 2009. During this period, the fiscal deficit will be fully financed by available external disbursements (which have already been committed), the acceleration of the privatization process, the issuance of treasury bills, and other domestic financing instruments, including Pakistan Investment Bonds, Ijara Sukuk, and National Savings Scheme (NSS) instruments.

14. **A further reduction in the fiscal deficit to 3.3 percent of GDP is envisaged for 2009/10.** The fiscal effort will be facilitated by the full-year effect of the elimination of energy subsidies by end-2008/09 and declining interest payments, following large bullet payments in the three-year period ending in 2009/10.

15. **Consistent with the government's objective of substantially increasing tax revenue, a number of tax policy and administration measures are envisaged during the program period.** Specifically, an integrated tax administration organization on a functional basis will be established at the Federal Board of Revenue (FBR) (integrating both the income tax and sales tax administration). In addition, audits will be reintroduced as part of a risk-based audit strategy that will be implemented by end-December 2008. A full description of the required reforms, together with an action plan will be provided to the IMF by end-December 2008, following a planned seminar to review tax policy and administration. As part of this process, the government plans to harmonize the income tax and GST laws, including for tax administration purposes, and reduce exemptions for both taxes. To that end, it will submit legislative amendments to parliament by end-June 2009. In addition, the excises on tobacco will be increased in the context of the 2009/10 budget. Following the seminar in December 2008, the government will initiate a process to implement a full VAT with minimal exemptions, to be administered by the FBR. Draft legislation for the VAT is expected to be ready for public debate by end-2009. The first program review will focus on the progress in developing the government's tax reform agenda.

16. **The government's fiscal consolidation efforts will continue over the medium term.** The government's fiscal framework assumes a further reduction in the fiscal deficit to 2–2½ percent of GDP by 2012/13. Fiscal consolidation will be supported by a strong tax effort, which will allow for higher spending in infrastructure and the social sectors. Specifically, the government is committed to increasing tax revenue by at least 3½ percentage points of GDP over the medium term as a result of measures to broaden the GST base, significantly reduce income tax exemptions, and further improve tax enforcement.

17. **The government will continue to press ahead with public financial management reforms, in line with fiscal ROSC recommendations.** Immediate priority will be given to completing the on-going gradual implementation of a single treasury account. This will involve the consolidation of government funds in its account with the SBP, from which withdrawals will be made only when actual payments are due. Existing funds held outside the SBP account will be transferred by end-June 2009. Furthermore, the coordination between the Planning Commission, which manages the developmental budget, and the Ministry of Finance will be strengthened in the context of the implementation of the medium-term budget framework.

C. Monetary policy, exchange rate policy, and financial sector issues

18. **The program envisages a significant tightening of monetary policy.** To that end, the SBP recently increased its discount rate by 200 basis points, to 15 percent. Following this first step, interest rate policy will be sufficiently flexible to protect the reserves position, bring down inflation, and allow the government to place T-bills and other securities with commercial banks and non-banks in order to avoid further central bank financing of the budget. A further increase in the discount rate will be considered at the time of the monetary policy statement scheduled for end-January 2009. However, the discount rate will be raised earlier if the actual reserves for end-November and end-December 2008 fall short of the program monthly floors on the SBP's net foreign assets. In addition, if the volume of T-bills placed in the auction scheduled for November 19 falls short of the announced target, understandings will be reached with Fund staff on corrective measures in order to meet the program targets.

19. **The conduct of monetary policy will be facilitated by significant improvements in liquidity management, including by improving the forecasting of the government's cash flow position.** As part of these efforts, the SBP and the Ministry of Finance have agreed on quarterly volumes of treasury bill placements consistent with zero SBP financing of the budget during October 1, 2008–June 30, 2009. The SBP has issued an auction calendar for November-December 2008 on November 1st, 2008, and in the future will issue a calendar every quarter one month in advance. In addition, the SBP will review the current procedures for liquidity management, and will adopt and publicize a transparent liquidity management framework by end-July 2009 as part of its Monetary Policy Statement. This framework will contain the following key elements:

- The announcement of an explicit corridor for money market interest rates: the SBP's reverse repo rate will be the ceiling, and a standing repo facility to absorb excess liquidity from commercial banks will serve as the floor of the proposed explicit corridor;
- The treasury will provide the SBP with T-bills, as needed, to conduct its open market operations.

20. **The SBP is committed to pursuing a flexible exchange rate policy.** To that end, intervention in the foreign exchange market (including the provision of foreign exchange for oil imports) will be aimed at meeting the program's reserve targets. This primary objective will be facilitated by phasing out the SBP's provision of foreign exchange for oil imports according to the following schedule:

- Furnace oil—by February 1, 2009.
- Diesel and other refined products—by August 1, 2009.
- Crude oil—by February 1, 2010.

21. **During the program period, the SBP intends to eliminate any exchange restriction subject to approval under Article VIII of the IMF's Articles of Agreement.** Specifically, the exchange restriction on advance import payments against letters of credit will be eliminated by end-January 2010, subject to a marked improvement in the balance of payments position. No intensification of existing restrictions and no new exchange restrictions or multiple currency practices will be introduced during the program period.

22. **The SBP will prepare a contingency plan to deal with problem private banks by end-December 2008.** The plan will contain criteria for SBP liquidity support, assessment of bank problems, and intervention procedures. The SBP has already dealt with problem banks through mergers. Looking ahead, if there are severe strains in the interbank market and interbank lending guarantees appear necessary, these guarantees will be provided in limited amounts only to solvent banks.

23. **To enhance the effectiveness of SBP enforcement powers, necessary amendments to the Banking Companies Ordinance will be submitted to Parliament by end-June 2009.** These amendments will strengthen the SBP's ability to (i) change management in banks; (ii) impose losses on shareholders by writing down their capital; (iii) intervene and take ownership of banks; (iv) appoint administrators to operate banks; and (v) restructure banks.

24. **The legal provisions relating to the operational independence of the SBP will be reviewed.** These provisions will be strengthened based on the recommendations of an interagency committee that will be established by mid-November 2008, and taking into

account technical recommendations from the IMF. The second program review will focus on specific details regarding required legislative changes in this area.

25. **The government believes that market confidence will improve significantly once the Fund-supported program is approved and the international reserves position is strengthened.** Therefore, it does not intend to remove the current floor on stock prices until after the program is in place. In any event, the timing and terms under which the floor on stock prices will be removed, including any use of public funds to support the stock market, will be decided after reaching understandings with Fund staff.

VIII. RISKS AND CONTINGENCIES

26. **Larger-than-expected external budget support may become available in 2008/09 and 2009/10.** In such a case, any additional external budget support to cover increased social safety net spending up to $500 million per year (0.3 percent of GDP) will be used to replace non-central bank domestic borrowing assumed under the program. Provided that downside risks do not materialize, the government will use any additional external budget financing beyond the first $500 million per year to further increase spending, up to a fiscal deficit of 4.7 percent of GDP in 2008/09 and 3.8 percent of GDP in 2009/10. Any external financing support exceeding these limits will be used to retire government debt with the SBP and strengthen the SBP's international reserves position.

27. **Key economic and financial downside risks to the program include lower-than-expected private capital inflows, a reversal of the current trend of declining oil prices, and a more severe-than-anticipated economic slowdown in trading partner countries.** If these risks materialize, the government stands ready to adjust its policies, in close consultation with IMF staff, to ensure the achievement of a sustainable external position by the end of the program period.

IX. PROGRAM MONITORING

28. The program will be subject to quarterly reviews and quarterly performance criteria as set out in the technical memorandum of understanding (TMU). Completion of the first two reviews scheduled for end-March 2009 and end-June 2009 will require observance of the quantitative performance criteria for end-December 2008 and end-March 2009, respectively, as specified in Table 1.

29. An updated safeguards assessment of the SBP will be conducted in the context of the first review.

30. The government authorizes the IMF to publish the Letter of Intent, its attachments, and the related staff report.

Table 1. Pakistan: Quantitative Targets, december 2008-June 2010

	Outst. Stock end-Sept. 2008	Prog. end-Dec. 2008	Prog. end-Mar. 2009	Prog. end-Jun. 2009
Floor on net foreign assets of the SBP* (stock, in millions of U.S. dollars)	3,953	1,165	671	2,782
Ceiling on net domestic assets of the SBP* (stock, in billions of Pakistani rupees)	1,250	1,346	1,412	1,314
Ceiling on net government borrowing from SBP* (stock, in billions of Pakistani rupees)	1,227	1,274	1,274	1,181
Ceiling on overall budget deficit* (cumulative flow, in billions of Pakistani rupees)	142	261	405	562
Ceiling on outstanding stock of short-term public and publicly guaranteed external debt* (in millions of U.S. dollars)	515	1,500	1,500	1,500
Cumulative ceiling on contracting of nonconcessional medium- and long-term public and publicly guaranteed external debt* (in millions of U.S. dollars) 1/	9,500	9,500	9,500	9,500
Accumulation of external payments arrears (continuous performance criterion during the program period)* (in millions of U.S. dollars)	0	0	0	0
Continuous ceiling on SBP's foreign currency swaps and forward sales* (in millions of U.S. dollars)	1,900	2,750	2,750	2,750
Memorandum items:				
Net external program financing (in millions of U.S. dollars)	-53	137	918	2,503
External project grants (in millions of U.S. dollars)	1	39	95	180
Foreign Exchange cash reserve requirement (CRR, incl. special CRR) deposits in SBP (in millions of U.S. dollars)	832	832	832	832
Weekly cash reserve requirement ratios (in percentage points)				
Rupee deposits (less than one year maturity)	9	5	5	5
Rupee deposits (more than one year maturity)	0	0	0	0
Foreign currency deposits CRR	5	5	5	5
Foreign currency deposits special CRR	15	15	15	15

Notes:
* denotes performance citeria.

1/ Excludes IMF.

Table 2. Pakistan—Prior actions, Structural Performance Criteria and Benchmarks

Prior actions (implemented before Board consideration of the program)
The SBP's discount rate was increased by 200 basis points.

Electricity tariffs were increased by an average 18 percent effective September 5, 2008.

The SBP and the government agreed on quarterly volumes of treasury bills to be issued, and published the expected volume for the remainder of the second quarter of 2008/09.

Performance criteria
Amendments to the banking legislation will be submitted to Parliament by end-June 2009 to enhance the effectiveness of SBP enforcement powers in the area of banking supervision.

The government will submit, by end-June 2009, draft legislative amendments to parliament to harmonize the income tax and GST laws, including for tax administration purposes, and to reduce exemptions for both taxes.

Benchmarks
A contingency plan for handling problem private banks will be finalized by end-December 2008.

A full description of required reforms in the area of tax administration, including an action plan for harmonizing the GST and income tax administration will be finalized by end-December 2008.

In close collaboration with the World Bank, the government will finalize the schedule for further electricity tariff adjustments during 2008/09, by end-December 2008, with a view to eliminating tariff differential subsidies by end-June 2009.

The SBP's provision of foreign exchange for furnace oil will be eliminated by February 1, 2009.

In close collaboration with the World Bank, the government will develop a strategy and a time-bound action plan, by end-March 2009, for the adoption of specific measures to strengthen the social safety net and improve targeting to the poor.

The government will prepare a plan for eliminating the inter-corporate circular debt by end-March 2009.

The transition to a single treasury account will be completed by end-June 2009.

Table 3. Pakistan: SBP Monthly NFA Targets
(In millions of U.S. dollars)

	Sept.	Oct.	Nov.	Dec.	Jan.
Gross reserves 1/	**5,171**	**3,530**	**5,400**	**5,400**	**5,300**
Fund disbursement	...	...	**3,066**	...	...
Cumulative increase in gross reserves since program	...	...	**1,870**	**1,870**	**1,770**
NFA 2/	3,953	2,312	1,117	1,165	1,065
Change in NFA	...	-1,641	-1,196	49	-100
Memorandum items					
Stock of forward/swap	1,900	1,900	1,900	1,900	1,900
Repurchase (of existing Fund credits)	...	...	...	49	...

1/ Excluding gold and foreign deposits of commercial banks held with the State Bank of Pakistan.
2/ End-December target is a performance criterion subject to adjustors as specified in the TMU.

Attachment III. Pakistan: Technical Memorandum of Understanding (TMU) on the Program Supported Under the Stand-By Arrangement

November 20, 2008

1. With effect from November 1, 2008, this Technical Memorandum of Understanding (TMU) describes the monitoring arrangements under the SBA-supported program. Throughout, unless otherwise stated, "government" is meant to comprise the federal and provincial governments.

I. Definitions of Monitoring Variables

Valuation of foreign exchange denominated assets, liabilities, and foreign exchange flows

2. For the purposes of monitoring under the program, all assets and liabilities as well as debt contracted, denominated in SDRs or in currencies other than the U.S. dollar, will be converted into U.S. dollars at the exchange rates prevailing at test dates, as posted by the State Bank of Pakistan (SBP) on its web site. Net external budget financing and external cash grants will be converted into Pakistani rupees at the exchange rates prevailing at the day of the transaction, as posted by the SBP on its web site, unless otherwise indicated.

3. **Reserve money** (RM) is defined as the sum of: currency outside scheduled banks (deposit money banks); scheduled banks' domestic cash in vaults; scheduled banks' required and excess rupee and foreign exchange deposits with the State Bank of Pakistan (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.

4. **Net foreign assets (NFA) of the SBP** are defined as the difference between its foreign assets and foreign liabilities. Foreign assets of the SBP consist of gold, foreign exchange, balances held outside Pakistan, foreign securities, foreign bills purchased and discounted, the reserve position with the IMF, and SDR holdings. The definition of foreign assets of the SBP will be consistent with the IMF Data Template on International Reserves and Foreign Currency Liquidity. Gold will be valued at $20.27 per troy ounce per fine troy ounce. Foreign liabilities of the SBP include outstanding IMF credits, deposits with the SBP of foreign governments, foreign central banks, foreign deposit money banks, international organizations, and foreign nonbank financial institutions (NBFI).

5. **Net domestic assets (NDA) of the SBP** are defined as the difference between the RM and the NFA of the SBP.

6. **Net borrowing from the banking system by the government** is defined as the difference between the banking system's claims, on a cash basis, on the federal, provincial, and local governments and the deposits of the federal, provincial, and local governments with

the banking system, including district government funds balances. For the purposes of this memorandum, claims on government exclude: credit for commodity operations; government deposits exclude outstanding balances in the Zakat Fund and balances in the various privatization accounts kept by the government in the banking system. The stock of bonds which were issued to banks in substitution of outstanding nonperforming loans to certain public entities, and which are being fully serviced by the government, are included in banking system claims on government. Table 1 summarizes the calculations of **net borrowing from the banking system by the government.**

7. **Net borrowing from the SBP by the government is defined as** SBP claims on the government minus government deposits with the SBP. SBP claims on the government include government securities, treasury bills, ways and means advances, 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 and Privatization accounts (Table 1).

8. The definition of the **overall budget deficit (excluding grants)** under the program will be the consolidated budget deficit, excluding grants, and including the operations of district governments financed from local funds. It will be measured by the sum of (a) total net financing to the federal, provincial, and local governments; and (b) total external grants to the federal and provincial governments. The former is defined as the sum of (i) net external budget financing (see ¶10); (ii) net borrowing from the banking system (as defined above); and (iii) net domestic nonbank financing (see ¶11). The total external grants 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.

9. **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 (AsDB) budget support and structural adjustment 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 onlent 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 2.

10. **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.

11. **Net domestic nonbank financing of the budget** is defined as follows: domestic privatization receipts transferred from the privatization accounts to the budget, plus the change, during each reporting period, in the stock of (a) permanent debt, which consists of nonbank holdings of prize bonds, all federal bonds, and securities; plus (b) floating debt held by nonbanks; plus (c) unfunded debt, which consists of National Savings Scheme (NSS) debt, Postal Life Insurance, and the General Provident Fund (GPF); plus (d) net deposits and reserves received by the government (public accounts deposits); plus (e) any other government borrowing from domestic nonbank sources net of repayments; minus (f) government deposits with NBFIs. Nonbank holdings of permanent and floating debt is defined as total debt outstanding, as reported by the SBP, minus holdings of banks as per the monetary survey. Total treasury bill and other relevant government debt is valued at discount value and excluding accrued interest.

External debt

12. The performance criterion on contracting or guaranteeing of medium-term and long-term nonconcessional external debt by the government or the SBP applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (adopted by the IMF Executive Board on August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received.[1] Excluded from this performance criterion are (a) foreign currency deposit liabilities of the SBP; and (b) the outstanding stock of debt of Foreign Exchange Bearer Certificates (FEBCs), Deposit Bearer Certificates (DBCs), and Foreign Currency Bearer Certificates (FCBCs). The performance criterion setting a limit on the outstanding stock of short-term external debt

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[1] The definition of debt set forth in No. 9 of the guidelines reads as follows: “(a) For the purpose of this guideline, the term “debt” will be understood to mean a current, that is, not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers’ credits, that is, contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. (b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (for example, payment on delivery) will not give rise to debt.”

refers to debt (as defined in Footnote 1) with original maturity of up to and including one year. Medium- and long-term external debt comprises debt with initial maturity of over one year.

13. **Nonconcessional borrowing** is defined as borrowing with a grant element of less than 35 percent, following the methodology set out in the "Guidelines on Performance Criteria with Respect to Foreign Borrowing—Change in Implementation of Revised Guidelines" (www.imf.org). The discount rates used to calculate the grant element will be the six-month and ten-year Commercial Interest Reference Rates (CIRRs) averages, as computed by the Strategy and Policy Review Department of the IMF. Six-month CIRRs are updated mid-February and mid-August (covering the six-month period preceding the date of update) and the ten-year CIRRs averages are updated mid-December (covering a period of 10 years preceding the date of the update). Six-month CIRRs averages are to be used for loans whose maturity is less than 15 years, while ten-year CIRRs averages are to be used for loans whose maturity is equal or more than 15 years.

II. ADJUSTORS

Adjustors related to net external program financing

14. **Adjusters to program targets will be implemented if the actual cumulative net external program financing in U.S. dollar terms is different from its projected value.**

15. If the actual cumulative net external program financing in U.S. dollar terms is higher than its projected value by more than $500 million, **the excess net external program financing in U.S. dollar terms** is defined as follows: actual external program financing in U.S. dollar terms minus projected net external program financing in U.S. dollar terms minus $500 million. The excess net external program financing in U.S. dollar terms multiplied by a fixed accounting exchange rate of RPs 80 per $1 represents **the excess net external program financing in rupee terms.**

16. 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 27.0 billion at end-December 2008, PRs 67.0 billion at end-March 2009, and PRs 67.0 billion at end-June 2009.

17. The cumulative excess net external program financing in U.S. dollar terms may exceed the cumulative maximum limits specified in paragraph 16 for end-December 2008, end-March 2009, and end-June 2009, when converted into U.S. dollar terms at a fixed accounting exchange rate of PRs 80 per $1. In such a case, the cumulative excesses in net external program financing in U.S. dollar terms minus the maximum cumulative amounts specified for end-December 2008, end-March 2009, and end-June 2009 converted into U.S. dollar terms at a fixed accounting exchange rate of PRs 80 per $1 are defined as **"surplus net external program financing in U.S. dollar terms."** The latter amount multiplied by a fixed accounting exchange rate of PRs 80 per $1 constitutes "surplus net external program financing in rupee terms."

18. The floors on the **NFA of the SBP** will be adjusted upward by the cumulative **surplus net external program financing** in U.S. dollar terms as defined above.

19. The ceilings on the **NDA of the SBP and net borrowing from the SBP by the government** will be adjusted downward by the cumulative **surplus net external program financing in rupee terms** as defined above.

20. If the actual cumulative net external program financing in U.S. dollar terms is lower than its projected value, **the shortfall in net external program financing in U.S. dollar terms** is defined as the difference between its projected and actual values in U.S. dollar terms. In such a case:

a. The floor on the NFA of the SBP is adjusted downward by the amount equivalent to 50 percent of the cumulative shortfall in net external program financing in U.S. dollar terms.

b. The ceiling on the NDA of the SBP is adjusted upward by the amount equivalent to 50 percent of the cumulative shortfall in net external program financing in U.S. dollar terms converted into rupees at a fixed accounting exchange rate of PRs 80 per $1.

c. The ceiling on **net borrowing from the SBP by the government** is not subject to adjustment.

Adjustor related to project grants

21. If the amount of project grants is higher than assumed under the program, the ceiling on the **consolidated overall budget deficit (excluding grants)** will be adjusted upward for the cumulative excess in project grants. This adjustor is applied in addition to any adjustment to the **consolidated overall budget deficit (excluding grants)** that is made under paragraph 16.

Adjustor related to changes in regulations on required reserves

22. The ceilings on the NDA of the SBP will also be adjusted downward/upward by the amount of (a) banks' Pakistani rupee reserves freed/seized by any reduction/increase of the daily CRR relative to the baseline assumption; and (b) any reduction/increase in the reservable deposit base that is related to definitional changes, as per the following formula: $\Delta NDA = \Delta r B_0 + r_0 \Delta B + \Delta r \Delta B$, where r_0 denotes the reserve requirement ratio prior to any change; B_0 denotes the level of the reservable deposits in the initial definition; Δr is the change in the reserve requirement ratio; and ΔB denotes the change in the reservable deposits as a result of definitional changes. In case of significant liquidity and other financial sector pressures, the SBP will engage in consultations with the IMF staff in order to reach understanding on appropriate monetary policy response.

Adjustor related to the SBP's net position under foreign exchange forwards and swaps
23. An adjustor to the NFA target of the SBP will be implemented to reflect changes in the SBP's net position under foreign exchange forwards and swaps. Specifically, the NFA target of the SBP will be adjusted upward/downward by the amount of the increase/decrease in the net SBP's position under foreign exchange forwards and swaps. The maximum SBP's net exposure under foreign exchange forwards and swaps is capped at $2.75 billion as of end-December 2008, end-March 2009, and end-June 2009. The SBP's net exposure under foreign exchange forwards and swaps was $1.9 billion at end-September 2008.

Adjustor related to foreign currency deposits of resident banks with the SBP
24. An adjustor to the NFA target of the SBP will be implemented to reflect changes in foreign currency deposits of resident banks. Specifically, the NFA target of the SBP will be adjusted upward/downward by the amount of increase/decrease in foreign currency deposits of resident banks with the SBP. The stock of foreign currency deposits with resident banks was $832 million at end-September 2008.

III. Program Reporting Requirements

25. The following information, including any revisions to historical data, will be provided to the Middle East and Central Asia Department of the IMF through the office of the Resident Representative of the IMF in Pakistan, within the timeframe indicated:

- Monthly provisional statements on federal tax and nontax revenue, within one month.
- Deposits into and withdrawals from the privatization accounts for each quarter, within one month. Withdrawals will be reported with the following breakdown (a) those which constitute budgetary use of privatization proceeds; (b) those which constitute costs of privatization; and (c) other (with explanation of the purpose of other withdrawals), as well as with the breakdown between domestic and external privatization receipts.
- Quarterly statements on budgetary capital receipts and disbursements, including repayments of bonds, recovery of loans from provinces and "others," within two months.
- Monthly (unreconciled) provisional data on federal expenditure and net lending (with separate data on disbursements and repayments), within one month.
- Quarterly statement on consolidated budgetary expenditure, with federal data approved by the Accountant General Pakistan Revenue (AGPR), within two months.
- Quarterly numbers on expenditure on social programs.

- Quarterly data on the stock of domestic government debt, broken down by instrument, within one month (Table 3).

- Quarterly data on WAPDA receivables within one month.

- Monthly data on Outstanding Audited Price Differential Claims.

- Monthly data on external budget financing, including (i) loan-by-loan program disbursements in U.S. dollar terms and rupee terms converted at exchange rates prevailing at the time of each transaction; (ii) cumulative amortization in U.S. dollar terms and rupee terms converted at exchange rates prevailing at the time of each transaction; and (iii) cumulative project loan disbursements in U.S. dollar terms and in rupees converted at exchange rates prevailing at the time of each transaction.

- Monthly data on Banks' Budgetary Support (Table 1) within one month.

- The following monthly monetary data on a last-Saturday basis within two weeks:

  (i) monetary survey;
  (ii) accounts of the SBP;
  (iii) consolidated accounts of the scheduled banks;
  (iv) banks' lending to the government;
  (v) detailed table on net foreign assets (both for the SBP and scheduled banks);
  (vi) detailed table of scheduled banks' reserves with the SBP.

- The same tables as in the preceding item, but on an end-month and end-quarter basis (last business day), both at current and program exchange rates, within one month.

- The SBP Table on outstanding stock of foreign currency deposits, amended to include the classification of new FCA according to the residency of the holder.

- Daily data on exchange rates (interbank, retail market, and Telegraphic Transfers for SBP purchases in the retail market), SBP's sales and purchases in the foreign exchange markets, swaps and forward outright sales, within two business days.

- Monthly data on the outstanding stock of the SBP's forward foreign currency operations, including swaps and outright forward sales and purchases, within two weeks. The terms of any new transactions (including rollover/renewal of existing ones) will also be provided.

- Monthly data on the SBP's foreign exchange reserves, with details on the currencies, instruments, and institutions in which the reserves are held, within one month.

- Monthly data on SBP direct or bridge loans to nationalized banks in the context of the restructuring and privatization operation, within four weeks.

- Monthly data on any other quasi-fiscal operations undertaken by the SBP, on behalf of the government.

- Monthly data on SBP holding of discounted export finance credit under the export finance scheme, within one month.

- Monthly data on outstanding credit to agriculture under the Agriculture Mandatory Credit Targets, within one month.

- The following data on external debt, within one month:

  (i) Quarterly stock of public- and publicly-guaranteed external debt (including deferred payments arrangements), by maturity (initial maturities of up to and including one year, and over one year), by creditor and by debtor (central government and publicly guaranteed);

  (ii) Quarterly contracting or guaranteeing of nonconcessional medium- and long-term government debt; and

(iii) Information on any rescheduling on public- and publicly-guaranteed debt reached with creditors.

- Quarterly data on external payments arrears on public and publicly guaranteed debt with details as in (i) of the preceding item within one month.

- Copies of new or revised ordinances/circulars regarding changes in: tax policy, tax administration, foreign exchange market regulations, and banking regulations no later than three days after official issuance, or notification that ordinances have been posted on the Federal Board or Revenue (FBR) and SBP websites.

- Copies of official notification of changes in gas and electricity tariffs and any surcharges (automatic or structural) and in ex-refinery petroleum product prices as well as of gas and petroleum surcharges/levies.

- Monthly data on the import parity prices as well as central depot prices of the six major oil products, within one month.

- Quarterly data on KESC and WAPDA loans and debt outstanding, within one month.

- Upon the adoption of the plan for the elimination of inter-corporate circular debt, monthly reports on inter-corporate circular debt will be reported within 1 month.

Table 1. Pakistan: Budgetary Support, June–November 2008

	30-Jun-08	1-Nov-08
Central Government	1,577,064	1,761,857
Scheduled Banks	509,710	384,579
Government Securities	173,171	166,481
Treasuy Bills	559,825	473,422
Government Deposits	-223,286	-255,324
State Bank	1,067,354	1,377,277
Government Securities	3,167	3,168
Accrued Profit on MTBs	18,200	39,342
Treasury Bills	1,053,122	1,326,510
MTFBs purchased for replenishment of cash balances	1,036,610	1,310,798
Adhoc Treasuy Bills	0	0
Ways and Means Advances	0	0
Treasuy Currency	8,152	8,150
Debtor Balances (Excl. Zakat Fund)	0	0
Government Deposits	-20,748	-5,356
(Excl. Zakat and Privatisation Fund)		0
Special Account-Debt Repayment	0	0
Payment to HBL on a/c of HC&EB	-287	-287
Adjustment for use of Privatisation Proceeds		0
for Debt Retirement	5,749	5,749
Provincial Governments	-212,460	-226,378
Scheduled Banks (a+b-c)	-178,821	-172,430
Government Securities	76	76
Advances to Punjab Government for Cooperatives	1,024	1,024
Government Deposits	-179,921	-173,530
State Bank	-33,639	-53,948
Debtor Balances (Excl. Zakat Fund)	18,719	14,363
Ways and Means Advances	0	0
Government Deposits (Excl.Zakat Fund)	-52,357	-68,311
Net Govt. Budgetary Borrowings		0
from the Banking system	1,364,604	1,535,478
Through SBP	1,033,715	1,323,329
Through Scheduled Banks	330,888	212,149
Memorandum Items		
Accrued Profit on SBP holding of MRTBs	18,200	39,342
Scheduled banks ' deposits of Privitization Commission	-1815	-2487
Outstanding amount of MTBs (Primary market; discounted value)	536,977	442,719
Net Govt. Borrowings (Cash basis)		
(i) From Banking System	1,325,371	1,467,919
(ii) From SBP	1,015,516	1,283,987
(iii) From Scheduled Banks	309,855	183,932

Source: State Bank of Pakistan.

Table 2. Pakistan: External Program Financing For Budget for 2008/09

	Q1	Q2	Q3	Q4	Total
Program Loans	500	840	1,295	700	3,335
World Bank	0	300	500	0	800
ADB	500	340	545	500	1,885
IDB	0	100	200	200	500
Short-term commercial	0	100	50	0	150
Budgetary Grants	59	30	0	0	89
Privatization	0	133	250	256	639
GDRs	0	0	0	1,100	1,100
Securitization					
Amortization	612	813	764	471	2,660
Medium and Long-term	450	257	764	371	1,842
Euro bonds			500		500
IDB>1 year	200	0	0	0	200
Other	250	257	264	371	1,142
Short-term	162	556	0	100	818
IDB	162	440	0	100	702
Commercial		116			116
Net program financing (Budget)	-53	190	781	1,585	2,503
Amortization of government guaranteed debt	13	24	12	21	70
Net program financing (BoP)	-66	166	769	1,564	2,433

Sources: Pakistani authorities; and Fund staff projections.

Table 3. Pakistan: Domestic Debt Outstanding, Jun. 2007–Sept. 2008

	Jun. 2007	Sep. 2007	Jun. 2008	Sep. 2008
A. Permanent Debt	553.0	553.7	608.4	618.3
Market Loans	3.0	3.0	3.0	3.0
Federal Government Bonds	9.3	9.3	9.3	9.3
Income Tax Bonds	0.0	0.0	0.0	0.0
Government Bonds (L.R.-1977)	0.1	0.1	0.1	0.1
Special Government Bonds For SLIC (Capitalization)	0.6	0.6	0.6	0.6
GOP Ijara Sukuk 3 years	0.0	0.0	0.0	6.5
Government Bonds (issued to HBL for settlement of CBR Refund)	9.8	0.0	0.0	0.0
Bearer National Fund Bonds(BNFB)	0.0	0.0	0.0	0.0
BNFB Roll Over-II	0.0	0.0	0.0	0.0
Special National Fund Bonds	0.0	0.0	0.0	0.0
Federal Investment Bonds(Auction)	3.1	2.4	1.0	1.0
Federal Investment Bonds (TAP)	0.0	0.0	0.0	0.0
Pakistan Investment Bonds (PIBs)	352.5	360.8	411.6	415.3
Prize Bonds	174.5	177.5	182.8	182.6
B. Floating Debt	1,107.7	1,184.6	1,637.4	1,809.7
Treasury Bills(3 Months)	0.0	0.0	0.0	0.0
Market Treasury Bills(auction)	656.1	784.3	537.0	451.8
MTBs for Replenishment 1/	451.5	400.2	1,100.4	1,357.9
C. Unfunded Debt	940.0	961.7	1,017.6	1,037.8
Defense Savings Certificates	289.0	293.6	284.6	283.5
National Deposit Certificates	0.0	0.0	0.0	0.0
Khas Deposit Certificates	0.3	0.3	0.3	0.3
Special Savings Certificates (Reg)	146.5	151.8	160.3	165.0
Special Savings Certificates (Bearer)	0.3	0.3	0.3	0.3
Regular Income Certificates	51.3	50.1	51.0	53.6
Premium Saving Certificates	0.0	0.0	0.0	0.0
Bahbood Savings Certificates	190.2	203.7	229.0	244.4
Khas Deposit Accounts	0.3	0.3	0.3	0.3
National Deposit Accounts	0.0	0.0	0.0	0.0
Savings Accounts	18.7	14.0	24.9	19.0
Special Savings Accounts	61.5	63.0	67.0	67.9
Mahana Amdani Accounts	2.5	2.5	2.5	2.4
Pensioners' Benefit Accounts	69.0	72.4	87.7	92.0
Postal Life Insurance	67.1	67.1	67.1	67.1
GP Fund	43.3	42.6	42.5	41.9
D. Total(A+B+C)	2,600.7	2,700.0	3,263.4	3,465.8

Source: State Bank of Pakistan.

1/ Inclusive of outright sale of MTBs to commercial banks.

INTERNATIONAL MONETARY FUND

PAKISTAN

Request for Stand-By Arrangement

Informational Annex

Prepared by Middle East and Central Asia Department

November 20, 2008

Contents Page

ANNEX I. PAKISTAN: RELATIONS WITH THE FUND

As of October 31, 2008

I. **Membership Status**: Joined: 07/11/1950; Article VIII

II. **General Resources Account**:	SDR Million	% Quota
Quota	1,033.70	100.00
Fund Holdings of Currency	1,041.48	100.75
Reserve position in Fund	0.12	0.01

III. **SDR Department**:	SDR Million	% Allocation
Net cumulative allocation	169.99	100.00
Holdings	132.75	78.10

IV. **Outstanding Purchases and Loans**:	SDR Million	% Quota
PRGF arrangements	779.07	75.37
Extended arrangements	7.90	0.76

V. **Latest Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	12/06/2001	12/05/2004	1,033.70	861.42
Stand-By	11/29/2000	09/30/2001	465.00	465.00
EFF	10/20/1997	10/19/2000	454.92	113.74

VI. **Projected Payments to the Fund**[1]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2008	**2009**	**2010**	**2011**	**2012**
Principal	29.00	146.36	172.28	172.28	146.44
Charges/Interest	2.30	4.25	3.36	2.50	1.67
Total	31.30	150.61	175.64	174.78	148.11

[1] This schedule presents all currently scheduled payments to the IMF, including repayment expectations and repayment obligations. The IMF Executive Board can extend repayment expectations (within predetermined limits) upon request by the member if its external payment position is not strong enough to meet the expectations without undue hardship or risk.

A. Nonfinancial Relations

VII. Exchange System

On May 19, 1999, the dual exchange rate system was unified, with all international transactions conducted at the interbank market exchange rate (FIBR). In their formal notification, the authorities classify Pakistan's exchange rate regime as a managed float with no predetermined path for the exchange rate. Pakistan has accepted the obligations of Article VIII. It maintains a restriction subject to Fund approval in the form of a 25 percent limit on advance payments for imports of goods.

VIII. Last Article IV Consultation

The last Article IV consultation (Country Report 08/21) was discussed by the Executive Board on December 17, 2007.

IX. Safeguards Assessments

In accordance with the Fund's safeguards assessment policy, the State Bank of Pakistan (SBP) was subject to a full safeguards assessment under the Stand-By Arrangement that expired on September 30, 2001. This assessment, which included a safeguards mission to the SBP, was completed on February 13, 2001. The staff's findings and recommendations were reported in Country Report No. 01/58, Appendix IV. The authorities have implemented all of the recommended remedial measures that were included under SBA conditionality, and no new critical vulnerabilities have been identified under Pakistan's subsequent PRGF Arrangement.

The latest information received at the beginning of 2007 indicates that the SBP continues selective application of International Financial Reporting Standards (IFRS) in combination with the Board-approved accounting policies; that financial statements are audited in conformity with the auditing standards applicable in Pakistan and published on the SBP website; and that a revised organizational structure has enhanced the SBP's internal control systems.

X. FSAP Participation and ROSCs

Fiscal Transparency Module	11/28/2000	(www.imf.org)
Fiscal Transparency Module—Update	11/22/2004	Country Report No. 04/416
Financial System Stability Assessment Financial Sector Assessment Program	6/23/2004	Country Report No. 04/215
Data Module and Detailed Assessment Using Quality Assessment Framework	11/29/2004	Country Report No. 04/398
Data Module, Reassessment of Monetary Statistics and Detailed Assessment Using Quality Assessment Framework	2/2/2007	Country Report No. 07/74
Fiscal Transparency Module—Draft Update	2/13/2007	Country Report No. 08/129
Financial System Stability Assessment, Financial Sector Assessment Program Update	9/22/2008	In progress

XI. Recent Technical Assistance

FAD
January 2002: Fiscal data management, quality, and transparency.
January 2003: Tax administration.
February/March 2003: Customs administration.
April 2004: Fiscal reporting.
April 2007: Public financial management.

MCM
November/December 2004: Public debt reform and capacity building program (joint with World Bank).
March/April 2005: Development of the Insurance Sector.
December 2006: Monetary policy framework.
April 2007: Monetary policy framework, the SBP's balance sheet, and the Banking Services Corporation.

STA
February 2002: External sector statistics/SDDS subscription.
April/May 2005: National accounts and consumer price statistics.
May 2007: Statistics on the international investment position.

LEG
July 2008: Deposit Protection Fund.
July 2008: Central Bank Law.
August 2008: Banking Law.

XII. Resident Representative

A resident representative has been stationed in Islamabad since August 1991.

ANNEX II. PAKISTAN: RELATIONS WITH THE WORLD BANK			
Area	**Issues**	**Product**	**Delivery Date**
World Bank:			
Fiscal Sector	Efficiency and equity of expenditure allocation	Public Expenditure, Procurement and Financial Management Review (PEPFM), Public Expenditure and Financial Accountability (PEFA), Sub-national operations	March-April 2009
	Medium-Term Budget Framework (MTBF)	PEPFM, Poverty Reduction Support Credit (PRSC), sub-national operations	March-April 2009
	Public Sector Development Program (PSDP) review	PEPFM, PRSC	2009
	Public procurement	PEPFM, PRSC, TA	2009
	Financial reporting, accounting and auditing	Project for the Improvement of Financial Reporting and Auditing (PIFRA), PEFA	June 2009
Private Sector Development	Competition policy	PRSC, TA	2009
	Business entry and exit	PRSC, Insolvency and Creditor Right ROSC	2009-2010
	Labor market flexibility	PRSC, analytical work	2009
Poverty & Social Protection	Income transfer targeting, implementation and monitoring arrangements	PRSC, social protection operation	2009
Government debt management	Debt management strategy	PRSC	2009
		Debt management TA and analytical work	2009
IMF:			
Fiscal Sector	Revenue mobilization, deficit target	Request for SBA	Fiscal years 2008/09, 2009/10
Monetary Policy Framework	Strengthening of liquidity management framework	Request for SBA	July 2009
	Strengthening of central bank independence		2009
Exchange Restrictions	Elimination of exchange restrictions	Request for SBA	January 2010

Shared Responsibility:			
Fiscal Sector	Tax administration, tax policy	**Bank:** PRSC Tax Administration Reform Program (TARP) programmatic analytical work on tax policy Review of FBR tax administration, and follow-up work **IMF:** Request for SBA	 2009 2009 January 2009; fall 2009 September 2008; June 2009 2008/09–2009/10
	Cash Management, treasury single account	**Bank:** PRSC **IMF:** Request for SBA	2009 2009
	Debt sustainability analysis	Request for SBA	November 2008
Financial Sector	**Joint Bank-IMF:** FSAP update **Bank:** Strengthening banking sector supervision Strengthening securities market regulation **IMF:** Strengthening of bank resolution framework	 Banking sector TA PRSC Request for SBA	 2009 2009 June 2009
Energy Sector	**Bank:** Automatic adjustment meachinism for power tariffs and domestic fuel prices Improving efficiency of distribution and transmission networks **IMF:** Electricity tariff increases	 PRSC Energy sector investment project and analytical work Request for SBA	 2009 ongoing November 2008

ANNEX III. PAKISTAN: STATISTICAL ISSUES

1. Data provision has some shortcomings, but is broadly adequate for surveillance. Further improvements in the availability and timeliness of key economic statistics would help policy analysis and formulation. The Report on the Observance of Standards and Codes (ROSC)—Data Module, a Response by the Authorities, and a Detailed Assessment Using the Data Quality Assessment Framework (DQAF) were published on the IMF website in December 2004. A ROSC reassessment focusing on monetary statistics was conducted in November 2006 and published on the IMF website in February 2007.

2. Pakistan participates in the General Data Dissemination System (GDDS) since 2003, meeting the recommendations for the coverage, periodicity, and timeliness of most GDDS data categories. For subscription to the Special Data Dissemination Standard (SDDS), Pakistan will need to disseminate (a) monthly data on central government operations with a timeliness of one month; (b) quarterly data on the national accounts, employment and unemployment, wages/earnings, and external debt, all with a timeliness of one quarter; (c) more detailed breakdown of data on central government debt and external debt; and (d) update and expand the metadata on compilation and dissemination practices.

3. In 2004, the Federal Bureau of Statistics (FBS) completed a revision of the national accounts statistics to bring them in line with the concepts and definitions of the *1993 System of National Accounts (1993 SNA)*. As noted by the December 2004 data ROSC, informal economic activities need to be better captured, while newly emerging activities, such as in the information technology sector, continue to pose challenges. The FBS is currently working on producing quarterly national accounts (QNA), which would be completed with a rebasing of the national accounts to the year 2005/06. With respect to labor market statistics, the FBS has recently started to compile quarterly employment/ unemployment data (although not with the frequency required for subscription to the SDDS) and is investigating the feasibility of disseminating data on wages/salaries.

4. The FBS produces three price indices: the CPI, the wholesale price index (WPI), and the sensitive price indicator (SPI). The CPI and WPI are compiled on a monthly basis. The SPI is compiled on a weekly basis and consists of 46 essential commodities that are consumed by the lowest income group. The concepts and definitions of the CPI and WPI follow international guidelines. Plans have been made to introduce the classification of individual consumption by purpose (COICOP) and to complete the work to develop a Producer Price Index (PPI), with base year 1999/2000; an IMF mission also provided some advice in this regard.

5. The concepts and definitions used in compiling governmet finance statistics are broadly based on the *GFSM 1986*, except that privatization proceeds are included below the

line. The scope of central government data is further limited because it does not cover the activity of extrabudgetary funds. Classification and sectorization in source data follow *GFSM 1986* standards to a limited extent. The classification of expenditure deviates from *GFSM 1986* methodology because the economic and functional classifications are mixed in reporting, in particular, with defense and government administration expenditures not clearly identified according to economic classification. The basis of recording GFS is on, or close to, a cash basis. Transactions are recorded on a gross basis. Corrective transactions are not necessarily made in the original period, as required by *GFSM 1986*. The authorities have indicated their intent to adopt the methodology of *GFSM 2001* over the medium term, and are in the process of improving government finance statistics in the context of the Project for the Improvement of Financial Reporting and Auditing (PIFRA). Budgetary central government operations data are regularly reported for publication in the *GFS Yearbook*, and use the *GFSM 2001* framework. However, no data are reported on transactions in nonfinancial and financial assets and liabilities. The authorities do not report higher frequency data for inclusion in the *IFS*.

6. The ROSC mission found that the scope of the monetary statistics is comprehensive. The classification and sectorization of the monetary survey compiled by the State Bank of Pakistan's (SBP) Statistics Department for reporting to the IMF and for internal use are broadly in line with the *Monetary and Financial Statistics Manual (MFSM)*. The basis for recording flows and stocks is largely consistent with the *MFSM*, and the SBP has indicated its intention to adopt the *MFSM* in order to further improve monetary statistics. The ROSC mission that conducted the reassessment of monetary statistics in November 2006 found that the authorities had implemented the *MFSM* guidelines on the sectorization of institutional units, classification of financial instruments, and the recording of securities repurchase agreements (repos). Also, a new reporting framework for other depository corporations has been designed and is being implemented. Further progress is needed in resolving discrepancies in the data on interbank positions between the SBP and scheduled banks. The SBP is in the process of implementing the Standardized Report Form framework for reporting monetary data to the Fund.

7. Starting in the third quarter of 2003 (July–September), Pakistan's balance of payments statements have been prepared according to the methodology of the *Balance of Payments Manual*, fifth edition (*BPM5*). A 2007 Fund technical assistance mission made recommendations to more closely align some recording practices with the *BPM5*, including in the areas of residency, sectorization, and consistency across related data sets. Based on these recommendations, a number of improvements have been made. Differences between the two sources of trade data (customs records for FBS and exchange records for SBP) for exports and imports have been widening. Most of the differences can be reconciled ex post (see SBP's Second Quarterly Report for FY2006), and the authorities are working to narrow these differences before the publication of the data.

8. Annual international investment position data are compiled and published on the SBP website. Data are available back to 2003.

PAKISTAN: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

AS OF NOVEMBER 20, 2008

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality – Accuracy and reliability[9]
Exchange Rates	real time	real time	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Sep. 2008	Oct. 2008	M	M	M		
Reserve/Base Money	Sep. 2008	Oct. 2008	M	M	M	O, O, O, LO	O, O, O, O, LO
Broad Money	Sep. 2008	Oct. 2008	M	M	M		
Central Bank Balance Sheet	Sep. 2008	Oct. 2008	M	M	M		
Consolidated Balance Sheet of the Banking System	Sep. 2008	Oct. 2008	M	M	M		
Interest Rates[2]	Sep. 2008	Oct. 2008	M	M	M		
Consumer Price Index	Oct. 2008	Nov. 2008	M	M	M	O, LO, LO, O	O, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Jun. 2008	Aug. 2008	Q	Q	Q	LO, LO, LNO, LO	O, O, LO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Jun. 2008	Aug 2008	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Sep. 2008	Nov. 2008	Q	Q	Q		
External Current Account Balance	Oct. 2008	Nov. 2008	M	M	M	LO, LO, LO, O	O, O, O, O, LNO
Exports and Imports of Goods and Services	Oct. 2008	Nov. 2008	M	M	M		
GDP/GNP	2007/08	Jul. 2008	A	A	A	LO, LNO, LO, LO	LNO, LNO, O, LNO, O
Gross External Debt	Sept. 2008	Oct. 2008	M	M	M		
International Investment Position [6]	2007	Jun. 2008	A	A	A		

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2]Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3]Foreign, domestic bank, and domestic nonbank financing.
[4]The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5]Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7]Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); or Not Available (NA).
[8]Reflects the assessment provided in the data ROSC published in December 2004 and its update published in February 2007, and based on the findings of the missions that took place during December 1–16, 2003 for the dataset corresponding to the variable in each row, and during November 1–15, 2006 for monetary statistics, respectively. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9]Same as Footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND

Pakistan—Assessment of the Risks to the Fund and the Fund's Liquidity Position

Prepared by the Finance and Strategy, Policy, and Review Departments

In consultation with other Departments

Approved by Andrew Tweedie and Adnan Mazarei

November 20, 2008

1. **This note assesses the risks to the Fund arising from the proposed Stand-By Arrangement (SBA) for Pakistan and its effects on the Fund's liquidity, in accordance with the policy on exceptional access.**[1] The authorities are requesting a 23-month SBA with access of SDR 5.17 billion (500 percent of quota). A front-loading of SDR 2.07 billion (200 percent of quota) would be made available upon approval of the arrangement; this would be followed by two quarterly purchases of SDR 568.5 million each, and four quarterly purchases of SDR 434.2 million each. The last purchase of SDR 227.4 million is scheduled to take place in September 2010 (Table 1).

Table 1. Pakistan: Proposed SBA—Access and Phasing

		Purchases		
			Percent of quota	
Availability	Date 1/	SDR mn	Annual	Cumulative
2008	November (Approval)	2,067.400	200	200
2009	March	568.535	55	255
	June	568.535	55	310
	September	434.154	42	352
	December	434.154	42	394
2010	March	434.154	42	436
	June	434.154	42	478
	September	227.414	22	500
	Total	5,168.500	500	500

Source: Finance Department.

1/ Starting from March 2009, purchases will depend on the completion of a review.

[1] See *The Acting Chair's Summing Up of the Review of Access Policy Under the Credit Tranches and the Extended Fund Facility, and Access Policy in Capital Account Crises—Modifications to the Supplemental Reserve Facility and Follow-Up Issues Related to Exceptional Access Policy*.

I. Background

2. **Pakistan has been one of the most prolonged users of Fund resources.** [2] Until the late 1970s, Fund arrangements for Pakistan were infrequent and mostly short term in nature. However, as growth faltered in the 1980s, and persistent fiscal and external imbalances produced an unsustainable debt burden, Pakistan became more heavily dependent on Fund financial support. Total Fund credit to Pakistan reached a peak of about SDR 1.5 billion following its 1980 EFF,[3] fell to less than SDR 0.5 billion in 1988, and increased gradually thereafter as Pakistan received financial assistance under nine different arrangements from the Fund between 1988–2001 (4 SBAs, 2 EFFs, 3 ESAF/PRGFs—see Table 2). Pakistan's last Fund arrangement was a PRGF arrangement in an amount equivalent to over SDR 1 billion, which was completed in 2004. As a result, the bulk of Pakistan's current outstanding obligations to the Fund are to the PRGF Trust (Figure 1).

3. **All but the last two Fund arrangements for Pakistan were undermined by severe policy slippages**. From 1988 to 1999, Fund arrangements were either extended to accommodate delays in the completion of reviews, or cancelled and replaced by new arrangements that partially accommodated deviations from the targets set in previous programs. In contrast, both the programs supported under the 2000 SBA and the follow-up 2001 PRGF arrangement were completed successfully without requiring extensions of the arrangements. At the 2005 Board discussion of Pakistan's ex post assessment, Directors highlighted the dramatic change in ownership of economic policies in Pakistan compared to the earlier period, and emphasized that steadfast implementation of sound policies and broad-based structural reforms were mainly responsible for Pakistan's economic recovery.[4]

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[2] See *Pakistan*: *Ex Post Assessment of Longer-Term Program Engagement* (Country Report No. 05/409, 11/17/05).

[3] This amount also includes borrowing under the Oil Facility, CFF, and Trust Fund loans.

[4] See *The Acting Chair's Summing Up, Pakistan—2005 Article IV Consultation, the Ex Post Assessment of Longer-Term Program Engagement, and the Report on Noncomplying Disbursements and Recommendation for Waiver of Nonobservance of Performance Criterion*.

Table 2. Pakistan: IMF Financial Arrangements, Purchases and Repurchases, 1973–2015

(in millions of SDRs)

Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount Approved	Amount Drawn	Purchases and Disbursements 2/ 3/	Repurchases and Repayments 2/ 3/	Fund Exposure 1/		
								GRA 2/	PRGF 3/	Total 2/ 3/
1973	SBA	11-Aug-1973	10-Aug-1974	75.0	75.0	60.0	40.9	129.8	--	129.8
1974	SBA	11-Nov-1974	10-Nov-1975	75.0	75.0	129.9	20.9	238.9	--	238.9
1975						161.4	25.9	374.4	--	374.4
1976						107.2	42.0	439.6	--	439.6
1977	SBA	09-Mar-1977	08-Mar-1978	80.0	80.0	92.1	68.9	437.6	25.1	462.8
1978						112.3	84.3	395.1	97.4	492.5
1979						21.2	80.7	337.4	97.4	434.8
1980	EFF	24-Nov-1980	23-Nov-1983	1,268.0	1,079.0	236.4	107.0	299.7	228.8	528.5
1981						483.8	132.6	650.0	229.7	879.7
1982						455.2	48.7	1,056.5	229.7	1,286.2
1983						285.0	30.9	1,317.2	223.1	1,540.3
1984						–	71.1	1,265.6	203.6	1,469.2
1985						–	180.7	1,116.4	172.1	1,288.5
1986						–	315.3	846.9	126.4	973.2
1987						–	326.0	566.6	80.6	647.2
1988	SBA	28-Dec-1988	30-Nov-1990	273.2	194.5	–	235.8	370.0	41.4	411.4
	SAF	28-Dec-1988	27-Dec-1991	382.4	382.4					
1989						467.6	169.4	421.4	288.3	709.7
1990						–	122.4	313.2	274.0	587.3
1991						231.7	72.5	364.0	382.4	746.4
1992						189.6	116.1	437.5	382.4	819.9
1993	SBA	16-Sep-1993	22-Feb-1994	265.4	88.0	88.0	91.4	434.1	382.4	816.5
1994	ESAF	22-Feb-1994	13-Dec-1995	606.6	172.2	295.4	45.1	523.2	543.7	1,066.8
	EFF	22-Feb-1994	13-Dec-1995	379.1	123.2					
1995	SBA	13-Dec-1995	30-Sep-1997	562.6	294.7	134.0	115.8	595.9	489.1	1,085.0
1996						107.2	221.6	536.1	434.4	970.5
1997	PRGF	20-Oct-1997	19-Oct-2000	682.4	265.4	205.2	226.2	488.8	460.7	949.5
	EFF	20-Oct-1997	19-Oct-2000	454.9	113.7					
1998						132.7	116.2	468.0	498.0	966.0
1999						447.5	172.3	770.0	471.2	1,241.2
2000	SBA	29-Nov-2000	30-Sep-2001	465.0	465.0	150.0	217.5	758.8	414.9	1,173.7
2001	PRGF	06-Dec-2001	05-Dec-2004	1,033.7	861.4	401.2	137.1	993.0	444.7	1,437.8
2002						258.4	201.8	825.6	668.7	1,494.4
2003						344.6	420.3	473.9	944.7	1,418.6
2004						172.3	383.0	164.5	1,043.4	1,207.9
2005						–	163.9	53.7	990.3	1,044.0
2006						–	72.0	34.8	937.2	972.0
2007						–	97.9	15.8	858.3	874.1
2008 4/						–	87.2	7.9	779.1	787.0
2008 5/ 6/	*SBA*	*24-Nov-2008*		*5,168.5*		*2,067.4*	*116.2*	*2,072.1*	*753.2*	*2,825.4*
2009 6/						*2,005.4*	*146.4*	*4,072.8*	*611.6*	*4,684.4*
2010 6/						*1,095.7*	*172.3*	*5,168.5*	*439.3*	*5,607.8*
2011 6/						--	*172.3*	*5,168.5*	*267.0*	*5,435.5*
2012 6/						--	*1,589.7*	*3,725.2*	*120.6*	*3,845.8*
2013 6/						--	*2,422.3*	*1,389.0*	*34.5*	*1,423.5*
2014 6/						--	*1,175.4*	*248.1*	*0.0*	*248.1*
2015 6/						--	*248.1*	*0.0*	*0.0*	*0.0*

Source: Finance Department.

1/ As of end-December, unless otherwise indicated.

2/ Includes purchases under the Oil Facility (1974-76), CFF (1976-77, 1982, 1991, 1999), first credit tranche purchases (1981), and Emergency Assistance (1992). These purchases are not listed separately under the arrangements heading.

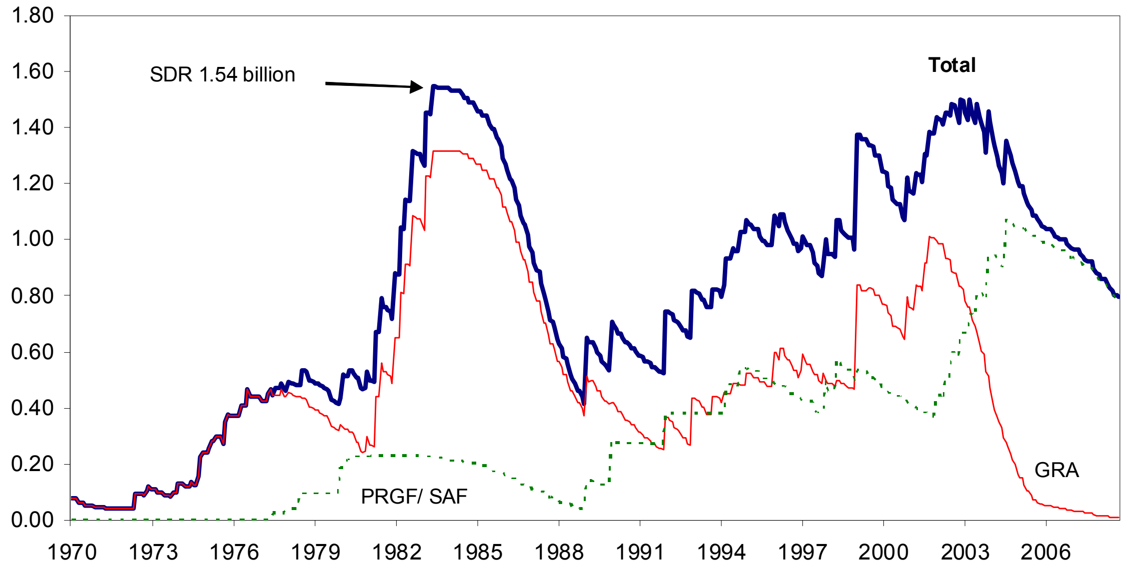
3/ Includes Trust Fund loans(1977-81), SAF loans(1988-91), and ESAF loans(1994). Loans under the Trust Fund were not made under a formal arrangement.

4/ As of end-October.

5/ Projected as of end-December.

6/ Figures under the proposed program in italics. Assumes repurchases on an obligations basis.

Figure 1. Pakistan: IMF Credit Outstanding, 1970–2008
(In billions of SDRs)



Source: IFS, Finance Department

4. **The large and sustained decline in the external debt-to-GDP ratio was one of Pakistan's most remarkable macroeconomic achievements of recent years.** By end-June 2008 (the end of fiscal year 2007/08), Pakistan's external debt-to-GDP ratio was 26½ percent, down from 45 percent in 2001/02 (Table 3). This level of external debt is significantly lower than those of countries that have had exceptional access arrangements from the Fund in recent years (Table 4).[5] The composition of Pakistan's external debt is also different from most recent exceptional access cases. Public and publicly guaranteed debt accounts for more than 90 percent of total external debt and over 90 percent of public external debt is owed to bilateral and multilateral creditors (Figure 2). As a result, external debt service is low and the implicit interest rate on external debt is about 2½–3 percent.

[5] The recent exceptional access cases used as comparators in this paper are those approved since this policy was put in place. The 2008 extended arrangement for Liberia also involved exceptional access. However, Liberia is excluded since this arrangement was different from other exceptional access cases in that exceptional access was granted in the context of Liberia's clearance of arrears to the Fund.

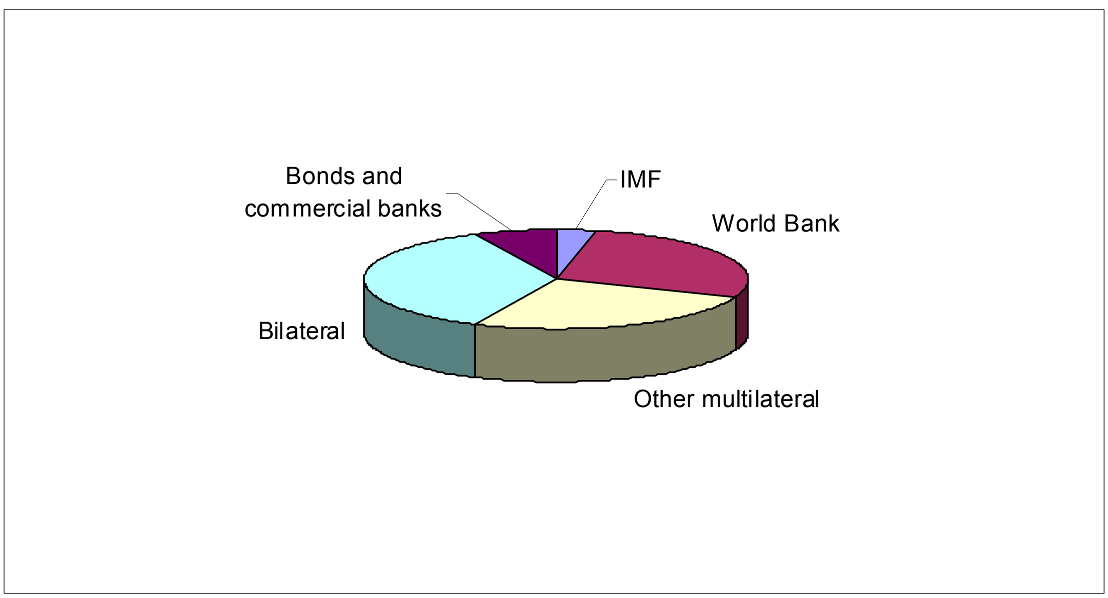
Table 3. Pakistan: Total External Debt, 2005/06–2008/09 1/

		2005/06	2006/07	2007/08	2008/09
		(In billions of U.S. dollars)			
Total External Debt		35.7	38.7	44.5	51.3
of which:	Public	34.1	36.7	41.6	48.1
	Multilateral	18.0	20.1	22.9	30.0
	IMF	1.5	1.4	1.3	5.8
	Other Multilateral 2/	16.5	18.7	21.6	24.2
	Bilateral & Commercial	16.0	16.6	18.7	18.1
	Private	1.6	2.0	2.9	3.2
		(In percent of GDP)			
Total External Debt		28.0	26.9	26.5	31.4
of which:	Public	26.7	25.5	24.8	29.5
	Multilateral	14.1	14.0	13.7	18.4
	IMF	1.2	1.0	0.8	3.5
	Other Multilateral 2/	13.0	13.0	12.9	14.8
	Bilateral & Commercial	12.6	11.5	11.1	11.1
	Private	1.2	1.4	1.7	1.9

Sources: Pakistani authorities and IMF staff estimates.

1/ Fiscal year ending June 30. Figures for 2008/09 are staff projections for end-June 2009.
2/ Includes the World Bank, the Asian Development Bank, and the Islamic Development Bank.

Figure 2. Pakistan: Total External Public Debt by Creditor, end-June 2008



Sources: Pakistani authorities and IMF staff estimates.

Table 4. Debt Ratios in Recent Exceptional Access Cases 1/
(in percent of GDP)

	Total External Debt	Public External Debt	Debt to IMF
A. Earlier arrangements, 2003-05:			
Argentina (2003)	129.0	82.5	12.2
Brazil (2003)	38.6	21.5	5.1
Turkey (2005)	35.0	17.8	3.0
Uruguay (2005)	82.0	60.8	13.8
B. Newly approved arrangements (2008):			
Georgia 2/	34.6	21.0	2.8
Hungary 3/	106.4	37.6	4.2
Iceland 4/	165.0	99.9	5.1
Ukraine 5/	54.3	10.4	2.5
Pakistan (2008/09) 6/	*31.4*	*29.5*	*3.5*

Sources: Board documents and IMF staff estimates.

1/ Ratios for the year indicated in parenthesis. Year in parenthesis corresponds to the year of approval of the last IMF arrangement with each country.
2/ Projected to end-2008, including PRGF resources.
3/ End-2008 projection, see Country Report No. 08/361 (11/04/08).
4/ End-2008 projection, see Country Report No. 08/362 (11/17/08).
5/ End-2008 projection.
6/ Projection for end-June 2009, including outstanding PRGF loans.

II. The New SBA—Risks and Impact on the Fund's Finances

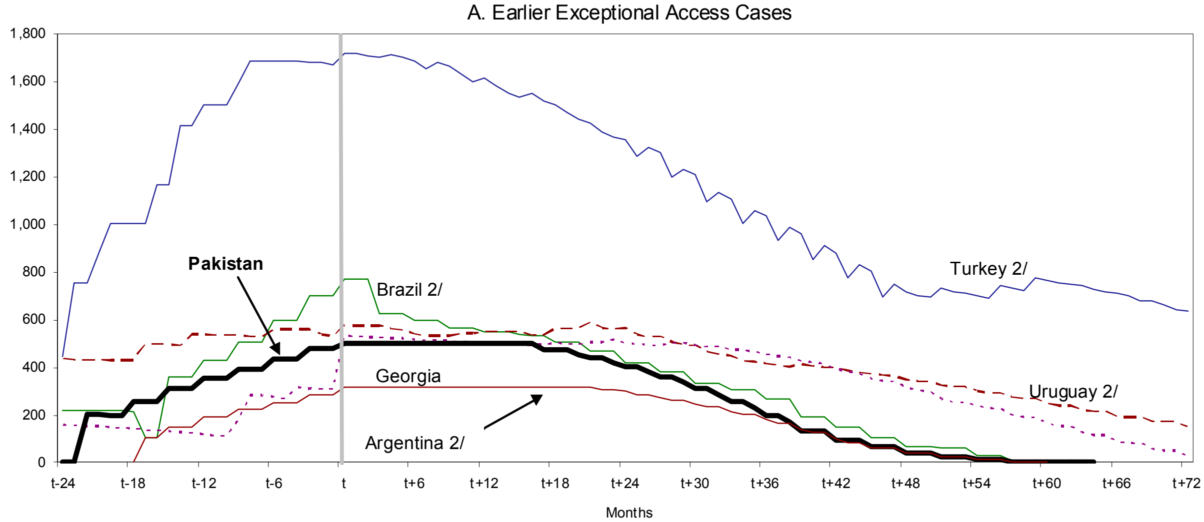
A. Risks to the Fund

5. **Access under the proposed arrangement would far exceed that in previous arrangements for Pakistan, and would surpass both the annual and cumulative limits.** If all purchases are made as scheduled, Pakistan’s total outstanding use of GRA resources would rise to slightly over 200 percent of quota with the first drawing and peak at 500 percent in September 2010, remaining at this level through January 2012. In terms of SDRs, this access would be more than 3½ times higher than Pakistan’s previous peak of Fund credit outstanding. In terms of quota, this peak exposure would be comparable to that of recent exceptional access cases, but lower than the peak exposure of Hungary, Iceland and Ukraine (Figure 3).[6]

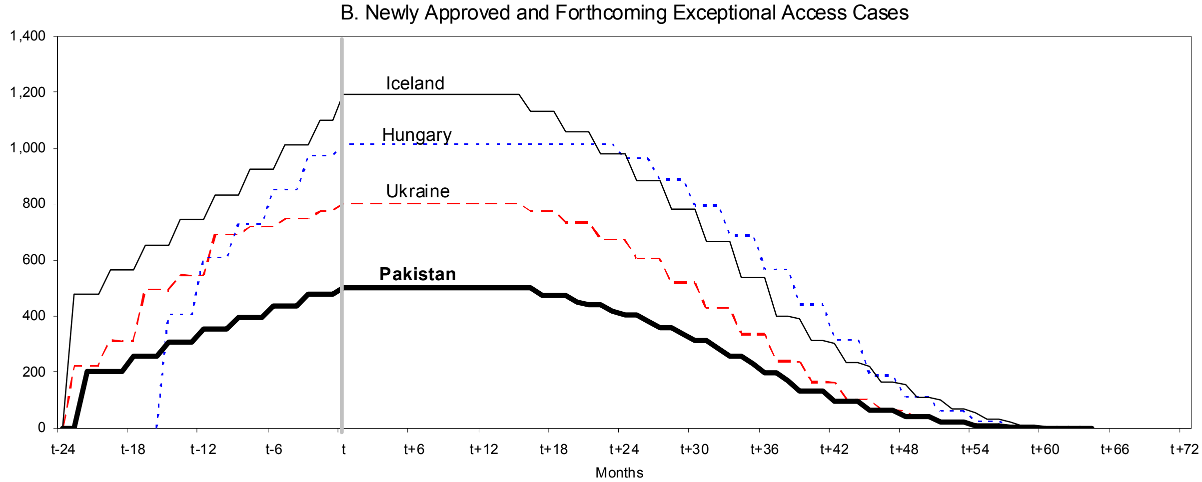
[6] Currency holdings resulting from the scheduled purchases under the proposed SBA would be subject to level-based surcharges of 100 basis points over the basic rate of charge (adjusted for burdensharing) on GRA credit outstanding exceeding 200 of quota from the time of the first purchase through July 2013 and to surcharges of 200 basis points on the credit outstanding exceeding 300 percent of quota starting in May 2009 through April 2013.

Figure 3. Fund Credit Outstanding in the GRA Around Peak Borrowing 1/
(In percent of quota)

A. Earlier Exceptional Access Cases



B. Newly Approved and Forthcoming Exceptional Access Cases



Source: IFS, Finance Department, and IMF staff estimates.

1/ Peak borrowing is defined as the highest level of credit outstanding for a member, in percent of quota. Month t represents the month of the highest historical credit outstanding (in percent of quota). For Argentina, t is September 2001; for Brazil, September 2003; for Turkey, April 2003; and for Uruguay, August 2004. For Georgia, t would be reached in October 2010. For the countries in Panel B, t would be reached in February 2010 in the cases of Hungary, October 2010 in the cases of Iceland and Ukraine, and September 2010 in the case of Pakistan. For comparability, projected repurchases are assumed to be on an obligations basis.

2/ Projected repurchases (on an obligation basis) as of May 2005. Schedules do not show large early repurchases made by Argentina, Brazil, and Uruguay in 2005-06.

6. **If the proposed SBA is fully disbursed, GRA credit outstanding to Pakistan will exceed 4 percent of GDP by June 2010** (Table 6).[7] Upon approval of the arrangement, and drawing of the first purchase, Pakistan would become the fourth largest exposure in the GRA (Table 5).

7. **Under the proposed SBA, Pakistan's debt to the Fund as a share of its public external debt would increase significantly.** Pakistan's outstanding use of Fund GRA resources would account for about 14 percent of public external debt by 2009/10, compared to close to zero at present.[8] Pakistan's projected repayments to the Fund would rise from about 5 percent of public external debt service in 2008/09 to nearly 30 percent in 2011/12 and about 45 percent in 2012/13.[9] In terms of exports of goods and services, Pakistan's external debt service to the GRA would amount to about 3 percent in 2011/12 and nearly 8 percent in 2012/13, similar to the ratios projected for the recently approved arrangements for Iceland and Ukraine.

B. Impact on the Fund's Liquidity Position and Risk Exposure

8. **The proposed arrangement for Pakistan would reduce Fund liquidity by about 5 percent (Table 6).**[10] Commitments under the proposed arrangement would reduce the one-year forward commitment capacity (FCC) by SDR 5.2 billion—from an estimated level of SDR 104.8 billion at the time of program approval.[11]

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[7] Economic data for Pakistan is on a fiscal year basis, which runs from July 1 to June 30; references for fiscal years are for the calendar year in which they end (FY10 refers to FY 2009/10). Indicators of capacity to repay shown in Table 6 are therefore calculated on a fiscal year basis.

[8] The debt to the Fund of 1.4 percent of GDP reported in Table 3 corresponds, primarily, to debt to the PRGF Trust.

[9] The figures on debt service used in this report correspond to the schedule on an obligations basis, in line with the guidelines stipulated in *Review of Fund Facilities—Proposed Decisions and Implementation Guidelines*. Under the obligations schedule, the first repurchase should take place in February 2012, 3¼ years after the first purchase under the arrangement. Under the policy on time-based repurchase expectations, there is an expectation that repurchases of holdings resulting from the purchases in the credit tranches and the EFF, including under exceptional access, will adhere to the expectations schedule, and an extension from the expectations to the obligations schedule would require a decision by the Executive Board.

[10] The FCC is the principal measure of Fund liquidity. The (one-year) FCC indicates the amount of GRA resources available for new financing over the next 12 months. See *The Fund's Liquidity Position—Review and Outlook*. Following the creation of the Short-term Liquidity Facility (SLF), the calculation of the FCC will exclude the repurchases falling due under the SLF—See *A New Facility for Market Access Countries—The Short-Term Liquidity Facility—Proposed Decision*.

[11] The FCC at the time of approval is assumed to be equal to its level as of November 6 minus the first purchase under the SBA for Iceland.

Table 5. Fund GRA Exposure 1/

		In Percent of			
				Total GRA Credit	
	SDR Millions	Quota	GDP 3/	As of end-Oct. 2008	After approval of arrangements in panel B 4/
A. Top five borrowers as of end-October 2008: 1/					
Turkey	5,742.5	482.0	1.2	77.9	33.4
Liberia	342.8	265.3	59.4	4.6	2.0
Dominican Republic	331.6	151.5	1.2	4.5	1.9
Sudan	220.9	130.2	0.6	3.0	1.3
Georgia	161.7	107.6	2.0	2.2	0.9
B. Proposed and newly approved exceptional access arrangements:					
Iceland 2/	560.0	476.2	5.1	…	3.3
Hungary 2/	4,215.0	405.9	4.2	…	24.5
Ukraine 2/	3,068.5	223.7	2.6	0.9	17.8
Pakistan 2/	2,075.3	200.8	2.9	0.1	12.1

Sources: Finance Department and IMF staff estimates.

1/ Fund credit outstanding as of October 31, 2008.

2/ Fund credit outstanding after the first purchases of the proposed SBA for Pakistan and the recently approved SBAs for Ukraine, Hungary (Country Report No. 361), and Iceland (Country Report No. 362). For Ukraine and Pakistan, it includes credit outstanding as of end-October 2008.

3/ Staff projections to end-2008 for all countries except Pakistan, where projections are for end-June 2009.

4/ Numerator is Fund credit outstanding as of end-October 2008 for countries in panel A, and Fund credit outstanding as of end-October 2008 plus the first purchases under the proposed and newly approved SBAs for countries in panel B. Denominator is the sum of total Fund GRA credit outstanding as of end-October 2008 and the first purchases of the proposed and newly approved arrangements in panel B.

9. **After the first drawing, Fund GRA credit to Pakistan as a share of total Fund credit from the GRA would be about 12 percent.** This share takes into account the initial purchase under the recently approved arrangements for Ukraine, Hungary, and Iceland. Concentration of Fund credit among the top five borrowers would decrease somewhat, but remain above 90 percent.

10. **Potential GRA exposure to Pakistan would be substantial in relation to the Fund's precautionary balances (the general and special reserves and the SCA-1).** Outstanding GRA credit to Pakistan following the first purchase would be equivalent to 30 percent of the Fund's current stock of precautionary balances.

Table 6. Pakistan—Impact on GRA Finances

(in millions of SDRs, at end of period unless otherwise noted)

	2008	2009	2010	2011	2012	2013	2014	2015
Exposure								
Fund GRA credit outstanding to Pakistan 1/	2,072.1	4,072.8	5,168.5	5,168.5	3,725.2	1,389.0	248.1	0.0
Fund GRA credit outstanding to Pakistan (percent of quota) 1/	200.5	394.0	500.0	500.0	360.4	134.4	24.0	0.0
Fund GRA credit outstanding to Pakistan (percent of total GRA credit outstanding) 2/	12.1	…	…	…	…	…	…	…
Fund GRA credit outstanding to five largest debtors (percent of total GRA credit outstanding) 2/	91.0	…	…	…	…	…	…	…
Liquidity								
One-year Forward Commitment Capacity (FCC) 3/	104,836.4	…	…	…	…	…	…	…
Pakistan's impact on FCC 4/	(5,168.5)	…	…	…	…	…	…	…
Prudential measures								
Fund GRA credit outstanding to Pakistan (percent of current precautionary balances) 5/	29.9	…	…	…	…	…	…	…
Debt and Debt Service Ratios 6/								
Pakistan's GRA credit outstanding (percent of total public external debt) 7/	0.0	9.9	13.7	13.7	11.7	6.7	1.7	0.1
Pakistan's GRA credit outstanding (percent of GDP) 7/	0.0	2.9	4.3	4.2	3.4	1.8	0.4	0.0
Pakistan's GRA credit outstanding (percent of gross international reserves) 7/	0.2	55.3	64.9	62.4	50.3	27.1	6.3	0.2
Pakistan's GRA debt service to the Fund (percent of exports of goods and services) 7/	0.1	0.3	0.6	0.9	3.2	7.7	6.8	2.1
Pakistan's GRA debt service to the Fund (percent of public external debt service) 7/	0.8	1.6	3.9	6.6	22.6	43.1	43.1	19.1
Pakistan's total debt to the Fund (percent of total public external debt) 7/ 8/	3.2	12.0	15.2	14.6	12.2	6.9	1.8	0.1
Pakistan's total debt service to the Fund (percent of total public external debt service) 7/ 8/	5.2	5.8	8.7	12.8	27.4	45.6	44.2	19.6
Memorandum items								
Fund's precautionary balances 5/	6,938.6	…	…	…	…	…	…	…
Fund's residual burden sharing capacity 9/	80.0	…	…	…	…	…	…	…
Projected payment of charges to the Fund on GRA credit outstanding	10.3	87.0	165.3	191.8	173.7	97.3	28.6	4.1
Projected debt service payments to the Fund on GRA credit outstanding	13.5	91.7	165.3	191.8	1,617.0	2,433.4	1,169.5	252.1

Sources: Pakistani authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Repurchases follow the obligations schedule.

2/ Reflects Fund GRA credit outstanding as of October 31, 2008, plus first purchases by Pakistan, Iceland (Country Report No. 362), Ukraine, and Hungary (Country Report No. 361).

3/ As of November 6, 2008 less the total commitments under the program for Iceland. The Forward Commitment Capacity is a measure of the resources available for new financial commitments in the coming year, equal to usable resources plus repurchases one-year forward minus the prudential balance.

4/ A single country's negative impact on the FCC is defined as the country's sum of Fund credit and undrawn commitments minus repurchases one-year forward.

5/ As of end-April 2008.

6/ Staff projections for total external public debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed SBA.

7/ Pakistan's fiscal year ends on June 30. All ratios are expressed as shares of the end-June projection of the corresponding years.

8/ Total debt to the Fund comprises balances outstanding on GRA credit and PRGF loans.

9/ Estimated based on end-October data and taking into account the first purchase of Iceland (Country Report No. 362), Ukraine, and Hungary (Country Report No. 361). Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

11. **Were Pakistan to incur arrears on the charges accruing to its GRA obligations, the Fund's burden sharing mechanism would be put under significant strain.**[12] Charges on the new GRA obligations will be about SDR 87 million over the next year. This would exceed the Fund's estimated residual burden-sharing capacity, taking into account the newly approved arrangements (see Table 6). However, the impact on the Fund's burden sharing capacity of potential arrears from this arrangement would be expected to decline if there is a sustained pick up in lending.

III. Assessment

12. **The proposed arrangement for Pakistan entails considerable financial risks for the Fund.** The proposed level of access is large in terms of most relevant metrics, including the size of Pakistan's economy and its debt servicing capacity and is more than 3½ times higher than the previous peak Fund exposure to Pakistan.

13. **Continued portfolio outflows, insufficient financial support from donors and other creditors, and weak policy implementation are major downside risks to the program.** Pakistan's large external imbalances and weak reserves position leave little room for accommodating additional delays in adopting measures to restrain demand or for absorbing new external shocks. Moreover, a difficult security situation in the context of global financial turmoil suggests that the risks of a balance of payments crisis, despite the Fund's financial support, cannot be ruled out.

14. **The above risks may adversely affect Pakistan's capacity to repay the Fund.** The proposed access is significant in terms of both the Fund's resources and the debt service burden it generates in a very challenging economic and security environment. A sustained and forceful implementation of the program, and a prompt response to changes in underlying conditions and deviations from program assumptions are essential to mitigating these risks and safeguarding Fund resources.

[12] Under the burden-sharing mechanism, the financial consequences for the Fund that stem from the existence of overdue financial obligations are shared between creditors and debtors through a decrease in the rate of remuneration and an increase in the rate of charge, respectively. The mechanism is used to accumulate precautionary balances in the special contingent account (SCA-1) and to compensate the Fund for a loss in income when debtors do not pay charges. The Executive Board has set a floor for remuneration at 85 percent of the SDR interest rate. No corresponding ceiling applies to the rate of charge. The adjustment for the SCA-1 was suspended, effective November 1, 2006, by the Executive Board (Decision No. 13858-(07/1), adopted January 3, 2007).

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$7.6 Billion Stand-By Arrangement for Pakistan

The Executive Board of the International Monetary Fund (IMF) today approved a 23-month Stand-By Arrangement for Pakistan in an amount equivalent to SDR 5.169 billion (about US$7.6 billion) to support the country's economic stabilization program.

Upon the Board's approval, an amount equivalent to SDR 2.067 billion (about US$3.1 billion) becomes immediately available to Pakistan, and the remaining amount will be phased in, subject to quarterly reviews. The total amount of the IMF resources made available under the arrangement equals 500 percent of the country's quota. The arrangement was approved by the Board under the Fund's fast-track Emergency Financing Mechanism procedures.

The IMF-supported program has two key objectives: to restore macroeconomic stability and confidence through a tightening of macroeconomic policies; and to ensure social stability and adequate support for the poor and vulnerable in Pakistan. Policies laid out in the program seek to achieve these two interrelated objectives.

Following the Executive Board discussion on Pakistan, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chairman, stated:

"The Pakistani economy was buffeted by large shocks during FY2007/08, including adverse security developments, higher oil and food import prices, and the global financial turmoil. The external current account deficit widened as a consequence, net capital inflows declined significantly, and the currency depreciated substantially. A delay in the pass-through of higher international prices to domestic consumers led to a large increase in the fiscal deficit, and its monetization by the State Bank of Pakistan contributed to rising inflation and a sharp decline in international reserves.

"The authorities' program, supported by a 23-month Stand-By Arrangement with the IMF under its exceptional access policy, aims to (i) restore macroeconomic stability and investor confidence through a tightening of macroeconomic policies, and (ii) ensure social stability and adequate support for the poor.

"The program targets a significant reduction in the fiscal deficit, aimed at eliminating State Bank of Pakistan financing of the government and reducing the external current account deficit, while allowing for increased social and development spending. The reduction will be achieved primarily by phasing out energy subsidies, better prioritizing development spending, and implementing tax policy and tax administration reforms. As a complementary measure, the authorities plan to put in place a comprehensive and effectively-targeted social safety net in close cooperation with the World Bank. In the interim, existing social programs will be strengthened and scaled up.

"The recent increase in interest rates, and the State Bank of Pakistan's commitment to further tighten monetary policy as needed, will help to bring down inflation, support the rupee, and boost international reserves. These results will enhance confidence in the Pakistani economy, facilitating a resumption of foreign capital inflows. The program also envisages reforms aimed at improving monetary management and at strengthening the bank resolution framework to address potential pressures in the banking system.

"The authorities' program requires forceful and sustained implementation to succeed. By providing large financial support to Pakistan, the IMF is sending a strong signal to the donor community about the country's improved macroeconomic prospects. The mobilization of additional donor financial support will help consolidate the country's international reserve position and finance the expanded social safety net. The program allows for additional development spending in case external assistance turns out to be higher than projected," Mr. Kato said.

ANNEX

Recent Economic Developments

The macroeconomic situation in Pakistan has deteriorated significantly since mid-2007. Adverse security developments, large exogenous price shocks, notably related to increases in oil and food import prices, and global financial turmoil buffeted the economy. These shocks, combined with policy inaction during the political transition to the new government and large central bank financing of the growing fiscal deficit, led to slower growth, higher inflation and a sharp deterioration of the external position.

Against this background, the Pakistani authorities have embarked on a program to restore macroeconomic stability while protecting the poor and vulnerable during the process of adjustment. To support this program, they have requested IMF financial assistance.

Program Summary

The authorities' program seeks to restore international and domestic investor confidence by addressing current macroeconomic imbalances while protecting the poor and vulnerable.

The program includes the following goals:

- To help reduce the external current account deficit and move toward a more sustainable fiscal position, the program envisages a significant tightening of fiscal policy. Specifically, the fiscal deficit will be reduced from 7.4 percent of GDP in 2007/2008 (July-June) to 4.2 percent in 2008/2009 and 3.3 percent in 2009/2010. This fiscal adjustment will be achieved primarily by phasing out energy subsidies, better prioritizing development spending, and implementing strong tax policy and administration measures.

- The program also envisages a tightening of monetary policy to bring down inflation and strengthen the country's international reserves position. The State Bank of Pakistan (SBP) recently increased its discount rate by 200 basis points to 15 percent, and stands ready to further tighten monetary conditions, as needed. Central bank financing of the government will be eliminated. Structural actions include the design of contingency plans to address problem banks, and measures to improve monetary management and strengthen the SBP's bank resolution capacity. The central bank will pursue a flexible exchange rate policy, with intervention in the foreign exchange market geared toward achieving the program's reserve targets and smoothing excessive exchange rate volatility.

- A strengthening and better targeting of social assistance to provide support for the poor and vulnerable is an essential element of the program. To this end, spending on the social safety net will be increased by 0.6 percentage point of GDP, to 0.9 percent of GDP in 2008/2009.

Pakistan, which joined the Fund on July 11, 1950, has a quota of SDR 1,033.7 million (about US$1,526.6 million).

Pakistan: Main Economic Indicators, 2004/05–2009/10 1/

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
					Proj.	
Real economy (change in percent)						
Real GDP	9.0	5.8	6.8	5.8	3.4	5.0
CPI (average)	9.3	7.9	7.8	12.0	23.0	13.0
CPI (end year)	8.7	7.6	7.0	21.5	20.0	6.0
Gross national saving (percent of GDP)	17.7	17.8	18.2	12.9	13.5	15.7
Gross capital formation (percent of GDP)	19.1	21.7	23.0	21.3	20.0	21.3
General government (percent of GDP)						
Overall balance (excluding grants)	-3.3	-4.3	-4.3	-7.4	-4.2	-3.3
Primary balance	0.2	-0.6	0.2	-2.5	0.6	1.6
Debt	61.2	55.8	54.1	57.9	54.6	52.4
Money and credit (end-of-period, percent change)						
M2	19.3	14.9	19.3	15.3	10.8	15.9
Credit to non-government	33.2	23.2	17.2	16.4	25.2	19.5
Interest rates (percent)						
Six-month treasury bill rate (average, in percent)	4.7	8.2	8.8	11.0	…	…
Balance of payments						
Current account (in percent of GDP)	-1.4	-3.9	-4.8	-8.4	-6.5	-5.7
External debt (in percent of GDP)	31.3	28.0	26.9	26.5	31.4	33.2
Reserves (in millions of U.S. dollars) 2/	9,805	10,765	14,302	8,591	8,591	11,291
Exchange rate						
Exchange regime			Managed float			
Present rate (November 21, 2008)			PRs 79.3 = US$ 1			
Real effective rate, CPI basis (annual average, 2000=100)	0.2	5.3	0.5	-0.8	…	…
Quota at the Fund			SDR 1,033.7 million			

Sources: Pakistani authorities; and IMF staff estimates and projections.
1/ Fiscal year ends June 30.
2/ Excluding gold and foreign deposits of commercial banks held with the State Bank of Pakistan.

Statement by Mohammad Mojarrad, Executive Director for Pakistan and Ehtisham Ahmad, Senior Advisor to Executive Director November 24, 2008

The transition to civilian rule in Pakistan was completed in September 2008, with the election of a civilian President. The preceding year was marked by external shocks, political turmoil including the assassination of Ms. Bhutto by terrorists, an intensification of the war against terror, and economic inaction during an election year. This left the new government facing a daunting task—with high inflation, increasing fiscal and current account deficits, and dwindling reserves. The policy response of the new government has been vigorous and rapid, including the preparation, by end-September, of a stabilization and development plan for the next five years to which it is strongly committed. This plan was prepared as a prelude to discussions with friendly countries for bilateral support, and with the international agencies, including the IMF, the World Bank, IDB and the ADB. The Pakistan authorities are grateful to management and staff for engaging with them in support of the stabilization program, and for the exceptionally dedicated work of the staff team.

The core of the government's adjustment plan is aggregate demand management through a combination of fiscal adjustment and monetary tightening, along with an effective and adequate social safety net.

To this end, the overall fiscal deficit is to be reduced by over 3 percentage of GDP to 4.2 percent during the current fiscal year. As the main accretions to domestic revenues will occur after the passage of the new legislation and the tax administration measures in 2009, the fiscal adjustments in the current year are based on a sharp reduction in subsidies, with the full pass through of the petroleum price increases and adjustment of agricultural prices in line with international prices. These measures were taken in the past few months at considerable political risk to the new administration.

Additional measures include a rationalization of development spending and a reduction of investment outlays, as well as freezing current (non-interest) expenditures. The only exception is the additional emphasis placed on the social safety net. This involves the identification of the poor and transparent mechanisms to provide cash support through the Benazir Income Support Scheme. The World Bank is engaged in advising on the modalities for this program. The authorities will also utilize existing programs to provide support quickly to the poor. The latter is important, as relief to those seriously affected by the price changes (exacerbated by the depreciation of the rupee) will help in shoring up political support for the difficult measures that are still to come.

Over the medium term, the authorities' focus is on domestic resource mobilization. A plan has been prepared to revamp the tax administration, including by bringing an ongoing World Bank/DFID project to a successful conclusion by end-2009. In parallel, the government is initiating a review of the tax policy options that will focus on the establishment of a proper VAT, administered by the restructured federal tax administration. VAT design, as is also the case in other federal countries, has to be carefully coordinated with the provinces, which have partial jurisdiction over the relevant tax base, and with the new Finance Commission. Nonetheless, it is expected that workable proposals will be enacted within the next year and implemented soon thereafter. Other measures will include full implementation of a global income tax law, prepared with IMF assistance, and a renewed emphasis on subnational tax heads to engender greater accountability for the provinces.

The buildup of idle government cash balances in the banking system over the past few years has been due to lax public financial management practices. The government has begun to implement a treasury single account; this measure should be completed during the current year. The Government Financial Information Management System implemented over the past few years with support from international agencies did not have a commitment control system and steps are being taken to address this regrettable weakness.

The State Bank of Pakistan (SBP) has been tightening the monetary stance over the past year, with a 350 basis point cumulative increase in the discount rate, and an additional 200 basis point adjustment last week, bringing the discount rate to 15 percent. It is noteworthy that the auction on November 19, which sought to raise PRs. 75 billion, generated an offer of PRs.129 billion, of which PRs. 104 billion was accepted at a cut off rate of 13.85 percent. The government is committed to the elimination of net borrowing from the SBP during the remainder of the year. Other domestic financing instruments are also being strengthened. The SBP also reiterates its commitment to additional tightening of monetary policy as needed.

The exchange rate has depreciated significantly over the past year, and together with the tightening of monetary policy and the fall in petroleum prices, should help in reducing the current account deficit. Exchange rate flexibility has served Pakistan well over the years and will be maintained together with an open trade regime.

The current spike in inflation is in part due to the pass-through of the energy and food price increases, together with the exchange rate adjustments. As petroleum prices fall, the external inflationary pressures should ease, and in due course, the monetary tightening will also help reduce inflation. The wholesale price index is beginning to show a decline, although the October CPI numbers do not reflect this trend.

The government's objective remains to return to a sustainable growth path to ensure gainful employment opportunities for the burgeoning young entrants to the labor force. The growth outcome is partly dependent on the weather and the agricultural sector's response to international prices. Recent domestic price increases should also eliminate incentives to smuggle grains out of Pakistan. However, a significant agenda remains for public investment in infrastructure and basic services, including in the troubled western regions. And for continued political and social stability, there has to be a system of adequate social safety nets. For these purposes, the assistance of friendly countries is being sought, and a pledging session of the Friends of Pakistan Group is to be arranged in the next couple of months.

Pakistan is not immune to the turbulence affecting global markets. Indeed, the high sectoral concentration of exports makes the immediate prospects quite uncertain. This may require additional financing, including from the Fund. The authorities expect that the Fund will keep these risks under review and, if needed, augment Pakistan's access under the program.