



# PAKISTAN

July 2017

## 2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; INFORMATIONAL ANNEX; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PAKISTAN

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with Pakistan, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 14, 2017 consideration of the staff report that concluded the Article IV consultation with Pakistan.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 14, 2017, following discussions that ended on April 5, 2017, 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 May 31, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Pakistan.

The documents listed below will be separately released.

### Selected Issues

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### **IMF Executive Board Concludes Article IV Consultation with Pakistan**

On June 14, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with Pakistan.

Pakistan's outlook for economic growth is favorable, with real GDP estimated at 5.3 percent in FY 2016/17 and strengthening to 6 percent over the medium term on the back of stepped-up China Pakistan Economic Corridor (CPEC) investments, improved availability of energy, and growth-supporting structural reforms. Inflation has been gradually increasing but remains contained, and the financial sector has remained sound.

However, macroeconomic stability gains made under the 2013-16 EFF-supported program have begun to erode and could pose risks to the economic outlook. Fiscal consolidation has slowed, with the 2016/17 budget deficit target of 4.2 percent of GDP (authorities' latest projection) likely to be exceeded. The current account deficit has widened and is expected at 3 percent of GDP in 2016/17, driven by quickly rising imports of capital goods and energy. Foreign exchange reserves have declined in the context of a stable rupee/dollar exchange rate. On the structural front, while the successful implementation of business climate and financial inclusion reforms has continued, some renewed accumulation of arrears in the power sector has been observed, and financial losses of ailing public sector enterprises continue to weigh on scarce fiscal resources. Key external risks include lower trading partner growth, tighter international financial conditions, a faster rise in international oil prices, and over the medium term, failure to generate sufficient exports to meet rising external obligations from large-scale foreign-financed investments.

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

## Executive Board Assessment<sup>2</sup>

Directors commended the Pakistani authorities for strengthening macroeconomic resilience during their 2013–16 Fund-supported program. Directors agreed that the growth outlook remains favorable, but noted that policy implementation weakened recently and macroeconomic vulnerabilities are reemerging. Against this backdrop, Directors called on the authorities to safeguard the macroeconomic gains of recent years through continued implementation of sound policies, and to continue with structural reforms to achieve higher and more inclusive growth.

Directors encouraged the authorities to strengthen fiscal consolidation. They noted that the FY 2017/18 budget aims at further gradual consolidation, albeit at a slower pace than targeted under the Fiscal Responsibility and Debt Limitation (FRDL) Act, and will likely require additional revenue measures in light of recent revenue underperformance. Directors emphasized that sustained fiscal consolidation over the medium term, in line with the FRDL Act, is critical to strengthen economic resilience, safeguard fiscal sustainability, and limit pressures on the current account and international reserves. To this end, Directors recommended mobilizing additional tax revenues by broadening the tax base and strengthening tax administration; and enhancing the composition of public spending by containing the wage bill's growth, further reducing electricity subsidies, and increasing priority social spending. They also recommended strengthening the national fiscal federalism framework and public debt management.

Directors stressed the importance of maintaining a prudent monetary policy stance to preserve low inflation. They noted that monetary policy has been appropriately accommodative, and urged the State Bank of Pakistan (SBP) to remain vigilant and be ready to tighten it in case inflationary pressures emerge or foreign exchange market pressures intensify. Directors called on the authorities to allow for greater exchange rate flexibility—rather than relying on administrative measures—to help reduce external imbalances and bolster external buffers. In this regard, they welcomed the authorities' commitment to remove, within one year, the cash margin requirement for imports of consumer goods, which constitutes an exchange restriction and multiple currency practice. Directors welcomed ongoing progress in strengthening central bank autonomy, and called for implementing the remaining recommendations from the 2013 Safeguards Assessment and to phase out government borrowing from SBP. Directors saw many of the abovementioned measures as preconditions for moving to an inflation targeting regime in the medium term.

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<sup>2</sup> At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Directors underscored the importance of further advancing financial sector reforms to continue strengthening resilience and support financial deepening. They welcomed efforts to bring undercapitalized banks into regulatory compliance, further strengthen the regulatory and supervisory frameworks, address non-performing loans, and enhance the AML/CFT framework. Directors looked forward to the operationalization of the new deposit insurance.

Directors stressed that further progress in the structural reform agenda is needed to make growth more inclusive and reduce poverty. They welcomed the progress in fostering financial inclusion and implementing the business climate reform strategy, and encouraged the authorities to press ahead with these efforts. Directors also recommended further strengthening social safety nets. They called for maintaining a strong regulatory framework in the energy sector, swiftly addressing the renewed build-up of arrears in the sector, and ensuring its financial soundness. Directors noted that restructuring and attracting private sector participation in public enterprises as well as improving their governance will ensure their financial viability and economic efficiency while reducing fiscal risks.

Pakistan: Selected Economic Indicators, 2012/13–2017/18 1/

Population: 195.4 million (2015/16)  
 Per capita GDP: US\$1,454 (2015/16)  
 Poverty rate: 29.5 percent (2012/13)  
 Main exports: Textiles (\$12.8 billion, 2015/16)  
 Unemployment: 5.9 percent (2014/15)

	2012/13	2013/14	2014/15	2015/16	2016/17 Proj.	2017/18 Proj.
	(Annual percentage change)					
<b>Output and prices</b>						
Real GDP at factor cost	3.7	4.1	4.1	4.5	5.3	5.5
GDP deflator at factor cost	7.1	7.4	4.3	0.6	3.5	5.0
Consumer prices (period average)	7.4	8.6	4.5	2.9	4.3	5.0
Consumer prices (end of period)	5.9	8.2	3.2	3.2	5.3	5.0
Pakistani rupees per U.S. dollar (period average)	8.4	6.4	-1.5	2.7	...	...
	(In percent of GDP)					
<b>Saving and investment</b>						
Gross saving	13.9	13.4	14.7	14.3	12.7	15.3
Government	-5.1	-1.4	-1.6	-0.7	-0.5	2.0
Nongovernment (including public sector enterprises)	19.0	14.7	16.3	15.0	13.2	13.3
Gross capital formation 2/	15.0	14.6	15.7	15.6	15.8	18.5
Government	3.2	3.5	3.7	3.7	3.9	6.0
Nongovernment (including public sector enterprises)	11.7	11.1	12.0	11.8	11.9	12.5
<b>Public finances</b>						
Revenue and grants	13.5	15.2	14.5	15.5	15.8	17.6
Expenditure (including statistical discrepancy)	21.9	19.8	19.1	19.2	20.2	21.6
Budget balance (including grants)	-8.4	-4.9	-5.3	-4.4	-4.3	-4.0
Budget balance (excluding grants)	-8.5	-5.7	-5.4	-4.6	-4.5	-4.2
Primary balance	-3.9	-0.3	-0.5	-0.1	-0.1	-0.1
General government debt incl. IMF obligations	63.9	63.5	63.3	67.6	66.6	65.1
External general government debt	21.1	20.2	18.9	20.8	21.3	21.5
Domestic general government debt	42.8	43.3	44.4	46.8	45.4	43.6
	(Annual changes in percent of initial stock of broad money, unless otherwise indicated)					
<b>Monetary sector</b>						
Net foreign assets	-3.5	3.7	2.2	1.7	0.1	0.4
Net domestic assets	19.3	8.8	11.0	11.9	13.3	11.4
Broad money (percent change)	15.9	12.5	13.2	13.7	13.4	11.8
Reserve money (percent change)	15.8	12.9	9.9	26.5	14.1	13.5
Private credit (percent change)	-0.2	12.1	5.9	11.1	13.0	13.5
Six-month treasury bill rate (period average, in percent)	9.8	9.7	8.8	6.3	...	...
<b>External sector</b>						
Merchandise exports, U.S. dollars (percentage change)	0.4	1.1	-3.9	-8.8	-0.8	9.4
Merchandise imports, U.S. dollars (percentage change)	-0.6	3.8	-1.0	-2.0	12.6	6.6
Current account balance (in percent of GDP)	-1.1	-1.3	-1.0	-1.2	-3.0	-3.2
	(In percent of exports of goods and services, unless otherwise indicated)					
External public and publicly guaranteed debt	140.7	161.2	159.8	193.3	209.7	210.0
Debt service	21.6	26.2	20.7	22.9	29.2	21.4
Gross reserves (in millions of U.S. dollars) 3/	6,008	9,096	13,534	18,143	18,518	18,883
In months of next year's imports of goods and services	1.5	2.2	3.3	4.0	3.8	3.6
<b>Memorandum items:</b>						
Underlying fiscal balance (excl. grants; percent of GDP) 4/	...	...	...	...	-4.8	-4.2
General government and government guaranteed debt (incl. IMF; % GDP)	66.7	65.7	65.7	70.0	69.1	67.6
Net general government debt (incl. IMF; % GDP)	60.1	58.0	58.2	61.2	60.3	58.9
Real effective exchange rate (annual average, percentage change)	-1.3	0.9	10.9	4.6	...	...
Terms of trade (percentage change)	-1.9	0.2	7.0	10.7	-0.9	-0.9
Real per capita GDP (percentage change)	2.1	2.6	2.0	2.5	3.3	3.5
GDP at market prices (in billions of Pakistani rupees)	22,386	25,169	27,443	29,103	31,862	35,390
GDP at market prices (in billions of U.S. dollars)	231.2	244.4	270.6	279.4	...	...

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

1/ Fiscal year ends June 30.

2/ Including changes in inventories

3/ Excluding gold and foreign currency deposits of commercial banks held with the State Bank of Pakistan.

4/ Excludes one-off transactions, including asset sales.



# PAKISTAN

## STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

May 31, 2017

### EXECUTIVE SUMMARY

**Economic context:** Macroeconomic resilience was strengthened during the three-year Extended Fund Facility (EFF)-supported program completed in September 2016: growth increased, the fiscal deficit was reduced, and foreign currency reserves recovered. Structural reforms were also set in motion: long-standing fiscal and energy sector constraints started to be tackled, and social safety nets were strengthened. Following completion of the program, there has been progress in implementing staff's policy recommendations, although policy implementation has weakened and macroeconomic vulnerabilities have begun to re-emerge: fiscal consolidation slowed, the current account deficit widened, and foreign exchange reserves declined. On the structural front, the accumulation of arrears in the power sector has resumed, financial losses of ailing public sector enterprises continue to weigh on scarce fiscal resources, and exports remain low. Despite progress, poverty and inequality are still significant, and growth needs to become more inclusive.

**Macroeconomic outlook and risks.** Pakistan's growth outlook is favorable, with real GDP growth estimated at 5.3 percent this fiscal year and strengthening to 6 percent over the medium-term on the back of stepped-up China Pakistan Economic Corridor (CPEC) investments, better energy availability, and growth-supporting structural reforms. Key external risks include lower trading partner growth, tighter international financial conditions, a faster rise in global oil prices and, over the medium term, failure to generate sufficient exports to meet rising external obligations from foreign-financed investments. Domestically, risks include a deterioration in security conditions and potential pressures on policy implementation ahead of the mid-2018 elections.

**Policy Focus.** To realize the favorable growth outlook, priorities include strengthening macroeconomic resilience and generating higher and more inclusive growth:

- **Fiscal consolidation** slowed substantially in FY 2016/17. The FY 2017/18 budget is subject to risks and reaching the deficit target will likely require significant additional revenue measures. Gradual fiscal consolidation should continue through the medium term to address debt-related vulnerabilities.
- **Prudent monetary policy and greater exchange rate flexibility** will be key to preserve low inflation and re-build external buffers.
- **Structural reforms to support higher and more inclusive growth** should focus on ensuring a financially sound and growth-supporting energy sector, restructuring and attracting private sector participation in PSEs to reduce financial losses and related fiscal costs and vulnerabilities, bolstering social protection, strengthening the business climate and governance, and fostering financial deepening and inclusion.

Approved By  
**Daniela Gressani and  
 Vitaliy Kramarenko**

Discussions took place in Dubai during March 28–April 5, 2017. Staff representatives comprised Messrs./Mmes. H. Finger (head), G. Albertin, M. Kryshko (all MCD), A. Haron (MCM), H. Chai (FAD), E. Hitaj (SPR), T. Mirzoev (Resident Representative), and A. Tasneem and H. Zaidi (Resident Representative Office, Islamabad). Mr. J. Pampolina (LEG) joined for part of the mission. The mission issued a press release on April 5, 2017. Mmes. J. Chen and M. Orihuela Quintanilla assisted in the preparation of the report.

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## CONTEXT AND BACKGROUND

### 1. Economic resilience was strengthened and a number of structural reforms were set in motion during the three-year EFF-supported program completed in September 2016.

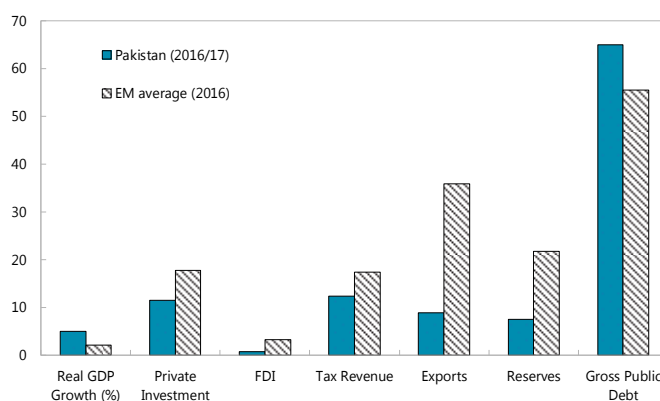
Economic growth gradually increased and the fiscal deficit was reduced, while spending on infrastructure and social safety nets increased. Tax policy and administration reforms fostered revenue mobilization. Helped by prudent policies and declining oil prices, inflation was contained and external buffers were rebuilt. Progress was made in strengthening the State Bank of Pakistan's (SBP's) independence, and the stability and resilience of the financial sector were reinforced. Key structural weaknesses started to be tackled, with energy sector reforms reducing growth-constraining power outages, and the successful launch of a new business climate reform.

### 2. However, macroeconomic risks have begun to re-emerge since the end of the EFF program and long-standing challenges remain.

The pace of fiscal consolidation has slowed, public debt remains high, and mobilization of tax revenue needs to be further strengthened. External vulnerabilities have increased with a widening current account deficit and rising medium-term external repayment obligations linked to the China Pakistan Economic Corridor (CPEC) and other large investment projects. Foreign exchange reserves have declined since the end of the EFF-supported program and remain below comfortable levels. On the structural front, progress in electricity sector reforms has been mixed, with a renewed build-up in circular debt; and financial losses of ailing public sector enterprises (PSEs) have continued. Private investment and exports remain low to support higher private-sector led growth and catalyze needed job creation. Unemployment is at 5.9 percent (10½ percent among youth and 9½ percent among women) and the informal economy is large. Despite significant progress over the past two decades, poverty remains high at about 30 percent in 2013 (9 percent based on the 2001 poverty line), inequality slightly declined but remains sizable, and priority social spending, although having increased significantly, needs to be further enhanced.

**Pakistan Relative to Emerging Market Economies**

(In percent of GDP, unless otherwise indicated)

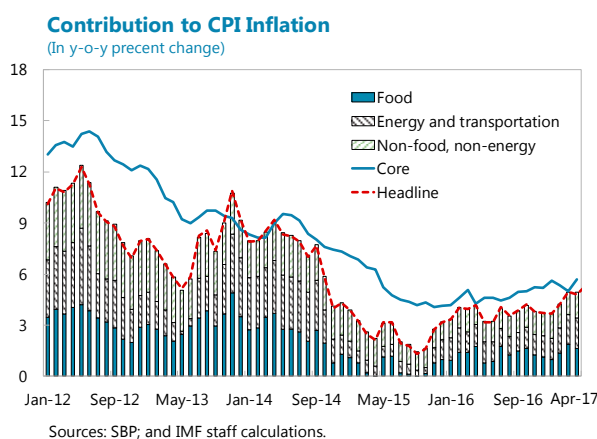


Sources: IMF WEO Database, and SPR VEE Database.

## RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

### 3. The economic recovery has continued in FY 2016/17 and inflation has remained contained.

Agricultural production (notably cotton) has been recovering following last year's decline, construction activity and services have remained strong, and growth in large-scale manufacturing has been improving following weaker-than-expected growth earlier in the year. While domestic demand strengthened, exports began to stabilize. Headline inflation has been trending up and reached 4.8 percent (y-o-y) in April 2017, driven by higher food prices. Core inflation inched up to 5.5 percent (y-o-y).



### 4. International reserves have declined amid a rising current account deficit and a broadly unchanged dollar/rupee exchange rate.

During the first three quarters of FY 2016/17, the current account deficit widened to 2 percent of GDP, reflecting increasing imports (14 percent, y-o-y) due to investments related to CPEC, recovering oil prices, and sluggish remittances (-2 percent y-o-y), driven by slower growth in the Gulf Cooperation Council (GCC) countries. After declining for two consecutive years, exports further dropped by 1 percent (y-o-y). The exchange rate continued to remain stable against the U.S. dollar, supported by the SBP's foreign exchange interventions, and further appreciated in real effective terms 6 percent during this fiscal year (18 percent cumulatively over the past three years). International reserves declined to US\$16.1 billion at end-April 2017 (3.4 months of imports) from US\$18.1 billion in June 2016 (four months of imports). In addition, the SBP's derivative position reached \$3.6 billion in net obligations (from \$2 billion in June 2016), which could put additional pressure on reserves.



### 5. Fiscal performance has been affected by lower-than-expected revenues.

The overall fiscal deficit (excluding grants) was higher than expected at 3.8 percent of GDP in the first three quarters of FY 2016/17. Tax revenues were 0.6 percent of GDP lower than expected, due to lower collection of sales tax (mainly driven by a reduction in petroleum tax rates in the first half of the year to cushion pump prices amid rising international oil prices), direct taxes, excises, and gas infrastructure development cess (GIDC). In addition, nontax revenues were 0.7 percent of GDP lower than anticipated, due to lower SBP profits, PSEs' dividends, and disbursements under the Coalition Support Fund. On the expenditure side, the execution of non-interest current spending and federal development spending was conservative in the first three quarters.

6. **The banking system has remained sound.** Bank private credit growth has continued to gradually increase, reaching 14 percent (y-o-y) at end-March 2017. Asset quality has improved, with the gross and net nonperforming loans (NPLs) ratios decreasing to eight-year lows of 10.1 percent and 1.6 percent, respectively (December 2016). However, in the low interest rate environment bank profitability has gradually declined and leverage increased. On average, the banking system is adequately capitalized, with a capital adequacy ratio of 16.2 percent, well above regulatory norms. While two small banks remain undercapitalized, they are expected to be brought into regulatory compliance by end-June 2017. Progress has been made towards the operationalization of the recently adopted Deposit Protection Corporation, also expected by end-June 2017. The stock market has performed strongly, and MSCI has reclassified Pakistan from frontier to emerging market, effective June 2017.

7. **There has been progress in implementing staff's policy recommendations from the 2015 Article IV consultation and subsequent reviews of the EFF-supported program, although recent slippages have resulted in slower fiscal consolidation and a decline in reserves.**

- Broadly in line with staff's recommendation for continued gradual fiscal consolidation, the budget deficit (excluding grants) declined to 4.6 percent of GDP in FY 2015/16, the FY 2016/17 budget targeted a deficit of 3.8 percent of GDP, and fiscal responsibility legislation was revised to target further consolidation through the medium term. Recent fiscal slippages and the 2017/18 budget imply that these targets will take longer to achieve. Progress has been made in raising the revenue-to-GDP ratio and strengthening tax compliance, with significant room for additional improvement going forward.
- Monetary policy has been targeting positive real interest rates while becoming increasingly accommodative. While recognizing recent current account pressures, the authorities have not allowed for more downward exchange rate flexibility in light of sustained real exchange rate appreciation.
- There has been progress with structural and financial sector reforms but significant challenges remain. Targeted cash transfers to the poor under BISP continued to increase, and efforts to improve the business climate and financial access have begun to bear fruit. Efforts to establish deposit insurance and to address undercapitalized banks and high NPLs have progressed. The authorities made progress in strengthening the SBP's autonomy although further steps will be needed. There has also been significant progress in energy sector reforms, though the recent resumption of circular debt accumulation points to the need for continued reform efforts. Despite some progress and substantial preparatory work, the agenda to restructure and seek private sector participation in public enterprises has seen significant setbacks.

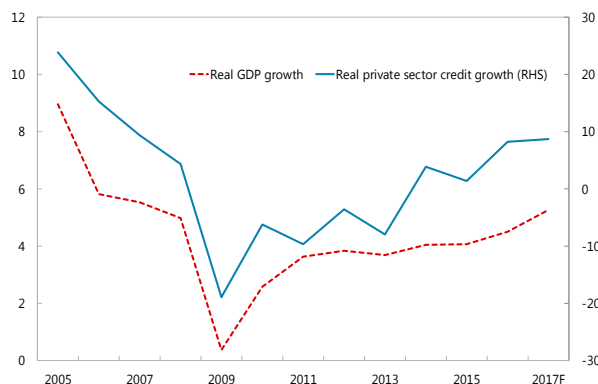
8. **Data provision is broadly adequate for surveillance and the authorities have sought technical assistance to improve their statistical base** (see Informational Annex—Statistical Issues). Upcoming IMF technical assistance will provide support to improve the compilation of fiscal accounts. Furthermore, IMF and World Bank technical assistance is being provided to strengthen the compilation of national accounts.

# MACROECONOMIC OUTLOOK AND RISKS

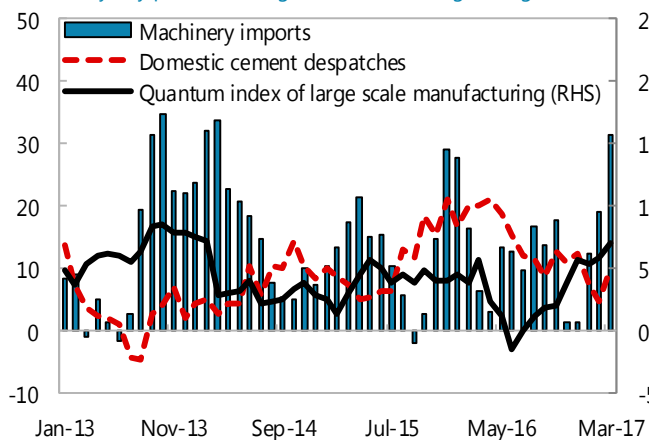
## 9. The economic recovery is expected to continue and to strengthen over the medium term.

Buoyant activity in construction and services along with recovering agriculture are driving real GDP growth, which is estimated at 5.3 percent in FY 2016/17. Strong machinery imports and fast-growing iron and steel and auto sectors point to strengthening domestic demand. Growth is benefitting from rising investment related to CPEC, strengthening private sector credit growth, and reduced fiscal drag, and there are increasing signs of a recovery in exports. However, moderating (though still strong) growth in domestic cement despatches and sluggish remittances are signs of caution. Headline inflation will likely be contained at 4.3 percent on average in FY 2016/17. Over the medium term, growth is expected to increase to about 6 percent on the back of CPEC and other energy sector investments, and helped by growth-supporting structural reforms (Section C).

**Credit to the Private Sector and Economic Activity**  
(In y-o-y percent change)



**Machinery Imports, Domestic Cement Despatches and Manufacturing Index**  
(In y-o-y percent change; 3-month moving average)



**Exports and Workers' Remittances**  
(In y-o-y percent change; 3-month moving average)

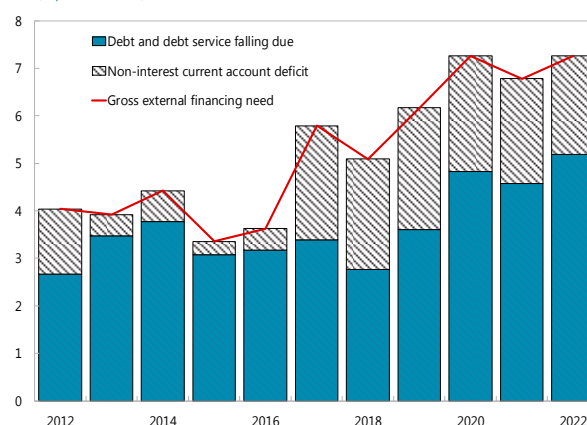


## 10. External financing needs are expected to pick up amid a widening current account deficit.

Rising imports, stagnant remittances, and weakly recovering exports are weighing on the current account deficit, which is expected to widen to 3 percent of GDP in FY 2016/17. FDI inflows and significant government external borrowing expected in the fourth quarter would allow financing the increase in the current account deficit and foreign reserves to recover to \$18.5 billion (3.8 months of imports; 73 percent of the IMF's reserve adequacy (ARA) metric), albeit with risks to

the downside.<sup>1</sup> Over the medium term, the current account deficit is expected to peak at 3.4 percent of GDP in 2019 as CPEC-related imports gather steam, and could subsequently moderate as exports recover, supported by the elimination of supply-side bottlenecks and the implementation of business climate reforms. Pakistan will face increasing government and CPEC-related external repayment obligations, and external financing needs are projected to increase to nearly 7½ percent of GDP over the medium term, highlighting the need for macroeconomic and structural policies supporting competitiveness.

**Gross External Financing Needs**  
(in percent of GDP)



11. **External risks to the outlook are, in staff's view, skewed to the downside** (Box 1). Lower growth in advanced countries and in emerging markets (notably China and GCC) along with greater uncertainty around world trade could weaken exports, FDI, and remittances, with the latter being particularly vulnerable to slower-than-expected growth in the GCC countries, where nearly two thirds of remittances to Pakistan originate. A more pronounced recovery of oil prices or stronger-than-expected growth in non-oil imports could add to balance of payments pressures. Tightening global financial conditions could adversely impact capital inflows, and continued appreciation of the real effective exchange rate would further erode export competitiveness and discourage remittances. Lower-than-expected export growth or remittances over the medium term could increase risks associated with rising repayment obligations and profit repatriation from energy investment and other CPEC-related projects (Annex I).<sup>2</sup> On the upside, a renewed decline in oil prices would ease balance of payments pressures and support growth.

12. **Domestic risks could arise from political polarization in the pre-election period and security issues.** In staff's view, fiscal pressures could rise during the period leading up to the mid-2018 general elections, and growth-supporting reforms could slow. While security conditions have improved over the past few years, a renewed deterioration could affect confidence, investment, and economic activity.

<sup>1</sup> Reserves stood at \$18.5 billion at the end of the EFF-supported program in September 2016.

<sup>2</sup> See accompanying Selected Issues Paper: "The Macroeconomics of Pakistan's Quest for Energy and the CPEC."

### Box 1. Pakistan: Risk Assessment Matrix<sup>1</sup>

Risk	Medium Term Likelihood	Expected Impact Upon Realization	Policies to Mitigate Risk
<b>Retreat from cross-border integration.</b>	<b>High</b> A fraying consensus about the benefits of globalization could lead to protectionism and economic isolationism, leading to reduced global and regional policy collaboration with negative consequences for trade, capital and labor flows, sentiment, and growth.	<b>Low to Medium</b> -Impaired exports; -Reduced remittances; -Weakened FDI prospects; -Dampened growth; - More difficult and costly external financing.	-Sustain build-up of fiscal and external buffers; -Allow for exchange rate flexibility to support competitiveness; -Maintain adequate medium-term debt strategy; -Ensure strong financial regulation and supervision.
<b>Structurally weak growth in key advanced and emerging economies (incl. GCC countries).</b>	<b>High/Medium</b> Low productivity growth, a failure to fully address crisis legacies and undertake structural reforms, and persistently low inflation could undermine medium-term growth in advanced economies (high likelihood). Resource misallocation and policy missteps, including insufficient reforms, could exacerbate declining productivity growth in emerging markets (medium likelihood).	<b>Medium</b> -Impaired exports; -Reduced remittances; -Weakened FDI prospects; -Dampened growth.	-Sustain build-up of fiscal and external buffers; -Allow for exchange rate flexibility to support competitiveness; -Improve business climate and enhance governance and anti-corruption measures.
<b>Significant slowdown in China.</b>	<b>Low/Medium</b> Key near-term risks are disruptive drying up of liquidity for weaker borrowers in the interbank market and increasing pressure on the Renminbi, which could lead to overcorrection. Weak domestic demand could further suppress commodity prices, roil global financial markets, and reduce global growth (likelihood: low in short-term, medium thereafter).	<b>Medium</b> -Impaired exports; -Reduced remittances; -Weakened FDI prospects, including in the context of CPEC; -Dampened growth; - More difficult and costly external financing.	-Sustain build-up of fiscal and external buffers; - Allow for exchange rate flexibility to support competitiveness; - Improve business climate; -Maintain adequate medium-term debt strategy; -Ensure strong financial regulation and supervision.
<b>Significant further strengthening of the U.S. dollar and/or higher rates.</b>	<b>High</b> As investors reassess policy fundamentals, as term premia decompress, or if there is a more rapid Fed normalization, leveraged firms, lower-rated sovereigns and those with unhedged dollar exposure could come under stress. Capital account pressures could ensue for some economies.	<b>Medium</b> -More difficult and costly external financing; -Deterioration of the stock market; -Possible difficulties with privatization.	-Sustain build-up of external buffers; -Allow for exchange rate flexibility to support competitiveness; -Maintain adequate medium-term debt strategy; -Ensure strong financial regulation and supervision.
<b>Security conditions</b>	<b>Medium to High</b> Regional tensions and possible retaliation against ongoing domestic security operations could increase security concerns.	<b>Medium</b> -Eroded confidence; -Discouraged investment; -Increased military spending/fiscal burden. -Disrupted economic activity.	-Instill confidence through a strong medium-term economic program; -Maintain engagement with donors; -Maintain fiscal and external buffers.
<b>Slippages in policy implementation and repercussions of judicial challenges</b>	<b>Medium to High</b> Fiscal pressures on the government could rise during the pre-election period and growth-supporting reforms could slow.	<b>Medium to High</b> -Eroded confidence; - Erosion of macroeconomic stability gains; -Discouraged investment; -Weakened growth prospects.	-Sustain build-up of fiscal and external buffers; -Continue outreach to build wide consensus on national economic policy agenda; -Strive to prevent further competitiveness losses.

<sup>1</sup> The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 percent and 30 percent, and "high" a probability between 30 percent and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

13. **The authorities broadly shared staff's assessment but were on balance more optimistic.**

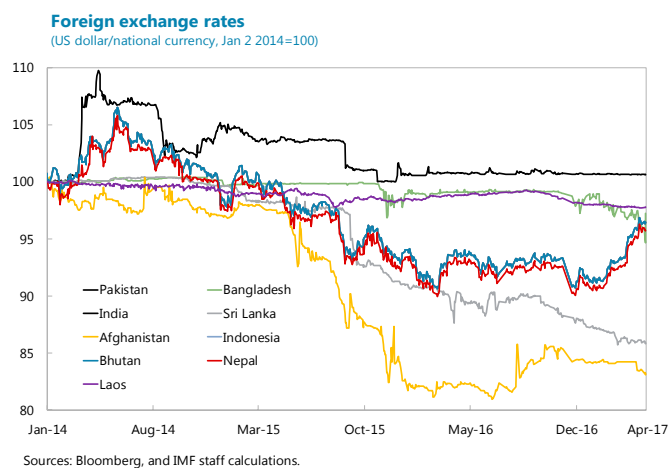
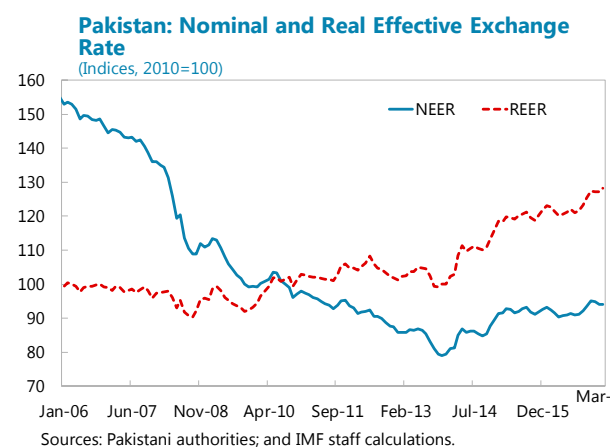
They expected growth to accelerate to 7 percent in the medium term supported by strong CPEC-related investments, favorable second-round effects from better infrastructure and energy availability, and an improved security environment. They expected a moderately smaller medium-term current account deficit, assuming a more pronounced slowdown in import growth and a stronger recovery in exports and remittances. The authorities also underscored that security conditions have significantly improved, with limited downside risks to the outlook.

## REINFORCING ECONOMIC RESILIENCE

*Maintaining a prudent monetary policy stance and allowing greater exchange rate flexibility are needed to preserve low inflation and re-build external buffers. Pursuing growth-supporting gradual fiscal consolidation will be important to strengthen the economy's resilience and preserve medium-term fiscal sustainability. In parallel, efforts to strengthen the SBP's autonomy and advance financial sector reforms should continue.*

### A. Preserving Low Inflation and External Buffers

14. **Bolstering external buffers and improving trade competitiveness are needed to strengthen macroeconomic resilience.** Staff stressed that reversing the recent decline in reserves and allowing for greater exchange rate flexibility are needed to rebuild external buffers, which are below adequate levels, and strengthen Pakistan's competitiveness, which has been affected by real effective exchange appreciation. Based on standard models of real effective exchange rate valuation, which are subject to significant uncertainty, staff estimated that Pakistan's external position is moderately weaker than suggested by fundamentals and desirable policies and that the real exchange rate is moderately overvalued (between 10 and 20 percent; Box 2). The authorities' own assessment suggested significantly lower currency overvaluation. In addition, they viewed reserves as adequate as they cover more than three months of imports.

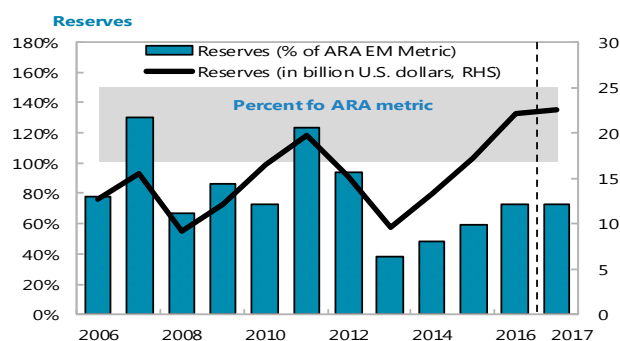
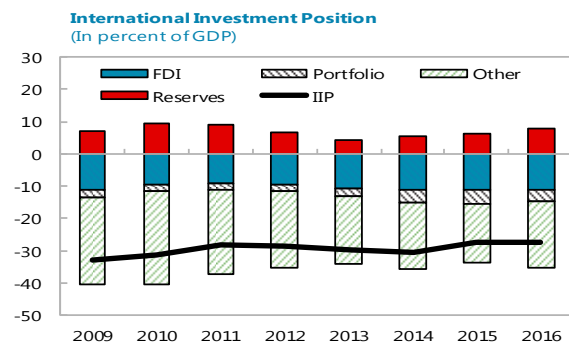
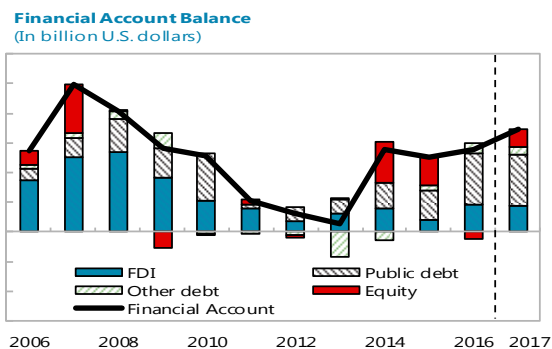
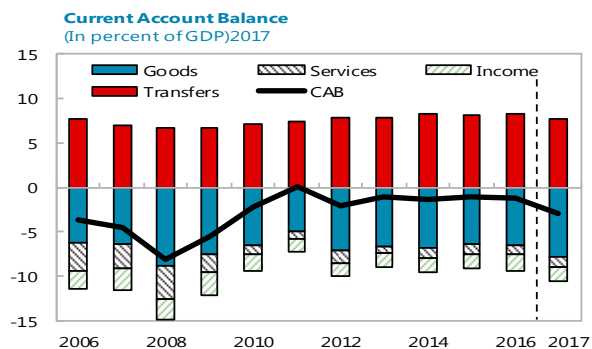




### Box 2. Pakistan: External Sector Assessment

The **current account deficit**, having declined from a peak of 8 percent of GDP in FY 2008 to about 1 percent of GDP in recent years, has begun to widen and could reach 3 percent of GDP this year. The fast pace of the recent increase, the structure of the deficit—a large trade deficit (6½ percent of GDP in FY 2016) covered by remittances (7 percent of GDP)—and losses in international reserves during FY 2017 highlight the importance of strengthening Pakistan’s export competitiveness.

The **financial account** balance has hovered around US\$5–5½ billion over 2014–16, helping to finance the current account balance and to accumulate reserves. However, the structure of the financial account shows reliance on debt issuance rather than on FDI flows, which have been on a declining trend over the last decade. The net International Investment Position (IIP) has been relatively stable, if slightly declining in the last years. With increasing CPEC project implementation, there will likely be a pick-up in FDI, portfolio and other investment over the medium term.



Sources: SBP; and IMF staff calculations.

The **external position** is moderately weaker than suggested by fundamentals and desirable policies. Estimates from standard methodologies for the assessment of the external position are subject to significant model uncertainty. The current account gap is estimated at between –1 and –1.8 percent of GDP based on the Fund-wide EBA exercise (Text Table).<sup>1</sup> This suggests an overvaluation in the 10–18 percent range. At the same time, the REER-based EBA-lite method, explicitly accounting for factors such as remittances and aid flows, suggests a slightly larger overvaluation of about 20 percent. The real effective exchange rate gap is therefore estimated to be in the 10 to 20 percent range. Greater exchange rate flexibility, fiscal adjustment, and structural reforms would help narrow the gap. The authorities indicated that their assessment suggests a significantly lower degree of overvaluation.

**Gross reserves** have remained below the adequacy level as suggested by the ARA metric (73 percent in December 2016) and have declined since completion of the EFF-supported program last year. Resumption of accumulation of reserves—including through allowing downward exchange rate flexibility—is needed to further strengthen buffers while also supporting competitiveness.

Pakistan: EBA - Results of the CA Model, 2016			
	EBA results	Adjustment (Reserves at 100 percent of ARA EM metric)	Staff assessment
2016 CA (cyclically adjusted)	-1.7%	-1.7%	
CA norm	-0.8%	0.0%	
CA gap	-1.0%	-1.8%	-1% to -1.8% (midpoint -1.4%)
REER gap	10%	18%	10% - 18% (midpoint 14%)

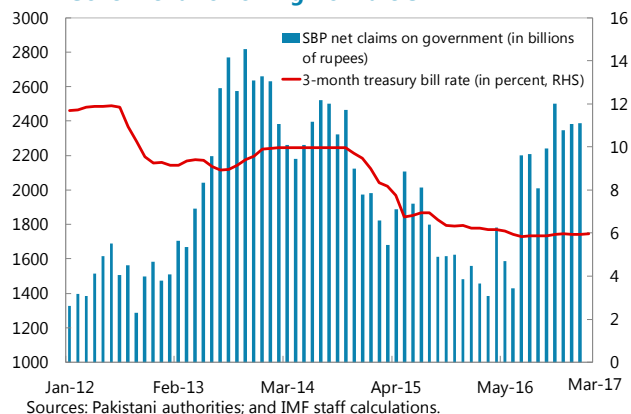
<sup>1</sup> EBA results (as of late March 2017) point to a current account gap of -1 percent of GDP. Adjusting the norm to reflect desirable reserve accumulation to 100 percent of the ARA EM metric yields a current account gap of 1.8 percent of GDP.



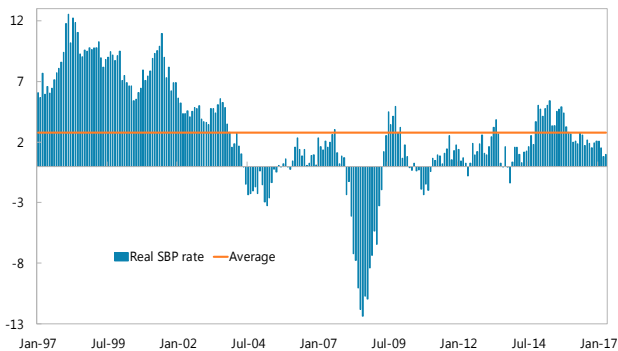
15. **Staff underscored that more prominence should be given to exchange rate flexibility, rather than administrative measures, to address external imbalances.** The authorities introduced cash margin requirements (100 percent) on nonessential consumer goods imports in February 2017 to contain the widening current account deficit. The cash margin deposits are not remunerated and constitute an exchange restriction and multiple currency practice subject to Fund jurisdiction under Article VIII Sections 2(a) and 3. Staff argued that allowing for greater downward exchange rate flexibility would be preferable to administrative measures and more effective as means to strengthen Pakistan's external position. The authorities expressed their commitment to remove such restrictions within one year and their expectation that recent policy initiatives to support exports, including sales tax zero rating for export industries and duty drawbacks, would sufficiently improve the current account imbalance in the interim.

16. **Staff advised for prudence in monetary policy and recommended to unwind the temporary surge in government borrowing from the SBP.** The monetary policy stance has been appropriately accommodative, with inflation below the SBP's target and the real policy rate below the historical average. In view of a shifting balance of risks, the SBP needs to remain vigilant and be prepared to tighten in case inflationary pressures build up or foreign exchange market pressures intensify. During the first quarter of FY 2016/17, the government resorted to increased SBP borrowing to settle large one-off Pakistan Investment Bond (PIB) maturities. Staff stressed that gradually reducing the stock of government borrowing from the SBP would be important to support the independence and credibility of monetary policy. The authorities indicated their commitment to reduce the stock and underscored that the surge in government financing earlier in the year was due to a one-off operation.

**Government Borrowing from the SBP**

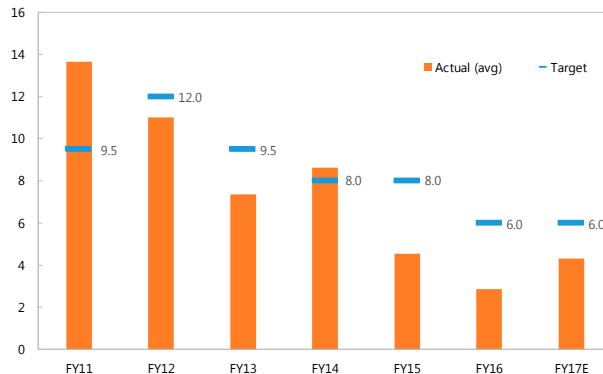


**Real SBP Target (Policy) Rate**  
(In percent)



Note: Deflated by year-on-year CPI inflation. Prior to Jun'2015, nominal policy rate equals SBP reverse repo rate minus 50 bps.

**Actual and SBP Target CPI Inflation**  
(In percent)



17. **Staff supported plans to move towards inflation targeting over the medium-term and stressed the need to put important pre-conditions in place.** Staff welcomed progress already made by the SBP, including strengthening the interest rate corridor, enhancing analytical and forecasting capabilities in support of the inflation targeting framework, and improving transparency and policy communication. Staff stressed that allowing greater exchange rate flexibility, strengthening reserve buffers, maintaining fiscal discipline, limiting government borrowing from the SBP and ensuring its full operational independence will be important pre-conditions that will need to be in place for effective inflation targeting.

18. **Staff welcomed renewed efforts towards further strengthening the SBP's autonomy.** In August 2016, the SBP developed a legislative action plan to address several remaining recommendations from the 2013 Safeguards Assessment. The proposed amendments to the SBP law represent good progress towards clarifying objectives, limiting scope for providing credit to the government, establishing an executive board, and enhancing financial autonomy. Staff welcomed the authorities' commitment to placing these amendments before parliament in FY 2017/18. Staff also called for addressing other remaining recommendations of the 2013 Safeguards Assessment in the areas of SBP's institutional autonomy, governance, and personal autonomy of board members. The authorities argued that, in their view, past and proposed amendments to the SBP law are sufficient to ensure the SBP's autonomy, which was significantly strengthened by the establishment of an independent Monetary Policy Committee without government representatives.

## B. Building Fiscal Buffers Through Gradual Consolidation

19. **Pakistan's fiscal space—the ability to use fiscal expansion without jeopardizing debt sustainability—is limited based on economic considerations and national fiscal rules.** Despite significant fiscal consolidation during the EFF-supported program, high debt levels and gross financing needs point to remaining vulnerabilities, and cautiously favorable medium-term debt dynamics in the baseline scenario are subject to adverse shocks to growth, the primary balance, and debt rollovers. An increase in external financing costs could also put a strain on international reserves. In addition, public debt and the fiscal deficit are projected to be above the ceilings set in the Fiscal Responsibility and Debt Limitation (FRDL) Act, placing a further constraint on the use of discretionary fiscal policy.<sup>3</sup>

20. **Despite resolve to improve revenue collection and maintain spending discipline, fiscal consolidation will likely be limited this fiscal year.** The revenue shortfall incurred earlier in the year is being mitigated by a correction in petroleum tax rates, strengthened tax administration efforts, and a recovery in non-tax revenue collection. Paired with continued public spending

<sup>3</sup> The FRDL Act as amended in 2016 imposes a limit on the federal government budget deficit (excluding foreign grants) of 4 percent of GDP for FY 2017/18-FY 2019/20, and 3.5 percent of GDP thereafter, and a limit of 60 percent of GDP on the general government debt (excluding guarantees) until FY 2017/18, and adopts a 15-year transition path toward 50 percent of GDP.

discipline, staff projected the overall fiscal deficit (excluding grants) at 4.5 percent of GDP, close to last year's outcome (4.6 percent of GDP) but above the budget deficit target (3.8 percent of GDP). The authorities expected the overall fiscal deficit (excluding grants) at 4.2 percent of GDP on the back of expectations of a stronger recovery in tax and non-tax revenue collection towards the end of the fiscal year.

21. **Fiscal consolidation efforts should be stepped up in FY 2017/18.** The draft budget targets the general government fiscal deficit (excluding grants) at 4.2 percent of GDP in FY 2017/18.<sup>4</sup> Staff recommended stronger consolidation in line with the new deficit objective under the FRDL Act.<sup>5</sup>

22. **The FY2017/18 budget is subject to significant risks.** The budget envisages marked increases in tax and non-tax revenue, a large expansion in development spending, and contained growth in current spending. The authorities expected the budget revenue target to be reached on the back of strong tax administration efforts. Staff advised that significant additional tax policy and administrative measures of around 1½ percent of GDP may be needed to achieve the FY 2017/18 revenue objective, especially if this fiscal year's revenue turns out lower than expected by the authorities and in line with staff's expectations. Staff highlighted that measures could include further reducing tax expenditures (estimated at 1.3 percent of GDP in FY 2016/17), gradually raising petroleum taxes, further strengthening the system of withholding taxes for non-filers, and improving provincial tax collection in agriculture, property, and services. These measures should be complemented by continued strong administrative efforts to improve tax compliance. Staff also argued that interest and other current spending could turn out higher than budgeted (by about ½ percent of GDP), that particular emphasis will be needed on ensuring the quality of development spending considering the planned scaling up, and that the targeted provincial surpluses (1 percent of GDP) could be subject to risks. Staff advised that the authorities should prepare contingency measures both on the revenue and spending sides, including a prioritization of development spending, in case revenue should fall short of the authorities' expectations. Staff also highlighted that a higher-than-budgeted deficit would exert additional pressures on the current account and reserves.

23. **Staff recommended sustained medium-term fiscal consolidation to ensure fiscal sustainability and rebuild buffers.**

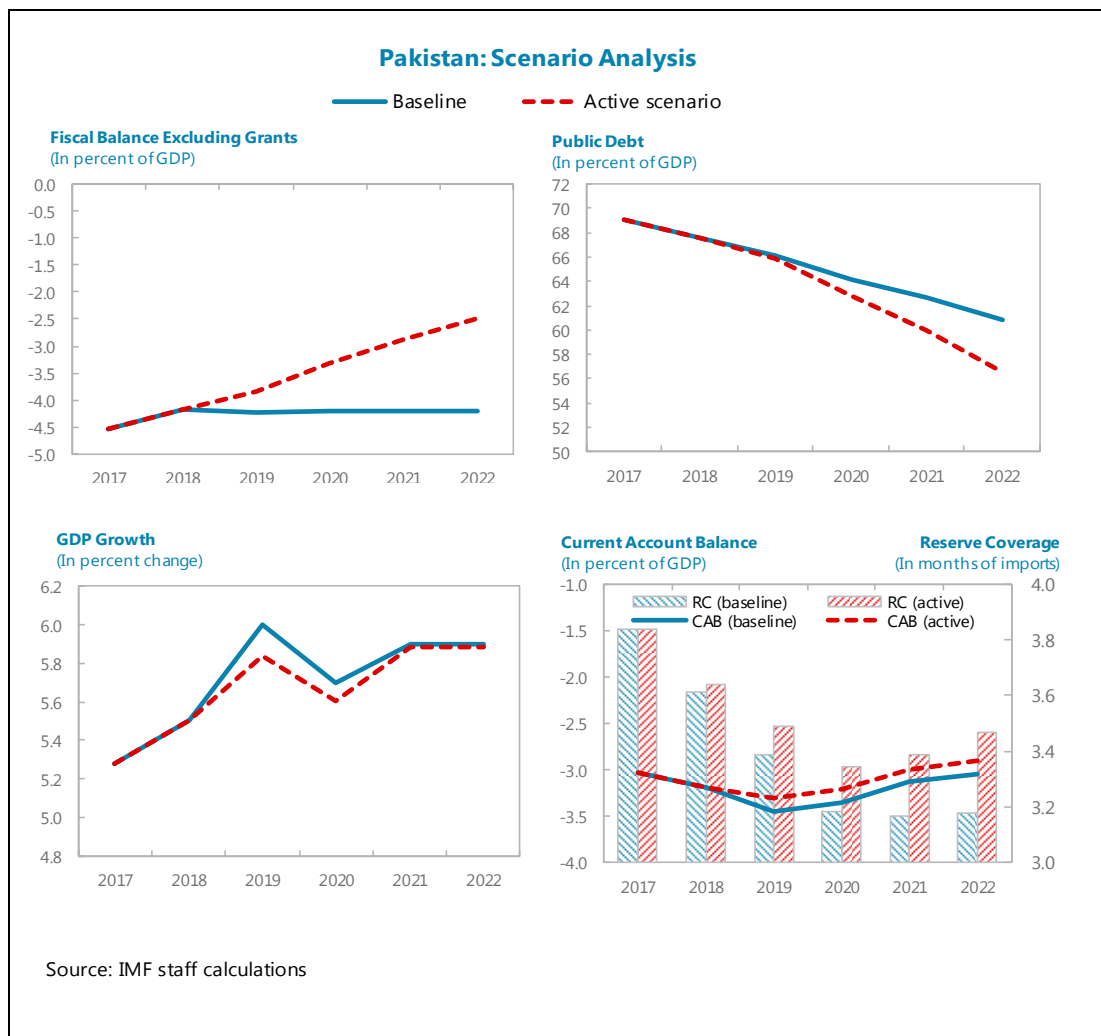
- Baseline projections on unchanged policies, with the fiscal deficit remaining at 4.2 percent of GDP over the medium term, imply a gradual decline in government and government-guaranteed debt to 61 percent of GDP in FY 2021/22 (58½ percent excluding guarantees). The federal budget deficit and public debt would remain above the limit specified in the FRDL Act

<sup>4</sup> The deficit is equivalent to 4.1 percent of GDP based on the authorities' GDP projections.

<sup>5</sup> The budget envisages a federal government deficit of 5.1 percent of GDP (1.1 percent of GDP above the limit specified in the FRDL Act) and provincial surpluses of 1 percent of GDP.

(Annex V). Pakistan's fiscal space would remain limited, with gross financing needs gradually declining to about 23 percent of GDP over the medium-term.

- Staff presented an active policy scenario based on further gradual fiscal consolidation over the medium term, which would allow to reduce fiscal imbalances and debt vulnerabilities. Driven by stronger revenue collection, the overall fiscal deficit (excluding grants) would gradually decline to 2½ percent of GDP and government and government guaranteed debt to around 57 percent of GDP over the medium term. Owing to fiscal consolidation, growth would be slightly lower than under the baseline scenario while the current account deficit would be reduced and reserves strengthened, helping to reduce external vulnerabilities. Stronger fiscal adjustment would also allow for less monetary tightening and additional room for private credit growth, and would support the SBP's operational independence. While the authorities agreed on the need for further fiscal consolidation, they argued that reducing the fiscal deficit to about 3½ percent of GDP over the medium term would be sufficient to reduce debt vulnerabilities while supporting higher growth.

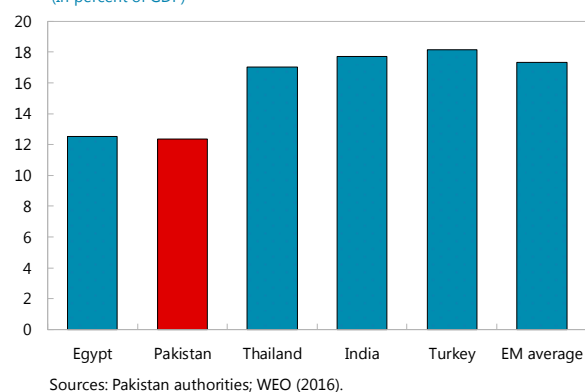


Pakistan: Baseline and Active Scenarios, 2017-2022 (In percent of GDP, unless otherwise indicated)												
	Baseline						Active scenario					
	2017	2018 <sup>1/</sup>	2019	2020	2021	2022	2017	2018 <sup>1/</sup>	2019	2020	2021	2022
Tax revenues 1/	12.8	14.0	14.1	14.2	14.2	14.2	12.8	14.0	14.1	14.5	14.9	15.3
Current Spending	16.3	15.7	15.8	15.9	15.9	15.9	16.3	15.7	15.6	15.5	15.5	15.4
Development spending	3.8	5.9	5.9	5.9	5.9	5.9	3.8	5.9	5.7	5.7	5.7	5.7
Fiscal balance excl. grants	-4.5	-4.2	-4.2	-4.2	-4.2	-4.2	-4.5	-4.2	-3.8	-3.3	-2.9	-2.5
Government and government guaranteed debt (incl. IMF)	69.1	67.6	66.1	64.1	62.6	60.9	69.1	67.6	65.8	62.8	59.9	56.6
GDP growth (percent)	5.3	5.5	6.0	5.7	5.9	5.9	5.3	5.5	5.8	5.6	5.9	5.9
Reserve assets (in months of Imports)	3.8	3.6	3.4	3.2	3.2	3.2	3.8	3.6	3.5	3.3	3.4	3.5
Current account balance	-3.0	-3.2	-3.4	-3.3	-3.1	-3.0	-3.0	-3.2	-3.3	-3.2	-3.0	-2.9

Notes: 1/ Based on the authorities' revenue projections.

24. **Revenue mobilization should be the main driver underpinning medium-term fiscal consolidation.** Pakistan's tax-to-GDP ratio has remained low by international comparison, and mobilizing additional tax revenues can support fiscal consolidation and generate resources to step up priority infrastructure and social spending. Staff stressed that options include further reducing tax concessions and exemptions, raising petroleum taxes and withholding taxes, and strengthening collection of provincial taxes on services, property, and agricultural income. Strengthening tax administration by improving the FBR's access to third-party information, enhancing tax audits, building a centralized electronic fiscal cadaster, and reducing the stock of outstanding tax refund claims will also be important. In this context, the financial transactions withholding tax for nonfilers has been helping to address tax evasion, and the FBR's new AML unit will also support efforts to combat tax evasion and recover their illicit proceeds.

**Tax Revenue - International Comparison**  
(In percent of GDP)



25. **These steps should be complemented by prudent spending plans.** Staff advised to strengthen the composition of spending by containing the wage bill growth and further rationalizing and strengthening the targeting of electricity subsidies to free resources to increase growth-supporting public investments and social expenditures.

26. **Staff stressed that strengthening the efficiency, flexibility, and responsiveness of the national fiscal federalism framework would support macroeconomic stability.**<sup>6</sup> The transfer of a significant share of federal tax revenues to the provinces—decided in 2009 with the 7th National Finance Commission Award—was not well-aligned with the devolution of expenditure

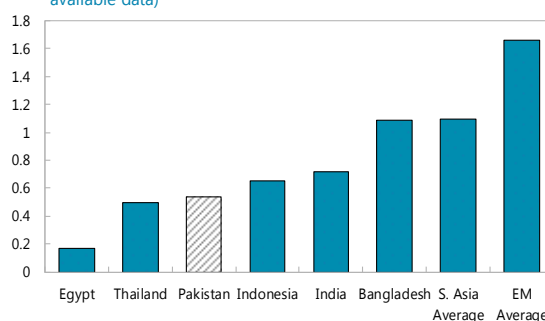
<sup>6</sup> See accompanying Selected Issues Paper "Fiscal Decentralization and Macroeconomic Challenges in Pakistan."

responsibilities. This resulted in an unbalanced fiscal position across different levels of government, reduced incentives to mobilize revenues, a fragmented fiscal system, and reduced overall efficiency of public expenditure. Staff advised both federal and provincial authorities to better align revenue and expenditure responsibilities consistent with the constitutional framework. Staff highlighted a number of policy options including: fully implementing expenditure responsibilities by provinces or establishing burden-sharing arrangements for joint tasks; establishing a fiscal council or similar body to set broad federal and provincial fiscal targets; setting up a jointly funded contingency fund for large unexpected shocks; instituting a national tax commission or coordination committee to facilitate vertical and horizontal coordination of tax policy and administration; strengthening public finance management frameworks; and increasing incentives to mobilize provincial tax revenues (Annex II). The authorities broadly agreed on the need for improvement, while noting that the range of politically feasible reforms may be limited and requires extensive consultations with the provinces.

27. **Strengthening public debt management will contribute to reducing fiscal and debt vulnerabilities.** Staff welcomed progress in strengthening the effectiveness of the Debt Policy Coordination Office by enhancing its staffing and improving debt management practices through the formulation of a debt and risk management strategy. The authorities' borrowing strategy focuses on remaining active in the international capital markets, mobilizing development partners' funding, and increasing mobilization from the domestic non-banking sector. Staff supported the authorities' intentions to gradually lengthen the maturity profile of domestic debt, minimize the exposure to interest rate risk, and reduce reliance on SBP financing and short-term borrowing.

28. **Staff pointed out that stepping up social safety nets is key to protect the most vulnerable from the impact of fiscal consolidation and alleviate poverty and inequality.** While public expenditures on social safety nets have increased almost threefold since 2008, they remain low at 0.54 percent of GDP (federal outlays) in international comparison (Annex III).<sup>7</sup> Since the Benazir Income Support Program (BISP) effectively contributed to reduce poverty among beneficiaries, staff advised to step up social safety nets by broadening BISP coverage and increasing the size and timeliness of educational transfers.<sup>8</sup> Staff welcomed progress to broaden the BISP coverage of unconditional cash transfers to 5.45 million beneficiaries at end-March 2017, the increase in stipends in line with inflation, new implementation contracts to ensure the timely

**Pakistan: Social safety nets are relatively small**  
(expenditures on social safety nets; in percent of GDP, latest available data)



Sources: Pakistan Authorities; IMF staff calculations; World Bank ASPIRE Database (2016)

<sup>7</sup> This refers to federal non-contributory social assistance programs. In addition, social assistance programs on a smaller scale are present at the provincial level; and private philanthropic initiatives to reduce poverty and foster development are sizable (1.1 percent of GDP).

<sup>8</sup> See accompanying Selected Issues Paper on "Poverty, Inequality and Social Safety Nets in Pakistan."

delivery of educational cash transfers, and the finalization of the pilot phase of the new national survey, with the roll-out expected to be completed by March 2018. Furthermore, staff supported the planned national roll-out of the new biometric payment system to reduce the possibility of fraud and strengthen the program's efficiency.

### C. Continuing to Strengthen the Financial Sector

29. **Advancing financial sector reforms is key to strengthen the sector's resilience.** Staff welcomed the authorities' commitment to bring the two small undercapitalized banks into regulatory compliance by June 2017. One bank is in the process of raising Tier-2 capital and the other (publicly owned) bank is in the divestment process. Furthermore, swiftly finalizing the operationalization of the Deposit Protection Corporation will strengthen the banking sector. Staff welcomed progress in strengthening the regulatory framework, including the ongoing phased implementation of Basel III liquidity (LCR and NSFR) and capital standards, to be finalized by end-2017 and end-2019, respectively. Addressing NPLs remains a priority and moving ahead with enactment of the Corporate Rehabilitation Act would strengthen the bankruptcy framework. Staff noted that NPLs could increase as private credit growth rises, and ensuring effective implementation of the regulatory and supervisory framework will help reduce the risk of a sharp increase. Finally, staff underscored that the newly planned infrastructure entities, including the Pakistan Investment Bank, the Pakistan Development Fund, and the PPP Authority, should be underpinned by a strong governance structure and finance only financially viable projects to avoid contingent liabilities for the government. With respect to the PPP Authority, staff stressed the importance of ensuring a gatekeeper role for the Ministry of Finance and strong secondary legislation, in line with international best practices.

30. **Staff welcomed efforts to strengthen the AML/CFT framework in line with international standards and ensuring its effective implementation, which should be continued.** The FBR created a new investigative AML unit following the designation of tax crimes as predicate offenses to money laundering, and the Financial Monitoring Unit (FMU) established an integrated data center to enhance its analysis and dissemination of financial intelligence. Ensuring the effective supervision of reporting requirements, strengthening the exchange of financial intelligence with the FMU, and enhancing the capacities of law enforcement agencies (including FBR's new AML unit) to conduct financial investigations would support detecting and investigating proceeds of tax crimes and corruption. Staff welcomed the finalization of the national risk assessment and progress in addressing ML/TF risks, and recommended to continue ensuring the effective implementation of the UNSCR resolutions to counter terrorism financing. The authorities indicated that, in line with the findings of the OECD 2016 report,<sup>9</sup> they are also committed to ensuring entity transparency and timely exchange of information on tax matters, and to addressing remaining shortcomings, such as ensuring availability of ownership information, and limiting delays in responding to requests for information.

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<sup>9</sup> OECD Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Pakistan (2016).



## STRENGTHENING MEDIUM-TERM GROWTH AND MAKING IT MORE INCLUSIVE

*Higher and more inclusive growth will be needed over the medium term to foster sustained job creation and reduce poverty and inequality. Priority reform areas include ensuring a financially sound and growth-supporting energy sector, restructuring and attracting private sector participation in PSEs to reduce financial losses, improving the business climate and governance, and fostering financial inclusion.*

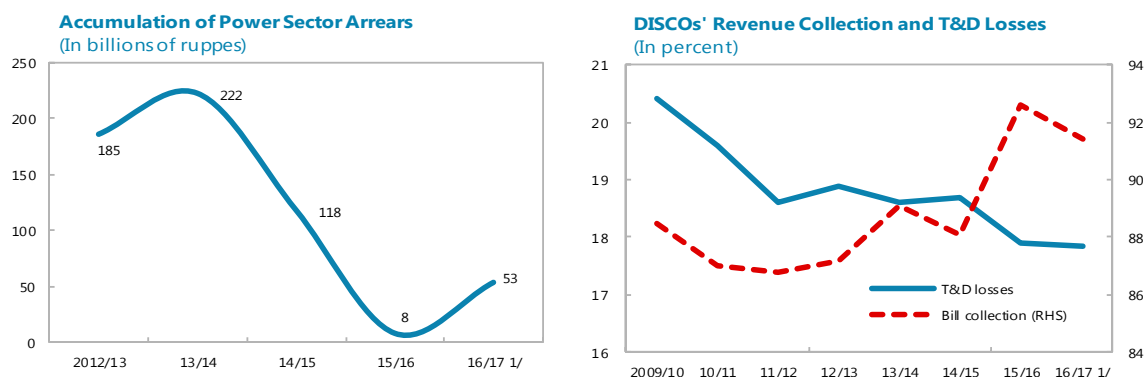
### Energy sector and public enterprise reforms

31. **Power sector reforms in recent years have been focusing on increasing generation capacity and bringing the distribution sector closer to cost recovery.** Faced with significant load-shedding a few years ago—due to insufficient generation capacity and large intercompany arrears (so-called circular debt) in the power sector—the government embarked on a number of projects (including in the context of CPEC) to more than double the country’s generation capacity over the next seven years. The government also addressed the new accumulation of arrears, which was brought to nearly zero by FY 2015/16 through sustained reform efforts and with the help of favorable oil prices (although the stock of accumulated arrears remains to be addressed).

32. **Staff called for swiftly addressing the resumption in the accumulation of arrears to ensure a financially viable and growth-supporting power sector.** Accumulation of power sector arrears resumed in the first half of FY 2016/17 (PRs 53 billion), with the stock increasing to PRs 374 billion (about 1.2 percent of GDP).<sup>10</sup> This reflected a widening of the system’s operational deficit due to delays in passing through to end-consumers higher generation tariffs and weaker bill collection by distribution companies (DISCOs), only in part compensated by the positive impact of a reduction in DISCOs’ distribution losses and still low oil prices. Staff stressed the need to strengthen DISCOs’ performance and adjust end-consumer tariffs to reflect higher input costs, also in view of upcoming increases in generation capacity. In this regard, staff welcomed the introduction of a daily monitoring system for DISCOs which will contribute to closely follow their operations. While most DISCOs met their end-December 2016 targets in terms of collection, about half met their targets in terms of distribution losses. Furthermore, moving ahead with the planned IPOs of DISCOs is key to strengthen corporate governance and mobilize proceeds to start reducing the stock of outstanding arrears. Staff stressed that ensuring transparency and managing risks associated with new power generation projects will be key. The authorities agreed with staff’s assessment, re-iterated their commitment to contain the accumulation of new arrears, and noted that the recent arrears build-up was due to a one-off delay in passing through higher generation tariffs.

<sup>10</sup> The overall stock of debt held in PHCL remained constant at PRs 335 billion (1.1 percent of GDP).





Sources: Pakistani authorities; and IMF staff calculations.  
1/ FY 2016/17 data refers to the first two quarters.

33. **Ensuring the power sector's operational and financial soundness and supporting investor confidence require maintenance of a strong regulatory framework.** Staff underscored that preserving NEPRA's independence and maintaining an appropriate tariff-setting process will be important in the context of planned amendments of the NEPRA Act. In parallel, swiftly resolving the ongoing litigation with the regulator on DISCOs' benchmark distribution losses and recoveries is necessary to resume regular tariff setting. In addition, moving forward with establishing a multi-year tariff framework is key to strengthen the regulatory framework, attract private sector investors, and support the planned IPOs of DISCOs.

34. **Gas sector reforms should focus on increasing supply, strengthening the sector's performance and maintaining its financial viability.** Staff supported the authorities' plans to step up LNG imports and foster domestic production to further reduce gas shortages. A new transmission pipeline was completed at end-2016 and the construction of a second LNG import terminal is expected to be finalized by August 2017. The authorities increased producer prices for non-conventional gas in December 2016 to foster domestic production. Staff stressed that resuming regular semi-annual gas tariff notification, ensuring cost-recovery tariffs, and maintaining full pass-through of LNG import prices to consumers are important to preserve the sector's financial viability. Despite further declining to 10.8 percent (y-o-y) at end-2016, gas system losses remain high by international standards. Staff welcomed the authorities' commitment to tackle losses by implementing recent legislation to curb gas theft, modernizing the network and introducing advanced technology for metering and identification of gas leakages. Staff welcomed advancements in the gas sector market reform, with the introduction of third party access and progress in separating licensing of gas transmission and distribution.

35. **Staff stressed that restructuring PSEs and attracting private sector participation are needed to improve efficiency, reduce financial losses and contain fiscal costs.** Despite some improvements, PSEs' annual financial losses remain high at about 0.3 percent of GDP, with accumulated losses at 3.8 percent of GDP.<sup>11</sup> In the near-term, it would be important to finalize the transaction structure for PIA's minority sale and for attracting private sector participation in PSM,

<sup>11</sup> These estimates include financial losses of PIA, PSM, Pakistan Railways and publicly-owned DISCOs.

move ahead with the IPO for GEPCO and set a timeline for other DISCOs' IPOs, finalize KAPCO's divestment, advance with the Pakistan Railways restructuring plan, and finalize ongoing capital market transactions. Continuing to produce and publish the annual report on PSEs' financial performance is important to strengthen monitoring and transparency. Over the medium term, a new comprehensive strategy to eliminate PSEs' losses and ensure private sector participation will be needed. The authorities indicated their continued intention to pursue restructuring and attract private sector participation to contain PSEs' financial losses.

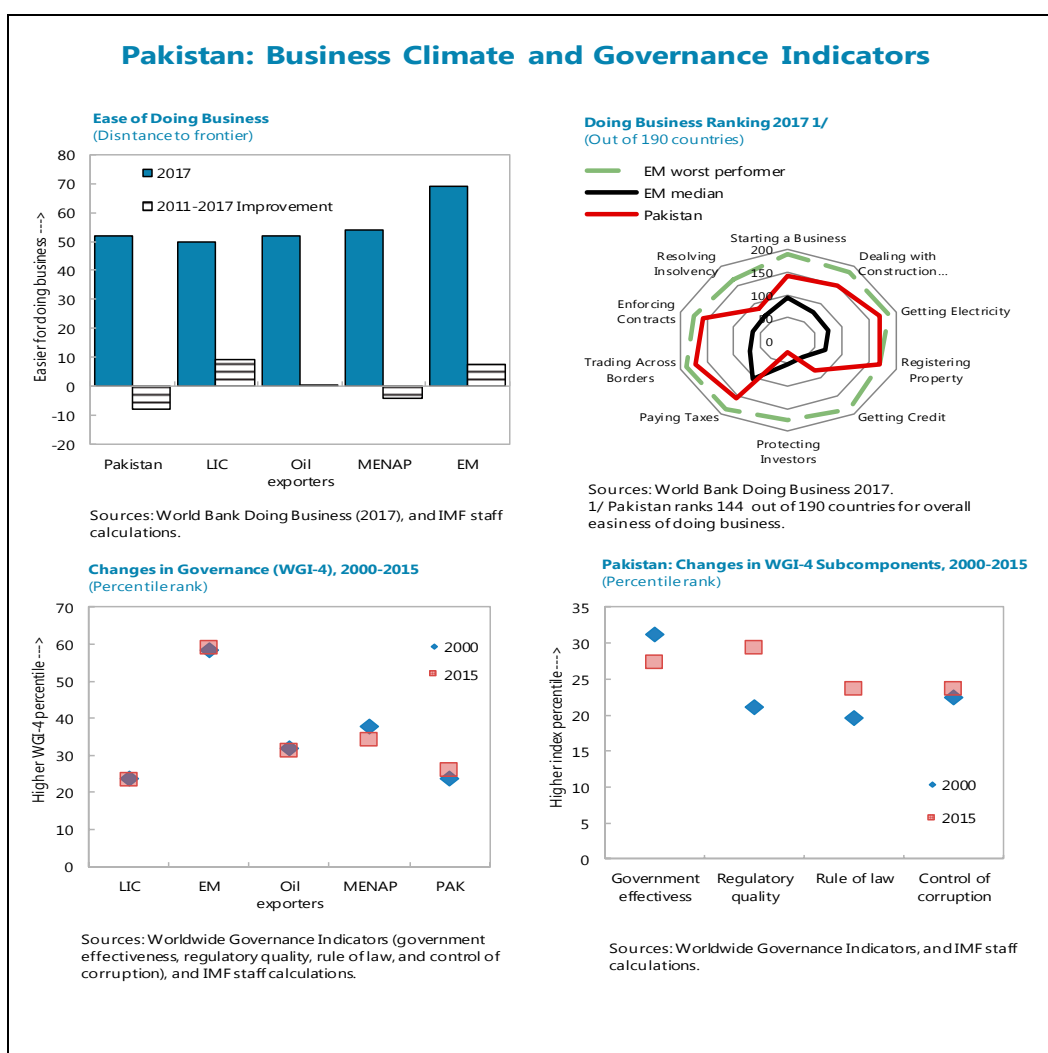
### **Strengthening the business climate, governance and financial inclusion**

36. **Efforts to improve the business climate have begun to bear fruit.** Pakistan was among the top 10 reformers in the World Bank Doing Business Indicators 2017 and its ranking improved to 144 from 148 (out of 190 countries). Main progress included the digitalization of land records in Punjab, the enactment of the Secured Transactions Law, the expansion of the electronic platform for trade (WeBOC) and the electronic data exchange with China and Afghanistan.

37. **Continued reform efforts will be important to foster growth-supporting private investment and strengthen exports.** Continuing to move ahead with the 2016 business climate strategy is key to realize the large potential for further improvement and support private sector development. To this end, it will be important to ensure coordination between federal and provincial governments, systematic monitoring of reform advancements, and outreach to the private sector. Staff and the authorities concurred that key measures ahead should include: introducing e-payment for taxes, customs and property registration; adopting the virtual one-stop shop (VOSS) at the provincial level; finalizing the digitalization of land records; further broadening the use of WeBOC; setting up a single window platform for trade and a registry for secured transactions; and expanding commercial Alternative Dispute Resolution mechanisms. In addition, measures to broaden the tax base and energy sector reforms would help level the playing field, promote competition, and reduce costs. In parallel, in light of significant unemployment, especially among youth and women, continued efforts to ease rigidities in the formal labor market, facilitate job supply and demand matching (including the ongoing development of an online job portal), encourage employment of women, and foster workers' mobility are needed to support private sector job creation.

38. **Staff highlighted that improving governance is also needed to foster the development of the private sector.** Pakistan has made steady progress in the Transparency International ranking, moving from 143 to 116 in the last five years. Despite progress, the country ranks below emerging market averages in the World Bank Governance Indicators. Staff stressed that efforts to improve governance need to continue and could have important payoffs in terms of promoting greater business confidence and leveling the playing field. In this context, strengthening the capacities of anti-corruption institutions, enhancing the asset declaration system (including mechanisms for verification and public access), and ensuring the effective use of AML tools (such as enhanced due diligence for high-risk customers) would contribute to reduce corruption and strengthen governance. Staff welcomed Pakistan's membership to the Open Government Partnership and the development of an action plan to enhance transparency and accountability.

39. **Staff and the authorities concurred that fostering financial sector deepening and inclusion would support higher and more inclusive growth.** Empirical findings suggest that raising the level of development of Pakistani financial institutions to emerging markets' average could yield annual economic growth gain of about 1 percent.<sup>12</sup> The implementation of the National Financial Inclusion Strategy 2016–20 is ongoing and staff noted substantial progress towards strengthening financial infrastructure and regulatory framework, including for Islamic finance. Increasing access points, building capacity of banks to provide easy and need-based funding products to small and micro businesses, and raising financial awareness and literacy will be important to foster financial sector deepening. Furthermore, facilitating access to credit for women, youth, low income and rural population, and SMEs would be key to strengthen financial inclusion (Annex IV).



<sup>12</sup> See accompanying Selected Issues Paper: "Supporting Growth and Inclusion Through Financial Development."

## STAFF APPRAISAL

40. **Pakistan's growth outlook is favorable.** Having made substantial strides in restoring macroeconomic stability and having set in motion structural reforms during the 2013–16 EFF-supported program, the outlook for near- and medium-term economic growth is favorable. This positive outlook is also supported by large energy and infrastructure investments, including in the context of CPEC, and favorable global developments.
41. **Policy efforts need to be re-invigorated to realize this outlook.** The favorable growth outlook is subject to significant risks if macroeconomic resilience is eroded. Since completion of the EFF-supported program, there has been progress in implementing staff's policy recommendations but policy implementation has weakened and economic vulnerabilities have begun to re-emerge: foreign exchange reserves have declined as the current account deficit has widened, the pace of fiscal consolidation has slowed, and arrears in the power sector have started to accumulate again. Over the medium-term, if policies remain unchanged, the fiscal deficit would remain substantial, and external payment obligations from CPEC-related investments would lead to a reduction in foreign reserves coverage, underscoring the need to foster a strong and sustained pick-up in exports.
42. **Macroeconomic policies should focus on bolstering external buffers and improving trade competitiveness.** With Pakistan's external position being moderately weaker than suggested by fundamentals, allowing for greater exchange rate flexibility, fiscal adjustment, and structural reforms would facilitate the building of external buffers and strengthen competitiveness. Exchange rate flexibility would also be preferable to administrative measures, such as the recently introduced cash margin requirement on imports, in addressing external imbalances. The authorities' intention to remove this measure within one year is welcome, and staff supports the authorities' request for approval of retention of the exchange restriction and multiple currency practice given that the measure has been adopted for balance of payments reasons and is temporary and non-discriminatory.
43. **Monetary policy needs to be prudent to preserve low inflation.** Monetary policy has been appropriately accommodative, and the SBP needs to remain vigilant and prepared to tighten in case inflationary or foreign exchange market pressures build up. Planned new legislation to strengthen the SBP's autonomy is welcome, and additional steps should be taken to address remaining recommendations of the 2013 Safeguards Assessment in the areas of the SBP's institutional autonomy, governance, and personal autonomy of Board members. Gradually reducing the stock of government borrowing from the SBP will also support the independence and credibility of monetary policy. Moving to inflation targeting over the medium term is welcome once key preconditions are in place, including greater exchange rate flexibility, stronger reserves buffers, full operational autonomy of the SBP, and reduced fiscal imbalances.

44. **With limited fiscal space and a favorable growth outlook, fiscal policy efforts should focus on consolidation.** A stronger consolidation in FY 2017/18 than planned in the budget, in line with the deficit target under the revised FRDL Act, would have been preferable. That said, reaching the FY 2017/18 budget target will likely require significant additional revenue measures. Gradual fiscal consolidation should continue through the medium term in line with the FRDL Act, addressing debt-related vulnerabilities and reducing pressures on the current account deficit and reserves.

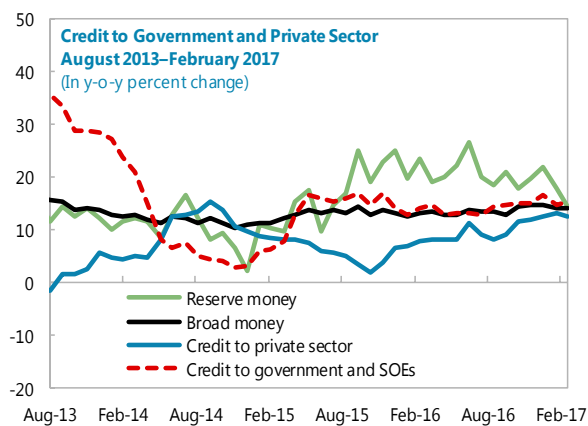
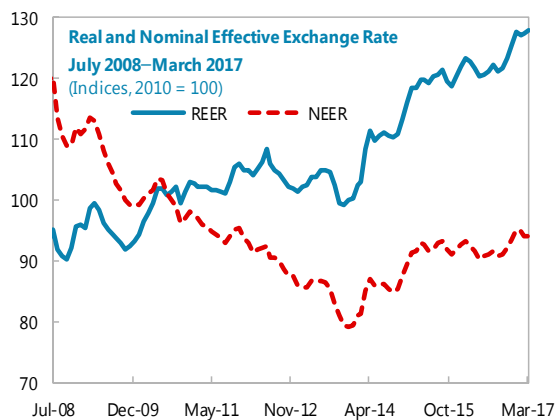
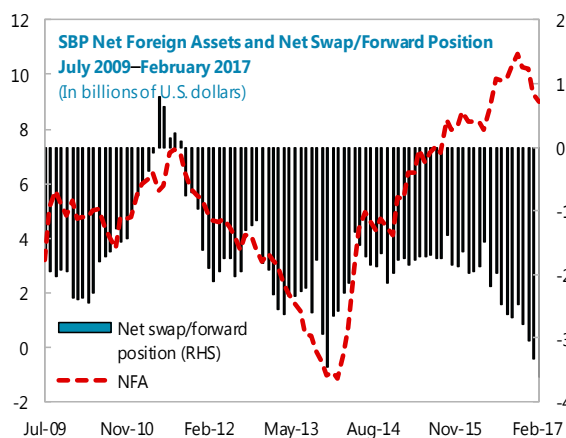
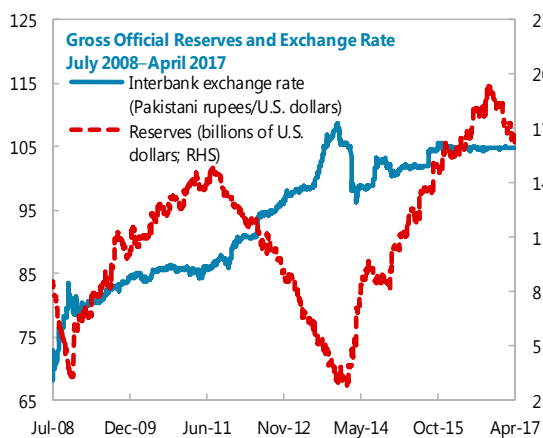
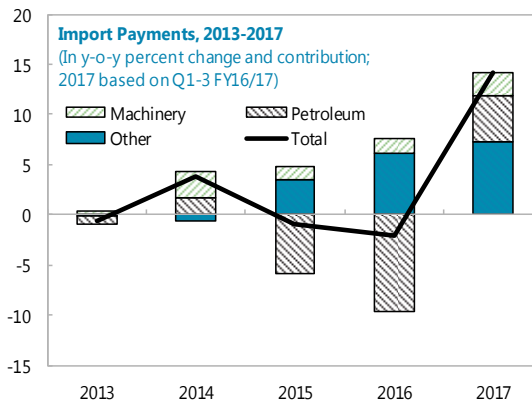
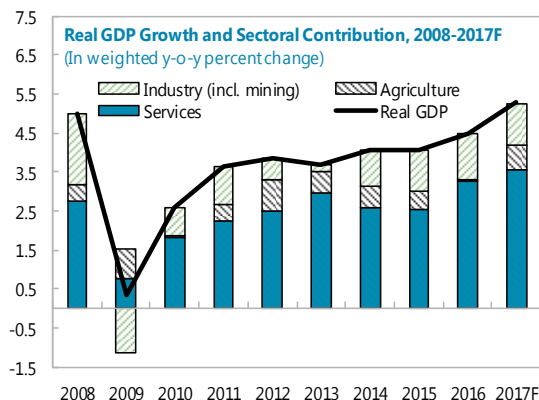
45. **Fostering revenue mobilization and strengthening the composition of public spending should be core elements in the medium-term fiscal consolidation strategy.** In view of Pakistan's still low tax-to-GDP ratio, mobilizing additional tax revenues by broadening the tax base and strengthening tax administration would be key to support fiscal consolidation and generate resources to step up priority spending. In parallel, containing the growth of the wage bill and further rationalizing electricity subsidies would free resources to increase growth-supporting public investment and priority social spending. Strengthening social safety nets will be important to protect the most vulnerable from the impact of fiscal consolidation and alleviate poverty and inequality. In parallel, strengthening the efficiency, flexibility, and responsiveness of the national fiscal federalism framework will be needed to support macroeconomic stability. Further strengthening public debt management would also contribute to reducing debt-related vulnerabilities.

46. **Advancing financial sector reforms is key to further strengthen the sector's resilience.** While the banking sector has remained sound, it will be important to see efforts through to bring all banks into regulatory compliance. Making the planned Deposit Protection Corporation operational will further support the stability of the banking sector. The planned infrastructure finance entities should be underpinned by strong governance with focus on financing only financially viable projects to avoid contingent liabilities. Efforts to strengthen the AML/CFT framework in line with international standards and ensuring its effective implementation should continue.

47. **Further progress on the structural reform agenda will be important to support higher and more inclusive growth, job creation, and further reduction of poverty and inequality.** Swiftly addressing the renewed build-up in circular debt and maintaining a strong regulatory framework are needed to ensure a financially sound and growth-supporting energy sector, especially in a context of a significant expansion in generation capacity. Restructuring and attracting private sector participation in ailing PSEs will be key to improve efficiency, reduce financial losses and related fiscal costs and vulnerabilities. Building on recent progress, implementation of further planned steps in strengthening the business climate and governance will be important to support private investment and job creation, and efforts to foster financial deepening and inclusion should also continue.

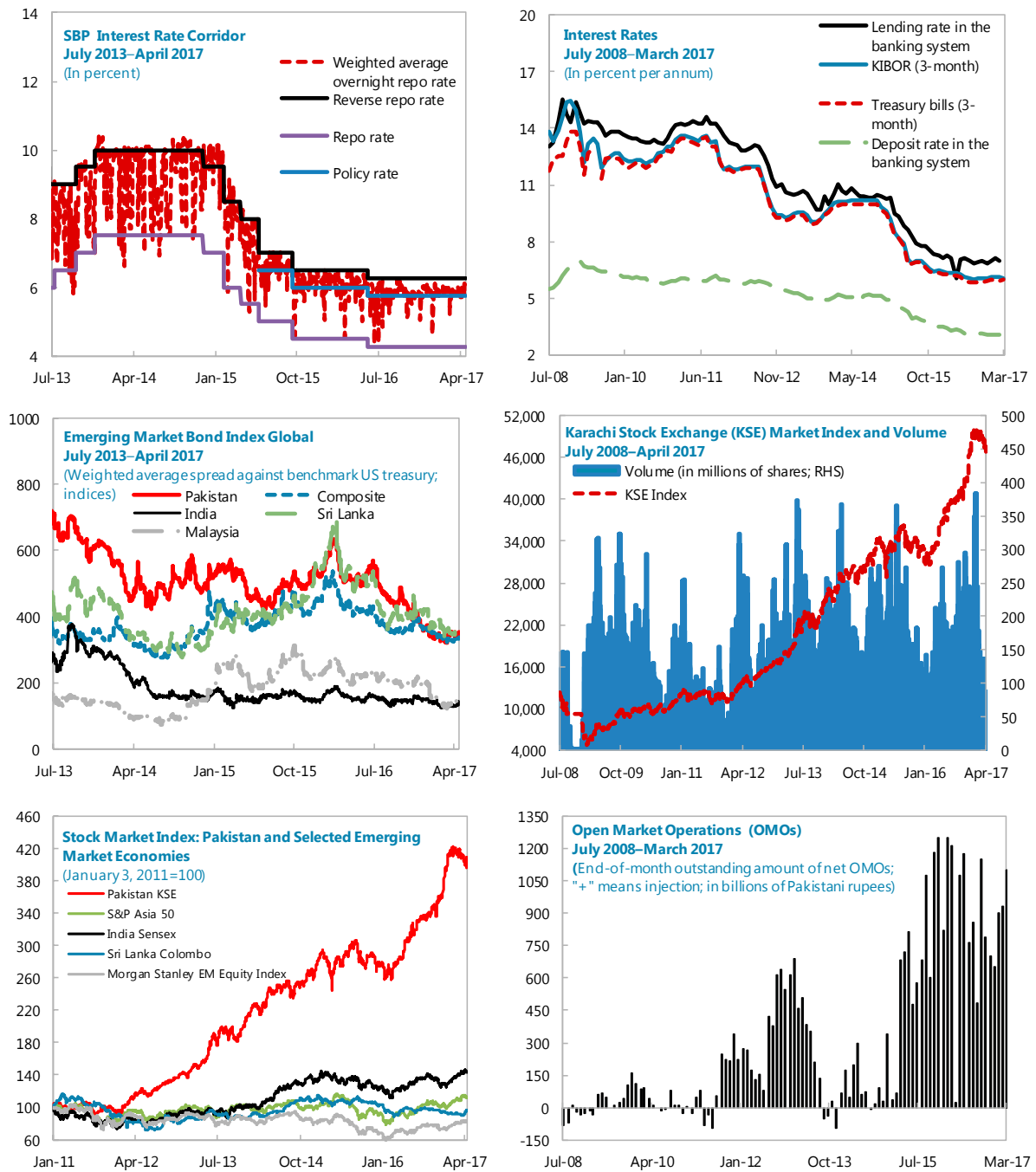
48. **Staff recommends that the next Article IV Consultation take place on the standard 12-month cycle.**

**Figure 1. Pakistan: Selected Economic Indicators, 2008–17**



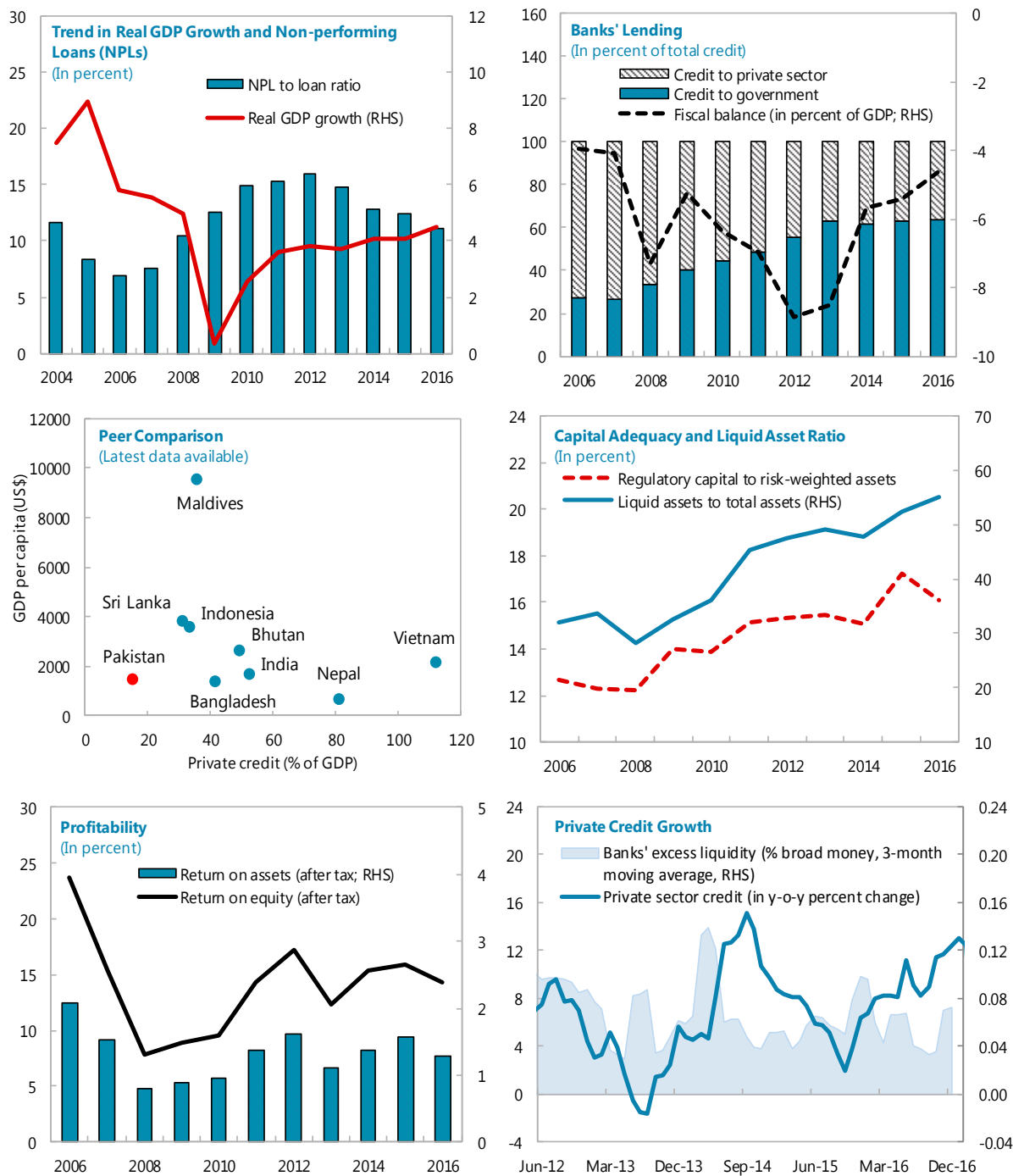
Sources: Pakistani authorities; IMF World Economic Outlook Database; and IMF staff calculations.

**Figure 2. Pakistan: Selected Financial Indicators, 2008–17**



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

**Figure 3. Pakistan: Selected Banking and Financial Indicators**



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



**Table 1. Pakistan: Selected Economic Indicators, 2012/13–2017/18 1/**

Population: 195.4 million (2015/16)  
 Per capita GDP: US\$1,454 (2015/16)  
 Poverty rate: 29.5 percent (2012/13)  
 Main exports: Textiles (\$12.8 billion, 2015/16)  
 Unemployment: 5.9 percent (2014/15)

	2012/13	2013/14	2014/15	2015/16	2016/17 Proj.	2017/18 Proj.
(Annual percentage change)						
<b>Output and prices</b>						
Real GDP at factor cost	3.7	4.1	4.1	4.5	5.3	5.5
GDP deflator at factor cost	7.1	7.4	4.3	0.6	3.5	5.0
Consumer prices (period average)	7.4	8.6	4.5	2.9	4.3	5.0
Consumer prices (end of period)	5.9	8.2	3.2	3.2	5.3	5.0
Pakistani rupees per U.S. dollar (period average)	8.4	6.4	-1.5	2.7	...	...
(In percent of GDP)						
<b>Saving and investment</b>						
Gross saving	13.9	13.4	14.7	14.3	12.7	15.3
Government	-5.1	-1.4	-1.6	-0.7	-0.5	2.0
Nongovernment (including public sector enterprises)	19.0	14.7	16.3	15.0	13.2	13.3
Gross capital formation 2/	15.0	14.6	15.7	15.6	15.8	18.5
Government	3.2	3.5	3.7	3.7	3.9	6.0
Nongovernment (including public sector enterprises)	11.7	11.1	12.0	11.8	11.9	12.5
<b>Public finances</b>						
Revenue and grants	13.5	15.2	14.5	15.5	15.8	17.6
Expenditure (including statistical discrepancy)	21.9	19.8	19.1	19.2	20.2	21.6
Budget balance (including grants)	-8.4	-4.9	-5.3	-4.4	-4.3	-4.0
Budget balance (excluding grants)	-8.5	-5.7	-5.4	-4.6	-4.5	-4.2
Primary balance	-3.9	-0.3	-0.5	-0.1	-0.1	-0.1
General government debt incl. IMF obligations	63.9	63.5	63.3	67.6	66.6	65.1
External general government debt	21.1	20.2	18.9	20.8	21.3	21.5
Domestic general government debt	42.8	43.3	44.4	46.8	45.4	43.6
(Annual changes in percent of initial stock of broad money, unless otherwise indicated)						
<b>Monetary sector</b>						
Net foreign assets	-3.4	3.7	2.1	1.7	0.1	0.4
Net domestic assets	19.3	8.8	11.1	11.9	13.3	11.4
Broad money (percent change)	15.9	12.5	13.2	13.7	13.4	11.8
Reserve money (percent change)	15.8	12.9	9.8	26.5	14.1	13.5
Private credit (percent change)	-0.6	12.5	5.9	11.1	13.0	13.5
Six-month treasury bill rate (period average, in percent)	9.8	9.7	8.8	6.3	...	...
<b>External sector</b>						
Merchandise exports, U.S. dollars (percentage change)	0.4	1.1	-3.9	-8.8	-0.8	9.4
Merchandise imports, U.S. dollars (percentage change)	-0.6	3.8	-1.0	-2.0	12.6	6.6
Current account balance (in percent of GDP)	-1.1	-1.3	-1.0	-1.2	-3.0	-3.2
(In percent of exports of goods and services, unless otherwise indicated)						
<b>External public and publicly guaranteed debt</b>						
Debt service	140.7	161.2	159.8	193.3	209.7	210.0
	21.6	26.2	20.7	22.9	29.2	21.4
Gross reserves (in millions of U.S. dollars) 3/	6,008	9,096	13,534	18,143	18,518	18,883
In months of next year's imports of goods and services	1.5	2.2	3.3	4.0	3.8	3.6
<b>Memorandum items:</b>						
Underlying fiscal balance (excl. grants; percent of GDP) 4/	...	...	...	...	-4.8	-4.2
General government and government guaranteed debt (incl. IMF; % GDP)	66.7	65.7	65.7	70.0	69.1	67.6
Net general government debt (incl. IMF; % GDP)	60.1	58.0	58.2	61.2	60.3	58.9
Real effective exchange rate (annual average, percentage change)	-1.3	0.9	10.9	4.6	...	...
Terms of trade (percentage change)	-1.9	0.2	7.0	10.7	-0.9	-0.9
Real per capita GDP (percentage change)	2.1	2.6	2.0	2.5	3.3	3.5
GDP at market prices (in billions of Pakistani rupees)	22,386	25,169	27,443	29,103	31,862	35,390
GDP at market prices (in billions of U.S. dollars)	231.2	244.4	270.6	279.4	...	...

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

1/ Fiscal year ends June 30.

2/ Including changes in inventories.

3/ Excluding gold and foreign currency deposits of commercial banks held with the State Bank of Pakistan.

4/ Excludes one-off transactions, including asset sales.

**Table 2. Pakistan: Medium-Term Macroeconomic Framework, 2012/13–2021/22**

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Projections									
(Annual percentage change)										
Output and prices										
Real GDP at factor cost	3.7	4.1	4.1	4.5	5.3	5.5	6.0	5.7	5.9	5.9
Consumer prices (period average)	7.4	8.6	4.5	2.9	4.3	5.0	5.0	5.0	5.0	5.0
(In percent of GDP)										
Saving and investment balance	-1.1	-1.3	-1.0	-1.2	-3.0	-3.2	-3.4	-3.3	-3.1	-3.0
Government	-8.4	-4.9	-5.3	-4.4	-4.3	-4.0	-4.1	-4.1	-4.2	-4.1
Non-government (including public sector enterprises)	7.3	3.6	4.3	3.2	1.3	0.8	0.7	0.8	1.0	1.1
Gross national saving	13.9	13.4	14.7	14.3	12.7	15.3	15.4	15.9	16.4	16.8
Government	-5.1	-1.4	-1.6	-0.7	-0.5	2.0	1.8	1.8	1.8	1.8
Non-government (including public sector enterprises)	19.0	14.7	16.3	15.0	13.2	13.3	13.5	14.0	14.6	14.9
Gross capital formation	15.0	14.6	15.7	15.6	15.8	18.5	18.8	19.2	19.5	19.8
Government	3.2	3.5	3.7	3.7	3.9	6.0	6.0	6.0	6.0	6.0
Non-government (including public sector enterprises)	11.7	11.1	12.0	11.8	11.9	12.5	12.8	13.2	13.5	13.8
(In billions of U.S. dollars, unless otherwise indicated)										
Balance of payments										
Current account balance	-2.5	-3.1	-2.7	-3.4	-9.0	-10.1	-11.6	-12.2	-12.3	-13.0
Current account balance (in percent of GDP)	-1.1	-1.3	-1.0	-1.2	-3.0	-3.2	-3.4	-3.3	-3.1	-3.0
Net capital flows 1/	0.5	7.0	5.4	7.3	9.5	10.6	12.1	13.0	14.5	14.6
Of which: foreign direct investment 2/	1.3	1.6	0.9	1.9	2.1	2.5	3.6	4.4	5.2	5.5
Gross official reserves	6.0	9.1	13.5	18.1	18.5	18.9	18.9	18.9	19.9	20.4
In months of imports 3/	1.5	2.2	3.3	4.0	3.8	3.6	3.4	3.2	3.2	3.2
External debt (in percent of GDP)	26.3	26.8	24.1	26.1	26.7	27.6	28.1	27.6	27.5	26.8
Terms of trade (annual percentage change)	-1.9	0.2	7.0	10.7	-0.9	-0.9	-0.4	-0.7	-0.9	-1.0
Real effective exchange rate (annual percentage change)	-1.3	0.9	10.9	4.5	...	...	...	...	...	...
(In percent of GDP)										
Public finances										
Revenue and grants	13.5	15.2	14.5	15.5	15.8	17.6	17.6	17.7	17.7	17.7
Of which: tax revenue	10.0	10.5	11.0	12.6	12.8	14.0	14.1	14.2	14.2	14.2
Expenditure, of which:	21.8	20.1	19.8	19.9	20.2	21.6	21.7	21.8	21.8	21.8
Current	16.8	16.4	16.6	16.9	16.3	15.7	15.8	15.9	15.9	15.9
Development and net lending	5.0	4.0	3.8	3.8	3.8	5.9	5.9	5.9	5.9	5.9
Primary balance (including grants)	-3.9	-0.3	-0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
Primary balance (excluding grants)	-4.1	-1.1	-0.7	-0.3	-0.3	-0.3	-0.2	-0.1	-0.1	-0.1
Overall fiscal balance (including grants)	-8.4	-4.9	-5.3	-4.4	-4.3	-4.0	-4.1	-4.1	-4.2	-4.1
Overall fiscal balance (excluding grants)	-8.5	-5.7	-5.4	-4.6	-4.5	-4.2	-4.2	-4.2	-4.2	-4.2
Underlying fiscal balance (excl. grants; percent of GDP) 4/	...	...	...	...	-4.8	-4.2	-4.2	-4.2	-4.2	-4.2
General government and government guaranteed debt (incl. IMF)	66.7	65.7	65.7	70.0	69.1	67.6	66.1	64.1	62.6	60.9
General government debt incl. IMF obligations	63.9	63.5	63.3	67.6	66.6	65.1	63.7	61.7	60.2	58.4

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

1/ Difference between the overall balance and the current account balance.

2/ Including privatization.

3/ In months of next year's imports of goods and services.

4/ Excludes one-off transactions, including asset sales.

**Table 3. Pakistan: Balance of Payments, 2012/13–2021/22**  
(In millions of U.S. dollars, unless otherwise indicated)

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
							Projections			
Current account	-2,496	-3,130	-2,709	-3,394	-8,990	-10,074	-11,629	-12,151	-12,306	-13,048
Balance on goods	-15,431	-16,701	-17,284	-18,478	-23,860	-24,848	-26,643	-27,116	-27,512	-27,658
Exports, f.o.b.	24,795	25,068	24,083	21,972	21,786	23,824	26,188	28,665	31,379	34,152
Imports, f.o.b.	40,226	41,769	41,367	40,550	45,646	48,672	52,830	55,780	58,890	61,811
Services (net)	-1,472	-2,551	-2,884	-2,964	-3,290	-3,788	-4,169	-4,403	-4,573	-5,478
Services: credit	6,733	5,322	5,854	5,459	5,090	5,434	5,688	6,707	7,836	8,346
<i>Of which:</i> Coalition Support Fund	1,806	1,050	1,452	937	720	580	0	0	0	0
Services: debit	8,205	7,873	8,738	8,423	8,380	9,221	9,857	11,110	12,409	13,824
Income (net)	-3,685	-3,943	-4,581	-5,335	-5,103	-5,356	-5,729	-6,482	-7,180	-8,263
Income: credit	488	541	679	608	577	457	478	684	787	842
Income: debit	4,173	4,484	5,260	5,943	5,681	5,813	6,207	7,166	7,967	9,105
<i>Of which:</i> interest payments	1,452	1,552	1,931	2,138	1,886	2,698	2,913	3,261	3,599	4,166
<i>Of which:</i> income on direct investment	2,714	2,932	3,327	3,807	3,021	3,115	3,294	3,905	4,368	4,939
Balance on goods, services, and income	-20,588	-23,195	-24,749	-26,777	-32,253	-33,991	-36,540	-38,001	-38,001	-41,399
Current transfers (net)	18,092	20,065	22,040	23,383	23,262	23,917	24,912	25,850	26,959	28,351
Current transfers: credit, <i>of which:</i>	18,183	20,222	22,304	23,524	23,463	24,076	25,071	26,009	27,118	28,510
Official	412	380	340	613	532	325	266	35	33	0
Workers' remittances	13,922	15,837	18,721	19,917	19,908	20,594	21,480	22,493	23,455	24,689
Other private transfers	3,849	4,005	3,243	2,994	3,023	3,157	3,324	3,481	3,630	3,821
Current transfers: debit	91	157	264	141	201	159	159	159	159	159
Capital account	264	1,857	375	273	394	552	385	241	112	52
Capital transfers: credit	266	1,857	375	279	394	552	385	241	112	52
<i>Of which:</i> official capital grants	250	352	364	266	394	552	385	241	112	52
Capital transfers: debit	2	0	0	6	0	0	0	0	0	0
Financial account	549	5,553	4,996	5,605	8,964	10,046	11,700	12,729	14,341	14,574
Direct investment abroad	-198	-128	-73	-19	-66	-69	-68	-68	-68	-68
Direct investment in Pakistan	1,456	1,700	923	1,904	2,147	2,595	3,632	4,515	5,267	5,537
<i>Of which:</i> privatization receipts	0	310	764	0	0	0	0	0	0	0
Portfolio investment (net), <i>of which:</i>	26	2,760	1,884	-429	-8	629	578	18	845	-162
Financial derivatives (net)	0	0	0	0	0	0	0	0	0	0
Other investment assets	-314	211	89	-27	-706	-96	56	143	291	300
Monetary authorities	0	0	0	0	0	0	0	0	0	0
General government	-2	5	-35	-45	-18	0	0	0	0	0
Banks	-126	8	-68	127	19	-92	-12	68	208	208
Other sectors	-186	198	192	-109	-707	-4	68	75	83	92
Other investment liabilities	-421	1,010	2,173	4,176	7,597	6,986	7,502	8,120	8,005	8,967
Monetary authorities	710	146	563	5	0	0	0	0	0	0
General government, <i>of which:</i>	248	1,610	1,400	3,445	6,493	5,128	4,354	4,273	3,399	4,514
Disbursements	2,530	4,349	4,243	6,159	11,313	8,401	7,393	9,345	6,782	7,907
Amortization	2,282	2,734	2,841	2,714	4,820	3,273	3,039	5,072	3,384	3,393
Banks	-1,117	-293	479	412	977	1,581	2,445	2,768	3,462	3,213
Other sectors	-262	-453	-269	314	129	278	703	1,079	1,144	1,239
Net errors and omissions	-309	-422	-16	168	185	0	0	0	0	0
Reserves and related items	1,992	-3,858	-2,646	-2,652	-519	-524	-456	-818	-2,147	-1,578
Reserve assets	4,530	-2,464	-4,595	-4,661	-552	-365	-15	-19	-1,046	-422
Use of Fund credit and loans	-2,538	-1,394	1,949	2,009	33	-159	-441	-800	-1,101	-1,155
Memorandum items:										
Current account (in percent of GDP)	-1.1	-1.3	-1.0	-1.2	-3.0	-3.2	-3.4	-3.3	-3.1	-3.0
Current account (in percent of GDP; excluding fuel imports)	5.0	4.8	3.5	1.5	0.5	0.5	0.6	0.8	1.1	1.2
Exports f.o.b. (growth rate, in percent)	0.4	1.1	-3.9	-8.8	-0.8	9.4	9.9	9.5	9.5	8.8
Imports f.o.b. (growth rate, in percent)	-0.6	3.8	-1.0	-2.0	12.6	6.6	8.5	5.6	5.6	5.0
Oil imports (in million US\$, cif)	14,066	14,774	12,167	7,668	10,348	11,692	13,496	14,977	16,665	18,208
Terms of trade (growth rate, in percent)	-1.9	0.2	7.0	10.7	-0.9	-0.9	-0.4	-0.7	-0.9	-1.0
External debt (in millions of U.S. dollars)	60,899	65,393	65,082	73,063	79,120	87,020	94,686	100,168	108,237	115,058
o/w external public debt	48,737	51,998	51,935	59,021	62,316	67,303	70,865	71,506	73,927	75,296
Gross external financing needs (in millions of U.S. dollars) 1/	7,458	9,536	6,983	7,520	14,965	13,626	16,900	20,515	18,673	20,618
End-period gross official reserves (millions of U.S. dollars) 2/	6,008	9,096	13,534	18,143	18,518	18,883	18,898	18,917	19,863	20,386
(In months of next year's imports of goods and services)	1.5	2.2	3.3	4.0	3.8	3.6	3.4	3.2	3.2	3.2
GDP (in millions of U.S. dollars)	231,218	244,361	270,556	279,430	...	...	...	...	...	...

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

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

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

**Table 4a. Pakistan: General Government Budget, 2012/13–2017/18**  
(In billions of Pakistani rupees)

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
					Projections	
Revenue and grants	3,011	3,837	3,984	4,512	5,050	6,234
Revenue	2,982	3,631	3,937	4,447	4,984	6,167
Tax revenue	2,231	2,640	3,024	3,660	4,081	4,957
Federal	2,081	2,450	2,818	3,377	3,736	4,330
FBR revenue	1,936	2,272	2,594	3,112	3,432	4,013
Direct taxes	736	884	1,029	1,192	1,292	1,595
Federal excise duty	119	145	170	191	221	232
Sales tax/VAT	841	1,002	1,089	1,324	1,429	1,605
Customs duties	240	241	306	406	494	581
Petroleum surcharge	110	104	131	149	178	160
Gas surcharge and other	35	43	35	36	46	47
GIDC	0.0	32	57	80	80	110
Provincial	151	190	206	283	345	627
Nontax revenue	751	990	913	786	902	1,210
Federal	680	941	838	693	800	966
Provincial	71	49	76	93	102	244
Grants	29	206	47	66	66	67
Expenditure	4,885	5,058	5,426	5,796	6,433	7,647
Current expenditure	3,757	4,123	4,556	4,907	5,208	5,546
Federal	2,647	2,950	3,169	3,357	3,527	3,603
Interest	991	1,148	1,304	1,263	1,342	1,363
Domestic	920	1,073	1,208	1,151	1,210	1,231
Foreign	71	75	96	113	132	132
Other	1,656	1,802	1,866	2,093	2,186	2,240
Defense	541	623	698	758	860	920
Other	1,116	1,179	1,168	1,336	1,325	1,320
Of which: subsidies	368	336	265	218	154	144
Of which: grants 1/	305	372	401	563	574	551
Provincial	1,110	1,173	1,387	1,550	1,681	1,943
Development expenditure and net lending	1,112	997	1,047	1,102	1,225	2,101
Public Sector Development Program	721	878	1,013	1,089	1,235	2,113
Federal	348	435	489	496	600	1,001
Provincial	373	443	524	592	635	1,112
Net lending	391	119	34	13	-10	-12
Statistical discrepancy ("+" = additional expenditure)	16	-62	-178	-212	0	0
Overall Balance (excluding grants)	-1,903	-1,427	-1,489	-1,349	-1,450	-1,480
Overall Balance (including grants)	-1,873	-1,221	-1,442	-1,284	-1,383	-1,413
Financing	1873	1,221	1,442	1,284	1,383	1,413
External	38	351	166	331	725	626
Of which: privatization receipts	0	1	2	0	0	0
Of which: IMF	0	0	0	0	0	0
Domestic	1836	870	1,276	953	658	787
Bank	1457	322	910	780	461	551
Nonbank	378	548	366	173	198	236
Memorandum items:						
Underlying fiscal balance (excl. grants) 2/	...	...	...	...	-1,545	-1,480
Primary balance (excluding grants)	-912	-279	-185	-86	-108	-117
Primary balance (including grants)	-882	-73	-138	-21	-42	-50
Total security spending	541	623	698	758	860	920
Energy sector circular debt clearance	322	0	0	16	19	4
General government debt incl. IMF obligations	14,296	15,975	17,378	19,665	21,229	23,051
Domestic debt	9,571	10,902	12,188	13,619	14,453	15,432
External debt	4,725	5,073	5,190	6,046	6,777	7,619
General government and government guaranteed debt (incl. IMF)	14,922	16,535	18,022	20,386	22,019	23,929
Net general government debt (incl. IMF)	13,462	14,608	15,984	17,811	19,200	20,830
Nominal GDP (market prices)	22,386	25,169	27,443	29,103	31,862	35,390

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

1/ Additional spending on security and internally-displaced people is recorded under transfers ("grants") instead of development expenditure as reported in the original FY2015/16 budget.

2/ Excludes one-off transactions, including asset sales.

**Table 4b. Pakistan: General Government Budget, 2012/13–2017/18**  
(In percent of GDP, unless otherwise indicated)

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
					Projections	
Revenue and grants	13.5	15.2	14.5	15.5	15.8	17.6
Revenue	13.3	14.4	14.3	15.3	15.6	17.4
Tax revenue	10.0	10.5	11.0	12.6	12.8	14.0
Federal	9.3	9.7	10.3	11.6	11.7	12.2
FBR revenue	8.6	9.0	9.5	10.7	10.8	11.3
Direct taxes	3.3	3.5	3.8	4.1	4.1	4.5
Federal excise duty	0.5	0.6	0.6	0.7	0.7	0.7
Sales tax	3.8	4.0	4.0	4.5	4.5	4.5
Customs duties	1.1	1.0	1.1	1.4	1.5	1.6
Petroleum surcharge / Carbon tax	0.5	0.4	0.5	0.5	0.6	0.5
Gas surcharge and other	0.2	0.2	0.1	0.1	0.1	0.1
GIDC	...	0.1	0.2	0.3	0.3	0.3
Provincial	0.7	0.8	0.8	1.0	1.1	1.8
Nontax revenue	3.4	3.9	3.3	2.7	2.8	3.4
Federal	3.0	3.7	3.1	2.4	2.5	2.7
Provincial	0.3	0.2	0.3	0.3	0.3	0.7
Grants	0.1	0.8	0.2	0.2	0.2	0.2
Expenditure	21.8	20.1	19.8	19.9	20.2	21.6
Current expenditure	16.8	16.4	16.6	16.9	16.3	15.7
Federal	11.8	11.7	11.5	11.5	11.1	10.2
Interest	4.4	4.6	4.8	4.3	4.2	3.9
Domestic	4.1	4.3	4.4	4.0	3.8	3.5
Foreign	0.3	0.3	0.3	0.4	0.4	0.4
Other	7.4	7.2	6.8	7.2	6.9	6.3
Defense	2.4	2.5	2.5	2.6	2.7	2.6
Other	5.0	4.7	4.3	4.6	4.2	3.7
Of which: subsidies	1.6	1.3	1.0	0.7	0.5	0.4
Of which: grants 1/	1.4	1.5	1.5	1.9	1.8	1.6
Provincial	5.0	4.7	5.1	5.3	5.3	5.5
Development expenditure and net lending	5.0	4.0	3.8	3.8	3.8	5.9
Public Sector Development Program	3.2	3.5	3.7	3.7	3.9	6.0
Federal	1.6	1.7	1.8	1.7	1.9	2.8
Provincial	1.7	1.8	1.9	2.0	2.0	3.1
Net lending	1.7	0.5	0.1	0.0	0.0	0.0
Statistical discrepancy ("+" = additional expenditure)	0.1	-0.2	-0.6	-0.7	0.0	0.0
Overall Balance (excluding grants)	-8.5	-5.7	-5.4	-4.6	-4.5	-4.2
Overall Balance (including grants)	-8.4	-4.9	-5.3	-4.4	-4.3	-4.0
Financing	8.4	4.9	5.3	4.4	4.3	4.0
External	0.2	1.4	0.6	1.1	2.3	1.8
Of which: privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0
Of which: IMF	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	8.2	3.5	4.6	3.3	2.1	2.2
Bank	6.5	1.3	3.3	2.7	1.4	1.6
Nonbank	1.7	2.2	1.3	0.6	0.6	0.7
Memorandum items:						
Underlying fiscal balance (excl. grants; percent of GDP) 2/	...	...	...	...	-4.8	-4.2
Primary balance (excluding grants)	-4.1	-1.1	-0.7	-0.3	-0.3	-0.3
Primary balance (including grants)	-3.9	-0.3	-0.5	-0.1	-0.1	-0.1
Total security spending	2.4	2.5	2.5	2.6	2.7	2.6
Energy sector circular debt clearance	1.4	0.0	0.0	0.1	0.1	0.0
General government debt incl. IMF obligations	63.9	63.5	63.3	67.6	66.6	65.1
Domestic debt	42.8	43.3	44.4	46.8	45.4	43.6
External debt	21.1	20.2	18.9	20.8	21.3	21.5
General government and government guaranteed debt (incl. IMF)	66.7	65.7	65.7	70.0	69.1	67.6
Net general government debt (incl. IMF)	60.1	58.0	58.2	61.2	60.3	58.9
Nominal GDP (market prices, billions of Pakistani rupees)	22,386	25,169	27,443	29,103	31,862	35,390

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

1/ Additional spending on security and internally-displaced people is recorded under transfers ("grants") instead of development expenditure as reported in the original FY2015/16 budget.

2/ Excludes one-off transactions, including asset sales.

Table 5. Pakistan: Monetary Survey, 2012/13–2017/18

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
					Projections	
(In billions of Pakistani rupees, unless otherwise indicated)						
<b>Monetary survey</b>						
Net foreign assets (NFA)	263	593	813	1,008	1,022	1,082
Net domestic assets (NDA)	8,594	9,374	10,469	11,817	13,522	15,174
Net claims on government, <i>of which:</i>	5,698	6,025	6,958	7,820	8,234	8,785
Budget support, <i>of which:</i>	5,118	5,442	6,330	7,117	7,681	8,232
Banks	2,957	3,121	4,443	5,705	5,329	5,561
Commodity operations	468	492	564	637	554	554
Credit to nongovernment	3,675	4,153	4,456	5,013	5,676	6,440
Private sector 1/	3,387	3,798	4,021	4,469	5,050	5,731
Public sector enterprises	288	355	435	544	627	708
Privatization account	-41	-41	-41	-41	-41	-41
Other items, net	-739	-764	-904	-974	-349	-11
Broad money	8,856	9,967	11,282	12,825	14,543	16,256
Currency outside scheduled banks	1,938	2,178	2,555	3,334	3,673	3,957
Rupee deposits	6,403	7,189	8,130	8,904	10,268	11,625
Foreign currency deposits	515	599	598	587	603	673
<b>State Bank of Pakistan (SBP)</b>						
NFA	127	482	722	1,033	1,102	1,163
NDA	2,407	2,378	2,420	2,941	3,432	3,985
Net claims on government	2,197	2,393	1,919	1,430	2,252	2,846
<i>Of which:</i> budget support	2,161	2,321	1,887	1,412	2,352	2,670
Claims on nongovernment	-6	-5	-6	-5	-2	-4
Claims on scheduled banks	448	500	401	407	448	409
Privatization account	-41	-41	-41	-41	-41	-41
Other items, net	-192	-469	146	1,148	775	775
Reserve money, <i>of which:</i>	2,534	2,860	3,142	3,974	4,534	5,148
Banks' reserves	476	531	413	392	677	766
Currency	2,049	2,317	2,715	3,563	3,857	4,382
(Annual percentage change, unless otherwise indicated)						
Broad money	15.9	12.5	13.2	13.7	13.4	11.8
NFA, banking system (in percent of broad money) 2/	-3.5	3.7	2.2	1.7	0.1	0.4
NDA, banking system (in percent of broad money) 2/	19.3	8.8	11.0	11.9	13.3	11.4
Budgetary support (in percent of broad money) 2/	19.0	3.7	8.9	7.0	4.4	3.8
Budgetary support	39.6	6.3	16.3	12.4	7.9	7.2
Private credit 1/	-0.2	12.1	5.9	11.1	13.0	13.5
Currency	15.8	12.4	17.3	30.5	10.2	7.7
Reserve money	15.8	12.9	9.9	26.5	14.1	13.5
<b>Memorandum items:</b>						
Velocity	2.5	2.7	2.6	2.4	2.3	2.2
Money multiplier	3.5	3.5	3.6	3.2	3.2	3.2
Currency to broad money ratio (percent)	21.9	21.9	22.6	26.0	25.3	24.3
Currency to deposit ratio (percent)	28.0	28.0	29.3	35.1	33.8	32.2
Foreign currency to deposit ratio (percent)	7.4	7.7	6.8	6.2	5.5	5.5
Reserves to deposit ratio (percent)	6.9	6.8	4.7	4.1	6.2	6.2
Budget bank financing (change from the beginning of the fiscal year; in Rs billions), <i>of which:</i>	1,451	324	888	787	564	551
By commercial banks	952	164	1,323	1,262	-376	232
By SBP	499	160	-434	-475	940	318
NFA of SBP (change from beginning of the year; in billions of U.S. dollars) 3/	-2.8	3.6	2.2	2.8	0.1	0.1
NFA of commercial banks (millions of U.S. dollars)	1,377	1,130	887	-243	-726	-698
NDA of commercial banks (billions of Pakistani rupees)	6,187	6,995	8,050	8,877	10,090	11,188

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

1/ Items pertaining to Islamic Financing previously reported under "Other assets" have been reclassified as "Credit to private sector" beginning March 2016.

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

3/ Includes valuation adjustments.

**Table 6. Pakistan: Financial Soundness Indicators for the Banking System**  
(December 2013–December 2016)

	Dec. 2013	Mar. 2014	Jun. 2014	Sep. 2014	Dec. 2014	Mar. 2015	Jun. 1/ 2015	Sep. 1/ 2015	Dec. 1/ 2015	Mar. 1/2/ 2016	Jun. 1/ 2016	Sep. 1/ 2016	Dec. 1/ 2016
<b>Capital adequacy</b>													
Regulatory capital to risk-weighted assets	14.9	14.8	15.1	15.5	17.1	17.4	17.2	18.2	17.3	16.3	16.1	16.8	16.2
Tier I capital to risk-weighted assets	12.6	12.5	12.8	13.1	14.3	14.2	14.1	15.0	14.4	13.2	13.0	13.6	13.0
Capital to total assets	9.0	8.9	8.8	9.0	10.0	10.0	8.3	8.5	8.4	7.9	7.5	7.9	7.8
<b>Asset composition and quality</b>													
Nonperforming loans (NPLs) to gross loans	13.3	13.4	12.8	13.0	12.3	12.8	12.4	12.5	11.4	11.7	11.1	11.3	10.1
Provisions to NPLs	78.4	77.8	79.5	77.6	79.8	80.2	80.8	81.8	84.9	83.6	82.4	82.7	85.0
NPLs net of provisions to capital	14.7	14.0	12.5	13.6	10.1	9.8	10.9	10.0	7.7	8.9	9.7	9.1	7.3
<b>Earnings and profitability</b>													
Return on assets (after tax)	1.1	1.3	1.4	1.4	1.5	1.7	1.6	1.5	1.5	1.5	1.3	1.3	1.3
Return on equity (after tax)	12.4	14.1	15.4	15.9	16.1	17.0	15.9	15.7	15.6	16.3	14.4	14.2	14.4
Net interest income to gross income	70.4	70.1	70.6	71.4	71.3	68.4	67.5	69.1	70.4	70.0	70.6	71.6	71.2
Noninterest expenses to gross income	57.2	57.0	54.7	54.8	53.3	47.0	46.1	46.9	47.8	50.6	51.0	52.2	53.1
<b>Liquidity</b>													
Liquid assets to total assets	48.6	48.3	47.8	48.3	49.2	51.9	52.3	53.8	53.8	55.9	55.2	55.6	53.7
Liquid assets to total deposits	61.3	63.7	60.6	61.4	64.5	70.4	69.5	74.8	73.3	77.3	77.0	75.9	72.1
Loans/Deposits	49.5	49.2	47.7	48.2	48.2	46.9	45.7	46.7	46.4	46.3	47.0	45.5	46.6

Source: State Bank of Pakistan.

1/ As required by Basel requirements, the authorities used regulatory capital instead of balance sheet capital to calculate FSI figures.

2/ Changes in the accounting treatment in capital in one bank resulted in a downward revision in regulatory capital to risk-weighted assets and Tier 1 capital to risk weighted assets. This change is not expected to affect other banks.

Table 7. Pakistan: Selected Vulnerability Indicators, 2012/13–2021/22

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Projections									
<b>Key economic and market indicators</b>										
Real GDP growth (factor cost, in percent)	3.7	4.1	4.1	4.5	5.3	5.5	6.0	5.7	5.9	5.9
CPI inflation (period average, in percent)	7.4	8.6	4.5	2.9	4.3	5.0	5.0	5.0	5.0	5.0
Emerging market bond index (EMBI) secondary market spread (basis points, end of period)	703	501	444	559	...	...	...	...	...	...
Exchange rate PRs/US\$ (end of period)	98.7	98.6	101.8	104.7	...	...	...	...	...	...
<b>External sector</b>										
Current account balance (percent of GDP)	-1.1	-1.3	-1.0	-1.2	-3.0	-3.2	-3.4	-3.3	-3.1	-3.0
Net FDI inflows (percent of GDP)	0.5	0.6	0.3	0.7	0.7	0.8	1.1	1.2	1.3	1.3
Exports (percentage change of U.S. dollar value; GNFS)	6.0	-3.6	-1.5	-8.5	-1.9	8.9	8.9	11.0	10.9	8.4
Gross international reserves (GIR) in billions of U.S. dollars	6.0	9.1	13.5	18.1	18.5	18.9	18.9	18.9	19.9	20.4
GIR in percent of ST debt at remaining maturity (RM) 1/	75.4	105.7	189.9	238.3	181.7	264.6	183.8	162.3	206.7	148.1
GIR in percent of ST debt at RM and banks' foreign exchange (FX) deposits 1/	45.6	61.9	104.1	137.2	118.6	145.6	114.5	103.1	117.7	93.8
Total gross external debt (ED) in percent of GDP, of which:	26.3	26.8	24.1	26.1	26.7	27.6	28.1	27.6	27.5	26.8
ST external debt (original maturity, in percent of total ED)	2.1	4.1	5.1	6.3	4.6	5.2	6.9	8.6	10.3	12.3
ED of domestic private sector (in percent of total ED)	10.4	13.5	15.6	15.8	16.9	18.7	21.3	24.1	27.4	29.4
ED to foreign official sector (in percent of total ED)	89.6	86.5	84.4	84.2	83.1	81.3	78.7	75.9	72.6	70.6
Total gross external debt in percent of exports	193.2	215.2	217.4	266.6	294.4	297.4	297.1	283.2	276.0	270.7
Gross external financing requirement (in billions of U.S. dollars) 2/	9.1	10.8	9.1	10.1	17.2	16.2	21.0	26.5	26.8	31.3
<b>Public sector 3/</b>										
Overall balance (including grants)	-8.4	-4.9	-5.3	-4.4	-4.3	-4.0	-4.1	-4.1	-4.2	-4.1
Primary balance (including grants)	-3.9	-0.3	-0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
Debt-stabilizing primary balance 4/	-1.3	-2.8	-0.1	1.0	-0.6	-2.1	-1.8	-1.7	-1.8	-1.8
Gross PS financing requirement 5/	31.4	28.9	31.4	28.5	24.7	23.6	23.7	23.2	24.1	23.0
General government and government guaranteed debt (incl. IMF)	66.7	65.7	65.7	70.0	69.1	67.6	66.1	64.1	62.6	60.9
General government debt incl. IMF obligations	63.9	63.5	63.3	67.6	66.6	65.1	63.7	61.7	60.2	58.4
Net general government debt (incl. IMF) 6/	60.1	58.0	58.2	61.2	60.3	58.9	57.5	55.6	54.2	52.5
<b>Financial sector 7/</b>										
Capital adequacy ratio (in percent)	15.5	15.1	17.2	16.1	...	...	...	...	...	...
Nonperforming loans (NPLs) in percent of total loans	14.8	12.8	12.4	11.1	...	...	...	...	...	...
Provisions in percent of NPLs	73.2	79.5	80.8	82.4	...	...	...	...	...	...
Return on assets (after tax, in percent)	1.1	1.4	1.6	1.3	...	...	...	...	...	...
Return on equity (after tax, in percent)	12.4	15.4	15.9	14.4	...	...	...	...	...	...
FX deposits held by residents (in percent of total deposits)	7.4	7.7	6.8	6.2	...	...	...	...	...	...
Government debt held by FS (percent of total FS assets)	64.3	60.5	61.7	61.0	...	...	...	...	...	...
Credit to private sector (percent change)	-0.6	12.5	5.9	11.1	...	...	...	...	...	...
<b>Memorandum item:</b>										
Nominal GDP (in billions of U.S. dollars)	231.2	244.4	270.6	279.4	...	...	...	...	...	...

Sources: Pakistani authorities; and IMF 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.

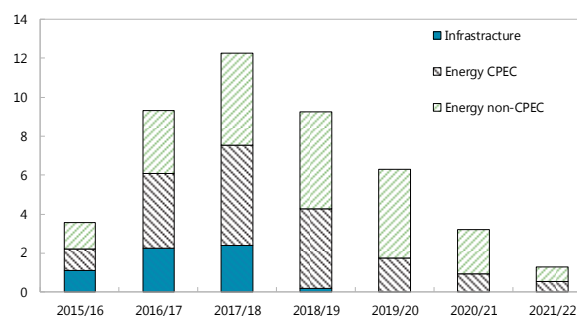
7/ Financial sector includes all commercial and specialized banks; for government debt also includes nonbanks, but excludes State Bank of Pakistan.



## Annex I. Macroeconomics of Pakistan's Quest for Energy and CPEC<sup>1</sup>

1. **Pakistan has embarked on a massive investment program in energy and infrastructure sectors to mitigate chronic energy shortages, diversify the country's fuel mix and improve trade connectivity.** Part of this investment is implemented in the context of the China-Pakistan Economic Corridor (CPEC)—a large package of investment projects, potentially totaling about \$55 billion (19 percent of FY 2015/16 GDP) over the next decade. The analysis below is based on realization of 19 CPEC projects (\$17.7 billion in energy sector and \$5.9 billion in infrastructure) and several non-CPEC energy sector projects (\$25.4 billion), which are either in advanced planning stages or already in the process of implementation.

**CPEC and Other Power Sector Investment Plans**  
(In billions of US dollars)

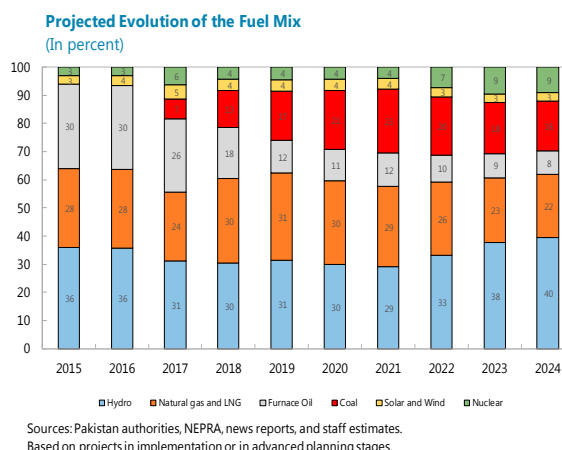
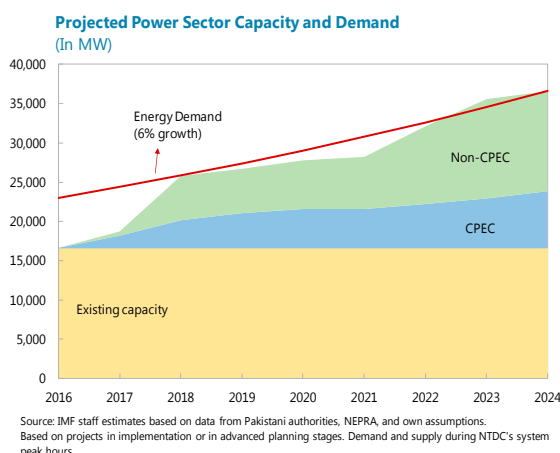


Source: Pakistan authorities, NEPRA, news reports, and staff estimates. Based on projects in implementation or in advanced planning stages.

2. **The authorities have facilitated a variety of financing modalities for the various investment plans.** CPEC infrastructure and transport projects are financed by long term concessional government borrowing from China. CPEC projects in the energy sector involve foreign direct investment and commercial borrowing from Chinese financial institutions, either by majority foreign-owned joint ventures or Chinese investors. Financing of non-CPEC energy projects ranges from private domestic financing to private commercial as well as government concessional borrowing from international financial institutions.

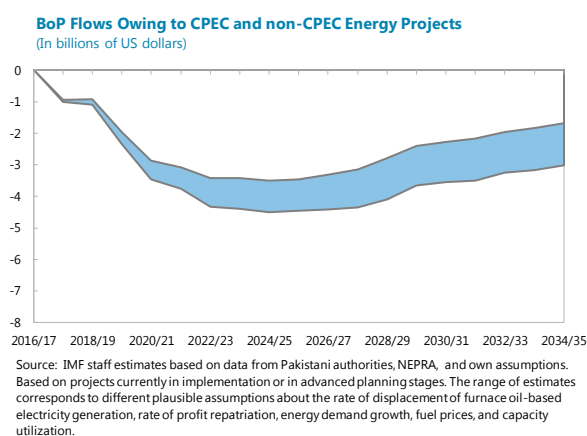
3. **If implemented on schedule, these investments could help close Pakistan's power deficit, significantly improve its fuel mix, and boost GDP.** The planned expansion of energy sector capacity could eliminate Pakistan's 6GW generation capacity gap in 2016 as early as end-2018. In the process, Pakistan's excessive reliance on furnace oil would be significantly reduced. Impact on GDP will likely come in three stages: construction, power generation, and—over time—second-round effects on broader economic activity due to increased productivity, lower costs, and improved trade connectivity. The first two stages (direct contribution) could add about \$13 billion to Pakistan's GDP in the next seven years (4.7 percent of FY 2015/16 GDP). Second-round effects will likely accrue gradually and could lead to a significant contribution in the long run, depending on various other supportive factors.

<sup>1</sup> See accompanying Selected Issues Paper: "The Macroeconomics of Pakistan's Quest for Energy and the CPEC."



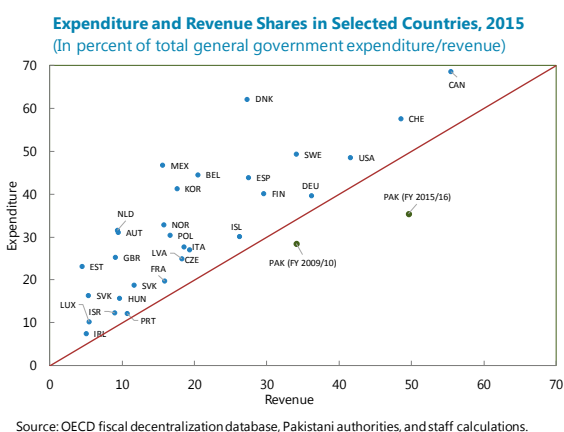
4. **At the same time, Pakistan’s investment initiatives will likely create long-term balance of payments outflows.** The authorities have facilitated a variety of financing modalities for the various investment plans, including concessional government borrowing, private commercial financing, and foreign direct investment. In the medium term, the operation of these projects will require balance of payments (BoP) outflows in the form of loan repayment, profit repatriation, and imports of input fuel. These outflows—which will be moderated by the expected savings from the displacement of oil in the fuel mix—are expected to rise in the next several years, peaking at about \$3.5–\$4.5 billion by FY 2024/25 (1.2–1.6 percent of FY 2015/16 GDP) and gradually declining in the long run.

5. **Realizing the transformational potential of Pakistan’s investment program while maintaining external stability will require supportive policy action.** Building up foreign exchange reserves will be important to cushion the period of increased BoP outflows. Strong and sustained reform efforts aimed at raising exports by improving competitiveness and the business climate will be critical to maintain long-term external sustainability. Bringing the power distribution sector to full cost recovery will help secure the long-term sustainability of the energy projects. Furthermore, containing fiscal costs by limiting tax exemptions, maintaining a supportive environment for all investments, and a gradual phasing in of new external commitments will help maintain macroeconomic stability and strengthen growth sustainability.



## Annex II. Fiscal Decentralization and Macroeconomic Challenges in Pakistan<sup>1</sup>

- In 2010, Pakistan embarked on a path of significant fiscal and administrative decentralization.** The 18th Constitutional Amendment significantly curtailed the responsibilities of the federal government and expanded the legislative and executive domain of Pakistan's four provinces. Implementation of the 18th Constitutional Amendment was enabled by the Seventh National Finance Commission (NFC) Award, which transferred revenue of about 1.1 percent of FY 2009/10 GDP to the provinces.
- The 7th NFC Award has resulted in an intergovernmental fiscal framework with a number of imbalances.** First, it has increased the vertical asymmetry, with the provincial share in general government revenue (50 percent in FY 2015/16) substantially higher than the expenditure share (35 percent). Second, it has reduced flexibility in economic management by narrowing the range and effectiveness of fiscal policy instruments at the federal level, potentially skewing incentives toward raising revenue outside of the divisible revenue pool, and diminishing provincial incentives to raise own tax revenue. Third, devolution of fiscal resources did not always match with the devolution of expenditure responsibilities and the development of appropriate public finance frameworks (PFM) which may have impacted the overall quality of public expenditure. Fourth, the fiscal framework did not create mechanisms for dealing with large unexpected shocks or ensuring a consistent fiscal stance across various layers of the government. Finally, the burden of providing resources for areas of joint federal-provincial policy responsibilities (under the Council of Common Interest (CCI)) has remained with the federal government, possibly creating skewed incentives in policy making and exacerbating the structural federal fiscal deficit. In more turbulent times, these imbalances could undermine macroeconomic stability.



- There is considerable scope to increase efficiency, flexibility, and responsiveness of the fiscal framework by the next NFC, although stakeholders' views on these matters differ** (Box 1). In this context, effective mechanisms for fiscal discipline and coordinating the fiscal stance,

<sup>1</sup> See accompanying Selected Issues Paper: "Fiscal Decentralization and Macroeconomic Challenges in Pakistan."

for example, a technocratic fiscal council or alternative body to develop and agree on broad fiscal rules for all levels of governments, would help improve macroeconomic management. Flexibility of the framework could be improved by establishing a jointly funded contingency fund aimed at absorbing large and unexpected shocks to expenditure of national importance. Macroeconomic risks from federal borrowing could be reduced by narrowing the vertical imbalance, for example, through assumption of additional expenditure responsibilities by the provinces or a burden-sharing arrangement with respect to joint areas of responsibility. Effectiveness of revenue mobilization efforts could be enhanced by establishing a national tax commission or coordination committee to help coordinate aspects of tax policy and administration across provinces and layers of government. Finally, continued improvement of PFM frameworks at both provincial and local government levels will be critical to ensure adequate efficiency of public expenditure and to reduce regional disparities in the provision of quality public services.

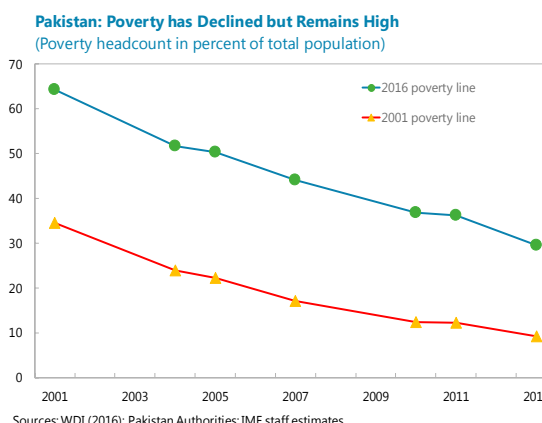
### **Box 1. Provincial Authorities' Feedback**

In their feedback to an earlier version of the paper, provincial authorities emphasized their individual achievements in tax revenue mobilization and devolution to local governments. All provinces strongly underscored the need to respect the constitutional protection of their revenue shares, and, in some cases, argued for additional resources needed to help them meet their social development goals. Some provinces challenged the connection between the 7th NFC Award and tax revenue mobilization incentives, and between social outcomes and the quality of PFM frameworks.

The provincial authorities expressed reluctance to co-finance joint tasks. Some provinces argued that the tasks falling under the jurisdiction of the CCI are not joint in that they remain in the legislative domain of the federal government, and, therefore, should not be co-financed from provincial resources. Despite some support, provincial authorities generally expressed reluctance with respect to the potential financing of large and unexpected shocks out of a jointly funded contingency fund. Notwithstanding mixed views, provincial authorities generally recognized the benefits of improved coordination mechanisms for the fiscal stance and tax administration as well as the need for continued strengthening of PFM frameworks. At the same time, provinces pointed to the need to retain their fiscal autonomy.

## Annex III. Poverty, Inequality, and Social Safety Nets in Pakistan<sup>1</sup>

1. **While poverty and inequality remain substantial, there has been significant poverty reduction over the last two decades.** Over the period 2000–2015, poverty incidence more than halved from 64 percent in 2001 to 29.5 percent in 2013 (from 34 percent to about 9 percent based on the 2001 poverty line). However, despite being below the South Asia average, it remains high, notably in rural areas. While access to basic services has significantly improved, education and health outcomes remain below regional average, with related social spending below emerging markets' average. Income inequality is relatively moderate in Pakistan but sizeable gaps in education and health outcomes between the richest and the poorest quintiles and genders remain. The size of the informal economy is estimated to be large thus constraining inclusiveness.



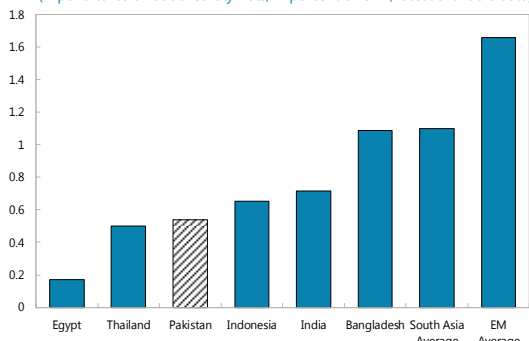
2. **Generating higher and more inclusive growth is needed to make a dent poverty and inequality.** Raising living standards of the Pakistani population, fostering job creation and ensuring shared equality is needed. To this end, preserving macroeconomic stability and moving ahead with key growth-supporting structural reforms is crucial to generate higher and more inclusive private-sector growth.

3. **In parallel, stepping up public expenditures on social safety nets is critical to support the most vulnerable.** Public expenditures on social safety nets (SSNs) have increased over time but are low compared to regional and emerging markets' averages. Furthermore, efficiency frontier analysis suggests that low spending on social safety nets in Pakistan is associated with higher poverty and inequality. BISP, the main SSN program, provides unconditional as well as educational cash transfers to poor households, using an effective targeting mechanism and sound delivery infrastructure. BISP has contributed to lift out of poverty targeted households but its small size constraints its impact. Broadening BISP coverage, updating the beneficiaries' database, and stepping up educational transfers is key to strengthen Pakistan's social safety nets. To this end, resources allocated to smaller and poorly targeted social assistance programs could be consolidated into BISP thus increasing overall efficiency. Furthermore, continuing efforts to reduce untargeted electricity subsidies is key to free up public resources.

<sup>1</sup> See accompanying Selected Issues Paper: "Poverty, Inequality, and Social Safety Nets in Pakistan."

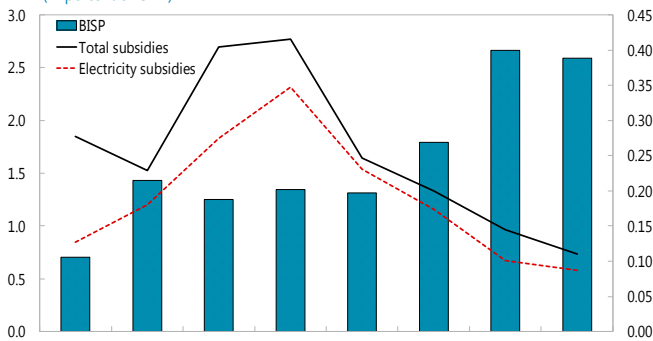
**Social Safety Nets are Relatively Small**

(Expenditures on social safety nets; in percent of GDP, latest available data)



Sources: Pakistan Authorities; IMF staff calculations; World Bank ASPIRE Database (2016)

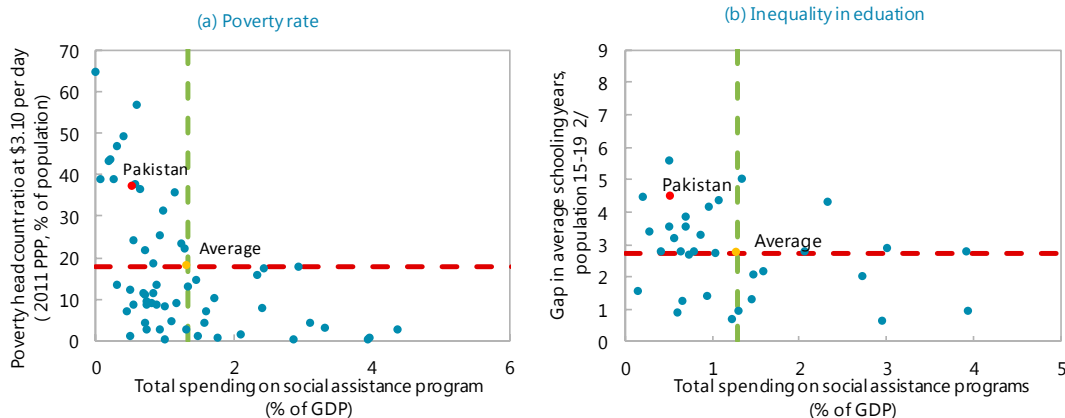
**Electricity Subsidies were Reduced and Social Safety Nets Strengthened**  
(In percent of GDP)



Sources: Pakistan authorities; and IMF staff calculations.

4. **Furthermore, stepping up public social spending is important to improve education and health outcomes.** Efficiency frontier analysis suggests that social spending in Pakistan is low compared to other countries, and is associated with weaker education and health outcomes. Further mobilizing higher fiscal revenues would create additional fiscal space to increase growth-supporting priority social spending. In parallel, strengthening the implementation capacity of the provinces is needed to ensure higher and more efficient social spending in education and health.

**Lower Spending on Social Safety Nets and Higher Poverty and Inequality 1/**

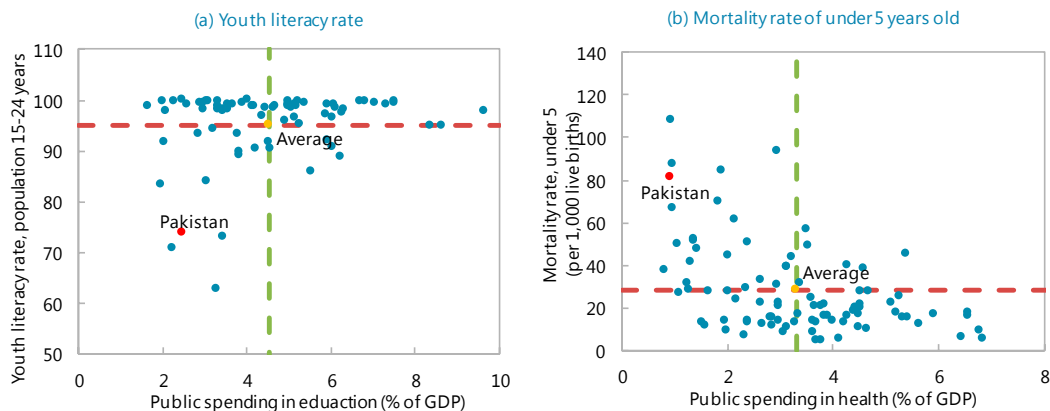


Sources: Human Development Reports (2016), ASPIRE Database (2016), WDI (2016), and IMF Staff estimates.

1/ The sample comprises middle income economies (2015 GNI per capital was between US\$1,026 and US\$12,475).

2/ Gap of average schooling years between poorest and richest income quintiles.

**Lower Social Spending in Education and Health and Weaker Outcomes 1/**



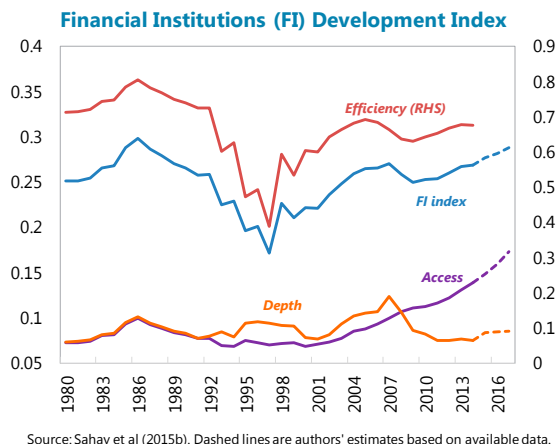
Sources: WDI (206), and IMF Staff estimates.

1/ The sample comprises middle income economies (2015 GNI per capital was between US\$1,026 and US\$12,475).

## Annex IV. Supporting Growth and Inclusion Through Financial Development<sup>1</sup>

### 1. Financial development and inclusion have made progress over the past decades, and there is large potential for further improvement.

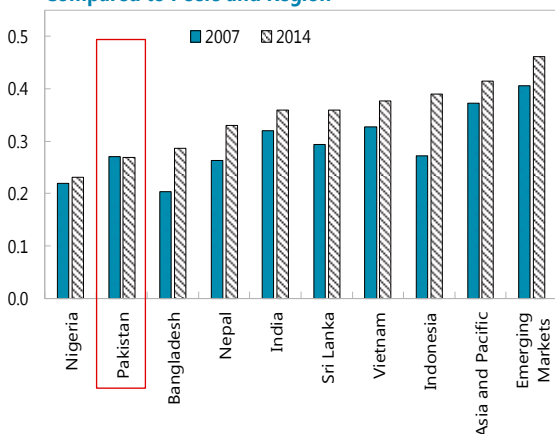
Analysis based on recently developed cross-country measures of financial development and inclusion (Sahay et al., 2015; Aslan et al., 2016) suggests that financial development trends show a beginning recovery in financial depth following a decade of decline, low yet quickly growing levels of access and financial inclusion, and overall favorable efficiency of the banking system. Despite recent trends and significant efforts, Pakistan still lags behind peers and countries with similar fundamentals, illustrating the large room for further improvement.



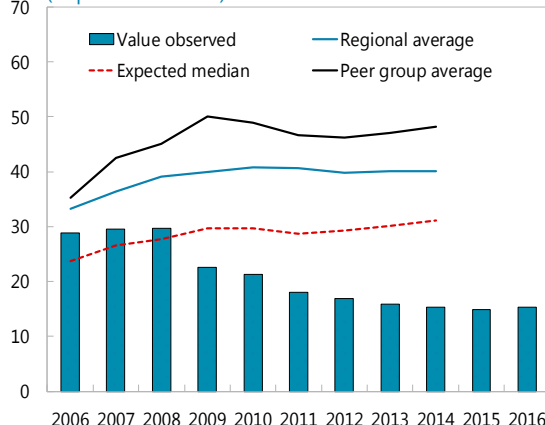
### 2. Continuing to foster financial deepening and inclusion in Pakistan will be important to increase the resilience of its economy to shocks and to promote economic growth and equality.

It will also help channel savings towards productive investment, improve the allocation of resources, foster sharing of information and allow to better diversify risks. Empirical results confirm that greater financial development is associated with higher economic growth and indicate that the growth dividend for Pakistan could be significant. Raising the level of development of Pakistan's financial institutions to average emerging market levels could generate an annual per capita growth dividend of about 1 percent.

Financial Institutions Development Index: Pakistan Compared to Peers and Region



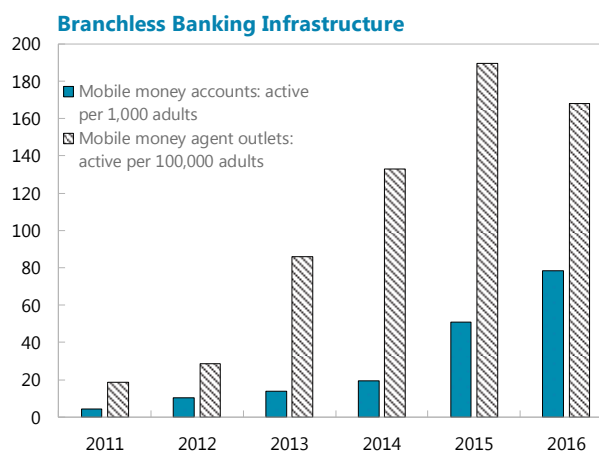
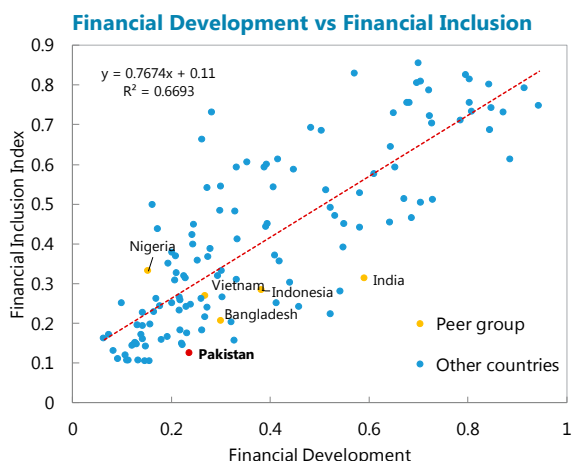
Private Credit (In percent of GDP)



<sup>1</sup> See accompanying Selected Issues Paper: "Supporting Growth and Inclusion Through Financial Development."



3. **Pakistan should continue to promote greater financial deepening and inclusion.** The authorities are implementing an ambitious plan under the National Financial Inclusion Strategy that would help boost financial coverage of underserved segments such as women, low-income and rural population, and SMEs. The priority areas to further improve the access to and the use of financial services include (i) promoting financial literacy and awareness; (ii) addressing the gender gap in access to finance; (iii) enhancing the financial, payments and information and communication technology infrastructure, including branchless banking; (iv) consumer protection; and (v) enhancing conducive policy environment for development of SME, agriculture and housing finance and pensions. To facilitate further financial development, Pakistan should strive to maintain an appropriate macroeconomic policy mix by continuing fiscal consolidation to channel more funds to private credit and by pursuing prudent monetary policy to encourage savings. It will also be important to continue strengthening the legal, institutional and regulatory frameworks, including operationalizing the planned deposit insurance, reforming credit information systems, creating an electronic collateral registry, improving collateral enforcement and the bankruptcy regime, strengthening the business climate and governance, moving toward registering prize bonds, and reviewing existing credit incentive schemes to maximize their efficiency. Policies to promote Islamic finance should focus on addressing gaps in consolidated supervision, ensuring tax neutrality for some Islamic products, development of domestic secondary markets and a holistic liquidity management framework, and raising financial awareness and literacy of Shariah-compliant products. Finally, continuing to promote microfinance, encouraging healthy bank competition, and further development of debt markets would facilitate private credit growth and contribute to greater financial development and inclusion.



## Annex V. Public and External Debt Sustainability

*Pakistan's public and publicly guaranteed debt is expected to decline from 70 percent of GDP in 2016 to 61 percent by 2022. The modest pace of debt reduction reflects continued fiscal imbalances under relatively benign real sector assumptions and is subject to a number of risks that could lead to significantly higher medium-term debt ratios. The baseline gross public debt path also violates the limits on public debt levels set in the revised Fiscal Responsibility and Debt Limitation (FRDL) Act. Gross financing needs are expected to decline but remain high throughout the projection period. To improve public debt sustainability and build sufficient fiscal buffers, sustained fiscal consolidation is needed. In the meantime, the external debt remains sustainable as reliance on external borrowing gradually declines over the medium term.*

1. **Pakistan's public and publicly guaranteed debt increased to 70 percent of GDP in FY 2015/16, while public debt excluding guarantees rose to about 67½ percent of GDP.** This increase reflects a relatively low GDP deflator, debt creation to allow for a rise in government bank deposits by 1.2 percent of GDP, and moderate depreciation of the rupee against the U.S. dollar. Net public debt increased to 61 percent of GDP.<sup>1</sup>
2. **Public and publicly guaranteed debt is projected to decline to 61 percent of GDP by 2022 under the baseline.** Public debt excluding guarantees is projected to decline to about 58½ percent of GDP over the same period. Fiscal consolidation over the last three years has put Pakistan in a position where the debt ratio is expected to decline in the medium term. The decline in the public debt level is driven by fast real GDP growth, projected to further improve to 6 percent in the medium term as the global economy recovers and CPEC projects start to bear fruits. However, a number of adverse shocks, notably to economic growth and the primary balance, could lead to higher debt ratios, while a combined macro-fiscal shock could lead to public debt ratios well above 70 percent. Contingent liabilities from restructuring of loss-making PSEs represent additional fiscal risks. Gross financing needs are projected to decline but remain above the benchmark, largely accounted for by loan amortization. While the shares of short-term and foreign exchange-denominated debt remain between the lower and upper early warning thresholds, high gross financing needs point to potential rollover risk.
3. **Fiscal consolidation needs to be strengthened to improve debt dynamics and build sufficient fiscal buffers.** The projected public debt trajectory is above that stipulated in the revised FRDL Act with a limit of 60 percent of GDP on the general government debt (excluding guarantees) until FY 2017/18 and a gradual transition toward 50 percent of GDP over a 15-year period. Gross financing needs are projected to stay elevated and gradually decline to 23 percent of GDP. To establish credibility of the fiscal responsibility framework, strengthen debt sustainability and build buffers to respond to adverse shocks, fiscal consolidation efforts need to be strengthened with clearly identified measures and a strong resolve to push reforms in tax administration and public debt management.

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<sup>1</sup> The net public debt is defined as gross public debt less government deposits with banks.

4. **The external DSA shows that the projected path for external debt is sustainable.** Gross external debt has gradually increased to 26 percent of GDP and is expected to inch up further, peaking at about 28 percent of GDP in 2019, before gradually declining over the medium term. This increase is consistent with rising gross external financing needs, which are expected to peak at close to 7½ percent of GDP in 2020. Bound and stress tests suggest that the external debt-to-GDP ratio is resilient to adverse shocks. While sensitive mostly to current account and exchange rate shocks, external debt would not exceed 41½ percent of GDP under any scenario.

## Pakistan Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

### Debt, Economic and Market Indicators <sup>1/</sup>

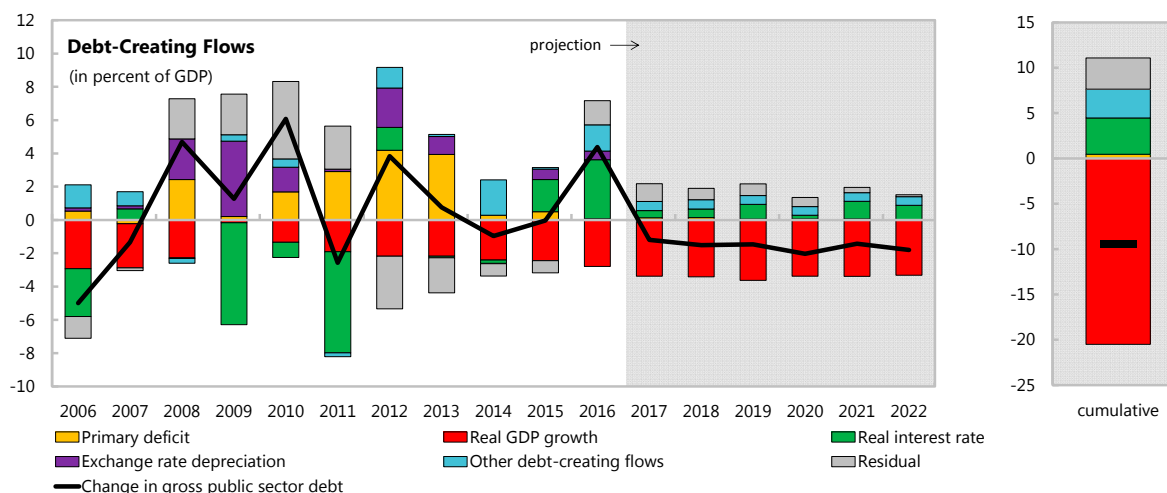
	Actual			Projections					
	2006-2014 <sup>2/</sup>	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	60.8	65.7	70.0	69.1	67.6	66.1	64.1	62.7	60.9
Of which: guarantees	1.7	2.3	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Public gross financing needs	25	31.4	28.5	24.7	23.6	23.7	23.2	24.1	23.0
Real GDP growth (in percent)	3.8	4.1	4.5	5.3	5.5	6.0	5.7	5.9	5.9
Inflation (GDP deflator, in percent)	11.2	4.8	1.5	4.0	5.3	5.0	5.1	5.0	5.0
Nominal GDP growth (in percent)	15.4	9.0	6.0	9.5	11.1	11.3	11.1	11.2	11.2
Effective interest rate (in percent) <sup>4/</sup>	8.3	8.2	7.3	4.9	6.4	6.8	5.8	7.2	6.9

As of April 11, 2017

Sovereign Spreads		
EMBIG (bp) <sup>3/</sup>		341
5Y CDS (bp)		344
Ratings	Foreign	Local
Moody's	B3	n.a.
S&P's	B	n.a.
Fitch	B	n.a.

### Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance <sup>9/</sup>
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022		
Change in gross public sector debt	0.8	0.0	4.4	-1.2	-1.5	-1.5	-2.0	-1.4	-1.8	-9.4	
Identified debt-creating flows	0.2	0.7	2.9	-2.3	-2.2	-2.2	-2.6	-1.7	-1.9	-12.9	
Primary deficit	1.8	0.5	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.5	
Primary (noninterest) revenue and grants	13.9	14.5	15.5	15.8	17.6	17.6	17.7	17.7	17.7	104.1	
Primary (noninterest) expenditure	15.7	15.0	15.6	16.0	17.8	17.7	17.7	17.7	17.7	104.5	
Automatic debt dynamics <sup>5/</sup>	-2.2	0.1	1.3	-2.9	-2.9	-2.7	-3.2	-2.3	-2.4	-16.5	
Interest rate/growth differential <sup>6/</sup>	-3.6	-0.5	0.8	-2.9	-2.9	-2.7	-3.2	-2.3	-2.4	-16.5	
Of which: real interest rate	-1.6	1.9	3.5	0.4	0.5	0.9	0.2	1.1	0.9	4.0	
Of which: real GDP growth	-2.0	-2.4	-2.8	-3.4	-3.4	-3.6	-3.4	-3.4	-3.3	-20.5	
Exchange rate depreciation <sup>7/</sup>	1.4	0.6	0.5	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.7	0.1	1.6	0.6	0.5	0.5	0.5	0.5	0.5	3.2	
Residual, including asset changes <sup>8/</sup>	0.5	-0.7	1.5	1.1	0.7	0.7	0.5	0.3	0.1	3.4	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as guarantees to PSEs.

2/ Based on available data.

3/ EMBIG.

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

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

6/ The real interest rate contribution is derived from the numerator in footnote 5 as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

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

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

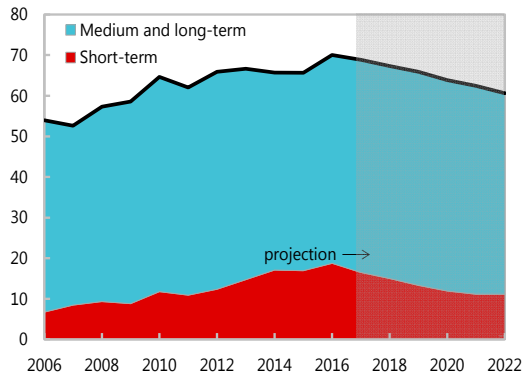
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

## Pakistan Public DSA - Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

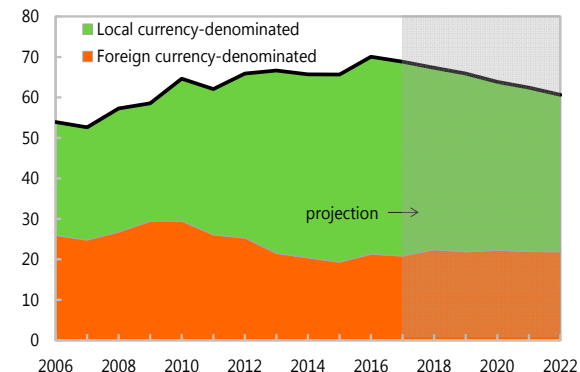
#### By Maturity

(in percent of GDP)



#### By Currency

(in percent of GDP)



### Alternative Scenarios

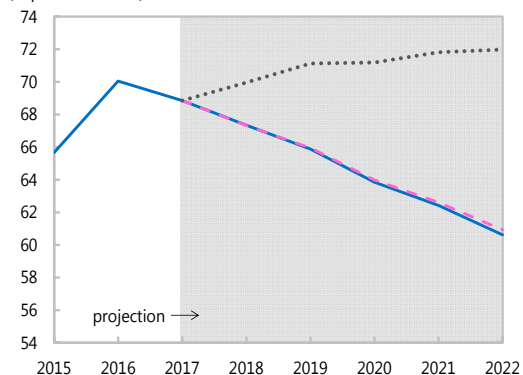
— Baseline

..... Historical

- - - Constant Primary Balance

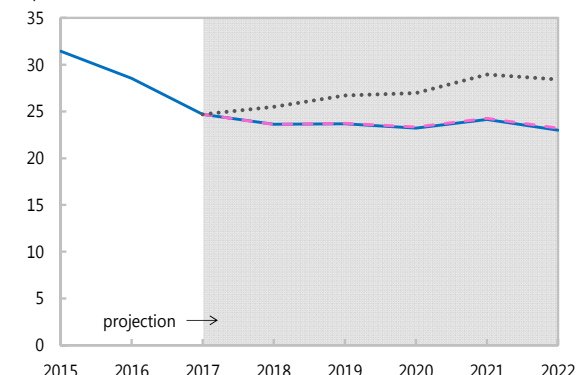
#### Gross Nominal Public Debt

(in percent of GDP)



#### Public Gross Financing Needs

(in percent of GDP)



### Underlying Assumptions

(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	5.3	5.5	6.0	5.7	5.9	5.9
Inflation	4.0	5.3	5.0	5.1	5.0	5.0
Primary Balance	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
Effective interest rate	4.9	6.4	6.8	5.8	7.2	6.9

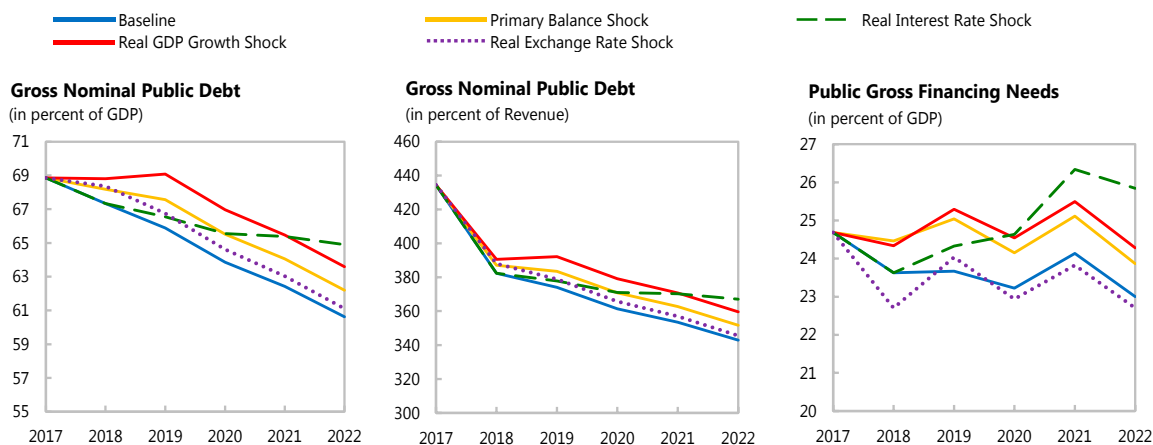
Constant Primary Balance Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	5.3	5.5	6.0	5.7	5.9	5.9
Inflation	4.0	5.3	5.0	5.1	5.0	5.0
Primary Balance	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Effective interest rate	4.9	6.4	6.8	5.8	7.2	6.9

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	5.3	3.7	3.7	3.7	3.7	3.7
Inflation	4.0	5.3	5.0	5.1	5.0	5.0
Primary Balance	-0.1	-1.6	-1.6	-1.6	-1.6	-1.6
Effective interest rate	4.9	6.4	6.2	4.9	6.0	5.6

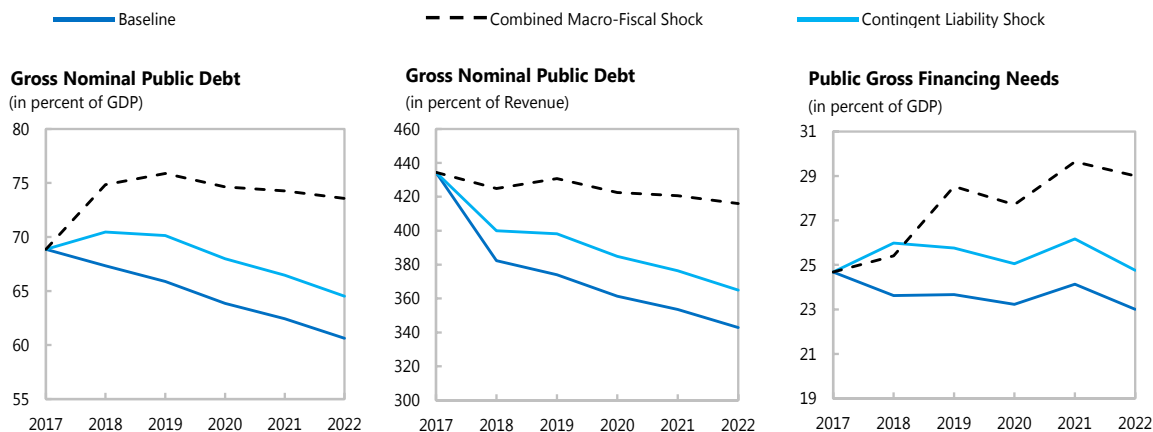
Source: IMF staff.

### Pakistan Public DSA - Stress Tests

#### Macro-Fiscal Stress Tests



#### Additional Stress Tests



#### Underlying Assumptions (in percent)

	2017	2018	2019	2020	2021	2022		2017	2018	2019	2020	2021	2022
<b>Primary Balance Shock</b>							<b>Real GDP Growth Shock</b>						
Real GDP growth	5.3	5.5	6.0	5.7	5.9	5.9	Real GDP growth	5.3	4.1	4.6	5.7	5.9	5.9
Inflation	4.0	5.3	5.0	5.1	5.0	5.0	Inflation	4.0	4.9	4.7	5.1	5.0	5.0
Primary balance	-0.1	-1.0	-0.9	-0.1	-0.1	0.0	Primary balance	-0.1	-0.4	-0.7	-0.1	-0.1	0.0
Effective interest rate	4.9	6.4	6.8	5.8	7.2	6.9	Effective interest rate	4.9	6.4	6.8	5.8	7.2	6.9
<b>Real Interest Rate Shock</b>							<b>Real Exchange Rate Shock</b>						
Real GDP growth	5.3	5.5	6.0	5.7	5.9	5.9	Real GDP growth	5.3	5.5	6.0	5.7	5.9	5.9
Inflation	4.0	5.3	5.0	5.1	5.0	5.0	Inflation	4.0	12.1	5.0	5.1	5.0	5.0
Primary balance	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	Primary balance	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
Effective interest rate	4.9	6.4	7.9	7.6	9.4	9.3	Effective interest rate	4.9	6.6	6.5	5.6	6.9	6.7
<b>Combined Shock</b>							<b>Contingent Liability Shock</b>						
Real GDP growth	5.3	4.1	4.6	5.7	5.9	5.9	Real GDP growth	5.3	4.1	4.6	5.7	5.9	5.9
Inflation	4.0	4.9	4.7	5.1	5.0	5.0	Inflation	4.0	4.9	4.7	5.1	5.0	5.0
Primary balance	-0.1	-1.0	-0.9	-0.1	-0.1	0.0	Primary balance	-0.1	-1.8	-0.1	-0.1	-0.1	0.0
Effective interest rate	4.9	6.6	7.5	7.6	9.4	9.3	Effective interest rate	4.9	7.0	6.8	5.8	7.2	6.9

Source: IMF staff.

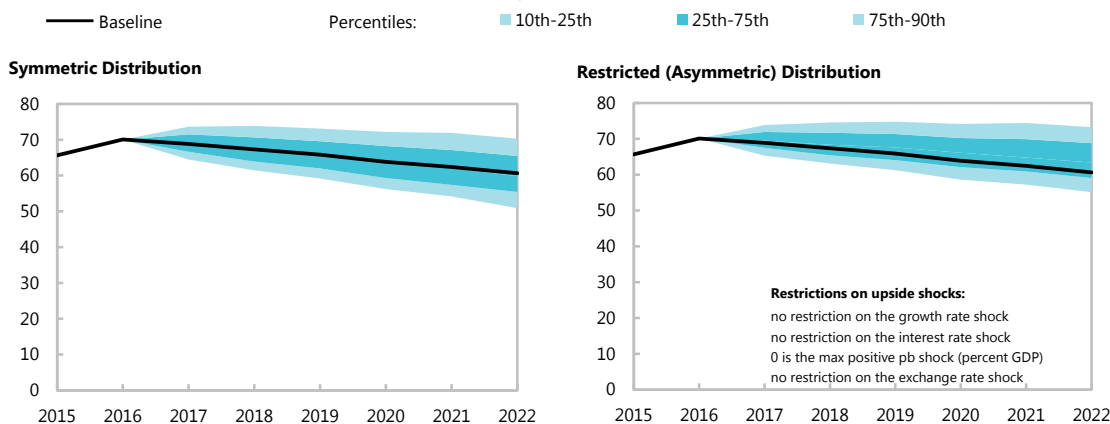
### Pakistan Public DSA Risk Assessment

#### Heat Map

Debt level <sup>1/</sup>	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs <sup>2/</sup>	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile <sup>3/</sup>	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

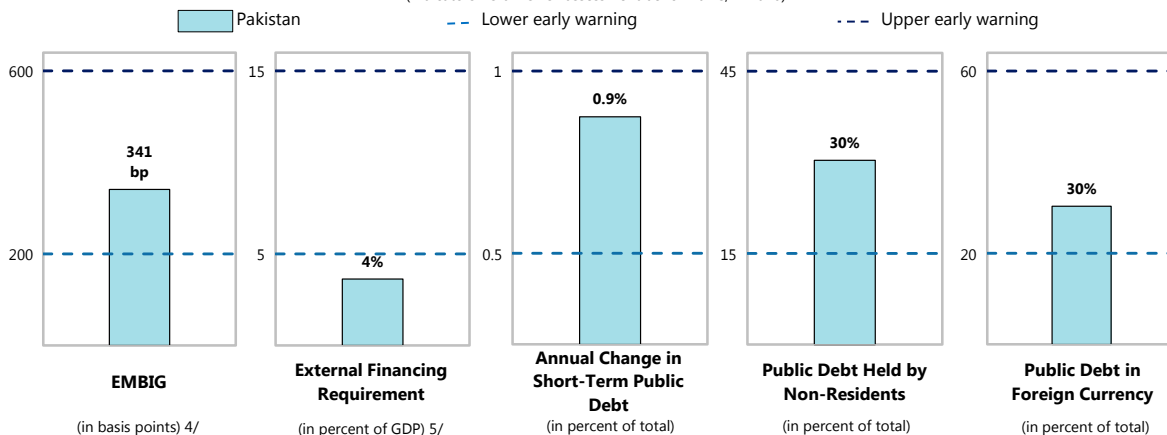
#### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



#### Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

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

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 11-Jan-17 through 11-Apr-17.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

## Pakistan Public DSA - Realism of Baseline Assumptions

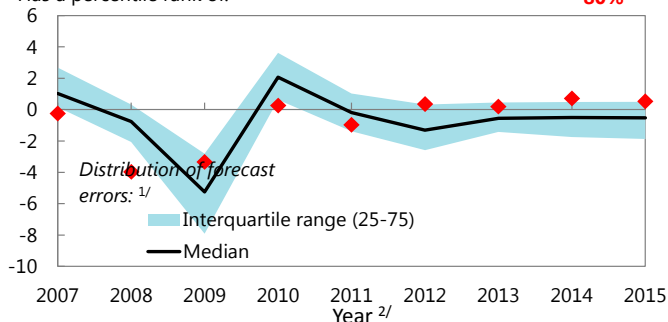
### Forecast Track Record, versus all countries

#### Real GDP Growth

(in percent, actual-projection)

Pakistan median forecast error, 2007-2015: **0.20**

Has a percentile rank of: **80%**

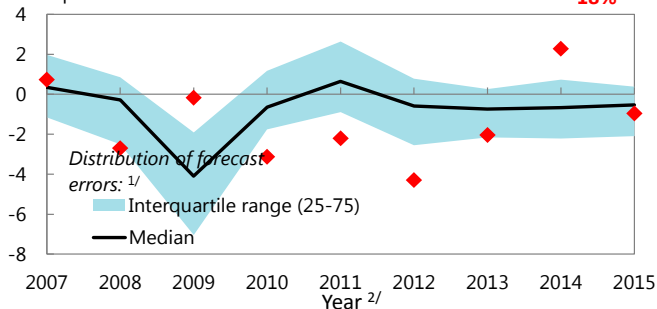


#### Primary Balance

(in percent of GDP, actual-projection)

Pakistan median forecast error, 2007-2015: **-2.04**

Has a percentile rank of: **18%**

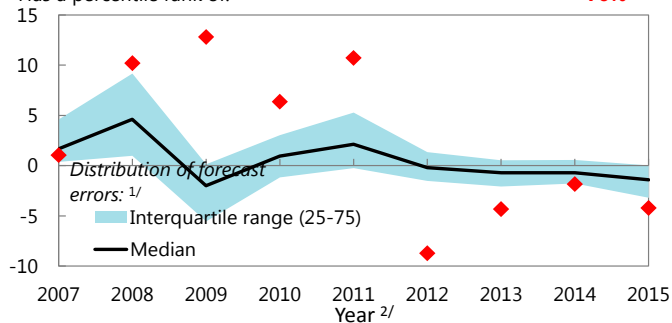


#### Inflation (Deflator)

(in percent, actual-projection)

Pakistan median forecast error, 2007-2015: **1.06**

Has a percentile rank of: **70%**



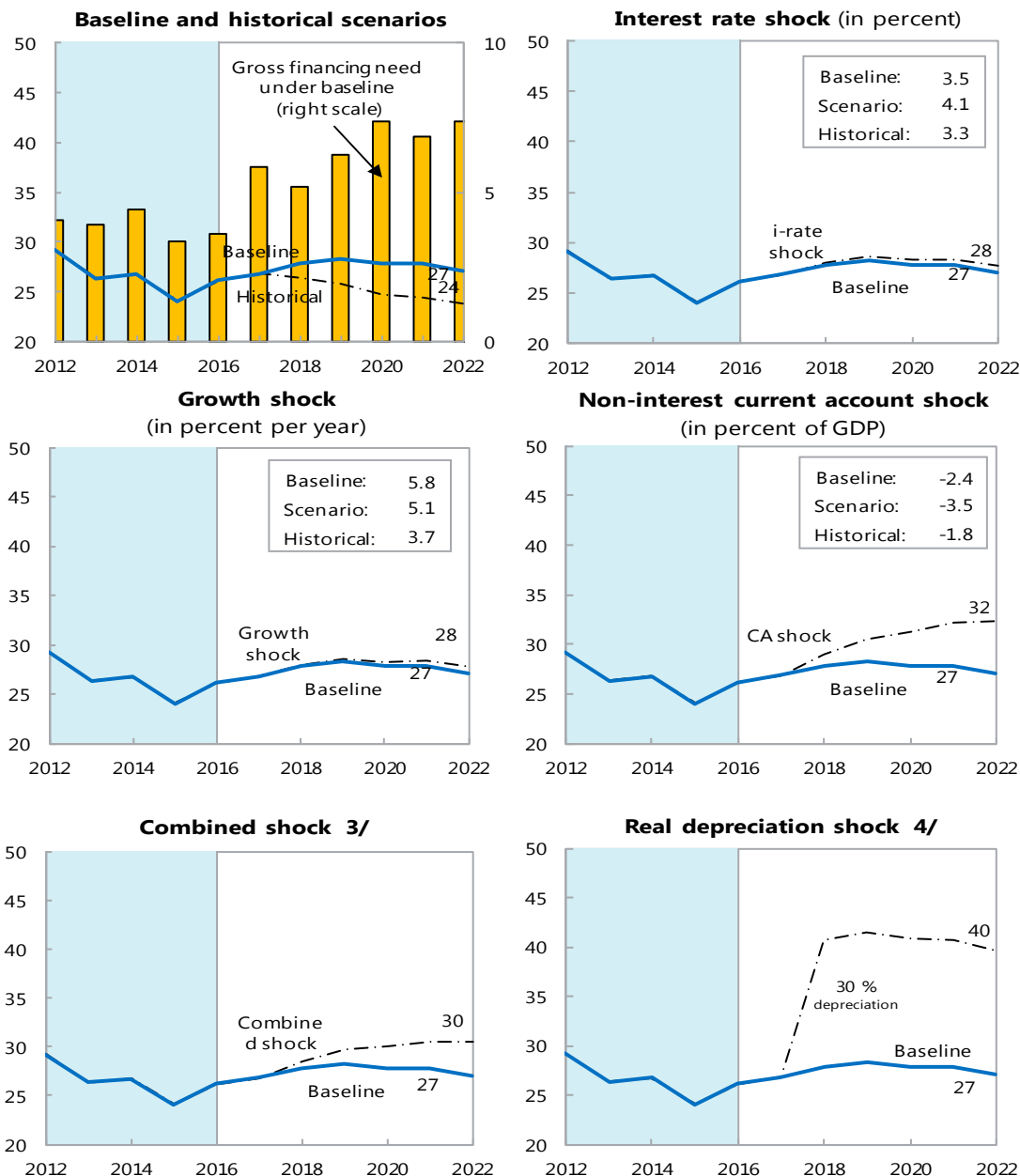
Source : IMF Staff.

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

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



### Pakistan: External Debt Sustainability: Bound Tests 1/ 2/ (External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2010.

**Pakistan: External Debt Sustainability Framework, 2012-2022**  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -2.6
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	
<b>1 Baseline: External debt</b>	29.2	26.3	26.8	24.1	26.1	<b>26.8</b>	<b>27.8</b>	<b>28.3</b>	<b>27.8</b>	<b>27.8</b>	<b>27.1</b>	
2 Change in external debt	-1.9	-2.8	0.4	-2.7	2.1	0.7	1.0	0.5	-0.4	-0.1	-0.7	
3 Identified external debt-creating flows (4+8+9)	0.3	-0.2	-0.6	-1.8	0.0	1.0	1.0	0.8	0.6	0.3	0.3	
4 Current account deficit, excluding interest payments	1.4	0.5	0.6	0.3	0.4	2.4	2.4	2.6	2.5	2.2	2.1	
5 Deficit in balance of goods and services	8.4	7.3	7.9	7.5	7.7	9.2	9.2	9.2	8.8	8.2	7.8	
6 Exports	13.3	13.6	12.4	11.1	9.8	9.1	9.3	9.5	9.8	10.1	10.0	
7 Imports	21.7	20.9	20.3	18.5	17.5	18.3	18.5	18.7	18.6	18.3	17.8	
8 Net non-debt creating capital inflows (negative)	-0.3	-0.5	-0.7	-0.3	-0.7	-0.7	-0.8	-1.1	-1.2	-1.3	-1.3	
9 Automatic debt dynamics 1/	-0.8	-0.1	-0.6	-1.8	0.2	-0.7	-0.5	-0.7	-0.6	-0.6	-0.5	
10 Contribution from nominal interest rate	0.7	0.6	0.6	0.7	0.8	0.6	0.9	0.9	0.9	0.9	1.0	
11 Contribution from real GDP growth	-1.1	-1.0	-1.0	-1.0	-1.1	-1.3	-1.4	-1.6	-1.5	-1.5	-1.5	
12 Contribution from price and exchange rate changes 2/	-0.4	0.3	-0.2	-1.5	0.5	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-2.1	-2.7	1.1	-0.9	2.1	-0.4	0.0	-0.4	-1.1	-0.3	-1.0	
External debt-to-exports ratio (in percent)	220.2	193.2	215.2	217.4	266.6	294.4	297.4	297.1	283.2	276.0	270.7	
<b>Gross external financing need (in billions of US dollars) 4/</b>	9.1	9.1	10.8	9.1	10.1	17.2	16.2	21.0	26.5	26.8	31.3	
in percent of GDP	4.0	3.9	4.4	3.4	3.6	10-Year 5.8	10-Year 5.2	6.3	7.4	6.9	7.4	
<b>Scenario with key variables at their historical averages 5/</b>						<b>26.8</b>	<b>26.4</b>	<b>25.8</b>	<b>24.7</b>	<b>24.5</b>	<b>23.9</b>	<b>-2.3</b>
<b>Key Macroeconomic Assumptions Underlying Baseline</b>						Historical Average	Standard Deviation					
Real GDP growth (in percent)	3.8	3.7	4.1	4.1	4.5	3.7	1.4	5.3	5.5	6.0	5.7	5.9
GDP deflator in US dollars (change in percent)	1.2	-1.2	0.9	6.0	-2.0	3.7	6.4	0.3	0.5	1.0	1.6	2.2
Nominal external interest rate (in percent)	2.4	2.2	2.5	3.0	3.3	3.3	1.0	2.6	3.4	3.3	3.4	3.6
Growth of exports (US dollar terms, in percent)	-4.5	6.0	-3.6	-1.5	-8.5	3.4	9.9	-1.9	8.9	8.9	11.0	10.9
Growth of imports (US dollar terms, in percent)	11.7	-0.5	2.5	0.9	-2.5	4.5	11.6	10.6	7.2	8.3	6.7	6.6
Current account balance, excluding interest payments	-1.4	-0.5	-0.6	-0.3	-0.4	-1.8	2.3	-2.4	-2.4	-2.6	-2.5	-2.2
Net non-debt creating capital inflows	0.3	0.5	0.7	0.3	0.7	1.3	1.1	0.7	0.8	1.1	1.2	1.3

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

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

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

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

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

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.



# PAKISTAN

## STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 31, 2017

Prepared By

Middle East and Central Asia Department  
(In Consultation with Other Departments)

### CONTENTS

RELATIONS WITH THE FUND	2
RELATIONS WITH THE WORLD BANK	6
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STATISTICAL ISSUES	10

## RELATIONS WITH THE FUND

(As of April 30, 2017)

### Membership Status:

Joined: 07/11/1950; Article VIII

### General Resources Account

	SDR Million	Percent Quota
Quota	2,031	100.00
Fund Holdings of Currency	6,423.88	316.29
Reserve Tranche Position	0.12	0.01

### SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	988.56	100.00
Holdings	454.58	45.98

### Outstanding Purchases and Loans

	SDR Million	Percent of Quota
Extended Arrangements	4393.00	216.30

### Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	09/04/2013	09/30/2016	4,393.00	4,393.00
Stand-by	11/24/2008	09/30/2011	7,235.90	4,936.04
ECF	12/06/2001	12/05/2004	1,033.70	861.42

### Projected Payments to Fund

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Principal		150.00	420.00	660.00	762.17
Charges/Interest	57.85	77.45	69.68	56.76	46.27
<b>Total</b>	57.85	227.45	489.68	716.76	808.44

### **Current Status of Safeguards Assessment**

An updated safeguards assessment with respect to the EFF program was completed on December 16, 2013. The assessment concluded that legal amendments are needed to strengthen the central bank's autonomy and the governance arrangements. The authorities have implemented the 2013 safeguards recommendations, except for some legal amendments to the SBP Act, which were only partially addressed. The authorities are taking steps to address a number of the remaining recommendations towards clarifying the SBP's objectives, limiting its scope for providing credit to the government, establishing an executive board, and enhancing SBP's financial autonomy. Several other recommendations in the areas of SBP's institutional autonomy, governance, and personal autonomy of board members remain to be addressed. Previous assessments were completed in February 2001, March 2009, and March 2010.

### **Exchange Rate Arrangement**

On May 19, 1999, the dual exchange system was unified, with all international transactions conducted at the interbank market exchange rate (FIBR). The de facto exchange rate arrangement has been classified as "other managed". De Jure exchange rate arrangement is managed floating with no predetermined path. Since the nominal exchange rate has stabilized against the U.S. dollar within a margin of 2 percent since March 2015, with one realignment in August 2015, Pakistan's de facto exchange rate arrangement is currently under review and could be potentially reclassified to "stabilized" from previous "other managed". The SBP does not make any explicit or implicit commitment with respect to an exchange rate target or path. The SBP intervenes in the foreign exchange market, but does not publish information regarding its interventions. Pakistan has accepted the obligations of Article VIII, sections 2, 3, and 4 of the Fund's Articles of Agreement. Pakistan maintains an exchange restriction and multiple currency practice (MCP) subject to Fund approval under Article VIII 2(a) and 3 arising from imposing a 100 percent cash margin requirement on a list of different types of consumer goods imports. The State Bank of Pakistan clarified that cash margin deposits pursuant to the requirements are non-remunerative.

### **Last Article IV Consultation**

The last Article IV consultation (Country Report 16/1) was discussed by the Executive Board on December 18, 2015.

### **FSAP Participation and ROSCs**

**FSAP.** The last FSAP was conducted in September 2008, however, the report was not published. The previous FSAP was conducted in February and April 2004. The report has been published and is available on the web through the following link:

<http://www.imf.org/external/pubs/ft/scr/2004/cr04215.pdf>

**Monetary and Financial Policy Transparency and Data Dissemination.** Data Module, Reassessment of Monetary Statistics and Detailed Assessment Using Quality Assessment Framework were completed in November 2006. The report has been published and is available on the web through the following link: <http://www.imf.org/external/pubs/ft/scr/2007/cr0774.pdf>. The previous

data dissemination monetary and financial policy transparency ROSCs were conducted in December 2004 and July 2004, respectively.

**Fiscal Transparency.** The last updated report of the fiscal module on Observance of Standards and Codes for Pakistan was prepared in April 2008. The report has been published and is available on the web through the following link: <http://www.imf.org/external/pubs/ft/scr/2008/cr08129.pdf>. The original fiscal ROSC was conducted in November 2000 with a subsequent update in December 2004.

### **Resident Representative**

Mr. Tokhir Mirzoev has been the Resident Representative in Islamabad since March 2015.

#### **Recent Technical Assistance**

##### **FAD**

April 2007: Public financial management.  
 July and November 2009: Valued Added Tax law.  
 July 2010: Review of Budgeting Accounting and Reporting System.  
 November 2015: Public financial management.  
 December 2015: Tax policy.

##### **MCM**

April 2007: Monetary policy framework, the SBP's balance sheet, and the Banking Services Corporation.  
 April 2011: Capital markets development issues.  
 May 2012: Credit Registry.  
 May 2013: Stress Testing the Banking System.  
 December 2013: MTDS.  
 November 2014: Consolidated Supervision.  
 April/May 2015: Deposit Insurance  
 February 2017: Contingency Planning  
 April/May 2017: Deposit Insurance

##### **STA**

May 2007: Statistics on the international investment position.  
 October 2009: Multisector statistics (remote technical assistance).  
 March 2011: Price statistics.  
 February 2012: Price statistics.  
 May 2014: National Accounts.  
 October 2014: Quarterly National Accounts.  
 August 2015: Consumer Price Index.  
 December 2015: Quarterly National Accounts/Consumer Price Statistics.  
 August 2016: Price statistics.

**Recent Technical Assistance (concluded)****STA**

August 2016: National Accounts Statistics.

February 2017: Monetary and Financial Statistics

March 2017: National Accounts statistics.

**LEG**

July 2008: Deposit Protection Fund.

July 2008: Central Bank Law.

August 2008: Banking Law.

May 2016: Central Bank Law

## RELATIONS WITH THE WORLD BANK

(As of April 30, 2017)

1. Pakistan is among the largest recipients of World Bank financial assistance. The World Bank Group program in Pakistan consists of an integrated package of financial support, including IBRD lending, concessional IDA credits, Trust Funds and Grants administered by the Bank on behalf of other development partners, Multi-Donor Trust Fund (MDTF) for Khyber Pakhtunkhwa (KP), Federally Administered Tribal Areas (FATA) and Balochistan, The Accelerated Growth and Reform (TAGR) from DFID, IFC investments, and MIGA guarantees, along with complementary analytical and advisory services. The Pakistan Portfolio (IDA, IBRD and MDTF) as of April 30, 2017, has 37 active projects.

2. The Country Partnership Strategy (CPS) outlines the Bank's strategic approach to helping Pakistan achieve its development goals over a five-year period. The Bank Group's Board of Directors endorsed a Country Partnership Strategy for Pakistan on May 1 2014, covering fiscal years 2015 through 2019. The WBG's Pakistan Country Partnership Strategy is anchored in the Government's framework of 4Es: Energy, Economy, Extremism and Education; and the initial priorities of the incoming Vision 2025. Enough flexibility has also been built into the Strategy to allow for quick reallocation of resources in case of unforeseen needs or emergencies.

3. The four strategic pillars or result areas and cross-cutting theme of the Country Partnership Strategy are:

- Transforming the energy sector. Policy reforms and large investments in the power sector aim to reduce load shedding, expand low-cost generation and supply, improve governance and cut losses;
- Supporting private sector development. WBG's support is aimed at strengthening the business environment, improving competitiveness and productivity of farms and businesses, and making cities growth friendly to support productive and quality jobs;
- Reaching out to the underserved, neglected, and poor. The strategy has a special focus on targeted support for poorer districts and vulnerable groups e.g. women and youth; micro, small and medium enterprises particularly in fragile and crises-affected provinces / regions; and support for enhancing resilience and adaptation to the impact of climate change;
- Accelerating improvements in public service delivery. WBG would support efforts for increasing revenues both at the federal and provincial levels to fund public services and setting more ambitious targets to create greater impact in critical areas especially education and health; and
- Leveraging regional markets. As part of the four result areas, this cross-cutting theme focuses on energy and trade, aimed at an integrated electricity market in South Asia with power transmission links to Central Asia and India; and other opportunities to capture the potential of



cross-border trade between Pakistan and its neighboring countries. Sustained economic cooperation can help contribute to growth as well as overall stability in the region.

4. IFC is supporting development of Pakistan's private sector through an integrated investment and advisory program. Its strategy is a direct response to the challenges facing the private sector in the country, including energy shortages, infrastructure constraints and lack of access to finance, which limit the growth of micro, small and medium enterprises (MSMEs). IFC has been focusing on mobilizing investments in infrastructure, energy (including renewable power), expanding access to finance to MSMEs, and helping create jobs. IFC's advisory services are particularly active in enhancing access to finance for MSMEs, the capacity building of small businesses, improving corporate governance, creating a better business environment, and promoting clean energy.

5. Pakistan is also a focus country for MIGA, where it has already provided guarantees in hydropower and microfinance. Going forward, MIGA's strategy seeks to support investments into IDA countries, South-South investments, complex infrastructure projects, and investments into conflict-affected areas.

6. Over the last few years, WBG has closely coordinated its development policy financing support with the IMF Program in Pakistan, with a focus on structural reforms in revenue mobilization, SOEs, private sector development, financial sector and energy sector to complement the 2013-2016 IMF program. Over the past three years the World Bank has provided over US\$3 billion budget financing in support of these reforms.

7. IBRD/IDA financial operations since FY2006 are summarized below:

### Pakistan: World Bank Group Financial Operations

US\$ million		FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
Commitments	IBRD	315	100	174	0	0	261	500	0	0	0	400
	IDA	1183	885	371	1610	300	1292	1290	744	1634	1351	1460
Disbursements	IBRD	149	154	56	91	86	35	92	85	121	35	110
	IDA	1063	1035	267	848	698	772	565	450	1533	1129	1360
Repayments	IBRD	297	273	295	273	225	172	157	162	166	156	147
	IDA	117	170	143	181	165	169	190	182	297	247	255

## RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of December 31, 2016)

Pakistan is a major recipient of financial support from the Asian Development Bank (ADB). Since 1968, the ADB has provided \$27.9 billion in assistance through the concessional Asian Development Fund window and the Ordinary Capital Resources window.

The ADB's Board of Directors endorsed the Country Partnership Strategy (CPS) covering the years 2015–19 in August 2015. In line with ADB's Midterm Review of Strategy 2020, ADB will support the government's objective of higher, inclusive, and sustained growth to create productive employment opportunities and reduce poverty. The thrust of ADB's strategy in Pakistan will be to improve connectivity, productivity, and access to markets and public services, focusing on infrastructure development and institutional reforms. The broad thrust of this strategy is similar to those in the previous CPS, reflecting the long-standing development constraints, the governments' priorities to relieve them, and ADB's accumulated experience. This CPS places greater emphasis on (i) partnerships and cofinancing, particularly from commercial sources; (ii) disaster risk management; and (iii) a more systematic approach to knowledge solutions.

The main areas of ADB operations in Pakistan include: (i) energy, focusing on sector reforms, energy efficiency, power generation, transmission, distribution, and renewable energy development; (ii) transport and logistics; (iii) irrigation and water resource management; (iv) urban services; (v) public sector management including reforms in key sectors of ADB's operations, development of public-private partnerships, public sector enterprise reforms and social protection; and (vi) finance, focusing on long-term sources of infrastructure finance and financial inclusion.

ADB's program consists of a mix of policy-based lending, multi-tranche financing facilities, stand-alone projects, technical assistance (TA) loans, TA grants, project design facilities, knowledge products and services, and policy dialogue. The policy-based lending targets specific areas of priority reforms, within a programmatic framework in collaboration with development partners, supplemented with TA for the design and implementation of these reforms. Multi-tranche financing facilities contain significant components for analytical and capacity development assistance. TA grants will finance these for stand-alone investment projects.

Pakistan's active public sector portfolio amounts to \$6.38 billion as of 31 December 2016. It comprises 49 loans and 7 grants for 37 investment projects and 27 TA projects of \$50.8 million. The figures exclude ADB's policy-based support, which is currently focused on energy sector reforms. The support for energy sector reform program consists of five annual sub-programs, with the first sub-program (DPC-I) of \$400 million approved and disbursed in 2014. The second sub-program, also of (DPC-II) \$400 million, has been signed on November 2015 and disbursement was made in

December 2015. Approval of the third sub-program (\$300 million) is scheduled for June 2017. The energy sector comprises about 43 percent of ADB's active public sector portfolio, followed by transport (25 percent); public sector management (15 percent); irrigation and water resource management (12 percent); a multi-sector emergency projects (3 percent); and urban infrastructure and services (2 percent).

ADB's private sector operations in Pakistan began in 1983 and complement its public sector support. As of 30 September 2016, cumulative private sector approvals amounted to \$1.25 billion, and total outstanding balance of projects amounted to \$624 million. Private sector operations are focused on infrastructure and finance. The infrastructure support comprises renewable energy development (hydro and wind), development of natural resources (e.g., thermal power capacity based on captive domestic gas fields), reform support (financing of a privatized distribution electric supply company) and energy security. Under the financial sector window, ADB provides guarantees, equity investment, and trade finance. ADB's Trade Finance Program in Pakistan has worked with twelve banks on 3,750 trade transactions of over \$10.7 billion, 53 percent of which was co-financed by the private sector.

## STATISTICAL ISSUES

(As of May 17, 2017)

<b>I. Assessment of Data Adequacy for Surveillance</b>
<p><b>General:</b> Data provision has some shortcomings, but is broadly adequate for surveillance.</p>
<p><b>National Accounts:</b> In 2013, the Federal Bureau of Statistics (FBS) completed rebasing and revising of the national accounts statistics from fiscal year 1999/2000 to 2005/06 to bring them in line with the concepts and definitions of the <i>2008 System of National Accounts (2008 SNA)</i>. The coverage of transport, storage and communication sector has been expanded, methodology better captures the measurement of value-added at basic prices (instead of factor cost), uses double deflation for some industries, and applies Financial Intermediation Services Indirectly Measured (FISIM). The current national accounts series goes back only to 2005/06 and the FBS was working to produce backward linking of series to 1999–2000. FBS has also begun developing quarterly national accounts (QNA). With respect to labor market statistics, the FBS has now compiled and started releasing quarterly employment/unemployment data, the first release being in February 2011 and included five years of historical data and is investigating the feasibility of disseminating data on wages/salaries. In March 2017, STA conducted a technical assistance (TA) mission to support the improvement of the QNA.</p>
<p><b>Price statistics:</b> 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 53 essential commodities. The concepts and definitions of the CPI attempt to follow international guidelines. There is a need to replace the WPI with a producer price index (PPI). FBS introduced the Classification of Individual Consumption by Purpose (COICOP) with the August 2011 index, along with updated weights and expanded item and geographic coverage. TA is being provided to further improve the CPI methodology and to update the weights again.</p>
<p><b>Government finance statistics:</b> The concepts and definitions used in compiling government finance statistics are broadly based on the <i>GFSM 1986</i>. The scope of central government data is further limited because it does not cover the activity of extra budgetary funds. Classification and sectorization in source data follow <i>GFSM 1986</i> standards to a limited extent. The classification of expenditure deviates from <i>GFSM 1986</i> 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 <i>GFSM 1986</i>. The authorities have indicated their intent to adopt the methodology of <i>GFSM 2001</i> over the medium term, and in line with the Board decision (No 14656 of October 2010) to strengthen fiscal analysis, they have compiled with staff assistance a fiscal table in the <i>GFSM 2001</i> presentation. However,</p>

further improvements in government finance statistics are needed and the authorities are making progress toward that objective 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 (the last available year is 2014). However, no data are reported on transactions in nonfinancial and financial assets and liabilities. The authorities also report higher frequency data for inclusion in the *International Financial Statistics (IFS)*. The principal issue involving GFS is to reduce the size of the statistical discrepancy between the financial and non-financial accounts which is reported to MCD.

**Monetary statistics:** The monetary statistics are broadly in line with the *Monetary and Financial Statistics Manual (MFSM)* and the *MFS Compilation Guide*. The SBP has reported the Standardized Report Forms for central bank (1SR), other depository corporations (2SR), and monetary aggregates (5SR) to the Fund publication in the *IFS*. In early 2017, STA has conducted a technical assistance for expanding the compilation of MFS. It is expected that money markets funds (MMFs) will be included in the depository corporation sector by mid-2017. The other financial corporations (OFCs) survey is expected to be compiled and reported to STA by end-2017 covering the accounts of Non-MMFs, pension funds, and financial auxiliaries. Insurance corporations subsector will be added to OFCs by mid-2018.

Pakistan reports all core Financial Soundness Indicators (FSIs) for the deposit takers (DT) sector and 16 out of 28 FSIs of the encouraged set for DT, non-financial corporations and real estate prices. These FSIs (including the sectoral balance for DTs) are disseminated in the IMF's FSI website.

**External sector statistics:** Starting from September 2013 SBP reports regularly quarterly balance of payments (BoP) statistics with data beginning in December 2005 in line with the *Balance of Payments Manual sixth edition (BPM6)*. In October 2015 SBP also started transmitting to the STA BPM6 based annual and quarterly international investment position (IIP) with data beginning in December 2014. Some issues of consistency between BoP and IIP remain to be addressed. Pakistan also participates in the Fund's Currency Composition of Official Foreign Exchange Reserves (COFER) surveys, as well as in the Coordinated Direct Investment Survey (CDIS) and the Coordinated Portfolio Investment Survey (CPIS). External debt data are not reported to the World Bank's Quarterly External Debt Statistics (QEDS) database.

## II. Data Standards and Quality

General Data Dissemination System (GDDS) participant since 2003.

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. An update to the ROSC on fiscal transparency was published on the IMF website in April 2008.

### Pakistan: Table of Common Indicators Required for Surveillance

As of May 2016

	Date of latest observation	Date received	Frequency of Data <sup>7</sup>	Frequency of Reporting <sup>7</sup>	Frequency of publication <sup>7</sup>	Memo Items:	
						Data Quality – Methodological Soundness <sup>7</sup>	Data Quality Accuracy and Reliability <sup>8</sup>
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	March 2017	Apr. 2017	M	M	M		
Reserve/Base Money	March 2017	May 2017	M	M	M	O, O, O, LO	O, O, O, O, LO
Broad Money	March 2017	May 2017	M	M	M		
Central Bank Balance Sheet	March 2017	May 2017	M	M	M		
Consolidated Balance Sheet of the Banking System	March 2017	May 2017	M	M	M		
Interest Rate <sup>2</sup>	April 2017	May 2017	M	M	M		
Consumer Price Index	April 2017	May 2017	M	M	M	O, LO, LO, O	O, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	March 2017	May 2017	Q	Q	Q	LO, LO, LNO, LO	O, O, LO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	March 2017	May 2017	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	March 2017	May 2017	Q	Q	Q		
External Current Account Balance	March 2017	May 2017	M	M	M	LO, LO, LO, O	O, O, O, O, LNO
Exports and Imports of Goods and Services	March 2017	May 2017	M	M	M		
GDP/GNP	2016/17 est.	May 2017	A	A	A	LO, LNO, LO, LO	LNO, LNO, O, LNO, O
Gross External Debt	Dec. 2016	Feb.2017	M	M	M		
International Investment Position <sup>6</sup>	Dec. 2016	March 2017	A/Q	A/Q	A/Q		

<sup>1</sup> Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

<sup>2</sup> Both market-based and officially determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing. Only Federal Board of Revenue's outcome is received on monthly basis

<sup>4</sup> The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Includes external gross financial asset and liability positions vis-à-vis nonresidents.

<sup>7</sup> Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); or Not Available (NA).

<sup>8</sup> 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).

**Statement by Jafar Mojarrad, Executive Director for Pakistan  
June 14, 2017**

On behalf of our Pakistani authorities, we thank Fund staff for the constructive engagement during the 2017 Article IV discussions and the high-quality report and Selected Issues paper. The authorities broadly agree with staff assessment and policy advice.

**Recent Economic Developments and Outlook**

Despite headwinds from global and regional developments and a tight security situation, the economic reform program supported by the three-year Extended Fund Facility (EFF) brought significant gains, and enhanced the country's economic and financial resilience: real GDP growth reached projected 5.3 percent in FY 2016/17 (the highest in ten years); FDI increased reflecting growing investor confidence; buffers against external shocks were fortified; and the standards of living improved markedly. Prudent monetary policy kept inflation low. The fiscal deficit was slashed almost in half, over three years, to 4.6 percent of GDP in FY 2015/16, and should decline marginally to 4.5 percent in FY 2016/17, on the back of significantly higher revenue and continued stringent control on current expenditure, including rationalization and better targeting of subsidies. At the same time, development expenditures and spending on social safety nets have been on a rising trend to ensure the sustainability of long term growth. The stock market in Pakistan has performed strongly, and MSCI has reclassified Pakistan from frontier to emerging market, effective June 2017.

Over the medium term, the authorities expect GDP growth to accelerate to 7 percent, supported by strong CPEC-related investment, positive externalities from better infrastructure and energy availability, and an overall improvement in the security situation. Inflation should remain subdued in the 4.0-4.5 percent range. After its projected increase to 3 percent of GDP in FY 2016/17, mainly due to higher oil prices and FDI-related imports, the external current account deficit should be contained over the medium term on expectations of a slowdown in import growth and stronger recovery in exports and remittances, with increasing contribution of non-debt creating inflows to its financing. Amid rising current account deficit and broadly stable exchange rate, foreign reserves have declined, but going forward will be maintained at comfortable levels to safeguard against external shocks.

**Fiscal Policy**

Fiscal consolidation, while accommodating higher development spending, remains a key priority. The authorities are fully committed to deficit reduction through revenue mobilization and rationalization of current expenditure, while providing adequate space for growth-enhancing spending and protection of vulnerable population through targeted social spending.

Revenue mobilization has been a major undertaking. Tax-to-GDP ratio has increased from 10 percent in FY 2012/13 to an estimated 12.8 percent in the current year. Tax collection has significantly improved owing to a number of measures instituted by the Federal Board of Revenue, including assembling a comprehensive database on potential taxpayers to improve tax audit and enhance compliance. These administrative measures will be expanded and strengthened.

The draft FY 2017/18 budget targets a fiscal deficit of 4.2 percent of GDP on the back of strong increases in tax and non-tax revenue and by limiting growth of current expenditure. Development expenditure, which had been contained in the last four years, is budgeted to rise by 2.1 percent of GDP to support medium term growth.

To anchor fiscal policy through a rule-based mechanism, the authorities amended the Fiscal Responsibility and Debt Limitations Act in 2016. The amended law (i) mandates the government to bring the public debt to GDP ratio to 60 percent by June 2018 and further to 50 percent over the next 15 years; and (ii) puts a cap on the federal budget deficit (excluding foreign grants) of 4 percent of GDP for the next three years and 3.5 percent thereafter. Pakistan's net public debt-to-GDP ratio stood at 61 percent in June 2016. Additionally, the authorities have set up a Fiscal Consolidation Committee to consider ways for synchronizing fiscal policy and strengthening budgeting and expenditure monitoring across all levels of government.

Despite strong competing demand on resources, the authorities are committed to further expand the coverage and benefits under the Benazir Income Support Program (BISP). They have initiated a program providing BISP beneficiaries on graduation a one-time cash grant of PRs 50,000 (about US\$500), initially extended to 250,000 families, to start own businesses.

### **Monetary and External Sector Policies**

Monetary policy will continue to target price stability in a forward-looking manner. The current policy rate—kept unchanged since May 2016—has been positive in real terms, containing inflation below the SBP target. Nevertheless, the central bank remains vigilant and stands ready to respond to changes in the macroeconomic environment and inflationary pressures.

The positive real interest rates have not hampered private sector credit growth. Backed by strong deposit growth, credit to the private sector continues to grow at a healthy pace, supporting the expansion of business activity, particularly in textile and garments, chemicals, sugar, construction, and power industries. Consumer financing has also been buoyant in the past few months, a trend that is expected to continue in FY 2017/18.



The authorities are committed to continue strengthening the autonomy of the SBP. An independent monetary policy committee has been constituted, fully empowered to decide on appropriate monetary policy stance. The authorities intend to place before Parliament a number of legislative measures based on SBP proposals—drawing on the Fund’s safeguards assessment recommendations—to further enhance central bank autonomy.

The authorities recognize that a durable and strong export recovery is key to strengthening Pakistan’s external sector position to meet the upcoming debt payments, as elaborated in the staff paper. While noting staff indication of a moderate overvaluation of the rupee, the authorities believe that the extent of overvaluation is less than what is estimated by staff, and are of the view that the recent rise in the current account deficit was largely due to petroleum price increase and CPEC-related imports. Nevertheless, going forward, the authorities would be willing to consider greater exchange rate flexibility, as long as there is a need and appropriate conditions are in place. A number of initiatives have been taken to promote exports, including sales tax zero rating for exports and duty drawbacks as well as a reduction in mark-up rates on Export Refinance Facility and Long Term Finance Facility. The Strategic Trade Policy Framework 2015-18 also aims to promote regional trade with focus on product sophistication and diversification, greater market access, institutional development, and trade facilitation. Most recent trade data suggest a recovery in exports.

### **Financial Sector**

Overall performance of the banking sector remains robust. Bank solvency is strong; capital adequacy ratios are above prudential minimums; and nonperforming loans (NPLs) are declining, with high and improving provisioning. Gross NPLs to total loans ratio declined to an 8-year low of 10 percent by end-2016, with provisions reaching 85 percent. Regulatory practices are now mostly aligned with best international practices. The authorities remain committed to lock in the hard-earned stability gains in the banking sector and, with that in mind, will continue with the phased implementation of Basel III regulatory norms with a view to completing it by 2019. They will continue with their efforts to strengthen the AML/CFT framework in line with international standards.

The authorities attach high priority to financial deepening and inclusion. The SBP has been striving to promote access to formal financial services across regions and population groups with the aim of achieving greater inclusion. To this end, it is pursuing a National Financial Inclusion Strategy covering regulations, development of market information, and infrastructure and capacity building.

## **Structural Reforms**

Continued structural reforms will be crucial for improving competitiveness and enhancing growth and job creation. The authorities are determined to continue consolidating the recent gains by strengthening and building on structural reforms.

Power sector reform, touching on many economic, financial and social dimensions of the economy, was one of the hallmarks of the reform agenda. Projects are underway—some in the context of the CPEC—to double the country’s power generation capacity within a few years. The large stock of power sector arrears was eliminated in just two years, and monitoring of power distribution companies was greatly enhanced. Noting that the recent small buildup of arrears was of a one-off nature, the authorities will remain vigilant that power sector arrears will not accumulate again especially as the generation capacity increases. Important strides have also been made in gas sector reform.

The authorities consider public sector enterprise (PSE) reform and privatization important for reducing fiscal costs and contingent liabilities and for enhancing efficiency. While noting that aggregate annual losses of PSEs remain modest and have been declining, they will continue to improve their financial situation through restructuring to enhance their attractiveness to private investors.

Since FY 2013/14 the authorities have enacted a number of legislative measures covering different sectors of the economy, and others are being implemented, with the objective of establishing a more business friendly legal environment. Particularly noteworthy is the Companies Law 2017 (replacing the Companies Ordinance of 1984), viewed as a major reform to promote corporatization by easing business starts and protecting private investment, based on best practices. The authorities have also consistently demonstrated their commitment to good governance, transparency and accountability. To this end, they have joined the ‘Open Government Partnership’ initiative and have already met virtually almost all of its criteria. Pakistan is also a signatory to the OECD’s Multilateral Convention on Mutual Administrative Assistance in Tax Matters which will help curb tax avoidance and establish a level playing field. The authorities’ commitment to promote Pakistan’s business climate is reflected in its improved rankings in the World Bank’s “Doing Business” and its recognition as one of the top ten reformers.

## **Conclusion**

The authorities are fully committed to consolidating the economic and structural gains achieved under the EFF-supported program. They request Fund approval of the exchange restriction and multiple currency practice arising from the 100 percent cash margin requirements for non-essential goods imports. They are committed to removing this requirement within one year. Finally, the authorities express their gratitude to the Fund management and staff for their continuous support and valuable advice, and look forward to continued cooperation with the Fund.