



PAKISTAN

July 2014

THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR WAIVER OF NONOBSERVANCE OF PERFORMANCE CRITERION, AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PAKISTAN

In the context of the third review under the Extended Arrangement for Pakistan and its request for waiver of nonobservance of performance criterion, and request for modification of performance criteria, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 27, 2014, following discussions that ended on May 12, 2014, with the officials of Pakistan on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on June 20, 2014
- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Statement by the Executive Director** for Pakistan.

The following documents have been or will be separately released.

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

*Also included in Staff Report

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

Copies of this report are available to the public from

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

International Monetary Fund
Washington, D.C.



PAKISTAN

June 20, 2014

THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR WAIVER OF NONOBSERVANCE OF PERFORMANCE CRITERION, AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

EXECUTIVE SUMMARY

Extended Arrangement under the Extended Fund Facility (EFF): A 36 month, SDR 4,393 million (425 percent of quota) Extended Arrangement under the Extended Fund Facility was approved by the Executive Board on September 4, 2013 and the second review was concluded on March 24, 2014, with a total of SDR 1,080 million disbursed. A fourth tranche of SDR 360 million will be available upon the completion of this review.

Status of the program: Program performance has been mostly positive, with all performance criteria for end-March met except the ceiling on Net Domestic Assets (NDA) of the State Bank of Pakistan (SBP), which was missed by a small margin. Since end-March 2014, the SBP has taken actions to address this shortcoming and is on track to meet the end-June target. The indicative target on social transfer payments was also met. The progress on fiscal and structural reform has been generally satisfactory. Of three structural benchmarks for this review, two were fully met, and the third was partially completed. The authorities completed three prior actions: (i) They sent to parliament a FY2014/15 budget proposal consistent with program objectives that will bring the fiscal deficit to 4.8 percent of GDP; (ii) They prepared a detailed plan to eliminate tax exemptions and concessions granted through Statutory Regulatory Orders (SROs) and converting the remainder into regular legislation over three years; and (iii) They finalized the determination and notification of electricity tariffs for FY2013/14. Four new structural benchmarks are proposed for inclusion at this review.

Key issues: Discussions focused on progress in addressing the main macroeconomic challenges facing the country and efforts to advance the structural reform agenda. Particular attention was given to: (i) agreement on the principal measures for further fiscal consolidation in the FY2014/15 budget consistent with program targets; (ii) measures to enhance tax revenues by broadening the tax net and improving tax administration; (iii) challenges on the balance of payments and efforts to address external vulnerabilities and boost reserves; (iv) ongoing steps to safeguard financial stability; (v) measures to protect the most vulnerable; and (vi) further structural reforms to unlock Pakistan's medium-term growth potential. The mission raised its growth forecast slightly. Risks to the outlook are easing, but remain tilted to the downside. Security concerns remain a critical risk factor. Delays and slippages in implementing key policy reforms could damage growth prospects and ultimately undermine macroeconomic stabilization. Pressures on the balance of payments have been ameliorated, but downward risks remain. Mission discussions were held offsite, but with COM's assistance, the mission chief conducted a joint press conference, along with several outreach events with press, parliamentarians, donors, and university students in Islamabad. Two outreach events were also held in London.

Approved By
**Mark Flanagan and
 Daniela Gressani**

Discussions took place in Dubai during April 30–May 12, 2014. Staff representatives comprised J. Franks (head), F. Salman, A. Shahmoradi, B. Baltabaev (all MCD), E. Flores (FAD), A. Al-Hassan (MCM), C. Tovar (SPR), K. Manasseh (COM), and M. Dailami (Resident Representative). Mr. Sethi (Senior advisor, OED) joined the meetings. At the conclusion, the mission chief held a press conference in Islamabad on May 10, 2014.

CONTENTS

INTRODUCTION	4
MACROECONOMIC DEVELOPMENTS AND OUTLOOK	5
A. Recent Economic Developments	5
B. Macroeconomic Outlook and Risks	7
POLICY DEVELOPMENTS	9
A. Fiscal Policy	9
B. Monetary and Exchange Rate Policies	13
C. Financial Sector Policies	15
D. Structural Issues	18
PROGRAM MODALITIES AND OTHER ISSUES	22
STAFF APPRAISAL	24
BOXES	
1. Regaining Access to International Debt Markets	8
2. Tax Measures for the FY14/15 Budget	10
FIGURES	
1. Selected Economic Indicators, 2008–14	28
2. Selected Financial Indicators, 2008–14	29
3. Selected Banking and Financial Indicators	30

TABLES

1. Quantitative Performance Criteria and Indicative Targets for FY 2013/14 and FY 2014/15	31
2. Structural Benchmarks Under Extended Fund Facility	32
3. Selected Economic Indicators, 2010/11–2014/15	33
4. Medium-Term Macroeconomic Framework, 2010/11–2018/19	34
5. Balance of Payments, 2010/11–2018/19	35
6a. General Government Budget, 2008/09–2014/15	36
6b. General Government Budget, 2009/10–2014/15	37
6c. General Government Budget, 2011/12–2014/15	38
7. Monetary Survey, 2010/11–2014/15	39
8. Financial Soundness Indicators for the Banking System	40
9. Indicators of Fund Credit, 2013–19	41
10. Selected Vulnerability Indicators, 2010/11–2018/19	42
11. Schedule of Reviews and Purchases	43
12. Gross Financing Requirements and Sources, 2013–17	44

APPENDIX

I. Letter of Intent	45
Attachment I: Memorandum of Economic and Financial Policies	47
Attachment II: Technical Memorandum of Understanding (TMU)	64

INTRODUCTION

- The economy is showing signs of improvement.** The FY2013/14¹ growth projection has been revised upward from 3.1 percent to 3.3 percent, as economic indicators continue to show better-than-expected performance. For FY2014/15, the economy is forecast to expand by around 4 percent, some 0.3 percent higher than initially projected, and growth will accelerate further in the medium term as fiscal adjustment eases and structural reforms help alleviate binding constraints in the energy sector, improve efficiency, and enhance the investment climate. Staff's inflation forecast has been adjusted slightly downward. We now expect end-year inflation of 9½ percent this fiscal year, while FY2014/15 inflation is projected to be around 7½ percent. The current account deficit is envisaged to be around 1.2 percent of GDP this fiscal year.
- Program performance was mostly positive.** All quantitative performance criteria (PC) were met with the exception of the ceiling on NDA of the SBP, which was missed by a small margin. Since end-March 2014, the SBP has taken corrective actions, and now is on track to meet the end-June target. The indicative target on social transfer payments was also met. The fiscal deficit target was comfortably met and the government is on track to meet its end-June objective. Progress on structural reform is mostly satisfactory. Of three structural benchmarks for this review, two were fully met—those on tax administration notices and the audit of NEPRA. The third benchmark—on hiring privatization advisers—was not met, as advisers were hired for only three firms rather than six. The government has agreed on a new benchmark to push forward the privatization process with completed share offers for two firms by end-June 2014.
- The balance of payments situation is improving, but remains delicate.** SBP Reserves have improved, boosted by bilateral inflows, including grants, Eurobond issue by the government, and official disbursements from development partners. These inflows contributed to an appreciation of the rupee by almost 7 percent against the dollar during the third fiscal quarter despite accelerated spot market purchases by the SBP. Despite these developments, the reserve position remains insufficient, covering less than two months of imports.
- Prospects are improving, but Pakistan remains vulnerable to economic and security challenges, as well as risks to program implementation.** As reserves have recovered, the exchange rate strengthened, and the fiscal balance has improved, short-term crisis risks have begun to recede. Initial success in stabilizing the economy seems to have attenuated opposition to program reforms somewhat, but the government faces political challenges in broadening the tax net, and in important structural and monetary policy reforms. The authorities also face challenges in their administrative capacity to carry out many complex reforms simultaneously. Finally, security conditions remain difficult and constitute a significant downside risk to the economy.

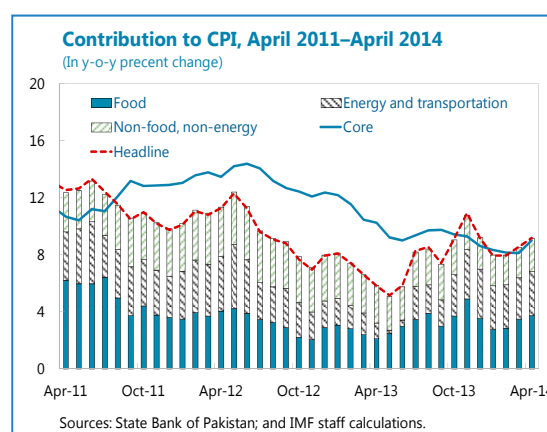
¹ Pakistan's financial year runs from July 1–June 30.

MACROECONOMIC DEVELOPMENTS AND OUTLOOK

A. Recent Economic Developments

5. **The economy is recovering gradually.** Provisional data suggest that the economy expanded by around 4.1 percent in the first half of FY2013/14 over the same period last year, supported by strong growth in manufacturing (5.4 percent y-o-y) and services sectors (4.4 percent y-o-y). Agricultural growth, on the other hand, remained at the same level as last year—around 2 percent. The large scale manufacturing index continues to show a fairly robust growth, with 4.3 percent growth in the first nine months of the current fiscal year, supported by strong food and fertilizer productions.

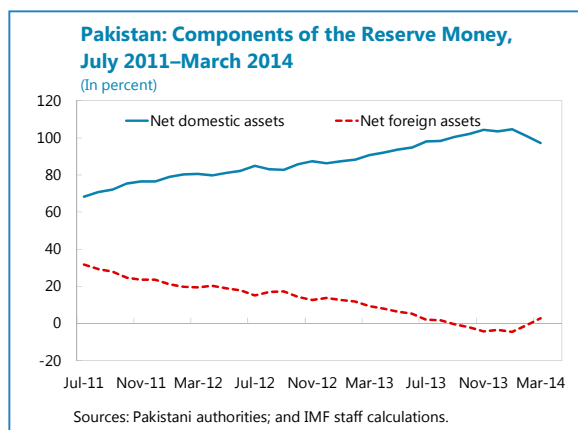
6. **Inflation rebounded to 9.2 percent y-o-y in April.** Headline inflation increased in March and April due to sharp increases in perishable food prices—particularly potato prices, but declined to 8.3 percent in May. However, core inflation increased from 8.1 percent at end-March to 9.5 percent at end-May. Going forward, 12 month inflation is likely to edge up to 9.5 percent by end-June, slightly lower than the 10 percent forecast at the outset of the program.



7. **Gross official reserves have continued to increase, exceeding US\$8.5 billion by late-May 2014.** The current account deficit has remained broadly stable, displaying a moderate slowdown in import growth and continued strong growth in remittances. In dollar terms, goods exports increased by 3.3 percent, while goods imports expanded by 1.8 percent y-o-y in March. Growth in remittances has remained strong, at 17.2 percent over the same period, while foreign direct investment has continued disappointingly weak. The capital and financial account have shown a stronger-than-expected performance, helped by a US\$2 billion Eurobond placement, two tranches of grants from Saudi Arabia totaling US\$1.5 billion, and significant program disbursements from the World Bank and the Asian Development Bank (ADB) amounting US\$1.6 billion. Taking advantage of favorable market conditions, the SBP continued to step up its efforts to build reserves, with net foreign exchange purchases of US\$575 million from the spot market during the third quarter of this fiscal year, and more than US\$995 million so far in the fourth quarter. Notwithstanding this intervention, the exchange rate appreciated sharply in March and has remained roughly stable thereafter, up some 1 percent against U.S. dollar since the beginning of FY2013/14.

8. During the third quarter of FY2013/14, monetary aggregates grew in line with program forecasts.

Foreign exchange inflows helped the SBP's coffers, and for the first time since September 2013 the stock of Net Foreign Assets (NFA) of the SBP turned positive at end-March 2014. With less-than-forecast sterilization, reserve money expanded by 12.2 percent y-o-y, 3 percent higher than the previous projection, causing the NDA target to be missed. Broad money expansion eased slightly to 12.7 percent y-o-y in the third quarter. Credit to the private sector increased by some 5 percent y-o-y in March, still negative in real terms. The government shifted from short-term domestic financing and borrowing from the SBP to longer-term domestic bond and external financing.



9. Fiscal performance in the third quarter was satisfactory. Nontax revenues were lower than envisaged, as revenues from 3G licenses did not materialize until the fourth quarter. However, the fiscal target was met with a margin, due to continued containment of current and capital spending. Moreover, the provinces have supported the consolidation efforts and are on-track to deliver the envisaged surpluses. The slow execution of provincial capital spending suggests that they might achieve larger-than-envisaged savings for the year as a whole.

10. Financial market indicators are broadly positive. Credit metrics show signs of improvement in market sentiments. Since June 2013, the Karachi Stock Exchange Index, KSE-100, has gained 13 percent and the sovereign spread has tightened by 242 basis points. Nonetheless, despite the commencement of trading of government securities in the KSE, secondary market activities remain thin compared to the over-the-counter market. In early April 2014, the authorities successfully returned to the international market with their first Eurobond issuance since 2007 (Box 1). They placed US\$1 billion each with 5- and 10-year maturities, with spreads of 560–554 basis points over U.S. treasuries. The issue was three times oversubscribed.

11. The banking sector continues to be stable and profitable. As of March 2014, overall capital adequacy remains around 15 percent, well above the statutory minimum Capital Adequacy Requirement (CAR), even after the implementation of Basel III. Asset quality indicators are largely stable, with NonPerforming Loans (NPL) hovering around 13 percent and provision coverage at 78 percent. Deposits have grown at steady pace (13 percent y-o-y). In part because of higher yields, in the first quarter of 2014, banks doubled their holdings of Pakistan Investment Bonds (PIBs), long-term government bonds, buying PRs 1.4 trillion against a target of PRs 280 billion. This may result in higher net interest margins, and if continued could perhaps crowd out private sector credit. Profitability indicators improved on the back of lower provision charges and interest income from holdings of government securities.

B. Macroeconomic Outlook and Risks

12. Macroeconomic projections forecast a moderate improvement in growth and external position, with falling inflation next year.

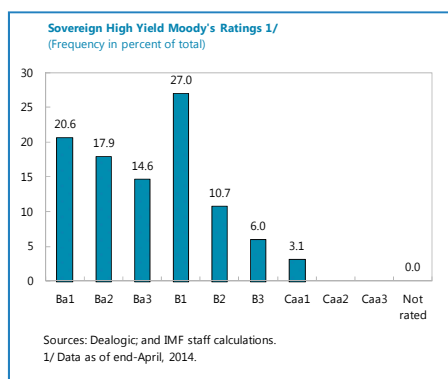
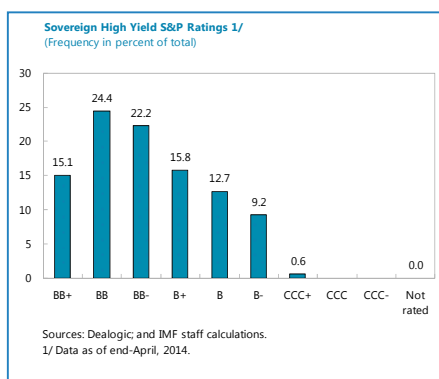
- Growth is expected to accelerate to about 4 percent, and to rise further in the medium-term due to easing fiscal adjustment and improvement in structural bottlenecks. The reform program will ease constraints in the energy sector, boost the efficiency of public enterprises, and improve the investment climate.
- Average inflation is expected to reach about 8.8 percent in FY2013/14 before easing to around 8.1 percent next year, as inflation expectations will be anchored by prudent monetary policy and sustainable fiscal policy.
- Foreign reserves are expected to reach US\$13.3 billion (covering 2.8 months of imports). The current account deficit is expected to remain at around 1.2 percent of GDP driven by the trade deficit, with financial inflows and official loan disbursements increasing, while the government continues to tap international markets for external borrowing and privatization receipts come in support of the authorities' adjustment program. In the medium term, the current account gap is expected to widen somewhat—remaining below 2 percent—as recovery takes hold driving higher imports and financed by higher capital inflows.

13. Crisis risks are expected to ease as program policies reduce macroeconomic imbalances, but downside risks to the outlook remain. Key risks include:

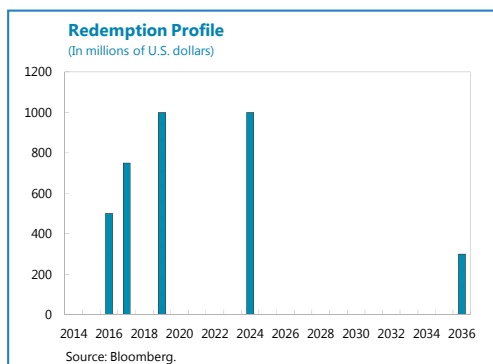
- **Slippages in policy implementation could depress growth.** Delays in the implementation of the reform agenda would impede investment and weaken growth prospects.
- **Security conditions remain challenging.** Investment and growth continue to be hampered by terrorist threats, street violence, and urban criminal activity. The upcoming withdrawal of coalition forces from neighboring Afghanistan may have negative spillovers on security in the border region.
- **External vulnerabilities have subsided somewhat, but the reserve situation remains weak.** Despite the recent improvement in gross reserves, their coverage remains low (below three months of imports). Other potential risks include: oil price volatility, which could threaten the trade balance, weakened economic conditions in GCC countries, which could have negative effects on remittances, and a weakening of the global economic recovery, which could impair exports.
- **Deterioration in the overall macroeconomic environment could have a negative effect on the banking system.** The balance sheets of commercial banks are highly exposed to the public sector (representing 46 percent of banks' total assets) with increase holding of government securities, so an unlikely fiscal crisis would have a large adverse impact.

Box 1. Pakistan: Regaining Access to International Debt Markets

After a gap of seven years, Pakistan raised US\$2 billion by tapping the international debt markets in April 2014. Following three Eurobonds between 2004 and 2007, Pakistan was recently successful in placing 5- and 10-year dollar-denominated Eurobonds in an offer that was three times oversubscribed. The government envisages issuing a US\$500–750 million Eurobond every year until FY2017/18. Fund managers took almost 85 percent of April 2014 issuance, followed by banks. Pakistan currently holds a Caa1 credit rating by Moody’s and B– by S&P.



The structure of sovereign debt issuance is similar to previous Eurobonds, with possible exposure to refinancing risks. The newly issued Eurobonds are denominated in U.S. dollars, fixed-coupon bullet securities, with maturities of 5 and 10 years, similar to earlier issues (except one Eurobond with a 30-years maturity). The bullet structure of these bonds has been widely used because of their secondary market liquidity, but it increases repayment and rollover risks.



Pakistan : Sovereign Debt Issuance Profile

Amount issued (Millions)	Currency	Credit ratings (Moody's)	Issue Date	Maturity Date	Coupon
500	USD	Caa1	Mar-06	Mar-16	7.13
300	USD	Caa1	Mar-06	Mar-36	7.88
750	USD	Caa1	Jun-07	Jun-17	6.88
1000	USD	Caa1	Apr-14	Apr-19	7.25
1000	USD	Caa1	Apr-14	Apr-24	8.25

Source: Bloomberg.

Going forward, in addition to good economic performance and a stable macroeconomic outlook, the authorities should consider a number of key factors when accessing international debt markets.

Specifically: (i) *use of the proceeds*: intended use of the bond proceeds should be publicly announced, especially if the purpose of the bond issuance is to fund projects, budget support, or increasing the efficiency of the local yield curve by benchmark securities; (ii) *debt strategy*: issuance should take into account the medium term objectives of debt strategy; (iii) *size*: a large issuance volume may have carry costs for undistributed balance of the issuance proceeds and rollover risks; and (iv) *currency denomination*: giving preference to foreign currency funding that matches Pakistan’s external liabilities.

POLICY DEVELOPMENTS

Discussions focused on progress in addressing the main macroeconomic challenges facing the country and efforts to advance the structural reform agenda. Particular attention was given to: (i) agreement on the principal measures for further fiscal consolidation in the FY2014/15 budget consistent with program targets; (ii) measures to enhance tax revenues by broadening the tax net and improving tax administration; (iii) challenges on the balance of payments and efforts to address external vulnerabilities and boost reserves; (iv) ongoing steps to safeguard financial stability, (v) measures to protect the most vulnerable; and (iv) further structural reforms to unlock Pakistan's medium-term growth potential.

A. Fiscal Policy

14. **The authorities are taking steps to ensure that FY2013/14 fiscal targets are met.** The tax revenue performance in April suggests a significant shortfall from the original program objectives. Although the authorities have taken some steps to strengthen tax administration in order to improve the underperformance, staff expects that tax revenues will be about $\frac{1}{4}$ percent of GDP lower than envisaged. Moreover, revenues from 3G licenses were also lowered than projected, which reduced nontax revenues by about 0.15 percent of GDP. To address these shortfalls, the authorities are expected to continue to contain current spending to deliver savings of about 0.15 percent of GDP—mainly in nonenergy subsidies and untargeted grants (MEFP ¶19). The lower tax revenues entail lower transfers to the provinces, which will have to reduce provincial current and capital spending to comply with agreed targets and generate additional savings. Provincial underspending—which has been the norm in recent years—could fully cover the remaining fiscal shortfall to meet the year-end deficit target while providing room to avoid further reductions in the federal capital spending.

15. **The authorities envisage further fiscal consolidation in line with program objectives for FY2014/15.** The authorities' budget proposal implies lowering the deficit to 4.8 percent of GDP (prior action). The consolidation is underpinned by tax policies that aim mainly to increase the tax base, including the initial steps to eliminate concessions granted through SROs and a further hike in the Gas Infrastructure Development Cess (GIDC) of around 0.2 percent of GDP (Box 2). While tax revenue measures, at about 0.8 percent of GDP, remain in line with the effort envisaged under the program, the lower revenue base (due to the underperformance in FY2013/14) will produce a lower tax-to-GDP ratio than envisaged in the program. Nonetheless, the remainder of 3G license receipts and a new 4G auction will compensate for this shortfall. The authorities are committed to additional permanent tax measures in FY2015/16 to further raise the tax-to-GDP ratio. On the expenditure side, the budget envisages that current spending will remain contained—including by further reducing electricity subsidies (see ¶132)—in order to provide space for a stronger increase in capital spending and for a further significant increase in targeted support for the poorest under the Benazir Income Support Program (BISP). To help assure program targets can be met, the authorities have identified several contingent measures (both on revenues and expenditures) that can be implemented if the expected fiscal adjustment begins to fall short of the objective (MEFP ¶110).

Box 2. Tax Measures for the FY14/15 Budget

The budget proposal includes a package to expand the tax base and raise additional revenues to support fiscal consolidation. The measures are expected to yield about 0.75 percent of GDP, with a large share coming from income taxes.

The first pillar of the package is expected to broaden the tax base, by implementing the first stage of the plan to eliminate most SROs. Key measures include:

- **Income tax SROs.** Eliminating some SROs that grant concessions on government subsidies, services, construction contracts outside Pakistan, large trading houses, advertising agencies, and foreign news agencies. Moreover, the exemption of nongovernment organizations will be replaced by a full tax credit.
- **Sales tax SROs.** Eliminating some SROs granting concessions on imported plants and machineries and 33 additional items, plus trimming concessions for 21 sectors—to charge them with the standard rate—and charge a higher, albeit still reduced, rate for the five export-oriented sectors.
- **Customs SROs.** Bringing 30 sectors and 133 HS codes under the normal tariff regimes, withdrawing concessions for 138 industries, and setting the normal tariff rates for machinery and equipment imported by textile firms.

Tax package for FY14/15	
	Yield (% of GDP)
Total	0.75
SROs	0.34
Income	0.12
Sales	0.12
Customs	0.10
Other measures	0.41
Income	0.34
Sales	0.04
Customs	0.02
Excise	0.01
Memorandum	
Base-broadening measures	0.52

The second pillar of the package includes a mixture of measures to increase other taxes, some of which broaden the tax base—including a new tax on capital gains—while others merely increase rates. These include:

- **Higher income taxes.** Harmonizing the tax rate for association of persons with the corporate tax rate, establishing an alternative minimum tax on accounting income, increasing tax rates on interest and dividends—albeit adjustable for tax filers, introducing an advance capital gains tax on bonus shares, increasing withholding tax on motor vehicles, increasing withholding rates on services for nonfilers, reducing exemptions from Mutual Funds, and increasing tax rates for banks.
- **Increased sales and excise taxes.** Setting higher sales tax under the special regimes for steel smelters and ship breakers and a new treatment for beverages. For excises, higher taxes are envisaged on cigarettes, sugar, cement, and air travel.
- **Increased custom tariffs.** Raising duties for certain tariff lines from zero rated, to 1 percent or 5 percent.

16. **The authorities have finalized a three-year plan to reduce tax exemptions and concessions granted through SROs** (prior action). At end-May, the authorities finalized a plan that will eliminate concessions and exemptions amounting about 1 percent of GDP over the next three years. In the first stage, the authorities have included 0.35 percent of GDP in SROs for elimination in the FY2014–15 budget, with another 0.3 percent of GDP slated for elimination in FY2015–16 and 0.35 percent of GDP in FY2016–17. By 2015, the remaining SROs will be incorporated into the tax law. These include customs SROs amounting to about 0.3 percent of GDP, which are linked to free trade agreements, income tax SROs related to international treaties amounting about 0.3 percent of GDP, and other SROs amounting about 0.4 percent of GDP that are considered by the authorities to be too sensitive to be eliminated. These remaining concessions include sensitive items like fuels, and concessions linked to bilateral/multi-lateral treaties, sovereign guarantees, and constitutional positions, etc. The authority to issue new SROs which grant concessions or exemptions will also be eliminated by 2015, and the authorities renewed their commitment to in the interim refrain from issuing any new ones.

17. **In parallel to the efforts to reduce tax expenditures, tax administration efforts are key to moving toward a more fair and equitable tax system.** Key developments include:

- **Expanding income tax compliance.** The authorities have issued more than 80,000 income tax notices to individuals with large apparent assets or income who have not filed tax returns, and have followed with second notices as envisaged under the program (MEFP ¶13). The effort in delivering these notices seems to be starting to bear fruits. So far more than 8,000 individuals have filed their taxes as a result of this scheme. Moreover, the authorities are strengthening the database of potential taxpayers by incorporating additional sources of information—like urban property transactions and vehicle procurement. The authorities issued a tax directory of parliamentarians in February, and of all taxpayers at end-April. They also issued notices to all 45 parliamentarians that have not paid taxes. These efforts will be further reinforced by increasing the number of tax audits to 5 percent—up from 2.2 percent.
- **Improving the compliance in other taxes.** To enhance the sales tax base, the authorities are: (i) pursuing electronic volume tracking of production; (ii) undertaking field surveys; (iii) implementing a computerized risk-based evaluation of sales taxes to highlight discrepancies of sales tax invoices; and (iv) pursuing e-registration to prevent spurious registration. With respect to customs, the authorities have revised valuation rulings, and are implementing electronic data interchange connectivity with Afghanistan.
- **Strengthening the Federal Board of Revenue (FBR).** The authorities have set up an Integrity and Performance Unit to encourage high achievers and prosecution of corruption. In addition, they set up a Fiscal Management Cell to handle intelligence and investigation of nontaxpayers.
- **Tax incentive scheme.** Fewer than 4,500 taxpayers took advantage of the authorities' tax amnesty scheme introduced in November 2013. Collections related to the nonfilers and nonregistered pillars of the scheme are minimal (less than PRs 150 million). The pillars related to current filers, nonfilers, and nonregistered are no longer available. However, the component of

the scheme designed to promote investment by granting immunity from investigation on the source of income to finance certain investments remains in effect.

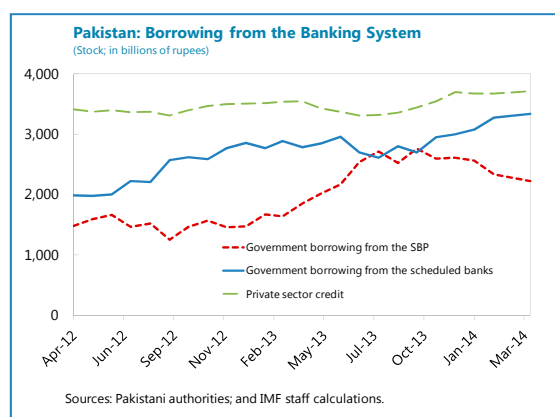
- **Stepping-up anti-tax evasion efforts using the anti-money laundering (AML) regime.** The Ministry of Finance and the Financial Management Unit (FMU) are working with the FBR to include serious tax crimes in the AMLA 2010. The authorities plan to submit amendments to the AMLA to Parliament by end-September 2014 (structural benchmark). In addition, by end-June 2014, the FMU should provide proper guidance to assist financial institutions and the FBR to detect abuse of the investment incentive scheme.

18. **Provincial support of fiscal consolidation efforts is key for fiscal sustainability.**

Following last years' agreement under the Council of Common Interest (CCI), the provincial finance secretaries have formally agreed to continue the arrangement of saving additional revenues to deliver surpluses for FY2014/15 in line with the program (MEFP ¶16). So far, these surpluses (about 0.8 percent of GDP) are consistent with saving of additional tax revenues envisaged under the program. However, the provinces' own efforts to collect revenues remain low, despite the large tax base that falls under their purview—including income tax on agriculture and sales tax on services. In addition, devolution of certain expenditure responsibilities has not produced a corresponding shift in public employment and reduction in federal spending, and scope remains for further decentralization. Considering low provincial own revenues and large surpluses, progress toward a new National Finance Commission (NFC) award is key to ensure long-term fiscal sustainability. The authorities plan to begin discussions toward a new NFC award in the coming months, and international partners have offered technical assistance to support this process.

19. **The government curtailed borrowing from the SBP in Q3 FY2013/14.**

The government managed to avoid further borrowing from the SBP and met the end-March performance criterion by a margin of PRs 160 million. The recent US\$2 billion Eurobond issue was a step toward diversifying funding sources and lengthening the maturity profile of public debt. Staff discussed with the authorities implementation of recommendations in the new Medium-Term Debt Strategy (MTDS) for a further reduction of government borrowing from the SBP in line with program targets. A strong appetite for longer-term PIB auctions and the less-than-expected performances in T-bills auctions are signs of that banks may require higher returns to cover fiscal financing needs, and may call for a revised debt issuance policy to accommodate such higher yields.



20. **Increasing targeted support for the poor remains a key component of the program.**

The authorities met the indicative target on cash transfers under the Benazir Income Support Program (BISP), reaching 4.4 million beneficiaries. They are also on track to achieve the end-June, 2014 target. In FY2014/15, the authorities will increase cash transfers to the vulnerable through the

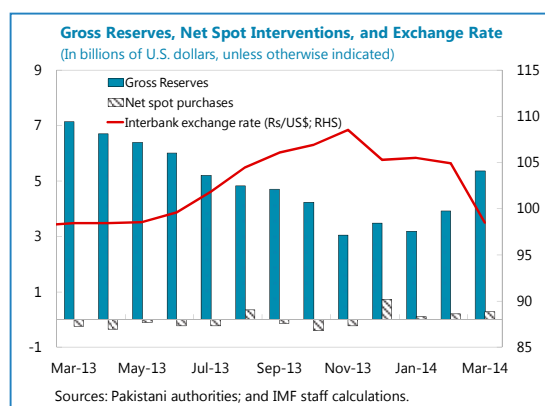
BISP by 25 percent to address poverty and inequality concerns and protect the most vulnerable from the impact of the energy price adjustments, inflation, and fiscal consolidation. Coverage of the BISP will also increase by an additional 10 percent in FY2014/15 (MEFP ¶17). In the meantime, to improve rural coverage, reduce disbursement costs, and ensure delivery of payments, the authorities will move towards branchless banking and personalized ATM cards by July 1, 2014.

21. **Staff welcomed the efforts to enhance public debt management operations.** The authorities have approved a MTDS in April 2014 and intend to issue an annual borrowing plan, which specifies types of instruments and distribution of financing throughout the year. The authorities and staff held a workshop, along with other stake holders, to discuss institutional reforms, capacity building, and necessary legal amendments to strengthen debt functions within the Ministry of Finance. As debt management functions are currently fragmented across several different agencies with weak coordination, the authorities plan to revamp debt operations through consolidating debt functions under a fully-fledged Debt Management Office with decision-making over all government debt by end-September 2014 (structural benchmark), filling vacancies, and designing a training program, (MEFP ¶20).

B. Monetary and Exchange Rate Policies

22. **The SBP comfortably met the foreign reserves target, but missed the NDA target by a small margin.** The central bank met the end-March Net International Reserves (NIR) target by a wide margin of US\$735 million. Favorable foreign exchange market conditions have helped the SBP to continue purchasing in the spot market, totaling US\$995 million so far in this quarter. The SBP managed to narrow its net short swap/forward position by US\$550 million, overperforming the end-March target by US\$120 million. The ceiling on government borrowing from the SBP was also met as the ministry of finance curtailed borrowing from the SBP (by PRs 163 billion, MEFP ¶19). However, sterilization of foreign exchange inflows and liquidity management through open market operations were not sufficient to contain NDA growth, and the SBP missed the end-March program ceiling by PRs 41 billion (about 2 percent of the NDA target, MEFP ¶4). The SBP had already reduced the stock of NDA by some PRs200 billion by end-April and is on track to meet the end-June target. Staff stressed that to avoid any slippages in future, the SBP should appropriately use open market operations to sterilize foreign exchange inflows and spot market interventions to keep NDA in line with program targets.

23. **Staff raised concerns about the recent rise in both core and headline inflation and urged the authorities to maintain a tight monetary policy aimed at anchoring inflationary expectations.** The SBP has raised the policy rate by 100 basis points in FY2013/14 and the rate is positive in real terms. The SBP agreed to adjust the policy interest rate in a forward-looking fashion to maintain positive real interest rates in line with low inflation path, and to ensure stable and well-managed macroeconomic

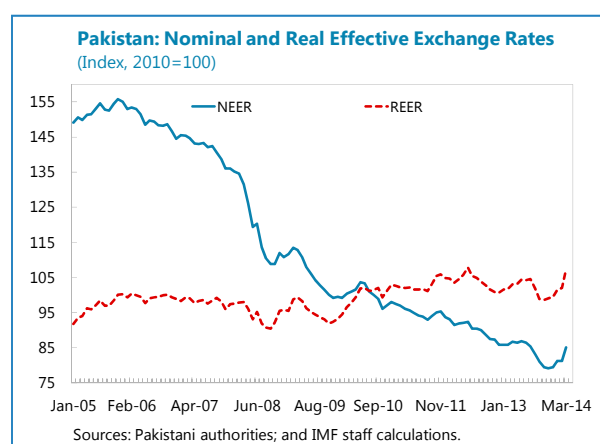


conditions for investors and market participants (MEFP ¶16). Staff argued that additional policy actions should be considered over the coming months to maintain the agreed declining inflation path. Staff encouraged the authorities to consider a transition to the inflation targeting framework over the medium term, and move beyond merely meeting program monetary targets. However, given the institutional arrangement between the SBP and the federal government, and the need to establish necessary legal and operational framework, the SBP noted that further study would be required and the existing framework would need to suffice for some time to come. The SBP agreed that the program should set NDA targets to reflect inflation dynamics and reduce government borrowing from the central bank.

24. Although foreign reserves have recovered, they are still low. Staff

encouraged the authorities to take advantage of the current favorable market conditions to continue purchasing foreign reserves in the spot market to build cushions and meet NIR targets. Although recent grants from Saudi Arabia (totaling US\$1.5 billion) and the successful US\$2 billion Eurobond issue have eased foreign exchange market pressures and have begun to alleviate balance of payments crisis concerns, staff suggested that the SBP

should not bet on one-offs inflows (e.g., grants and privatization receipts) and should align monetary and exchange rate policy to further boost reserves. Staff also raised concerns about the recent appreciation of the nominal exchange rate and stressed that a more flexible exchange rate will help SBP to better reach its reserves objectives and boost competitiveness. The SBP agreed with staff that one of the major challenges faced by the economy is to build foreign exchange reserves. It understands that higher interest rates could help attract private inflows to finance the current account deficit, but believes that currently the current account deficit is low and the main deterrent to private inflows is not the interest rate. However, the authorities do not share staff's view that the exchange rate is somewhat overvalued, and place greater priority on the nominal exchange rate stability.



25. Staff reiterated that enhanced central bank independence is key for an improved monetary policy framework. The authorities have submitted amendments to the SBP Act to the National Assembly (NA), with a view toward having them enacted by end-June 2014 (structural benchmark). Staff provided comments on proposed amendments, noting that while the draft addresses some key weaknesses identified in the Safeguards Report, other weaknesses remain, including constraints to the SBP's autonomy in the pursuit of its objective, and weaknesses in the SBP's governance and internal control framework. The authorities agreed to continue working to ensure that the final law incorporates the recommendations of the IMF safeguards assessment mission and comments provided by Fund staff.

- Staff stressed that the law should strengthen the autonomy of the SBP, through (i) full operational independence in the pursuit of price stability as the SBP's primary objective, (ii) enhanced governance structure, including strong internal controls; and (iii) strengthened personal autonomy of Board members and the financial autonomy of the SBP. Among other things, the amendments should establish an independent decision-making monetary policy committee to design and implement monetary policy and prohibit any form of new direct lending from the SBP to the government.
- Independent of the new legislation, the SBP also agreed that to improve its internal operations, by end-August 2014 (new structural benchmark), by (i) reestablishing an advisory monetary policy committee to advise the Board on its policy decisions, which could then be converted into a decision-making body once the legislation is approved; (ii) establishing a Board committee to centralize and oversee risk management activities across the bank; and (iii) start publishing summaries of the monetary policy proceedings of the Board meetings and monetary policy committee deliberations (with an appropriate lag) (MEFP ¶17). Finally, to help with the transition to International Financial Reporting Standards (IFRS), the SBP agreed to hire a consultant to help with the adoption of IFRS as its financial reporting framework by end-September 2014.

C. Financial Sector Policies

26. **Staff urged the SBP to continue monitoring the implementation of the time-bound action plan to address capital adequacy issues with a few problem banks.** Plans to deal with undercapitalized banks are advancing relatively well. There are four banks (one state-owned and three private) operating below the statutory minimum CAR (10 percent), comprising 6.4 percent of banking assets and with the total capital shortfall being less than 0.05 percent of GDP (PRs 13.2 billion).²

- **State-owned bank.** After the bank's CAR declined to almost 9 percent due to the implementation of Basel III, it has improved to 9.3 percent as of end-March 2014. Given the current profitability trend, the bank will possibly meet the CAR requirement by end-December 2014.
- **Private banks.** To meet its capital shortfalls, one bank received an Expression of Interest from a strategic foreign investor for both capital injection and acquisition of shares from existing major shareholders. Another bank has received PRs 2.5 billion from major shareholders as advance against a subscription of rights issue and offers from potential foreign investors as well as commitment from existing sponsors for injection of the remaining capital shortfall. The SBP is actively engaged with the last bank for merger with a domestic bank over the coming months and possibly a capital injection.

² The state-owned bank, representing around 3.7 percent of banking assets, is only 0.7 percentage points below the statutory CAR.

27. **To avoid any perceived forbearance, staff stressed the importance of taking regulatory measures in case banks are unable to raise needed capital.** The authorities indicated that the SBP has sufficient legal powers for resolution or restructuring of problem banks as in the past.³

Moreover, the SBP has made a preliminary assessment of its resolution framework against the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions and plan to perform a detailed assessment in the context of a technical assistance from the IMF.

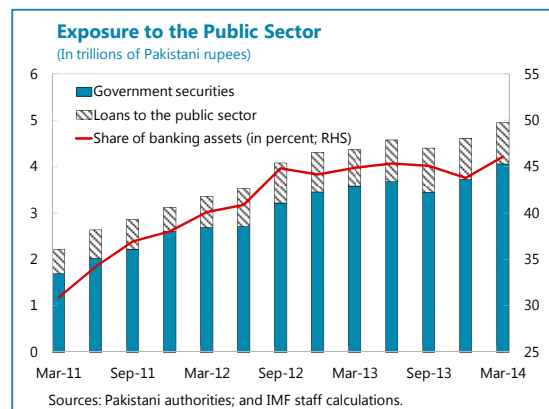
28. **Staff supported ongoing financial sector reforms to ensure financial stability** (MEFP ¶23 and ¶24). In particular:

- **Deposit insurance scheme.** The draft legislation for the Deposit Protection Fund (DPF) will be finalized during the second half of 2014 in consultation with the IMF in the context of a technical assistance on a contingency planning framework. Therefore, the authorities requested a modification of the structural benchmark to June 2015. The proposed amendments to the SBP Act establish the DPF as a subsidiary of the SBP, with benefits being: cost-effectiveness, ability to share staff resources and skills, better information sharing and cooperation, and prompt reimbursement to insured depositors in the event of a bank failure.
- **Bankruptcy issues.** To help expedite the process of rehabilitation and liquidation under a formal and regulated framework, the Securities and Exchange Commission of Pakistan (SECP) envisages addressing bankruptcy issues through: (i) establishing Corporate Restructuring Companies (i.e., asset management companies) for managing troubled assets; and (ii) developing a bankruptcy law to tackle stakeholders' concerns on the draft Corporate Rehabilitation Act, relating to the appropriate balance between creditors and debtors, and long litigation and resolution processes.
- **Consolidated supervision.** Staff welcomed periodical meetings over the last few months of the SBP-SECP joint task force (JTF) on consolidated supervision. The JTF is developing an early warning system for financial conglomerates with trigger points on corporate governance and compliance with regulatory instructions; financial performance; credit worthiness; capital adequacy; cross shareholding; risks management and controls systems; and intra-group exposures.

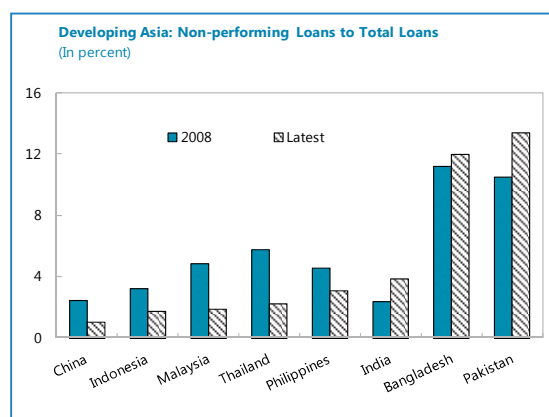
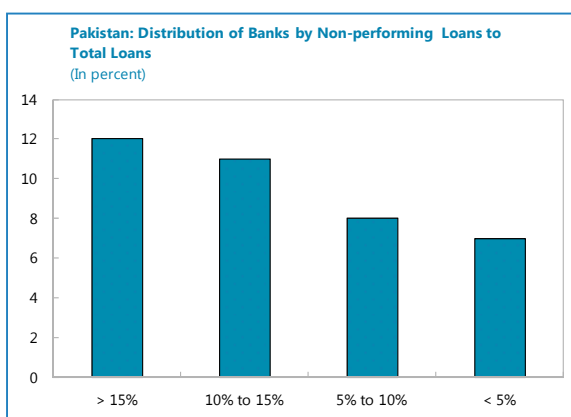
29. **Increasing exposure of banks to the public sector may pose risk and hinder financial intermediation.** Over the last two years, bank exposure to the public sector has increased from 30 percent to 46 percent, mainly because of holdings of government securities. Banks hold around 76 percent of outstanding government securities, and 83 percent of these securities are held as

³ In the absence of a deposit insurance scheme, one shortcoming of the resolution framework is that deposit guarantee only applies to nationalized banks under the Banks (Nationalization) Act.

Available for Sale that may expose banks' balance sheet to revaluation risks. Similarly, loans to public sector entities are generally guaranteed by the government; and thereby, carry the possibility of being converted to government securities in case public sector entities are unable to meet their debt service obligations. The authorities and staff agreed that lower fiscal financing needs from the banking system—as envisaged under the program—is ultimately critical to foster the recovery of private sector credit and economic growth.



30. **Staff urged the authorities to finalize a set of measures to address high levels of nonperforming loans.** Though NPLs remain at elevated levels when compared to other countries in the region, provisioning seems to be adequate (around 80 percent). The SBP has a conservative approach in defining NPLs, as subjective evaluation of the credit portfolio is being made for risk assessment in addition to time-based criteria, and provisioning requirements are assessed on quarterly basis.⁴ The SBP, in consultation with stakeholders, is formulating few proposals to address high NPLs by: (i) proposing amendments to the Financial Institutions (Recovery of Finances) Ordinance 2001 to give adequate powers to financial institutions for the expeditious recovery of finances (in light of the Supreme Court decision on foreclosure related provision); (ii) introducing legal amendments to enable appointment of District Judges in banking courts to fulfill vacant positions, since High Court judges are not always available for posting in banking courts; and (iii) allocating necessary resources to address lack of facilities and equipment as well as training staff in the banking courts. Successful implementation of these measures over time, along with supporting markets for distressed debt, should help to reduce the large amount of NPLs in the banking system and stimulate private sector credit.



Sources: Pakistani authorities; IMF Financial soundness Indicators, and IMF staff calculations.

⁴ NPLs are classified as: watch (30–60 days), substandard (60–90 days), doubtful (90–180 days) and loss (over 180 days). Both NPLs and provisioning are verified by external auditors.

31. **Compliance with the AML/CFT standard should be stepped up swiftly.** Pakistan's current listing by the Financial Action Task Force (FATF) imposes costs on financial intermediation because of heightened due diligence requirements by international financial institutions. The authorities are therefore encouraged to enact the Anti-Terrorism (Amendment) Ordinance 2013 as a permanent law in line with the action plan agreed with the FATF.

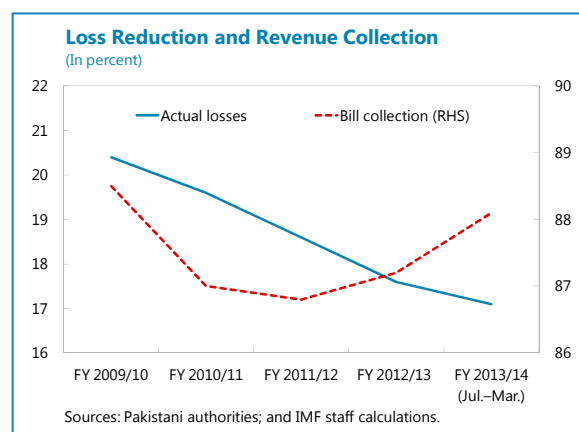
D. Structural Issues

32. **Staff welcomed the continued implementation of key structural reforms.** Efforts by the authorities focus on: (i) continuing with energy sector reforms; (ii) acting decisively on commitments to privatize public sector enterprises; (iii) continuing efforts in moving to a simpler and more transparent import tariff regime; and (iv) enhancing the business climate. Two new structural benchmarks are set for meeting key objectives in the energy sector and on privatization.

Energy Sector

33. Energy price adjustments

(MEFP ¶26). The authorities continue with their plans to bring electricity tariffs to cost recovery levels. The National Electric Power Regulatory Authority (NEPRA) finalized the FY2013/14 determination of electricity tariffs (prior action). Despite, lower fuel cost and reduced technical and distribution losses translating into lower determined prices. NEPRA's notification implied an increase in electricity tariffs by on average 4 percent, while eliminating subsidies on industrial, commercial, bulk, and residential consumers above 200kWh of monthly consumption. This tariff adjustment is expected to reduce the electricity subsidies to 0.5 percent of GDP in FY2014/15 from around 1 percent in the previous year.



34. **Arrears** (MEFP ¶27). The technical and financial audit report identifying the stock and flow of payables in the electricity sector (the so-called "circular debt") has been completed at all levels of the power sector but the generation companies. After the significant payments made by the government to reduce arrears in June 2013 and some accumulation of new arrears thereafter, the preliminary analysis including the generation companies suggests that the stock of arrears stands at around PRs 500 billion by end-March 2014 (about 2 percent of GDP) of which half is the stock of payables in the power sector and the other half is at Power Sector Holding Company Limited (PSHCL) as a debt instrument (the Syndicated Term Credit Finance or STCF). The authorities have identified steps designed to prevent the accumulation of new arrears in the system by the end of the program, while also dealing with the stock. The measures include the following components:

- The stock of arrears at the PSHCL in the STCF facility stood at around PRs 240 billion at end-March 2014. The corresponding accrued debt service continues to add to the payables. The authorities have requested that servicing of the STCF be included in the upcoming NEPRA determination, but if this does not occur, they will levy a surcharge to match the servicing costs in the coming years. If fully serviced, the STCF will constitute a debt instrument and not be included as arrears.
- Outside the PSHCL, payables in the power sector reached around PRs 270 billion at end-March 2014 of which around PRs 90 billion constitute current payables that are less than 45 days overdue and thus not considered arrears. The remainder comprises: (i) a residual leftover from payables clearance the government undertook last year; (ii) a disputed amount with the Independent Power Producers (IPP); and (iii) Nonrecovery and penalties levied on past nonpayment from power distribution companies (DISCOs) to generation companies. Before the close of the current fiscal year, the authorities expect to recover around PRs 100 billion receivables in the power sector owed to DISCOs and to use these resources to reduce the stock of arrears to around PRs 200 billion at the end-June, 2014. Continued efforts to recover DISCO receivables will help the authorities to service the remaining payables to generation companies.
- The authorities are continuing to reduce losses and improve collections through capital expenditures and revenue protection measures including revenue based load management.⁵ At end-March 2014 the losses stood at around 17 percent (down by 0.5 percent from last year) and revenue collections increased from 86.5 percent to 88 percent. Going forward, continued efficiency improvements and higher collection rates (from better enforcement and revenue-based load shedding) will gradually eliminate the accumulation of new arrears and—together with appropriate pricing policies and load management—should allow the residual stock of arrears to be addressed.

35. Monitoring, enforcement, and demand and supply management in the electricity sector (MEFP ¶128–30).

- The authorities finalized six performance contracts with electricity distribution companies and are expected to complete the remaining three by end-May 2014.
- Since the outset of the revenue-based load shedding, collections have increased by 1.5 percent. The authorities are committed to further accelerate the collections.
- Further enhancements were made to the real time reporting of electricity draws, with additional information on subsidy paid, billings, collections and receivables for each consumer group.

⁵ The majority of DISCO receivables are due to non-collection from consumers.

- An additional 700 MW of supply capacity was added to the system. Rehabilitation of generation plants and upgrading electricity transmission and distribution facilities are aimed at recovering an additional 1–1.5 percent of technical losses.
- Finally, the Pakistan Energy Efficiency and Conservation Act was placed before the Council of Common Interest (CCI) for consideration in the upcoming meeting.

36. **The authorities met the structural benchmark on power sector regulatory reform** (MEFP ¶131). Enhancing the administrative and technical capacity of the regulatory body, NEPRA, is key to improve governance in the power sector. The diagnostic study of the regulatory framework of the power sector and the proposed interim report were completed at end-April (structural benchmark). In cooperation with international partners, the authorities identified an action plan with key reform measures:

- Vacancies on the NEPRA Board will be filled by end-July 2014 (new structural benchmark). The board members will possess legal, financial, regulatory or technical skills. To have a comprehensive skill mix, membership will consist of one member with expertise in each of the skills mentioned, after the expiration or renewal of current members' terms.
- Preparations for a multi-year tariff framework have begun, which is critical for eventually reaching full cost recovery. The authorities are on track to establish three year investment plans for at least three distribution companies by end-September 2014.

37. **Oil and gas sector** (MEFP ¶133). Staff is encouraged by the steps taken by the authorities to support new investment, promote efficiency in gas use, and assure that there will continue to be no fiscal costs from the gas sector.

- The authorities finalized the services agreement to facilitate the import of Liquefied Natural Gas (LNG), which should help mitigate gas shortages. LNG imports, which are expected to begin in early 2015, will be directed to the power plants.
- To incorporate inflation and generate additional fiscal revenues (¶15) the authorities will further adjust gas prices by July 1, 2014, including by increasing the GIDC.
- They have also started implementing the new Petroleum Exploration and Production Policy 2012 (2012 Policy) to promote new exploration efforts. The 2012 policy offers higher producer prices for incremental production. As a first step, the authorities awarded 50 new blocks for new exploration, which will be followed by another 10–15 awards later this year.
- In order to bring in efficiencies in the transmission and distribution segments for better operation of the market system, the authorities will hire consultants by end-December 2014 to conduct a study on restructuring and unbundling the downstream gas business. The study will help formulate recommendations based on international best practices including segregating the gas network into one transmission and multiple distribution companies.

Public Sector Enterprises

38. **The structural benchmark on the hiring of privatization transaction advisors was partially met.** The advertisements for the transaction advisors for the six public sector enterprises (PSEs) were issued in March 2014, which delayed the original timeline for capital market transactions. The authorities hired three financial advisors for United Bank Limited (UBL), Pakistan Petroleum Limited (PPL), and Oil and Gas Development Company Limited (OGDCL) in May 2014. Contingent on investor sentiment, the government is committed to offering minority shares in UBL and PPL to domestic and international investors by end-June 2014 (new structural benchmark). The hiring of the remaining three financial advisors will be completed by end-June 2014. Going forward, the privatization program is aimed at offering and/or marketing at least one transaction in each quarter during the upcoming year.

Timeline of the Privatization of PSEs		
1	United Bank Limited (UBL), Pakistan Petroleum Limited (PPL)	End-June 2014
2	Oil and Gas Development Company Limited (OGDCL)	End-September 2014
3	National Power Construction Co. (NPCC)	End-December 2014
4	Allied Bank Limited (ABL), Habib Bank Limited (HBL)	End-March 2015

- The auction of 3G telecoms licenses were successfully launched on April 2014. The auction raised US\$1.1 billion, of which about half was received in foreign currency in this quarter. The remainder will be paid by firms in the next financial year.
- On June 12, 2014, the authorities successfully concluded the first transaction on their privatization agenda with the sale of a residual stake in UBL bank for US\$386 million.
- Pakistan Steel Mills (PSM), Pakistan International Airlines (PIA), and Pakistan Railways (PR) are the major budgetary drains among PSEs. A professional board to PSM was appointed and approved a comprehensive restructuring plan in April 2014 to prepare for potential strategic private sector participation in the company. PR improved revenues in the first nine months of the year through rationalization of tariffs and expenditures and improved occupancy rates. The authorities are also finalizing the renewal of PR Board end-July 2014.

Business Climate and Trade Policy

39. **Staff is encouraged by the progress in moving forward with trade policy reforms however business climate improvement efforts are lagging.** The design of the plan to simplify the import tariff structure was completed by end-May 2014. For FY2014/15, the authorities are moving from eight tariff slabs to six slabs by shifting most items currently at 30 and 35 percent to

the 25 percent rate. Phase-out of trade related SRO's will also begin with the new fiscal year. The broad parameters of the plan for improving the business climate were completed in March 2014. The plan includes simplifying procedures, and reducing costs for setting up businesses and paying taxes. The detailed time-bound plan will be completed by end-June 2014, in coordination with international partners. The elimination of most nontrade SROs which grant tax exemptions and concessions will also improve the business climate by helping to level the playing field across businesses.

PROGRAM MODALITIES AND OTHER ISSUES

40. **The attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) describe the authorities' progress in implementing their economic program and set out their commitments, and propose the establishment of end-September 2014 PCs.**

A waiver of nonobservance is requested, and some modifications to the program's conditionality are proposed (Tables 1–2):

- *A Waiver for the nonobservance of the end-march 2014 performance criterion on the ceiling of the NDA is requested.* The SBP has taken corrective actions to address the missed ceiling on NDA. The SBP has already reduced the stock of NDA by some PRs 200 billion by end-April and is on track to meet the end-June program target.
- *Modification of the adjustor for the end-June performance criterion on the NIR target is requested.* The adjustor will be modified for the fourth review to compensate for a delay in US\$1.2 billion in expected privatization proceeds—which will now materialize in early FY2014/15—with reserves obtained from the overperformance on the Eurobond placement. Staff is of the view that notwithstanding the temporary shortfall in privatizations receipts, the authorities are making sufficient sustainable effort through medium- to long-term borrowing, to raise reserves. As a result, NIR adjustor for the end-June NIR target will exclude the US\$2 billion proceeds from the Eurobond transaction. Going forward, to encourage a balanced approach to reserve accumulation, the adjustor will revert to its previous definition.
- *Modification of the adjustor for the end-June fiscal deficit target is requested.* The adjustor will be modified to allow for the possibility of a small increase in the deficit (up to 0.05 percent of GDP) if the additional deficit is exclusively due to a greater increase in targeted social spending under the BISP than in the baseline (as specified in the TMU). Previously, this adjustor only lowered the deficit if BISP spending fell short of the baseline.
- **The authorities completed three prior actions for the review.**
 - (i) First, the authorities sent to parliament the FY2014/15 budget proposal consistent with program objectives of bringing the fiscal deficit to 4.8 percent of GDP. The budget was approved by parliament on June 18, 2014.

- (ii) Second, to increase the tax base and support the fiscal consolidation effort, the authorities completed a calendar to eliminate tax exemptions or concessions granted through SROs and convert the remainder into regular legislation, which will deliver 1 percent of GDP over the next three years.
 - (iii) Finally, to support regulatory reform in the energy sector, NEPRA continued to adjust the electric tariffs to cost recovery levels by finalizing the determination and notification of electric tariffs for FY2013/14 consistent with program objectives of cutting budgetary subsidies while reducing arrears accumulation.
- *Four new structural benchmarks are proposed* (Table 1):
 - (i) Steps to improve the SBP's internal operations, by: (a) reestablishing the advisory monetary policy committee to advise the Board on its policy decisions; (b) establishing a Board committee to centralize and oversee risk management activities across the bank; and (c) beginning publishing summaries of the monetary policy proceedings of the Board meetings and monetary policy committee deliberations (with an appropriate lag) (end-August 2014);
 - (ii) Filling the vacancies in the NEPRA Board (end-July 2014);
 - (iii) Offering minority shares in UBL and PPL to domestic and international investors (end-June 2014); and
 - (iv) Approving an administrative order to consolidate the responsibilities of public debt management in the debt management office (end-September, 2014).
 - *Two structural benchmarks are to be modified*: The benchmark on SRO reduction will be clarified to include in the FY2014/15 budget the elimination of tax exemptions and concessions granted through SROs for an amount consistent with the fiscal deficit reduction objective. The date for the submission of deposit insurance legislation will be modified to allow more time for technical assistance on the draft.

41. **Financing program risks and capacity to repay the Fund.** Pakistan's program financing needs are fully covered for FY2014/15 and prospect remain good for full financing for the remainder of the program thereafter. Disbursements from multilateral and bilateral partners have materialized in FY2013/14 and new agreements have been reached, providing financing assurances for the next 12-months. Some privatization receipts originally expected in FY2013/14 will also materialize next fiscal year. At end March-2014, the Fund's exposure to Pakistan stood at roughly US\$3.5 billion (65 percent of official gross reserves). Total repurchase for the FY2014/15 is US\$1.3 billion, compared with US\$2.2 billion anticipated in disbursements. Pakistan's capacity to repay the Fund has improved as net exposure has declined, reserves are improving but still remain low, and fiscal and balance of payments pressures have begun to ease. However, materialization of risks to the macroeconomic outlook could still erode repayment capacity (¶13).

42. **Data Issues.** An IMF Technical Assistance mission on Quarterly National Accounts (QNA) statistics was conducted in Dubai from April 29 to May 3, 2014. The mission assessed the sources and methods used to compile the preliminary QNA estimates recently released by the Pakistan Bureau of Statistics (PBS). The mission found that data sources and methodology for compiling the QNA were broadly adequate. The mission recommended improvements in data sources, including possibly the use of additional sources such as monthly sales tax records, government employment and quarterly employment by economic activity from the Labor Force Survey, imports of construction inputs, and data from the rent survey. In order to improve the methodology and the capacity of PBS, the mission and the authorities agreed on a number of steps including compilation of quarterly statistics at current prices.

STAFF APPRAISAL

43. **The threat of an immediate crisis has begun to recede due to the authorities' efforts to address the twin fiscal and balance of payments imbalances, but significant downside risks remain.** Both gross and net foreign exchange reserves are recovering, the net foreign exchange swap/forward position is declining, and exchange rate pressure has eased. Targets on fiscal consolidation are on track, and the government has begun to improve its debt financing by diversifying financing sources, lengthening maturities, and reducing dependence on borrowing from the SBP. While the level of reserves remains too low, and the fiscal deficit is still too high, significant progress has been made in the government's first year and commitments are in place to cut the fiscal deficit further and substantially increase SBP reserves in the coming fiscal year. Among key downside risks, the challenging security situation continues to dampen the investment climate and raise political uncertainty. Delays and slippages in reform implementation could dim the outlook. External shocks, such as oil and food price volatility, interruption in remittance inflows, or delays in realization of official and private inflows, could also add pressures on the balance of payments.

44. **Macroeconomic conditions are improving, but further progress is needed.** GDP growth prospects have been slightly revised upward, reflecting better-than-expected manufacturing output this year, and a less negative fiscal impulse next year accompanied with some easing in energy bottlenecks. Inflation remains high—above 9 percent—but is expected to fall in FY2014/15, as the result of a continued prudent monetary policy stance. Growth remains well below what is needed to boost job creation to fully absorb the rising workforce and generate sustained improvements in living standards for all Pakistanis. Attaining the needed growth of 5–7 percent per year will require continued efforts to safeguard the still fragile macroeconomic stability, but will also necessitate accelerated structural reforms to boost private investment, ease growth bottlenecks, and enhance productivity.

45. **Fiscal consolidation efforts remain on track in FY2013/14, albeit with some compromises on the quality of the adjustment.** While the authorities remain on track to achieve the FY2013/14 deficit targets, lower-than-projected tax revenues are requiring a lower increase in public investment spending than was originally envisaged. The authorities have, however, delivered

on their commitments to reduce electricity subsidies and to raise additional revenues from a levy on natural gas. Moreover, the provinces continue to run the agreed fiscal surpluses, contributing to the adjustment effort.

46. **For FY2014/15, the authorities have committed to reducing the deficit by nearly an additional point of GDP, to 4.8 percent of GDP.** This reduction should further allay fiscal crisis fears and bring the deficit closer to a sustainable level. The bulk of the agreed adjustment will also improve the efficiency of tax collections and expenditures. On the expenditure side, there will be a significant further reduction in untargeted electricity subsidies while making room for increase investment spending and an additional sharp increase in targeted support for the poorest through the BISP. On the revenue side, measures should increase the tax-to-GDP ratio by $\frac{3}{4}$ percent of GDP, mainly via measures to close tax loopholes and broaden the tax base. These objectives will require firm implementation and vigilance against any deterioration in tax administration and full pass-through of any future changes in energy costs. This revenue increase, while welcome, still leaves Pakistan's tax-to-GDP as one of the lowest in the world. Staff would have preferred a more ambitious tax effort for FY2014/15, particularly in terms of base broadening to move Pakistan more decisively toward a tax-to-GDP ratio of 13–15 percent of GDP over the medium term, which is necessary to secure lasting fiscal sustainability while allowing for much needed higher investment in infrastructure, health and education.

47. **Proposed measures to broaden the tax base are welcome, but could have been more ambitious.** The authorities' plan to eliminate concessions and exemptions granted through SROs is a positive development. The SRO reduction or elimination, expected to yield 0.3 percent of GDP in additional revenue in FY2014/15, is a first step but should have gone further. The authorities have committed to a similar effort to cut additional SROs in FY2015/16 and FY2016/17 which will help move toward a modern tax base. Outside of SROs, the FY2014/15 budget could have placed greater emphasis on other bold base broadening measures with a more decisive permanent impact on the revenue-to-GDP ratio, rather than on small tax measures of limited quality. In the next fiscal cycle, the government will need to press forward with additional steps to simplify the tax system, broaden the tax base (including beyond SRO elimination), and provide a level playing field for taxpayers.

48. **On the tax administration side, the FBR has begun to launch initiatives to improve collections, but concrete results are still meager.** Building on the recent release of a registry of all taxpayers, more determined enforcement actions are needed to strengthen compliance, which may also help maintain popular support for the authorities' program. Decisive implementation will not only improve the fiscal stance but will improve the equity and legitimacy of the tax system, and create fiscal space for higher social spending and higher infrastructure investment—encouraging larger private investment by improving the business climate. As a first step it will be important for the authorities to develop a comprehensive strategy to guide their efforts.

49. **The SBP should continue its aggressive efforts to boost foreign exchange reserves.** Encouraged by favorable market conditions, in recent months the SBP has considerably stepped up its purchases of foreign exchange in the spot market. This laudable effort has contributed to the sharp recovery in reserves. However, they remain at low levels and the SBP should continue its

efforts until reserves comfortably exceed three months' of import cover. Greater willingness to accommodate downward exchange rate flexibility could play an important role in accelerated reserves accumulation, while helping boost exports over time. Recent government efforts to attract additional foreign exchange through disbursements from international partners and the recent Eurobond are welcome contributions, which should be complemented in the coming months by privatization proceeds.

50. **Going forward, the SBP should focus on bringing down inflation.** The authorities need to pursue a conservative monetary policy to anchor inflationary expectations. The SBP should adjust the policy interest rates in a forward-looking fashion to maintain positive real interest rates and consistent with reducing inflation sustainably below 8 percent by the end of FY2014/15. Additional policy actions should be taken, without hesitation, to contain inflation in coming months. Over the medium term, the SBP should begin to study adopting an inflation targeting framework in the medium-term, to better manage monetary policy. Legislation to enhance SBP independence by remains a priority, and the authorities should work to ensure that the draft legislation currently in parliament fully conforms to international best practices, including by giving the proposed monetary policy committee decision-making power. The central bank should simultaneously pursue internal reforms (as agreed in a new structural benchmark) to improve its operations, giving it greater credibility and enhancing *de facto* autonomy. In particular, the SBP needs to reestablish the advisory monetary policy committee, constitute a Board committee to centralize and oversee risk management activities across the bank, and start publishing summaries of the monetary policy proceedings of the Board meetings and monetary policy committee deliberations

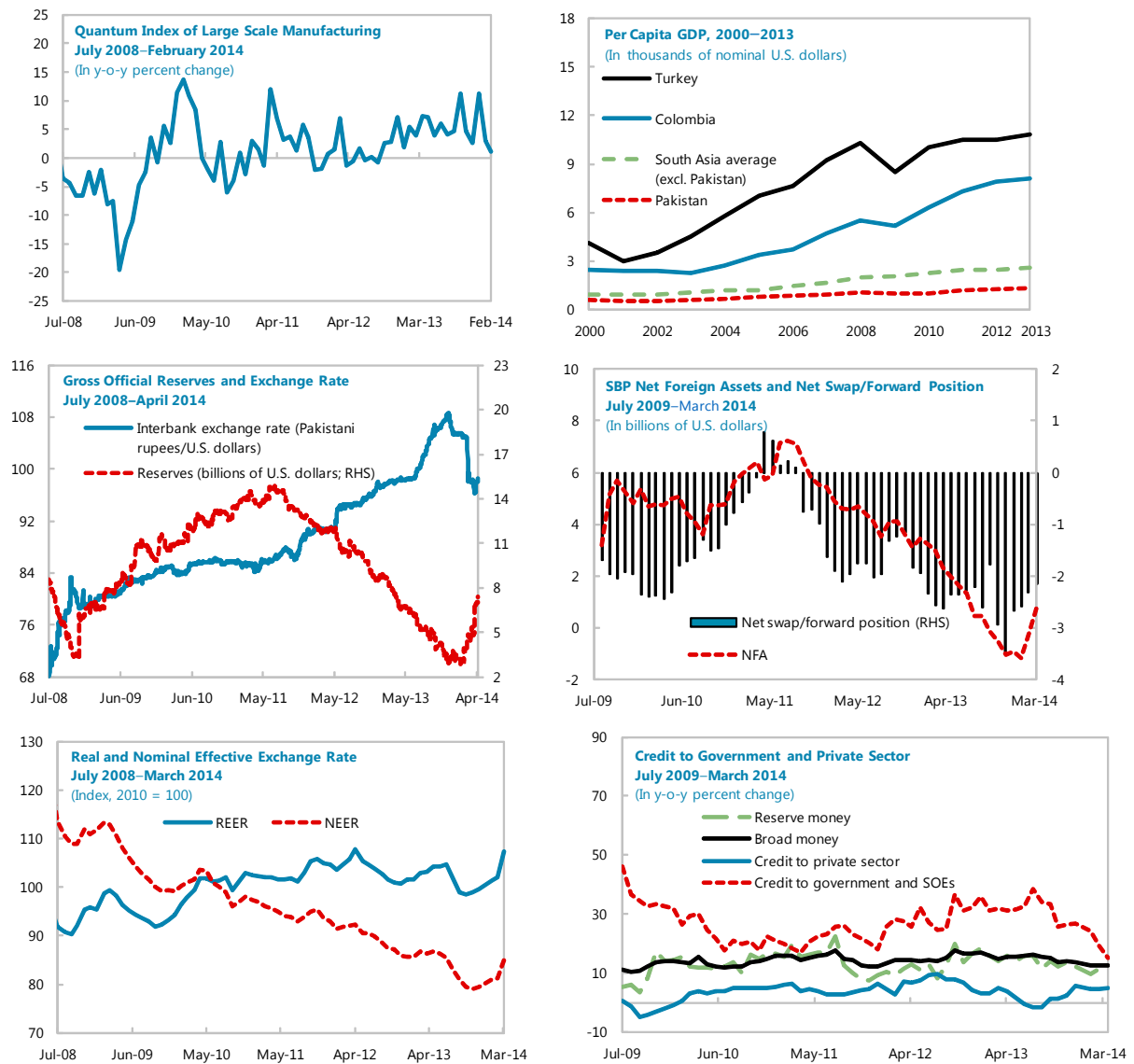
51. **Steps to address financial stability risks and enhance debt management operations are critical.** The authorities are moving satisfactorily to safeguard the stability of the financial sector by addressing those banks that fall below minimum CAR, monitoring sovereign-bank interlinkages, and resolving high NPLs. Staff welcomed the authorities' firm commitment to enhance the effectiveness of public debt management and publish a medium-term debt strategy.

52. **Deep structural reforms remain critical for improving economic performance over time.** The authorities' progress on their energy policy is welcome; they have begun addressing the administrative constraints on the power sector's regulatory framework and continue to work on improvements in the operations and collections of energy companies. The implementation of gas price rationalization is moving forward with the gas levy and more favorable producer prices to better allocate the current supply and encourage new production. Despite some delays, the commitment to privatization of public sector enterprises (PSEs) remains strong with first revenues to arrive soon. The authorities may, however, encounter difficulties if market appetite diminishes. The government is moving forward with trade policy implementation in the coming fiscal year. However, firmer action is needed on business climate reforms to move forward.

53. **Keeping the program on track in future reviews will require strong political commitment at the highest levels, together with steadfast implementation by the government and SBP.** As crisis risks begin to ease, there may be renewed pressure to slack off on politically sensitive reforms. However, permanent improvement in the economy can only be achieved if the reform process continues. The authorities may need to step up efforts to explain the benefits of the difficult fiscal, monetary, and structural measures contained in the program to political and business leaders, as well as to the general public. While many of these measures may entail short-term political costs, they will bring lasting benefits to the country in higher and more inclusive economic growth.

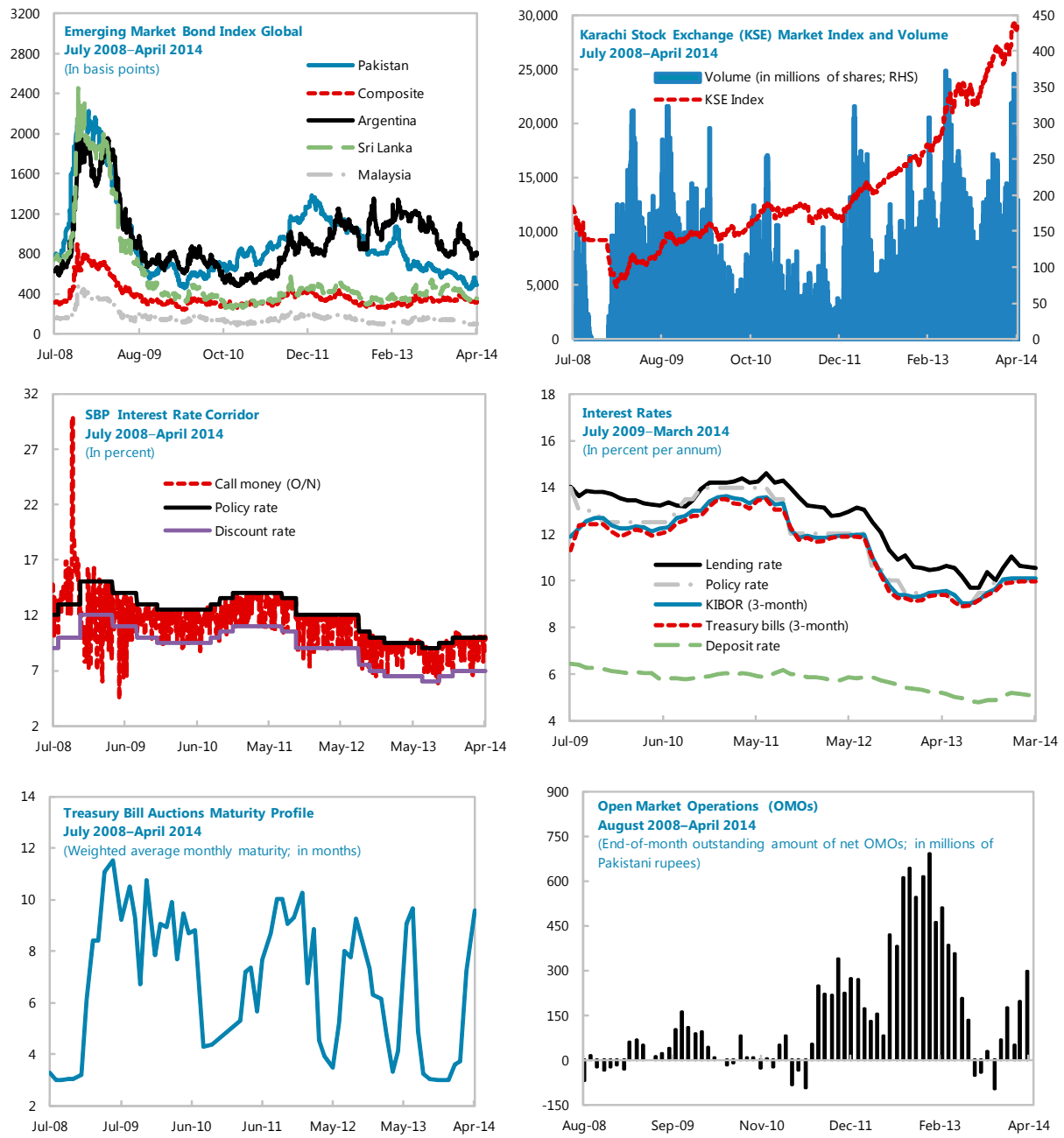
54. **On the basis of Pakistan's performance under the extended arrangement, staff supports the authorities' request for completion of the third review under the arrangement and for a waiver for the nonobservance of the end-March 2014 performance criterion (PC) on NDA of the SBP and modification of adjustors for the NIR target and the fiscal deficit target.** Staff also recommends the establishment of the end-September 2014 PCs as proposed in the attached MEFP, setting of four new structural benchmarks, and the revised definitions of a structural benchmark in the attached TMU.

Figure 1. Pakistan: Selected Economic Indicators, 2008–14



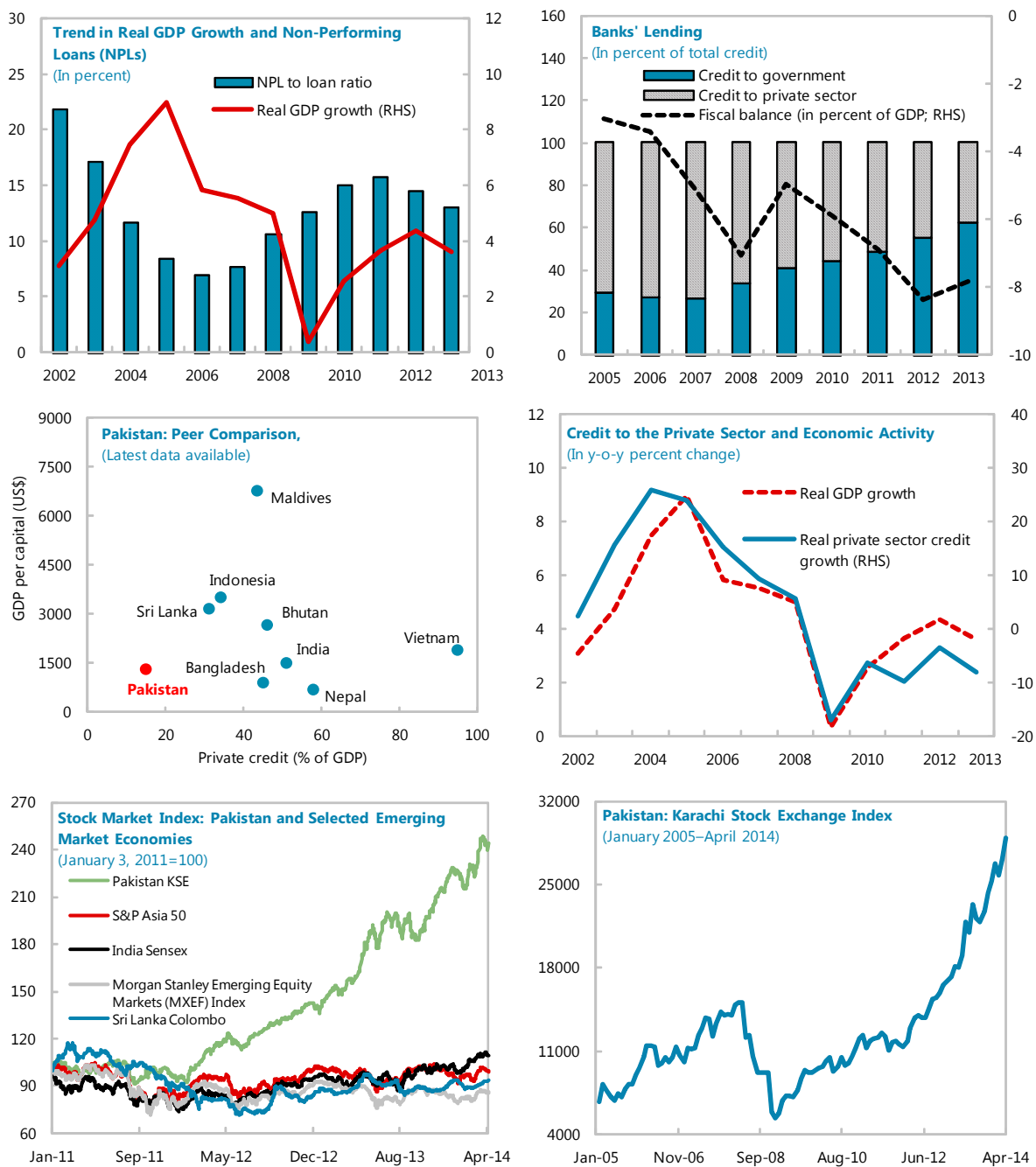
Sources: Pakistani authorities; and IMF staff calculations.

Figure 2. Pakistan: Selected Financial Indicators, 2008–14



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

	FY2012/13		FY2013/14						FY2014/15		
	end-June	end-September		end-December		end-March		end-June	end-September	end-December	end-March
	Actual	First Review	Actual	Second Review	Actual	Third Review	Actual	Program	Projection		
Performance Criteria											
Floor on net international reserves of the SBP (millions of U.S. dollars) 2/, 3/ 4/	-2,437	-2,850	-3,154	-5,107	-4,547	-2,872	-2,140	1,800	3,000	3,500	4,500
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees) 5/, 6/	2,402	2,877	2,595	2,968	2,821	2,609	2,650	2,324	2,306	2,420	2,324
Ceiling on overall budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 7/	2,012	419	297	882	572	1,209	982	1,464	376	711	1,095
Ceiling on SBP's stock of net foreign currency swaps/forward position (millions of U.S. dollars)	2,255	2,255	1,775	2,255	2,650	2,255	2,135	2,150	1,900	1,775	1,775
Ceiling on net government borrowing from the SBP (including provincial governments, stock, billions of Pakistani rupees) 1/, 8/	2,168	2,690	2,521	2,560	2,611	2,390	2,227	2,240	2,070	2,000	1,905
Continuous Performance Criterion											
Accumulation of external public payment arrears by the general government (continuous)	0	0	0	0	0	0	0	0	0	0	0
Indicative Targets											
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees)	54	19	14	32	16	48	49	62	14	44	69

Sources: Pakistani authorities; and Fund staff estimates.

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

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

3/ End-December 2013 target of -4130 has been adjusted by -977 millions of U.S. dollars to reflect a shortfall in multilateral/bilateral disbursements to Pakistan.

4/ End-March 2014 target of -2750 has been adjusted by -122 millions of U.S. dollars to reflect a shortfall in multilateral/bilateral inflows to Pakistan.

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

6/ End-March 2014 NDA target of 2627 has been adjusted downward by 18 billions of PRs to reflect an excess in multilateral/bilateral disbursements to Pakistan

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

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

Table 2. Pakistan: Structural Benchmarks Under Extended Fund Facility

Item	Measure	Time Frame (by End of Period)	Comment
Prior Actions			
1	Finalize the determination and notification of electricity tariffs for FY2013/14.		
2	Complete a calendar to eliminate the vast majority of SROs granting tax exemptions or concessions and convert the remainder into regular legislation		
3	Send to parliament a FY2014/15 budget proposal consistent with the program objectives		
Structural Benchmarks			
Fiscal sector			
1	Develop and finish launching initiatives to enhance revenue administration for sales tax, excises, and customs similar to that prepared for income tax.	end-December 2013	Met
2	Announce a rationalization plan for gas prices which will involve a levy to generate 0.4 percent of GDP fiscal savings.	end-December 2013	Met
3	Increase the issuance of first notices (u/s 114) to 75,000 and follow up with a second notice (u/s 122c) to 75 percent of those who did not respond satisfactorily to their first notice within 60 days by end-March, 2014. Issue a provisional tax assessment to 75 percent of those who did not respond satisfactorily within 60 days to the second notice by end-March, 2014.	end-March 2014	Met
4	Eliminate exemptions and concessions granted through SROs for an amount consistent with the fiscal deficit reduction objective in the FY2014/15 budget.	end-June-2014	
5	Enact amendments to the relevant tax laws (as defined in the TMU) and submit amendments to the Anti-Money Laundering Act (AMLA) to Parliament	end-September 2014	
Monetary sector			
6	Enact the amendments to the SBP law to give SBP autonomy in its pursuit of price stability as its primary objective, while strengthening its governance and internal control framework, in line with Fund staff advice.	end-June 2014	
Financial sector			
7	Prepare detailed plans to achieve compliance of all banks that fall below minimum capital adequacy, including specific actions, end dates, and contingency arrangements. Also detail a plan for recapitalization, consolidation or liquidation of banks that fall below the minimum capital requirement but not CAR.	end-December 2013	Met at end-Feb, 2014
8	Enact the Deposit Protection Fund Act, in line with Fund staff advice.	end-June 2015	
9	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014	
Structural Policies			
10	Develop and approve PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by the Council of Common Interest (CCI).	end-September 2013	Met
11	Hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited).	end-November 2013	Met
12	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), advertise key staff positions, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013	Met at end-Feb, 2014
13	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013	Met
14	Initiate revenue based load shedding in six remaining electricity distribution companies .	end-January 2014	Met
15	Hire three financial advisors for three PSEs in the capital market transactions list and three financial advisors for the three PSEs in the strategic private sector enterprises list for privatization in the TMU.	end-March 2014	Partially met
16	Conduct a diagnostic study of the regulatory framework of the power sector and prepare an interim report.	end-April 2014	Met
17	Privatize 26 percent of PIA's shares to strategic investors.	end-December 2014	
New Structural Benchmarks			
18	Improve the internal operations of the SBP by: i) reestablishing an advisory monetary policy committee to advise the Board on its policy decisions; ii) establishing a Board committee to centralize and oversee risk management activities across the bank; and iii) begin publishing summaries of the monetary policy proceedings of the Board meetings and monetary policy committee deliberations.	end-August 2014	
19	Fill the vacancies in the NEPRA Board.	end-July 2014	
20	Offer the minority shares in United Bank Limited and Pakistan Petroleum Limited to domestic and	end-June 2014	
21	Approve an administrative order to consolidate the responsibilities of public debt management in the debt management office.	end-September 2014	

Table 3. Pakistan: Selected Economic Indicators, 2010/11–2014/15 1/

Population: 178.9 million (2011/12)
 Per capita GDP: US\$1,228 (2011/12)
 Poverty rate: 17.2 percent (2007/08)
 Main exports: Textiles (\$12.7 billion)
 Unemployment: 6.2 percent (2012/13)

	2010/11	2011/12	2012/13	2013/14		2014/15
				Second Review	Projections	Projections
(Annual percentage change)						
Output and prices						
Real GDP at factor cost	3.7	4.4	3.6	3.1	3.3	4.0
GDP deflator at factor cost	19.5	5.3	7.5	8.8	8.8	8.1
Consumer prices (period average) 2/	13.7	11.0	7.4	8.8	8.8	8.1
Consumer prices (end of period) 2/	13.3	11.3	5.9	10.0	9.5	7.5
Pakistani rupees per U.S. dollar (period average)	2.2	4.1	8.5	...	...	...
(In percent of GDP)						
Saving and investment						
Gross saving	14.2	12.9	13.2	14.1	14.0	15.7
Government	-4.2	-5.1	-4.9	-2.0	-1.7	-1.1
Nongovernment (including public sector enterprises)	18.4	17.9	18.1	16.2	15.7	16.8
Gross capital formation 3/	14.1	14.9	14.2	15.1	15.2	16.9
Government	2.5	3.3	3.0	3.2	3.1	3.5
Nongovernment (including public sector enterprises)	11.6	11.6	11.2	11.8	12.1	13.4
Public finances						
Revenue and grants	12.6	13.1	13.0	14.9	14.9	14.8
Expenditure (including statistical discrepancy)	19.8	21.9	21.1	20.2	19.6	19.4
Budget balance (including grants)	-6.9	-8.4	-8.0	-5.3	-4.8	-4.6
Budget balance (excluding grants)	-7.1	-8.8	-8.2	-5.7	-5.7	-4.8
Primary balance	-3.1	-4.0	-3.7	-0.6	-0.1	0.1
Total general government debt 4/	59.5	63.8	63.1	64.0	63.0	65.8
External general government debt	26.6	25.8	21.5	23.3	22.5	25.0
Domestic general government debt	32.9	38.0	41.6	40.7	40.5	40.7
(Annual changes in percent of initial stock of broad money, unless otherwise indicated)						
Monetary sector						
Net foreign assets	4.1	-3.8	-3.4	4.3	3.5	3.7
Net domestic assets	11.8	17.9	19.3	9.2	8.9	8.5
Broad money (percent change)	15.9	14.1	15.9	13.5	12.4	12.2
Reserve money (percent change)	17.1	11.3	15.8	11.3	10.9	12.1
Private credit (percent change)	4.0	7.5	-0.6	7.5	7.0	9.0
Six-month treasury bill rate (period average, in percent)	13.3	12.3	10.1	...	...	...
External sector						
Merchandise exports, U.S. dollars (percentage change)	28.9	-2.6	0.4	6.3	3.6	3.5
Merchandise imports, U.S. dollars (percentage change)	14.9	12.8	-0.6	6.1	5.0	4.3
Current account balance (in percent of GDP)	0.1	-2.1	-1.1	-0.9	-1.2	-1.2
(In percent of exports of goods and services, unless otherwise indicated)						
External public and publicly guaranteed debt						
Debt service	153.4	160.3	144.6	149.0	164.9	176.3
	11.7	16.0	21.1	24.4	25.1	29.8
Gross reserves (in millions of U.S. dollars) 5/						
In months of next year's imports of goods and services	14,784	10,799	6,008	9,282	9,308	13,326
	3.6	2.7	1.4	2.0	2.1	2.8
Memorandum items:						
Real effective exchange rate (annual average, percentage change)	4.2	3.8	1.7	...	...	...
Terms of trade (percentage change)	6.9	-10.4	-0.7	-4.4	-3.9	-1.4
Real per capita GDP (percentage change)	1.5	2.3	1.5	1.1	1.3	2.0
GDP at market prices (in billions of Pakistani rupees)	18,285	20,091	22,909	25,705	25,744	28,946
GDP at market prices (in billions of U.S. dollars)	213.7	225.6	237.1	...	...	...

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

1/ Fiscal year ends June 30.

2/ Inflation after 2009/10 based on new CPI weights, recalculated in September 2011.

3/ Including changes in inventories. Investment data recorded by the Pakistan Bureau of Statistics are said to underreport true activity.

4/ Excludes military debt, and commercial loans.

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

Table 4. Pakistan: Medium-Term Macroeconomic Framework, 2010/11–2018/19

	2010/11	2011/12	2012/13	2013/14	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
				Second Review		Projections				
(Annual percentage change)										
Output and prices										
Real GDP at factor cost	3.7	4.4	3.6	3.1	3.3	4.0	4.3	4.7	5.0	5.0
Consumer prices (period average)	13.7	11.0	7.4	8.8	8.8	8.1	7.0	6.0	6.0	6.0
(In percent of GDP)										
Saving and investment balance	0.1	-2.1	-1.1	-0.9	-1.2	-1.2	-1.9	-1.7	-1.4	-1.4
Government	-6.7	-8.4	-8.0	-5.3	-4.8	-4.6	-3.5	-3.5	-3.6	-3.5
Non-government (including public sector enterprises)	6.8	6.3	6.9	4.4	3.6	3.4	1.6	1.8	2.2	2.1
Gross national saving	14.2	12.9	13.2	14.2	14.0	15.7	17.3	18.2	18.7	19.4
Government	-4.2	-5.1	-4.9	-2.0	-1.7	-1.1	0.2	0.5	0.6	0.8
Non-government (including public sector enterprises)	18.4	17.9	18.1	16.2	15.7	16.8	17.2	17.6	18.1	18.7
Gross capital formation	14.1	14.9	14.2	15.1	15.2	16.9	19.2	19.9	20.1	20.8
Government	2.5	3.3	3.0	3.2	3.1	3.5	3.7	4.0	4.2	4.2
Non-government (including public sector enterprises)	11.6	11.6	11.2	11.8	12.1	13.4	15.6	15.9	15.9	16.6
(In billions of U.S. dollars, unless otherwise indicated)										
Balance of payments										
Current account balance	0.2	-4.7	-2.5	-2.2	-3.0	-3.1	-5.2	-5.0	-4.6	-4.8
Net capital flows 1/	2.3	1.4	0.5	5.8	6.8	6.1	6.9	6.6	6.9	7.3
Of which: foreign direct investment 2/	1.6	0.8	1.5	2.3	1.3	4.3	4.5	5.7	6.5	6.2
Gross official reserves	14.8	10.8	6.0	9.3	9.3	13.3	17.2	18.9	21.2	23.5
In months of imports 3/	3.6	2.7	1.4	2.0	2.1	2.8	3.4	3.5	3.7	4.1
External debt (in percent of GDP)	31.1	29.0	25.2	26.5	26.4	28.0	28.1	26.6	24.7	22.6
(In percent of GDP)										
Public finances										
Revenue and grants	12.6	13.1	13.0	14.9	14.9	14.8	15.4	15.3	15.3	15.3
Of which: tax revenue	9.5	10.3	9.7	10.4	10.5	11.5	12.4	13.0	13.0	13.0
Expenditure (incl. stat. discr.), of which:	19.5	21.5	21.0	20.2	19.7	19.4	19.0	18.8	18.9	18.7
Current	16.5	17.8	16.3	17.1	16.9	15.9	15.3	14.8	14.6	14.5
Development (incl. net lending)	2.6	3.4	4.6	3.1	2.9	3.5	3.7	4.0	4.3	4.3
Primary balance 4/	-3.1	-4.0	-3.7	-0.6	-0.1	0.1	0.7	0.3	0.1	0.2
Overall fiscal balance 4/	-6.9	-8.4	-8.0	-5.3	-4.8	-4.6	-3.5	-3.5	-3.6	-3.5
Total public debt (including obligations to the IMF)	59.5	63.8	63.1	64.0	63.0	65.8	65.0	63.6	61.4	59.3

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

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

2/ Including privatization.

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

4/ Including grants.

Table 5. Pakistan: Balance of Payments, 2010/11–2018/19

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

	2010/11	2011/12	2012/13	2013/14	2013/14					2014/15					2015/16	2016/17	2017/18	2018/19						
					Q1		Q2		Q3		Q4		Q1						Q2		Q3		Q4	
					Second Review		Actual		Actual		Projections		Projections						Projections		Projections		Projections	
Current account	214	-4,658	-2,496	-2,250	-1,206	-551	-316	-957	-3,030	-877	-1,105	-604	-470	-3,055	-5,248	-4,999	-4,635	-4,770						
Balance on goods	-10,516	-15,765	-15,431	-16,306	-4,267	-4,156	-3,670	-4,456	-16,549	-4,481	-4,696	-4,227	-4,057	-17,461	-18,711	-19,911	-21,317	-22,080						
Exports, f.o.b.	25,356	24,696	24,795	26,356	6,273	6,253	6,395	6,774	25,695	6,196	6,497	6,614	7,275	26,582	28,369	30,299	32,557	35,027						
Imports, f.o.b.	35,872	40,461	40,226	42,662	10,540	10,409	10,065	11,230	42,244	10,677	11,193	10,841	11,332	44,043	47,080	50,210	53,874	57,107						
Services (net)	-1,940	-3,192	-1,472	-1,548	-868	-564	-493	-186	-2,111	-700	-656	-730	-753	-2,839	-5,260	-5,449	-5,493	-6,340						
Services: credit	5,768	5,035	6,733	7,287	987	1,417	1,320	1,916	5,640	1,318	1,401	1,326	1,411	5,457	3,817	4,533	5,390	5,489						
Of which: Coalition Support Fund	743	0	1,806	1,024	0	322	352	375	1,049	350	350	350	350	1,400	0	0	0	0						
Of which: 3G Licenses	0	0	0	1,200	0	0	0	516	516	0	0	0	0	0	0	0	0	0						
Services: debit	7,708	8,227	8,205	8,835	1,855	1,981	1,813	2,101	7,750	2,019	2,057	2,164	8,296	9,077	9,982	10,883	11,829							
Income (net)	-3,017	-3,245	-3,685	-3,934	-807	-1,187	-850	-1,108	-3,952	-895	-1,110	-938	-1,131	-4,073	-4,708	-5,164	-5,371	-5,829						
Income: credit	716	826	488	543	154	115	133	92	494	149	173	155	196	672	549	508	695	831						
Income: debit	3,733	4,071	4,173	4,477	961	1,302	983	1,200	4,446	1,043	1,282	1,093	1,327	4,745	5,257	5,672	6,066	6,660						
Of which: interest payments	1,408	1,589	1,325	1,424	367	451	299	403	1,520	404	498	433	477	1,812	2,073	2,025	2,045	2,183						
Of which: income on direct investment	2,065	2,177	2,714	2,944	594	851	683	798	2,926	639	784	660	850	2,933	3,185	3,647	4,021	4,477						
Balance on goods, services, and income	-15,473	-22,202	-20,588	-21,788	-5,942	-5,907	-5,013	-5,749	-22,611	-24,374	-28,679	-30,524	-32,181											
Current transfers (net)	15,687	17,544	18,092	19,538	4,736	5,356	4,697	4,792	19,581	5,199	5,357	5,292	5,471	21,318	23,431	25,525	27,545	29,479						
Current transfers: credit, of which:	15,863	17,686	18,183	19,654	4,756	5,373	4,730	4,832	19,691	5,239	5,397	5,331	5,510	21,477	23,590	25,684	27,704	29,638						
Official	845	658	412	536	81	100	75	195	451	174	191	127	191	683	699	453	396	396						
Workers' remittances	11,201	13,186	13,922	15,037	3,927	3,863	3,793	3,731	15,314	4,143	4,184	4,090	4,290	16,708	18,490	20,488	22,290	23,991						
Other private transfers	3,817	3,842	3,849	4,081	748	1,410	862	906	3,926	922	1,022	1,114	1,029	4,087	4,400	4,744	5,019	5,251						
Current transfers: debit	176	142	91	116	20	17	33	40	110	40	40	40	159	159	159	159	159							
Capital account	161	189	264	679	46	119	1,561	292	2,018	110	117	110	128	464	582	279	102	102						
Capital transfers: credit	161	186	266	679	46	119	1,561	292	2,018	110	117	110	128	464	582	279	102	102						
Of which: official capital grants	160	180	250	676	44	118	60	292	514	110	117	110	128	464	582	279	102	102						
Capital transfers: debit	0	3	2	0	0	0	0	0	0	0	0	0	0	0	0	0	0							
Financial account	2,103	1,275	549	5,506	382	-310	290	4,619	4,981	1,756	1,392	1,407	1,119	5,673	6,362	6,311	6,831	7,211						
Direct investment abroad	-44	-77	-198	-87	-59	-28	-6	0	-93	0	-9	-4	-3	-15	-16	-16	-16	-16						
Direct investment in Pakistan	1,636	821	1,456	2,259	231	189	250	600	1,270	522	1,572	943	1,280	4,317	4,512	5,718	6,520	6,198						
Of which: privatization receipts	1	0	0	1,500	0	0	0	400	400	0	900	350	500	1,750	750	900	900	0						
Portfolio investment (net), of which:	339	-149	26	611	107	1	19	2,121	2,248	159	561	580	80	1,380	140	-170	480	1,329						
Financial derivatives (net)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0							
Other investment assets	-920	9	-314	22	195	-180	-177	-52	-214	320	-135	-301	-151	-267	-12	-12	-12	68						
Monetary authorities	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0							
General government	-3	3	-2	0	2	0	-2	0	0	0	0	0	0	0	0	0	0							
Banks	-63	-91	-126	-83	190	-298	-299	-77	-484	73	-157	-331	-151	-566	-12	-12	-12	-12						
Other sectors	-854	97	-186	105	3	118	124	25	270	247	22	30	0	299	0	0	0	80						
Other investment liabilities	1,092	671	-421	2,701	-92	-292	204	1,950	1,770	754	-598	189	-87	258	1,738	791	-140	-368						
Monetary authorities	-10	-105	710	145	245	0	0	-100	145	0	-1,065	0	0	-1,065	0	0	0							
General government, of which:	298	998	249	1,824	-258	-94	14	1,134	796	-701	-266	-749	-1,451	-3,168	-682	-1,531	-2,364	-2,264						
Disbursements	2,377	2,633	2,530	5,814	525	757	601	2,346	4,229	399	614	1,212	563	2,788	2,950	1,514	1,000	1,000						
Amortization	1,957	1,577	2,282	3,990	783	851	587	1,212	3,433	1,100	881	1,961	2,014	5,956	3,632	3,045	3,364	3,264						
Banks	52	220	-1,117	-160	-5	-153	332	350	524	350	116	133	210	809	246	187	265	172						
Other sectors	752	-442	-262	892	-74	-45	-142	566	305	1,105	618	805	1,154	3,682	2,175	2,134	1,958	1,724						
Net errors and omissions	14	-81	-309	-392	-415	26	169	0	-220	0	0	0	0	0	0	0	0							
Reserves and related items	-2,492	3,275	1,992	-3,543	1,193	716	-1,704	-3,954	-3,749	-989	-403	-913	-777	-3,082	-1,696	-1,591	-2,298	-2,543						
Reserve assets	-2,225	4,430	4,530	-3,424	1,321	1,059	-1,917	-3,942	-3,479	-1,017	-606	-1,265	-1,130	-4,018	-3,889	-1,706	-2,298	-2,303						
Use of Fund credit and loans	-267	-1,155	-2,538	-119	-128	-343	213	-12	-270	28	203	352	353	936	2,192	115	0	-240						
Memorandum items:																								
Current account (in percent of GDP)	0.1	-2.1	-1.1	-0.9					-1.2					-1.2	-1.9	-1.7	-1.4	-1						
Current account (in percent of GDP, excluding fuel imports)	5.9	4.3	4.9	5.6					5.0					4.9	3.9	4.1	4.3	4						
Exports f.o.b. (growth rate, in percent)	28.9	-2.6	0.4	6.3					3.6					3.5	6.7	6.8	7.5	8						
Imports f.o.b. (growth rate, in percent)	14.9	12.8	-0.6	6.1					5.0					4.3	6.9	6.6	7.3	6						
Oil imports (in million US\$, cif)	12,317	14,368	14,066	15,723					15,452					15,756	16,084	17,174	18,464	19,858						
Terms of trade (growth rate, in percent)	6.9	-10.4	-0.7	-4.4					-3.9					-1.4	0.5	-0.5	-1.0	0						
External debt (in millions of U.S. dollars)	66,366	65,478	59,779	63,941					66,110					72,927	77,648	78,910	79,309	79,342						
Gross external financing needs (in millions of U.S. dollars) 1/	1,990	6,960	4,909	8,486					9,374					10,778	9,982	9,591	9,133	10,248						
End-period gross official reserves (millions of U.S. dollars) 2/	14,784	10,799	6,008	9,282	4,694	3,478	5,366	9,308	9,308	10,325	10,931	12,196	13,326	13,326	17,215	18,921	21,219	23,522						
(in months of next year's imports of goods and services)	3.6	2.7	1.4	2.0	1.1	0.8	1.2	2.1	2.1	2.3	2.4	2.7	2.8	2.8	3.4	3.5	3.7	4.1						
GDP (in millions of U.S. dollars)	213,725	225,558	237,103	...					...					...	...	...	...	...

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 the period.

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

Table 6a. Pakistan: General Government Budget, 2008/09–2014/15
(In billions of Pakistani rupees)

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14		2014/15
						Second Review	Projections	Projections
Revenue and grants	1,878	2,130	2,306	2,642	2,988	3,834	3,843	4,289
Revenue	1,851	2,079	2,261	2,567	2,949	3,727	3,613	4,206
Tax revenue	1,331	1,500	1,738	2,076	2,231	2,674	2,712	3,342
Federal	1,285	1,445	1,673	1,969	2,081	2,504	2,527	3,134
FBR revenue	1,157	1,329	1,558	1,881	1,936	2,345	2,275	2,810
Direct taxes	440	529	602	732	736	892	858	1,026
Federal excise duty	116	121	137	122	119	151	151	185
Sales tax/VAT	452	517	633	809	841	1,014	978	1,241
Customs duties	148	161	185	218	240	287	287	358
Petroleum surcharge	112	89	83	60	110	108	108	123
Gas surcharge and other	16	28	32	27	35	51	52	42
GIDC 1/	...	...	...	...	...	93	93	159
Provincial	46	55	65	107	151	170	185	208
Nontax revenue	520	579	523	491	717	1,054	901	863
Federal	436	512	461	443	646	891	841	788
Provincial	84	68	62	48	71	70	60	75
Grants	27	51	46	75	39	107	230	83
Expenditure	2,531	3,008	3,566	4,326	4,816	5,192	5,072	5,609
Current expenditure	2,093	2,482	3,012	3,579	3,742	4,405	4,338	4,592
Federal	1,547	1,855	2,227	2,611	2,647	3,181	3,138	3,242
Interest	638	642	698	889	991	1,208	1,192	1,352
Domestic	559	578	630	821	920	1,114	1,108	1,224
Foreign	79	64	68	68	71	94	84	128
Other	909	1,213	1,529	1,722	1,656	1,973	1,946	1,890
Defense	330	375	450	507	541	637	637	706
Other	579	838	1,078	1,215	1,116	1,336	1,310	1,185
Of which: subsidies 2/	244	227	493	556	305	479	472	229
Of which: grants	136	361	259	291	368	412	382	442
Provincial	546	627	786	968	1,095	1,224	1,200	1,350
Development expenditure and net lending	404	558	469	681	1,058	787	748	1,017
Public Sector Development Program	398	519	462	669	695	834	795	1,012
Federal	196	260	216	293	324	420	420	525
Provincial	202	258	246	375	372	414	375	486
Net lending	7	39	7	12	363	-48	-48	5
Statistical discrepancy ("+" = additional expenditure) 3/	34	-32	46	67	16	0	-14	0
Overall Balance (excluding grants)	-680	-929	-1,306	-1,760	-1,867	-1,464	-1,459	-1,404
Overall Balance (including grants)	-653	-878	-1,260	-1,685	-1,828	-1,357	-1,229	-1,320
Financing	653	878	1,260	1,685	1,828	1,357	1,229	1,320
External	75	138	62	53	24	414	324	-46
Of which: privatization receipts	1	0	0	0	0	160	41	195
Of which: IMF	0	0	0	0	0	0	0	0
Domestic	579	740	1,198	1,631	1,804	943	905	1,367
Bank	351	304	727	1,102	1,317	754	724	1,093
Nonbank	227	436	471	529	487	189	181	273
Memorandum items:								
Primary balance (excluding grants)	-43	-287	-608	-871	-876	-257	-267	-52
Primary balance (including grants)	-16	-236	-562	-796	-837	-150	-37	32
Total security spending	330	375	450	507	541	637	637	706
Total government debt	7,387	8,448	10,112	12,130	14,021	15,978	15,830	18,468
Domestic debt	3,860	4,654	6,014	7,638	9,521	10,464	10,426	11,793
External debt 4/	3,527	3,794	4,098	4,492	4,500	5,514	5,404	6,675
Total government debt including IMF obligations	7,805	9,138	10,879	12,822	14,454	16,441	16,227	19,032
Nominal GDP (market prices)	13,200	14,867	18,285	20,091	22,909	25,705	25,744	28,946

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

1/ For historical series, GIDC is part of non-tax revenue

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

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

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

Table 6b. Pakistan: General Government Budget, 2009/10–2014/15

(In percent of GDP, unless otherwise indicated)

	2009/10	2010/11	2011/12	2012/13	2013/14		2014/15
					Second Review	Projections	Projections
Revenue and grants	14.3	12.6	13.1	13.0	14.9	14.9	14.8
Revenue	14.0	12.4	12.8	12.9	14.5	14.0	14.5
Tax revenue	10.1	9.5	10.3	9.7	10.4	10.5	11.5
Federal	9.7	9.1	9.8	9.1	9.7	9.8	10.8
FBR revenue	8.9	8.5	9.4	8.5	9.1	8.8	9.7
Direct taxes	3.6	3.3	3.6	3.2	3.5	3.3	3.5
Federal excise duty	0.8	0.8	0.6	0.5	0.6	0.6	0.6
Sales tax/VAT	3.5	3.5	4.0	3.7	3.9	3.8	4.3
Customs duties	1.1	1.0	1.1	1.0	1.1	1.1	1.2
Petroleum surcharge / Carbon tax	0.6	0.5	0.3	0.5	0.4	0.4	0.4
Gas surcharge and other	0.2	0.2	0.1	0.2	0.2	0.2	0.1
GIDC 1/	...	...	...	...	0.4	0.4	0.6
Provincial	0.4	0.4	0.5	0.7	0.7	0.7	0.7
Nontax revenue	3.9	2.9	2.4	3.1	4.1	3.5	3.0
Federal	3.4	2.5	2.2	2.8	3.8	3.3	2.7
Provincial	0.5	0.3	0.2	0.3	0.3	0.2	0.3
Grants	0.3	0.2	0.4	0.2	0.4	0.9	0.3
Expenditure	20.2	19.5	21.5	21.0	20.2	19.7	19.4
Current expenditure	16.7	16.5	17.8	16.3	17.1	16.9	15.9
Federal	12.5	12.2	13.0	11.6	12.4	12.2	11.2
Interest	4.3	3.8	4.4	4.3	4.7	4.6	4.7
Domestic	3.9	3.4	4.1	4.0	4.3	4.3	4.2
Foreign	0.4	0.4	0.3	0.3	0.4	0.3	0.4
Other	8.2	8.4	8.6	7.2	7.7	7.6	6.5
Defense	2.5	2.5	2.5	2.4	2.5	2.5	2.4
Other	5.6	5.9	6.0	4.9	5.2	5.1	4.1
Of which: subsidies 2/	1.5	2.7	2.8	1.3	1.9	1.8	0.8
Of which: grants	2.4	1.4	1.4	1.6	1.6	1.5	1.5
Provincial	4.2	4.3	4.8	4.8	4.8	4.7	4.7
Development expenditure and net lending	3.8	2.6	3.4	4.6	3.1	2.9	3.5
Public Sector Development Program	3.5	2.5	3.3	3.0	3.2	3.1	3.5
Federal	1.8	1.2	1.5	1.4	1.6	1.6	1.8
Provincial	1.7	1.3	1.9	1.6	1.6	1.5	1.7
Net lending	0.3	0.0	0.1	1.6	-0.2	-0.2	0.0
Statistical discrepancy ("+" = additional expenditure) 3/	-0.2	0.3	0.3	0.1	0.0	-0.1	0.0
Overall Balance (excluding grants)	-6.2	-7.1	-8.8	-8.2	-5.7	-5.7	-4.8
Overall Balance (including grants)	-5.9	-6.9	-8.4	-8.0	-5.3	-4.8	-4.6
Financing	5.9	6.9	8.4	8.0	5.3	4.8	4.6
External	0.9	0.3	0.3	0.1	1.6	1.3	-0.2
Of which: privatization receipts	0.0	0.0	0.0	0.0	0.6	0.2	0.7
Of which: IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	5.0	6.6	8.1	7.9	3.7	3.5	4.7
Bank	2.0	4.0	5.5	5.7	2.9	2.8	3.8
Nonbank	2.9	2.6	2.6	2.1	0.7	0.7	0.9
Memorandum items:							
Primary balance (excluding grants)	-1.9	-3.3	-4.3	-3.8	-1.0	-1.0	-0.2
Primary balance (including grants)	-1.6	-3.1	-4.0	-3.7	-0.6	-0.1	0.1
Total security spending	2.5	2.5	2.5	2.4	3.1	2.5	2.4
Total government debt 4/	56.8	55.3	60.4	61.2	62.2	61.5	63.8
Domestic debt	31.3	32.9	44.6	41.6	40.7	40.5	40.7
External debt 4/	25.5	22.4	26.2	19.6	21.5	21.0	23.1
Total government debt including IMF	61.5	59.5	63.8	63.1	64.0	63.0	65.8
Nominal GDP (market prices, billions of Pakistani rupees)	14,867	18,285	20,091	22,909	25,705	25,744	28,946

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

1/ For historical series, GIDC is part of non-tax revenue

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

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

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

Table 6c. Pakistan: General Government Budget, 2011/12–2014/15
(In billions of Pakistani rupees)

	2011/12	2012/13	2013/14					2014/15					
			End-Year	Q1	Q2	Q3	Q4	End-Year	Q1	Q2	Q3	Q4	End-Year
			Second Review	Actual			Projections		Projections				
Revenue and grants	2,642	2,988	3,834	826	834	965	1,196	3,843	920	1,041	1,047	1,281	4,289
Revenue	2,567	2,949	3,727	817	825	803	1,148	3,613	901	1,022	1,024	1,260	4,206
Tax revenue	2,076	2,231	2,674	558	637	626	870	2,712	703	823	808	1,008	3,342
Federal	1,969	2,081	2,504	516	591	578	821	2,527	660	768	759	947	3,134
FBR revenue	1,881	1,936	2,345	469	557	550	700	2,275	584	690	679	857	2,810
Direct taxes	732	736	892	161	224	214	259	858	213	252	248	313	1,026
Federal excise duty	122	119	151	24	31	35	61	151	38	45	45	56	185
Sales tax/VAT	809	841	1,014	231	243	243	261	978	258	305	300	378	1,241
Customs duties	218	240	287	53	59	57	118	287	74	88	87	109	358
Petroleum surcharge	60	110	108	26	26	20	36	108	31	31	31	31	123
Gas surcharge and other	23	32	48	21	8	6	13	48	7	9	9	12	37
GIDC 1/	—	—	93	3	3	15	72	93	37	37	40	46	159
Provincial	107	151	170	42	46	49	49	185	43	55	49	61	208
Nontax revenue	491	717	1,054	259	188	177	278	901	198	199	216	251	863
Federal	443	646	984	248	173	168	253	841	181	181	197	229	788
Provincial	48	71	70	11	15	9	25	60	16	17	19	22	75
Grants	75	39	107	9	10	162	48	230	19	19	23	22	83
Expenditure	4,326	4,816	5,192	1,116	1,102	1,228	1,625	5,072	1,277	1,356	1,408	1,568	5,609
Current expenditure	3,579	3,742	4,405	876	1,043	1,064	1,356	4,338	1,103	1,145	1,159	1,184	4,592
Federal	2,611	2,647	3,181	647	737	777	977	3,138	768	810	795	870	3,242
Interest	889	991	1,208	301	297	311	283	1,192	331	344	327	350	1,352
Domestic	821	920	1,114	286	273	296	253	1,108	304	308	301	311	1,224
Foreign	68	71	94	15	24	16	30	84	28	36	25	39	128
Other	1,722	1,656	1,973	346	441	466	694	1,946	436	466	468	520	1,890
Defense	507	541	637	146	149	156	185	637	153	176	176	200	706
Other	1,215	1,116	1,336	200	292	309	509	1,310	283	289	292	320	1,185
Of which: subsidies 2/	556	305	479	65	77	78	252	472	58	55	53	64	229
Of which: grants	291	368	412	43	98	107	133	382	97	106	111	128	442
Provincial	968	1,095	1,224	229	306	287	379	1,200	335	335	365	315	1,350
Development expenditure and net lending	681	1,058	787	163	133	184	269	748	173	211	249	384	1,017
Public Sector Development Program	669	695	834	80	133	180	402	795	172	210	248	382	1,012
Federal	293	324	420	45	74	75	227	420	89	105	126	205	525
Provincial	375	372	414	35	59	106	176	375	83	105	122	178	486
Net lending	12	363	-48	83	0	3	-133	-48	1	1	1	1	5
Statistical discrepancy ("+" = additional expenditure) 3/	67	16	0	78	-73	-19	0	-14	0	0	0	0	0
Overall Balance (excluding grants)	-1,760	-1,867	-1,464	-300	-278	-425	-477	-1,459	-376	-335	-384	-309	-1,404
Overall Balance (including grants)	-1,685	-1,828	-1,357	-291	-268	-263	-429	-1,229	-357	-315	-361	-287	-1,320
Financing	1,685	1,828	1,357	291	268	263	429	1,229	357	315	361	287	1,320
External	53	24	414	-30	-19	-13	386	324	-48	131	74	-203	-46
Of which: IMF	0	0	0	0	-16	0	0	0	0	0	0	0	0
Domestic	1,631	1,804	943	321	287	276	42	905	405	184	287	490	1,367
Bank	1,102	1,317	754	198	254	-14	286	724	361	361	165	207	1,093
Nonbank	529	487	189	123	33	290	-244	181	44	-176	122	284	273
Memorandum items:													
Primary balance (excluding grants)	-871	-876	-257	1	19	-114	-194	-267	-45	9	-58	41	-52
Primary balance (including grants)	-796	-837	-150	10	29	48	-145	-37	-26	29	-34	63	32
Total security spending	507	541	787	146	149	156	185	637	153	176	176	200	706
Government Arrears	1,427	1,627	1,825					1,828					2,055
Total government debt	12,130	14,021	15,978					15,830					18,468
Domestic debt	7,638	9,521	10,464					10,426					11,793
External debt 4/	4,492	4,500	5,514					5,404					6,675
Total government debt including IMF obligations	12,822	14,454	16,441					16,227					19,032
Nominal GDP (market prices)	20,091	22,909	25,705					25,744					28,946

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

1/ For historical series, GIDC is part of non-tax revenue

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

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

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

Table 7. Pakistan: Monetary Survey, 2010/11–2014/15

	2010/11	2011/12	2012/13	2013/14				2014/15					
				End-Year		Q3		Q4		Q1		Q2	
				Second Review	Actual	Actual	Projections	Actual	Projections	Actual	Projections		
(In billions of Pakistani rupees, unless otherwise indicated)													
Monetary survey													
Net foreign assets (NFA)	780	527	270	647	96	54	166	579	685	729	834	926	
Net domestic assets (NDA)	5,915	7,115	8,588	9,405	8,784	9,332	9,219	9,378	9,271	9,795	9,703	10,247	
Net claims on government, of which: 1/	2,983	4,197	5,629	6,127	5,646	5,776	5,467	5,510	5,915	6,099	6,386	6,876	
Budgetary support, of which:	2,523	3,667	5,125	5,839	5,323	5,608	5,562	5,066	5,464	5,678	5,955	6,395	
Banks	1,369	2,005	2,957	3,599	2,802	2,997	3,335	2,826	3,394	3,678	4,050	4,551	
Commodity operations	397	436	468	288	446	378	334	444	451	421	431	481	
Credit to nongovernment	3,547	3,653	3,664	3,656	3,682	4,039	4,074	3,993	3,971	4,321	4,286	4,262	
Private sector	3,159	3,395	3,376	3,629	3,358	3,697	3,711	3,613	3,606	3,979	3,976	3,938	
Public sector enterprises	388	257	288	27	323	343	363	380	365	342	310	324	
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	
Other items, net	-612	-732	-702	-375	-541	-481	-320	-121	-612	-622	-966	-889	
Broad money	6,695	7,642	8,858	10,052	8,879	9,386	9,384	9,958	9,956	10,524	10,537	11,172	
Currency outside scheduled banks	1,501	1,674	1,938	2,484	1,984	2,087	2,117	2,216	2,225	2,352	2,358	2,495	
Rupee deposits	4,819	5,528	6,405	6,931	6,333	6,704	6,705	7,145	7,134	7,542	7,548	8,008	
Foreign currency deposits	375	440	515	637	562	595	562	596	596	630	631	669	
State Bank of Pakistan (SBP)													
NFA	614	389	134	496	-13	-97	74	488	593	637	742	834	
NDA	1,352	1,800	2,401	2,324	2,594	2,821	2,663	2,324	2,306	2,420	2,324	2,319	
Net claims on government	1,184	1,665	2,156	2,178	2,460	2,506	2,006	2,138	1,948	1,863	1,760	1,767	
Of which: budget support	1,155	1,662	2,168	2,240	2,521	2,611	2,227	2,240	2,070	2,000	1,905	1,844	
Claims on nongovernment	-6	-5	-6	-6	-6	-6	-6	-6	-6	-6	-6	-6	
Claims on scheduled banks	315	289	448	340	466	532	531	530	550	570	600	642	
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	
Other items, net	-139	-146	-195	-185	-323	-207	134	-336	-183	-4	-27	-82	
Reserve money, of which:	1,966	2,189	2,535	2,821	2,581	2,724	2,737	2,811	2,899	3,057	3,066	3,153	
Banks' reserves	349	396	476	512	454	494	473	503	503	531	532	564	
Currency	1,606	1,784	2,049	2,309	2,117	2,220	2,254	2,308	2,396	2,526	2,534	2,589	
(Annual percentage change, unless otherwise indicated)													
Broad money	15.9	14.1	15.9	13.5	15.4	13.7	12.7	12.4	12.1	12.1	12.3	12.2	
NFA, banking system (in percent of broad money) 2/	4.1	-3.8	-3.4	4.3	-5.8	-6.0	-2.5	3.5	6.6	7.2	7.1	3.5	
NDA, banking system (in percent of broad money) 2/	11.8	17.9	19.3	9.2	21.2	19.7	15.1	8.9	5.5	4.9	5.2	8.7	
Budgetary support (in percent of broad money) 2/	10.2	17.1	19.1	8.1	19.5	16.8	12.5	-0.7	1.6	0.7	4.2	13.4	
Budgetary support	30.4	45.3	39.7	13.9	39.4	32.7	22.9	-1.2	2.6	1.2	7.1	26.2	
Private credit	4.0	7.5	-0.6	7.5	1.5	5.6	5.0	7.0	7.4	7.6	7.1	9.0	
Currency	15.9	11.5	15.8	28.2	13.0	13.8	10.2	14.3	12.1	12.7	11.4	12.6	
Reserve money	17.1	11.3	15.8	11.3	14.3	12.1	12.2	10.9	12.3	12.2	12.0	12.1	
Memorandum items:													
Velocity	2.7	2.6	2.6	2.7	3.0	3.3	3.5	2.7	2.7	2.7	2.7	2.7	
Money multiplier	3.4	3.5	3.5	3.6	3.4	3.4	3.4	3.5	3.4	3.4	3.4	3.5	
Currency to broad money ratio (percent)	22.4	21.9	21.9	24.7	22.3	22.2	22.6	22.3	22.3	22.3	22.4	22.3	
Currency to deposit ratio (percent)	28.9	28.0	28.0	32.8	28.8	28.6	29.1	28.6	28.8	28.8	28.8	28.8	
Foreign currency to deposit ratio (percent)	7.2	7.4	7.4	8.4	8.2	8.2	7.7	7.7	7.7	7.7	7.7	7.7	
Reserves to deposit ratio (percent)	6.7	6.6	6.9	6.8	6.6	6.8	6.5	6.5	6.5	6.5	6.5	6.5	
Budget bank financing (change from the beginning of the fiscal year; in Rs billions), of which:	589	1,144	1,458	714	198	483	437	-59	339	553	830	1,330	
By commercial banks	606	636	952	642	-155	40	378	-131	437	721	1,093	1,726	
By SBP	-17	508	506	72	353	443	59	72	-98	-168	-263	-396	
NFA of SBP (change from beginning of the year; in billions of U.S. dollars) 3/	2.7	-3.0	-2.8	3.2	-1.5	-2.3	-0.6	3.3	4.2	4.4	5.1	2.1	
NFA of commercial banks (millions of U.S. dollars)	1,937	1,464	1,377	1,368	1,032	1,406	918	876	861	831	798	776	
NDA of commercial banks (billions of Pakistani rupees)	4,563	5,315	6,187	7,081	6,190	6,511	6,555	7,055	6,965	7,375	7,379	7,928	

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

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

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

3/ Includes valuation adjustments.

Table 8. Pakistan: Financial Soundness Indicators for the Banking System
(December 2008–March 2014)

	Dec. 2008	Dec. 2009	Dec. 2010	Dec. 2011	Dec. 2012	Mar. 2013	June 2013	Sep. 2013	Dec. 2013	Mar. 2014
Capital adequacy										
Regulatory capital to risk-weighted assets	12.2	14.1	13.9	15.1	15.4	15.1	15.5	15.5	14.9	14.8
Tier 1 capital to risk-weighted assets	10.1	11.6	11.6	13.0	12.8	12.7	13.0	13.2	12.6	12.5
Capital to total assets	10.0	10.1	9.8	9.6	9.0	8.9	8.9	9.3	8.9	8.9
Asset composition and quality										
Nonperforming loans (NPLs) to gross loans	10.5	12.6	14.9	15.7	14.5	14.7	14.8	14.3	13.0	13.4
Provisions to NPLs	69.6	69.9	66.7	69.3	71.8	71.9	73.2	76.5	78.4	77.8
NPLs net of provisions to capital	19.4	20.4	26.7	23.1	19.4	19.9	18.3	15.7	13.4	14.0
Earnings and profitability										
Return on assets (after tax)	0.8	0.9	1.0	1.5	1.4	1.1	1.1	1.1	1.1	1.3
Return on equity (after tax)	7.8	8.9	9.6	15.1	14.9	12.6	12.4	12.3	12.4	14.1
Net interest income to gross income	70.3	72.4	74.7	76.0	71.1	71.6	70.0	70.3	70.3	69.9
Noninterest expenses to gross income	50.1	51.2	52.7	51.1	52.4	54.1	56.4	56.8	57.4	56.8
Liquidity										
Liquid assets to total assets	28.2	32.7	36.1	45.5	47.4	47.4	49.0	46.7	47.3	48.3
Liquid assets to total deposits	37.7	44.5	47.1	59.5	63.3	63.3	63.7	59.2	60.0	63.7
Loans/Deposits	75.2	67.7	61.4	53.6	51.5	51.6	48.1	48.7	48.6	49.2

Source: State Bank of Pakistan.

Note: As of December 2013, CAR indicators are reported under Basel III.

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

	2013	Projections					
		2014	2015	2016	2017	2018	2019
(Projected Level of Credit Outstanding based on Existing Drawings and Prospective Drawings)							
Total	2,296.8	2,463.0	3,600.0	4,393.0	4,393.0	4,213.0	3,793.0
<i>Of which:</i>							
ECF, SBA, and ENDA	1,576.8	303.0	0.0	0.0	0.0	0.0	0.0
Extended Fund Facility	720.0	2,160.0	3,600.0	4,393.0	4,393.0	4,213.0	3,793.0
In percent of end-period gross official reserves	101.8	35.1	38.9	38.9	36.0	32.0	24.6
(Projected Debt Service to the Fund based on Existing and Prospective Drawings) 1/							
Total	2,355.1	721.7	341.4	65.7	74.6	255.4	496.0
<i>Of which:</i>							
Principal	2,313.5	703.6	303.0	0.0	0.0	180.0	420.0
Interest and charges	41.7	18.09	38.39	65.72	74.58	75.39	76.04
ECF Principal		17.2	0.0	0.0	0.0	0.0	0.0
SBA and ENDA Principal		686.4	303.1	0.0	0.0	0.0	0.0
Extended Fund Facility Principal		0.0	0.0	0.0	0.0	180.0	420.0
In percent of end-period gross official reserves	104.3	10.3	3.7	0.6	0.6	1.9	3.2
Memorandum items							
Quota (millions of SDRs)	1,033.70	...	...	...	...	...	...
Gross official reserves (millions of U.S. dollars)	3,478	10,931	14,517	17,880	19,304	20,850	24,413

Source: IMF staff projections.

1/ Excludes current year obligation paid up to May 29, 2014.

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

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
				Projections					
Key economic and market indicators									
Real GDP growth (factor cost, in percent)	3.7	4.4	3.6	3.3	4.0	4.3	4.7	5.0	5.0
CPI inflation (period average, in percent) 1/	13.7	11.0	7.4	8.8	8.1	7.0	6.0	6.0	6.0
Emerging market bond index (EMBI) secondary market spread (basis points, end of period)	857	1,136	703	...	...	...	...	...	...
Exchange rate PRs/US\$ (end of period)	85.8	94.3	98.7	...	...	...	...	...	...
External sector									
Current account balance (percent of GDP)	0.1	-2.1	-1.1	-1.2	-1.2	-1.9	-1.7	-1.4	-1.4
Net FDI inflows (percent of GDP)	0.7	0.3	0.5	0.5	1.7	1.6	1.9	2.0	1.8
Exports (percentage change of U.S. dollar value; GNFS)	25.0	-4.5	6.0	-0.6	2.2	0.5	8.2	8.9	6.8
Gross international reserves (GIR) in billions of U.S. dollars	14.8	10.8	6.0	9.3	13.3	17.2	18.9	21.2	23.5
GIR in percent of ST debt at remaining maturity (RM) 2/	332.8	273.7	107.3	122.8	129.5	223.3	295.0	538.0	611.9
GIR in percent of ST debt at RM and banks' foreign exchange (FX) deposits 2/	167.8	125.4	55.5	70.1	83.4	125.1	147.1	193.6	205.1
Total gross external debt (ED) in percent of GDP, of which:	31.1	29.0	25.2	26.4	28.0	28.1	26.6	24.7	22.6
ST external debt (original maturity, in percent of total ED)	1.0	0.6	0.0	2.0	2.2	1.5	1.4	1.4	1.4
ED of domestic private sector (in percent of total ED)	10.8	10.8	10.5	14.0	15.5	15.5	15.7	17.0	19.0
ED to foreign official sector (in percent of total ED)	89.2	89.2	89.5	86.0	84.5	84.5	84.3	83.0	81.0
Total gross external debt in percent of exports	213.2	220.2	189.6	211.0	227.6	241.2	226.5	209.0	195.8
Gross external financing requirement (in billions of U.S. dollars) 3/	1.8	6.7	5.3	6.9	9.5	9.9	9.6	9.1	10.0
Public sector 4/									
Overall balance (including grants)	-6.9	-8.4	-8.0	-4.8	-4.6	-3.5	-3.5	-3.6	-3.5
Primary balance (including grants)	-3.1	-4.0	-3.7	-0.1	0.1	0.7	0.3	0.1	0.2
Debt-stabilizing primary balance 5/	-7.9	1.3	-2.7	-1.3	0.1	-1.9	-2.0	-2.3	-2.1
Gross PS financing requirement 6/	26.9	32.5	35.2	34.1	34.2	31.9	31.8	31.9	31.5
Public sector gross debt 7/	55.3	60.4	61.2	61.5	63.8	62.4	60.8	58.9	57.1
Public sector net debt 8/	52.0	57.1	58.5	59.0	61.6	60.4	59.1	57.3	55.6
Financial sector 9/									
Capital adequacy ratio (in percent)	15.1	15.4	15.1	...	...	...	...	...	...
Nonperforming loans (NPLs) in percent of total loans	15.7	14.5	13.0	...	...	...	...	...	...
Provisions in percent of NPLs	69.3	71.8	78.4	...	...	...	...	...	...
Return on assets (after tax, in percent)	1.5	1.4	1.1	...	...	...	...	...	...
Return on equity (after tax, in percent)	15.1	14.9	12.4	...	...	...	...	...	...
FX deposits held by residents (in percent of total deposits)	7.2	7.4	7.4	...	...	...	...	...	...
Government debt held by FS (percent of total FS assets)	44.6	54.9	63.6	...	...	...	...	...	...
Credit to private sector (percent change)	4.0	7.5	-0.6	...	...	...	...	...	...
Memorandum item:									
Nominal GDP (in billions of U.S. dollars)	213.7	225.6	237.1	...	...	...	...	...	...

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

1/ Inflation after 2009/10 based on new CPI weights, recalculated in September 2011.

2/ Debt at remaining maturity is defined as maturing short-, medium-, and long-term external official debt.

3/ Current account deficit plus amortization of external debt.

4/ Public sector covers general (consolidated) government.

5/ Based on the end of period debt stock in year t-1, and the baseline assumptions for the relevant variables (i.e., growth, interest rates, inflation, exchange rates) in year t.

6/ Overall balance plus debt amortization.

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

8/ Net debt is defined as gross debt minus government deposits with the banking system.

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

Table 11. Pakistan: Schedule of Reviews and Purchases

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

Source: IMF staff estimates.

Table 12. Pakistan: Gross Financing Requirements and Sources, 2013/14–2016/17

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

	2013/14	2013/14	2014/2015				2014/15	2015/16	2016/17
	Q4	FY	Q1	Q2	Q3	Q4	FY	FY	FY
		Program	Program	Proj				Proj	
	2014						2015	2016	2017
Gross external financing requirements	2,856	9,374	2,619	2,459	2,888	2,811	10,778	9,982	9,591
Current account deficit (if surplus = -) 1/	957	3,030	877	1,105	604	470	3,055	5,248	4,999
Of which: Interest payments (if net receipts = -)	403	1,520	404	498	433	477	1,812	2,073	2,025
Of which: CSF	375	1,049	350	350	350	350	1,400	0	0
Amortization of medium- and long-term debt	1,391	5,836	1,572	1,066	1,483	1,282	5,404	3,115	4,005
To external private creditors	120	429	116	120	116	120	472	1,044	1,547
To external official creditors	1,272	5,408	1,456	946	1,367	1,162	4,932	2,071	2,458
IMF	567	2,482	527	354	206	207	1,294	58	0
To other official creditors	705	2,926	929	592	1,160	956	3,637	2,013	2,458
Maturing short-term debt	507	507	170	289	801	1,059	2,319	1,619	587
Available financing	856	5,689	1,853	1,459	1,420	1,721	6,452	4,979	8,276
Net FDI (including privatization receipts)	600	1,177	522	1,564	939	1,277	4,302	4,496	5,702
Medium- and long-term borrowing	2,684	4,098	120	646	693	183	1,642	1,185	1,571
From external private creditors	2,059	2,236	195	738	721	274	1,929	1,489	1,757
Borrowing by domestic private sector	59	236	195	238	221	274	929	1,289	1,557
Borrowing by domestic public sector	2,000	2,000	0	500	500	0	1,000	200	200
From external official creditors (non-IMF, currently identified)	625	1,862	-75	-92	-28	-92	-287	-303	-186
Roll-over of short-term debt	276	894	262	262	331	125	980	500	500
Other net capital inflows	1,238	2,999	1,965	-407	722	1,267	3,546	2,686	2,210
Reserve Assets (decrease = +)	-3,942	-3,479	-1,017	-606	-1,265	-1,130	-4,018	-3,889	-1,706
Remaining financing gap	1,999	3,684	767	1,001	1,468	1,090	4,326	5,003	1,314
Program Financing	1,999	3,684	767	1,001	1,468	1,090	4,326	5,003	1,314
Borrowing from IMF (gross)	554	2,211	555	557	559	560	2,231	2,250	115
Loans and Grants from other official creditors	1,445	1,473	211	444	910	530	2,095	2,753	1,200
Of which: WB	1,000	1,000	137	182	711	268	1,297	1,397	1,297
Of which: ADB	400	400	0	0	0	0	0	300	300
Of which: Bilateral and other	45	73	75	262	199	262	798	1,056	-398
Memorandum items									
Gross official reserves in US\$ billions	9.3	9.3	10.3	10.9	12.2	13.3	13.3	17.2	18.9
In months of imports	2.1	2.1	2.3	2.4	2.7	2.8	2.8	3.4	3.5
Total gross external debt in percent of GDP	27.9	26.4	26.8	23.8	28.4	29.2	28.0	28.1	26.6

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

1/ Excludes program related budgetary grants

Appendix I. Letter of Intent

June 19, 2014
Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC, 20431

Dear Ms. Lagarde.

The Pakistani authorities reaffirm our commitment to our economic program supported by the International Monetary Fund (IMF). Performance for the third review was mostly positive. We have met all but one of the performance criteria for the third program review and have made progress on our ambitious structural reform agenda. While further effort is needed in some areas, we are committed to the additional actions described in the attached Memorandum of Understanding of Economic and Financial Policies (MEFP). There are signs of improvement in economic conditions and balance of payments pressures have begun to subside, but challenges remain. We believe that as structural reforms take hold, bottlenecks will ease, growth will accelerate, and vulnerabilities will recede. We are committed to firm policy implementation and maintenance of fiscal, monetary, and financial sector buffers to safeguard against risks.

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

- Quantitative performance criteria and indicative targets. The end-March 2014 quantitative performance criteria were observed with the exception of the target on Net Domestic Assets of the SBP which was missed by a small margin. We have since taken action to address this shortcoming and are on track to meet the end-June 2014 target as outlined in the attached MEFP. The indicative target on transfers under the Benazir Income Support program (BISP) was also met.
- Structural Benchmarks. The end-March 2014 structural benchmark on tax administration notices was observed as was the end-April 2014 benchmark on the audit of NEPRA. However, the benchmark on hiring privatization advisers was only partially met, as advisers were hired for only three firms rather than six. To address this shortcoming we have agreed on a new benchmark to push forward the privatization process with completed share offers for two firms by end-June 2014.

The program will continue to be monitored through quarterly reviews, prior actions, quantitative performance criteria and indicative targets, and structural benchmarks. As detailed in the MEFP, we propose four new structural benchmarks against which to measure progress under the program (MEFP, Table 2). The TMU explains how the program targets are measured.

In the attached MEFP, we set out our plans to further advance on the objectives of our macroeconomic program. In view of our strong performance under the program supported by the IMF, the Government of Pakistan and the State Bank of Pakistan (SBP) request a waiver on the missed performance criterion and completion of the third review under the Extended Arrangement. We also propose modification of the adjusters on the end-June NIR and budget deficit performance criteria.

We believe that the policies set forth in this letter and in the letters of August 19, 2013, December 11, 2013, and March 6, 2014 are adequate to achieve the objectives of our economic program, but we stand ready to take additional measures as appropriate to ensure achievement of its objectives. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in this Letter or adopting new measures that would deviate from the goals of the program, and will provide the IMF with the necessary information for program monitoring. We authorize the IMF to publish this Letter of Intent and its attachments, and the related staff report.

/s/
Ishaq Dar
Minister of Finance
Pakistan

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

Attachment I. Memorandum of Economic and Financial Policies

Recent Economic Developments and Outlook

1. **Economic activity is improving.** Preliminary estimates show that the aggregate output grew above 4 percent in the first half of FY2013/14 over the same period last year. This was primarily driven by the services and manufacturing sectors, as reforms in the electricity sector seem to be bearing fruit with declining electricity shortages. Large scale manufacturing continues to show strong growth (at about 5¼ percent) in the first eight months of the fiscal year. Agricultural growth, on the other hand, remains roughly at the same rate as last year. We now expect that GDP will expand by about 3.3 percent in FY 2013/14, while in the next fiscal year, the expansion should accelerate to around 4 percent. Risks to growth remain tilted downside, but have begun to ease as the recovery in reserves provides an improving cushion against external vulnerabilities (such as oil price volatility, capital flows, or declines in economic activity elsewhere). Annual headline inflation is now forecast at 9½ percent by end-June, 2014. For next fiscal year, inflation is expected to fall to around 7½ percent by end-June 2015, helped by prudent monetary policy and a favorable commodity price outlook.

2. **The overall balance of payments situation for the third quarter of FY2013/14 was broadly in line with expectation.** The current account deficit was as expected, with lower-than-forecast imports and continued strong growth in remittances. In contrast, the capital and financial account was stronger than expected, helped by two tranches of grant aid from a friendly Gulf country totaling US\$1.5 billion. All told, gross reserves increased from US\$3.5 billion at end-December to US\$5.4 billion by end-March, in line with expectations. After significant downward pressure on the Rupee in late 2013, the currency rebounded strongly in the third quarter, appreciating by 6.5 percent against the dollar. The sharp recovery in reserves has continued since end-March, bolstered by the oversubscribed placement of US\$2 billion in Eurobonds and significant program disbursements from the World Bank and ADB. For the next fiscal year, we expect the current account to remain broadly stable, and its financing will continue to be supported by significant program disbursements.

A. Monetary and Exchange Rate Policies

Economic Policies

3. **Monetary aggregates continued to grow in line with program objectives in the third quarter of FY 2013/14.** The stock of Net Foreign Assets (NFA) of the SBP turned positive at end-March 2014, for the first time since September 2013. The growth rate of broad money declined by 1 percent to 12.7 percent y-o-y in the third quarter, while reserve money stayed flat during the same period. Credit to the private sector increased by some 5 percent y-o-y in March, a slight slowdown compared to 5.6 percent in the past quarter and still negative in real terms.

4. **Performance under the end-March monetary targets was mixed.** The PC on Net International Reserves (NIR) was met by a wide margin of US\$732 million, due in part to ambitious spot market purchases in the month of March. The ceiling on the net swap/forward position was also met (by US\$120 million), as was the ceiling on government borrowing from the SBP (by PRs 163 billion) (see ¶19). Although the government reduced borrowing from the SBP in line with program targets, sterilization of the grants through Pakistan Development Fund was not sufficient to contain Net Domestic Assets (NDA) growth, and the SBP missed the program ceiling by PRs 41 billion. The central bank has since taken steps to bring NDA back within the programmed path. To avoid any slippages in future, the SBP will appropriately sterilize foreign exchange inflows and spot market intervention to keep NDA in line with future program targets.
5. **Monetary and exchange rate policies continue to be geared toward rebuilding SBP reserves and reducing inflation.** The SBP has taken advantage of the current favorable foreign exchange market conditions to further accelerate purchases of foreign reserves in the spot market, and is on track to achieve the projected increase in gross international reserves and the NIR target for end-June 2014. However, a modification of the adjuster on the NIR target to allow use of the overperformance on the Eurobond issue to partially cover the anticipated shortfall in privatization and 3G license receipts will be needed for end-June 2014 for the SBP to meet the end-June NIR program target. The SBP has continued to unwind its net swap/forward position to US\$1325 million as of end-April 2014 and is on track to meet the end-June program target.
6. **The SBP is committed to sustainably reducing inflation over time.** The recent spike in both headline and core inflation in March and April is a cause for concern, and the SBP will use monetary policy tools to contain inflation, consistent with bringing it sustainably below 8 percent by the end of FY2014/15. In particular, the central bank will adjust the policy interest rate in a forward-looking fashion to maintain positive real interest rates in line with its desired inflation path. Going forward, the SBP is committed to taking additional policy actions as and when needed to assure achievement of its reserve accumulation and price stability objectives.
7. **Enhanced central bank independence is key for an improved monetary policy framework.** We have submitted amendments to the SBP Act to the National Assembly (NA), with a view toward having them enacted by end-June 2014 (structural benchmark), although there may be some delays in the parliament. We will continue to work to ensure that the final law incorporates the recommendations of the IMF safeguards assessment mission and comments provided by Fund staff. It will strengthen the autonomy of the SBP, including full operational independence in the pursuit of price stability as the SBP's primary objective. Among other things, the amendments will establish an independent decision-making monetary policy committee to design and implement monetary policy and prohibit any form of new direct lending from the SBP to the government. Independent of the new legislation, the SBP will undertake several initiative to improve its internal operations, including by: (i) reestablishing an advisory monetary policy committee to advise the Board on its policy decisions; (ii) establishing a Board committee to centralize and oversee risk management activities across the bank; and (iii) begin publishing summaries of the monetary policy proceedings of the Board meetings and monetary policy committee deliberations (with an appropriate lag). These

initiatives will be implemented by end-August 2014 (new structural benchmark). Finally, the SBP will hire a consultant to help with the transition to International Financial Reporting Standards (IFRS), and we now plan to adopt IFRS as our financial reporting framework by end-[September] 2014.

B. Fiscal Policy

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

9. **Fiscal performance was strong in the first nine months of FY 2013/14, with a smaller deficit than envisaged under the program.** Revenues were broadly in line with expectations, while the pace of spending remains slower than programmed—particularly on capital spending—as a way to manage the risks related to some of the envisaged revenues. As part of our initial adjustment package, we undertook across-the-board reductions of 30 percent from budget allocations in ministries' nonwage current expenditures—amounting to about 0.15 percent of GDP. We have also scaled back the budgeted increase in capital spending, and delayed some remaining capital spending as a precaution against shortfalls in revenue. For FY 2013/14 as a whole, the government remains committed to deliver a fiscal adjustment of some 2 percent of GDP. The initial consolidation effort relied mainly on the revenue side given the chronically low tax revenue-to-GDP ratio. To strengthen revenues, in addition to the measures approved in the 2013 Finance Bill, we increased the Gas Infrastructure Development Cess (GIDC) at the start of 2014. While the current GIDC is entering the government coffers, the expected recovery of arrears has yet to materialize due to legal issues. The increase in the Cess and the envisaged higher-than-budgeted volumes will lead to additional revenues of about 0.36 percent of GDP on an annualized basis, and we will make further adjustments to bring the yield to 0.55 percent of GDP in FY2014/15. This charge also fosters a more efficient allocation of gas to its highest value economic uses. The provinces are running surpluses which are consistent with achieving the envisaged year-end fiscal outturn. Despite these efforts, recent tax collection data suggest that fourth quarter revenues may end up lower than envisaged under the program by about ¼ percent of GDP due to less-than-budgeted revenue collection at the import stage because of exchange rate appreciation and a slowdown in import growth. However, after adjusting for the base rate effect, the tax-to-GDP ratio will still increase by the envisaged 0.7 percent of GDP. In this context, we are strengthening our tax administration efforts—particularly with respect to enforcement, accelerated auctions of seized assets and recoveries from arrears. We are also redoubling efforts to recover GIDC arrears, and have further reduced our envisaged capital spending to ensure that we achieve the program target. Moreover, the government has sent to parliament a FY2014/15 budget proposal consistent with the program objectives (prior action). The deficit (excluding grants) will be lowered from 5.7 percent of GDP to 4.8 percent of GDP. The

envisaged fiscal adjustment is underpinned by tax revenue measures amounting to 0.8 percent of GDP, and further rationalization of subsidies of 0.5 percent of GDP. These additional revenue efforts will ensure that the reduction in capital spending undertaken to address the tax revenue shortfall in FY2013/14 does not become permanent.

10. To ameliorate risks to the program, several contingent measures have been identified and will be implemented in case the expected fiscal adjustment falls short of objectives.

On the revenue side, plans to eliminate Statutory Regulatory Orders (SROs) in FY2015/16 will be brought forward if tax revenues fall below the level envisaged in the program. On the expenditure side, we will again reduce expenditure allocations in the first nine months of the year compared to the budget to create a reserve against any shortfall. These measures could yield savings amounting to [0.5] percent of GDP. In any case, we stand ready to take compensatory measures as needed, including adjustment on the revenue side, to reach our fiscal target.

11. On the expenditure side, the government continues to implement its National Energy Policy which, among other things, will largely phase out electricity subsidies over the life of the program.

The policy entails periodic increases in the average tariff, aimed at eliminating the tariff differential subsidy for all consumers except the most vulnerable over the next three years. The first adjustments to commercial, industrial, bulk, and large consumers (T26) reduced subsidies about $\frac{3}{4}$ percent of GDP on an annualized basis. In the context of the FY 2014/15 budget, we will further rationalize subsidies by roughly 0.5 percent of GDP. We will undertake additional action in the FY 2015/16 budget to reach a maximum of 0.3 percent of GDP thereafter.

12. Tax administration reforms will gradually deliver further improvements in revenue collections.

The strategy is aimed at addressing structural flaws in the taxation system, improving tax administration and inducing behavioral change. The plan comprises among others, measures for: (i) electronic volume tracking of production to improve sales tax collection; (ii) field surveys for the broadening of the sales tax base, (iii) the implementation of an IT solution (CREST) for pointing out discrepancies in sales tax invoices at different stages and putting an effective check on fake invoices; (iv) risk based e-registration in sales tax to thwart spurious registration; (v) revised valuation rulings in customs duties to arrest the tendency of misdeclaration and underinvoicing, and (vi) the electronic data interchange (EDI) connectivity to streamline trade with Afghanistan. Moreover, setting up an integrity and performance unit to encourage high achievers and prosecute the corrupt elements in the tax service, and a fiscal management cell to target non taxpayers with an ostentatious lifestyle, will further strengthen the FBR.

13. Efforts to broaden the income tax net also seek to foster a culture of compliance.

The Prime Minister's incentive package provided a final opportunity for tax payers to voluntarily comply, and the way forward will focus on enforcement. The initiative to incorporate 300 thousand new taxpayers into the income tax net is moving ahead. For this purpose, we continue to strengthen our database by collecting information from multiple sources including urban property transactions, motor vehicle procurement, and international travel. More than 80 thousand initial notices (u/s 114 of the Income Tax Ordinance 2001) have been issued—based on large potential fiscal liabilities and location to ensure the initiative is nationwide—and more than 20 thousand second

notices (u/s 122c of the law) which will be followed by a provisional assessment, collection procedures, and penal and prosecution proceedings. By end-September, we will issue 125,000 first notices (u/s 114) which will be followed by second notices (u/s 122c) to at least 75 percent of those who did not respond satisfactorily to their first notice within 60 days. The FBR will also issue a provisional tax assessment to 75 percent of those who did not respond satisfactorily within 60 days to the second notice. So far, over 6,300 individuals have registered and filed returns as a result of the initiative, and this number is expected to rise in the coming months. We published in mid-February a tax directory of all current parliamentarians at both the federal and provincial levels and the full directory of all taxpayers at end-April, in an effort to foster a culture of transparency and compliance. These efforts will be further assisted by increasing the number of tax audits to 5 percent of declarations (from 2.2 percent last year), which is already underway. We will also continue to seek technical assistance on tax administration from our international partners.

14. **We remain committed to our plan to broaden the tax net through the elimination of most tax exemptions and loopholes granted through SROs.** Since the start of the program, we have issued a few SROs to address some implementation issues of already budgeted measures and address some legal concerns. The budgetary implications of these SROs are negligible and we are covering the cost through administrative measures. We have issued no new SROs granting so-called “special exemptions,” compared to some 56 in the previous fiscal year. We reaffirm our commitment to refrain from issuing any new tax concessions or exemptions (including customs tariffs) through SROs, and will approve legislation by end-December 2015 to permanently prohibit the practice. At end-December 2013, we finalized an analysis of all existing SROs granting tax exemptions or concessions. At end-May 2014, we completed a calendar to eliminate the vast majority of them and convert the remainder into regular legislation (prior action). This plan will ultimately increase revenues by 1–1½ percent of GDP, with all designated SROs eliminated in no more than three years. The FY2014/15 budget proposal includes the necessary legislation to eliminate SRO exemptions and concessions totaling 0.4 percent of GDP (structural benchmark). It also includes additional tax policy measures to broaden the tax base amounting 0.2 percent of GDP. Moreover, the FY2014/15 budget proposal includes a detailed list of the remaining tax expenditures and we will continue to include it in future budgets. These steps will facilitate gradually moving the General Sales Tax (GST) to a full-fledged integrated modern indirect tax system with few exemptions along with an integrated income tax by 2016/17.

15. **Beyond the current fiscal year, further revenue and expenditure measures will be implemented to achieve a sustainable deficit of around 3½ percent of GDP by 2016/17.** This will require further fiscal consolidation of 1¼–1½ percent of GDP in FY2015/16. Well over half of the adjustment should come from the revenue side, mainly through further widening of the tax base (particularly from the elimination of SROs), with some contribution from improved tax administration. With improved collections and a broader tax base, we hope to avoid the need for further increases in GST or income tax rates while achieving our overall deficit targets. On the expenditure side, further reductions in untargeted subsidies will be undertaken in 2015/16, along with steps to streamline wage and salary costs via civil service reforms.

16. **Provincial governments remain crucial in the fiscal reform process.** Under successive constitutional amendments (most recently the 18th), Pakistan has moved decisively to a more decentralized federal system of government. The most recent National Finance Commission (NFC) award granted 57.5 percent of most revenues to the provinces, along with a substantial devolution of spending responsibilities and taxation authority in agriculture, property and services. To assure achievement of our fiscal targets in FY2014/15, and following last year's agreement under the Council of Common Interest, the provincial finance secretaries have agreed to increase provincial budget surpluses consistent with the program. In addition, the federal government is encouraging the provinces to balance their budgets and has provided incentives for them to maintain surpluses. The new National Finance Commission will be established by end-August, and the government will seek a new agreement that will ensure that the terms of fiscal decentralization find a balance between devolution of revenue and expenditure responsibilities and is consistent with the imperatives of macroeconomic stability. In preparation for these negotiations, we will seek technical assistance from our international partners on best practices in sustainable federal-provincial fiscal relations.

17. **We continue our support to the poor and most vulnerable segments of the population through the Benazir Income Support Program (BISP).** We have reached around 4.4 million women paid by end-March 2014 and achieved the indicative target for transfer payments. Funds for the current quarter have already been released to allow time for BISP to begin delivering payments by mid-May. We remain on track to reach around 4.7 million women paid by end-June 2014. To protect the vulnerable segments of the society from reduction in untargeted electricity subsidies, inflation, and fiscal adjustment measures, we will increase the stipends paid to the poorest families from PRs 3600 to PRs 4500 per quarter starting from FY 2014/15. We will also expand coverage through stepped-up outreach efforts, with a target of reaching an additional 0.6 million eligible women by end-June 2015. We will shift our payment mechanism to competitively selected e-banking options by July 1, 2014. In parallel, we will roll-out new ATM cards that will include identity and security features to avoid fraud. This transition will reduce costs, improve beneficiary services—including using branchless banking options to ensure greater financial inclusion—and improve access for beneficiaries who are in rural and security affected areas with limited banking access. This transition may temporarily affect the timeliness of beneficiary payments in the first quarter of the FY 2014/15, and we will assure that all beneficiaries will receive their payments before the quarter ends. We also made significant progress in preparing the rollout of the education conditional cash transfers with an objective to move from five pilot districts to at least 27 more districts by end-September 2014.

18. **In order to enable the use of anti-money laundering (AML) tools to combat tax evasion, we have started preliminary work to include tax crimes in the Schedule of Offences of the 2010 Anti-Money Laundering Act (AMLA).** A list of serious tax offences is being identified. In order to ensure that serious tax crimes are predicate offences to money laundering, we will enact amendments to the relevant tax laws (as defined in the TMU) and submit amendments to the Anti-Money Laundering Act (AMLA) to Parliament by end-September 2014 (structural benchmark). We will also ensure that the AML framework is properly implemented to facilitate detection of potential

cases of abuse of the investment incentive scheme to launder criminal proceeds. Proper guidance will be provided by the Financial Intelligence Unit to financial institutions and the FBR by end-June 2014. Finally, the Anti-Terrorism (Amendment) Ordinance 2013 will be enacted as a permanent law, in line with the action plan agreed with the Financial Action Task Force (FATF).

C. Fiscal Financing

19. The government continued taking measures to reduce budget financing from the SBP.

The government has curtailed government borrowing to PRs 2,226 billion (some PRs 164 billion below the program target) and will continue to reduce it to achieve the end-June 2014 program target. The successful US\$2 billion Eurobond issue helped the government to diversify budget financing, as it continued to shift from short-term domestic financing and borrowing from the SBP to longer-term domestic and external bond financing. In addition, we will continue to tap into international markets to attract external commercial financing and floating government T-bills in the stock exchange will enlarge the market for domestic debt. The government will also accommodate higher yields if needed to meet its borrowing targets without further reliance on the SBP.

20. We remain committed to enhancing the effectiveness of public debt management operations.

We continue to diversify financing requirements from both domestic and external sources. For this purpose, we have finalized a Medium Term Debt Strategy (MTDS) in April 2014. The MTDS provides detailed guidelines to achieve desired composition of government's debt portfolio, by capturing preference of the government with regard to cost-risk tradeoff. As part of the strategy, we also intend to revamp our Debt Policy Coordination Office (DPCO) to a fully-fledged and operational debt management office. We plan to complete a detailed report on skills-gap analysis of the existing DPCO by end-September 2014 with the assistance of our development partners. Simultaneously, we will initiate the process of hiring of a professional Director General to lead DPCO and transform it into an operational Debt Management Office. As part of strengthening the debt management functions, scattered responsibilities in different wings of the MoF (dealing with the debt functions) will be consolidated in the Debt Management Office by approving an administrative order by September 2014 (new structural benchmark) and subsequently draft required rules under the Fiscal Responsibility and Debt Limitation Act 2005. These actions will lead to more effective decision-making for government borrowing.

D. Financial Sector

21. The banking system continues to show good indicators of financial soundness. As of end-March 2014, nonperforming loans (NPLs) decreased slightly (to 13.4 percent, with net NPLs to net loan ratio of 3.3 percent). Profitability indicators (ROA and ROE) improved, mainly attributable to increased net income and lower provision charges. Capital adequacy (CAR) remained well above the minimum requirement of 10 percent even after implementation of Basel-III. CAR remained around 15 percent on account of improved earnings of the banking system. To further enhance the assessment of financial health and soundness of the financial sector, the SBP has made progress in compiling the "encouraged" set of the Financial Soundness Indicators (FSIs) and will work with the IMF on dissemination of some additional FSIs to the public.

22. **The SBP is following up with the few banks that fall below the minimum capital requirement.** The CAR shortfall for noncomplaint banks (one state-owned and three private) is only PRs 13.2 billion (less than 0.05 percent of GDP) as of end-April 2014. Although these banks do not pose major systemic risks as they comprise 6.4 percent of banking assets, the SBP has maintained strong vigilance on the activities of these banks to ensure compliance with minimum CAR by end-December 2014. Specifically:

- **State-owned bank:** the bank's CAR has improved to 9.3 percent as of end-March 2014 and will be able to meet the CAR requirement by end-December 2014 given the present profitability trend.
- **Private banks:** one bank received an Expression of Interest from a strategic foreign investor for both capital injection and acquisition of shares from the existing major shareholders. The sponsors of another bank have already deposited an additional PRs 2.5 billion as an advance against subscription of a rights issue, and the bank has received offers from potential foreign investors as well as a commitment from existing sponsors for injection of remaining capital shortfall. The SBP is actively engaged with the last bank for its capitalization either through equity injection or through possible merger with domestic bank over the coming months.

23. **We remain committed to safeguarding financial stability by strengthening the regulatory and supervisory frameworks.** Specifically:

- a. The draft Securities Bill is being finalized by the authorities and will be discussed with the IMF by end-June 2014. It will be adopted by end-December 2014 (structural benchmark).
- b. The revised SECP Act to enhance the regulatory power of the SECP will be discussed with the IMF, before being submitted to Parliament by [end-September] 2014. The Futures Trading Bill is also being finalized.
- c. The SBP-SECP joint task force has resumed its regular meetings over the last few months to ensure cooperation on the supervision of financial groups. The SBP shared its assessment about consolidated financial position of the conglomeration in the financial sector with SECP.

24. **Consultation with key stakeholders on a deposit insurance scheme and a bankruptcy law are ongoing.** The SBP has revised the Deposit Protection Fund (DPF) Act, which will be finalized during the second half of 2014 in consultation with the IMF in the context of a technical assistance on a contingency planning framework. Due to this change in the timeline, we request the revision of the corresponding structural benchmark to June 2015. In the meantime, the proposed amendments to the SBP Act include enabling clause to establish the DPF as a subsidiary of the SBP, which will be a cost effective option and facilitate avoiding regulatory overlaps and ensuring prompt reimbursement. Furthermore, after eliciting stakeholders' views (SBP, Pakistan Banks Association, business groups, and legal experts), the draft Corporate Rehabilitation Act (CRA) will be broken down into two components: (i) Corporate Restructuring Companies Act provided as a separate

legislative Bill for managing troubled assets; and (ii) Corporate Rehabilitation Act given more time is needed to prepare a concept note on the suitable mode of rehabilitation law.

E. Structural Reforms

Energy Sector Reforms

25. **The National Energy Policy identified priority steps to anchor the reform agenda for the next three–five years.** We are implementing our time-bound strategy to tackle price distortions, insufficient collections, costly and poorly targeted subsidies, governance and regulatory deficiencies, and low efficiency in energy supply and distribution with the support of our international partners.
26. **Price Adjustments.** We have prepared the third round identified in the three-year plan for phasing out the Tariff Differential Subsidy (TDS) to continue to bring tariffs to cost recovery level. In this round, NEPRA will finalize the determination and notification of tariffs for FY2013/14 by end-May (prior action). Lower oil prices and better company performance led to a lower tariff determination relative to the previous fiscal year. For this reason, the notification will produce only a [4] percent increase in the weighted average notified tariff (as defined in the TMU), while continuing to protect the most vulnerable consumers. The notified tariff will reduce the electricity subsidy to 0.5 percent of GDP for FY 2014/15.
27. **Arrears.** The technical and financial audit of the system which was finalized in early-May identified the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited, PHCL). Building on this audit, we have designed a roadmap to limit the accumulation of payables arrears and to gradually reduce the stock:
- a. The stock of arrears at the PHCL in the syndicated term credit finance (STCF) facility stood at PRs 240 billion at end-March 2014. The servicing of these payables will be made through inclusion in the tariff notification for FY 2013/14. Alternatively a suitable surcharge will be levied for this purpose.
 - b. The payables in the power sector reached around PRs 270 billion at end-March 2014 of which around PRs 90 billion constitute current payables. The remainder comprises: (i) a residual leftover from payables clearance of May and July 2013; (ii) A disputed amount with the Independent Power Producers (IPP); and (iii) DISCO nonrecovery and penalties levied on past nonpayment. We will pursue the recovery of receivables in the power and oil and gas sector and use the proceeds to reduce payables by end-June 2014.
 - c. We will continue to reduce losses and improve collections through capital expenditures and revenue based load management. We envisage reducing losses by 1 percentage point [(to 17 percent)] and increase revenues by 3 percentage points at the end of the current fiscal year. Going forward, continued efficiency improvements will reduce the pace of the payables buildup due to corporate losses.
 - d. We are developing a monitoring mechanism to track the stock and flow of payables.

28. **Monitoring and Enforcement.** To tackle losses, raise payment compliance, and improve energy efficiency and service delivery in the distribution companies (DISCOs), we have already signed six performance contracts; we are on track to finalize the contracts for the remaining three DISCOs by end-May 2014. We have also finalized the signing of the remaining power purchase agreement in March 2014. In cases of failure to comply with the performance contracts, we will invoke remedial measures for management and Boards as specified in the Companies' Ordinance. The amendments to Penal Code 1860 and the Code of Criminal Procedures 1898 have been promulgated through Presidential ordinance. The ordinance has been submitted to Parliament for ratification, and the President extended the promulgation by another 120 days. In parallel, we drafted the new Electricity Act to modernize governance of the sector and have circulated it for comments. We declared the session courts (district level courts) as Utility Courts as defined in the Penal Code. Utility Courts will build on investigation systems and fast track mechanisms to improve enforcement by end-2014. In order to minimize losses from low payment rates, all state-owned DISCOs are now implementing revenue-based load shedding, which has begun to help increase collections. To minimize losses in fuel delivery to generation companies (GENCOs), we signed a Memorandum of Understanding (MoU) between Muzaffargah Power Generation Company (GENCO-III) and Pakistan State Oil (PSO) to lease the fuel storage and delivery facilities to Pakistan State Oil (PSO). The implementation of the MoU has begun and the handover will begin by end-September 2014.

29. **Demand Side Management.** To encourage energy conservation, we will use pricing ¹²⁷ and other market based instruments to improve resource allocation and energy efficiency. In this regard, we have begun the consultative process with the stakeholders on the draft Pakistan Energy Efficiency and Conservation Act. We placed the revised draft before the Council of Common Interest (CCI) for expected consultation in the upcoming meeting. The act will include equipment performance standards, and would cover key electrical and gas equipment and appliances which are not yet covered.

30. **Supply Side Management.** We will continue to prioritize the use of gas and coal rather than fuel oil in electricity generation and remain committed to a transition to market-based allocation of natural gas in the medium-term. The Economic Coordination Committee has approved the policy directive to encourage the conversion of fuel oil-based GENCOs and Independent Power Producers (IPPs) to coal-based plants. To further improve supply, we will continue to rehabilitate generation plants, while upgrading electricity transmission and distribution facilities to reduce technical losses. We finalized the efficiency testing of fuel-based GENCOs and the current round of three rehabilitations in March 2014, which are expected to: (i) generate savings by next fiscal year; (ii) recover around 700 MW of capacity; and (iii) increase efficiency by 1–1.5 percent. Moreover, to enhance clean energy supply, we will continue with the development of hydropower projects—the cheapest source of supply. We will promote policies for private investment for power generation through both the entry of new players as well as expanding existing capacity of those IPPs systematically adhering to energy mix targets and least-cost generation plans. The expansions are expected to generate additional 2000 MW by 2016.

31. **Governance, Regulatory, and Transparency Improvements.** We continue to place high priority on improving energy sector governance and transparency. We have already hired entry and middle management positions to enhance the technical capacity of the regulatory body, the National Electric Power Regulatory Authority (NEPRA). In order to begin addressing administrative and technical constraints, we conducted a diagnostic study of the regulatory framework of the power sector and prepared an interim report in April 2014 (structural benchmark). We will begin implementing the findings of the report by initially filling the vacancies on the NEPRA Board by end-July 2014 (new structural benchmark). We aim to appoint individuals with legal, financial, regulatory and technical skills, and include the key performance indicators in the employment contract. The performance indicators of NEPRA will be a part of the annual performance report of NEPRA. NEPRA is also committed to streamlining the tariff determination process to four months by the next determination cycle. In the meantime, NEPRA has begun preparations for a multi-year tariff framework. The methodology for the framework was finalized in March 2014. To facilitate the transition, we will establish three year investment plans for at least three DISCOs by end-September 2014. The first phase of the determination and notification of multi-year tariffs will begin with these DISCOs by end-September 2015. We will continue to apply fuel price adjustments (FPAs) determined by NEPRA in its normal monthly schedule. We have set-up the Central Power Purchasing Agency (CPPA) by separating it from the National Transmission and Despatch Company (NTDC) and have amended the Articles of Association. To make CPPA operational, we issued the standard operating procedures for payments and settlements and key CPPA staff will be in place by end-June 2014.

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

33. **Oil and Gas Sector**

- **Supply.** To help tackle gas shortages, we have started efforts to import Liquefied Natural Gas (LNG). We finalized the evaluation and awarded an LNG services agreement in April, 2014, with a view toward receiving the first LNG imports by early 2015. Moreover, we will accelerate the development of domestic natural gas and continue to limit further expansion of the gas distribution networks for domestic consumption. We are committed to maintaining the priority ranking of the power sector to second (after households) and continue to divert the excess supply of gas to the most efficient power plants.

- **Pricing.** We will gradually rationalize gas prices to encourage new investment, promote efficiency in gas use, and assure that there will continue to be no fiscal cost from the gas sector. We have produced a gas price rationalization plan in December 2013 to address both production and consumption of gas.
 - We have begun implementing the new Petroleum Exploration and Production Policy 2012 (2012 Policy) with amendments for enhanced production from existing and new fields, and to further improve producer incentives. With price increases ranging from 2.8–3 U.S. dollars per MMBTU to 6–10 U.S. dollars per MMBTU, we are incentivizing producers to enhance production from existing fields as well as initiate new exploratory efforts. We have awarded 43 new blocks for exploration in new fields while finalizing the concession agreements for 7 blocks. During the next financial year we will award an additional 10–15 blocks. As new production and additional gas supply from imports come on line, the cost of this gas will continue to be fully reflected in the base tariff on a semiannual basis, beginning with the next adjustment on July 1, 2014;
 - To better allocate gas consumption, we adjusted the weighted average consumer prices at end-December 2013, through the application of the GIDC, which will be further adjusted with the FY 2014/15 budget to generate 0.55 percent of GDP fiscal revenues.
 - We are evaluating the downstream gas business with the objective of bringing in efficiencies in the transmission and distribution segments for better operation of the market system. In this respect, we will hire consultants by end-December 2014 to conduct the study on the restructuring and unbundling of the two gas utility companies. This study will help formulate recommendations based on international best practices including segregating the gas network into one transmission and multiple distribution companies. These companies will further be internally segregated into independent profit and cost centers to ensure maximum efficiency. A mechanism will be developed for determining separate transmission and distribution tariffs and a new pricing mechanism for sale of natural gas to various sectors of the economy will be devised to account for the higher cost of additional gas in the system, especially the imported gas.
- **Governance.** We have been enhancing the capacity of Ministry of Petroleum and Natural Resources to fully implement the 2012 Policy, streamline approval processes, and complete the conversion to the 2012 Policy for those Petroleum Concession holders who wish to do so. We will further encourage bilateral contracting between producers and consumers and improve rules for third party access to the gas transmission system. The current level of unaccounted for gas losses (UFG) is on average 11 percent due to commercial and technical losses. We will expedite the work on National Gas Efficiency Project (NGEP) in coordination with IFIs. We are pursuing companies at the highest level to reduce losses benchmarking international standards through investment measures, managerial and administrative improvements, and through building the capacity of the gas distribution companies. In January 2014, the President has promulgated the Gas (Theft Control and Recovery) Ordinance 2014, which was sent to the

Parliament. Finally, we affirm our commitment to enhance the capacity of Oil and Gas Regulatory Authority (OGRA).

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

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

35. **Business Climate.** Private investment and growth are hampered by impediments in the legal framework for creditors' rights and contract enforcement, barriers to new business start-ups, complicated legal and taxation requirements, and impaired access to finance hamper the business climate and investment.

- **Contract enforcement.** While the draft Corporate Rehabilitation Act is prepared (¶[19]), we completed in March 2014 a study to identify the needs of corporations to speed up rehabilitation of weak but viable companies. Based on the findings of the study, we will expedite the liquidation of the insolvent entities. In addition, we have begun expanding the use of Alternative Dispute Resolution (ADR) Mechanisms beyond Karachi. ADR is now open to all businesses in Lahore.
- **Start-ups.** The FBR, in coordination with SECP, Employees Old-Age Benefits institute (EOBI), and other stakeholders (including provinces) have approved a plan to simplify procedures and costs for setting up businesses and have prepared another for paying taxes in Pakistan. We will finalize a time-bound detailed implementation plan in coordination with IFIs and after consultation with key stakeholders by end-June, 2014.
- **Access to credit.** Access to finance for poor and marginalized segments including micro, small and rural enterprises remains very limited owing to both demand and supply-side constraints. The SBP, with the help of World Bank experts, is developing a comprehensive National Financial Inclusion Strategy under its financial inclusion program to address industry bottlenecks and barriers in access of micro, small and rural enterprises to financial services. The strategy will include regulatory reforms to encourage microfinance banks (MFBs) to upscale their credit operations, developing risk mitigation mechanism, and market interventions for strengthening credit enhancement mechanisms, improving market information and infrastructure, product innovation, improved delivery mechanisms, financial literacy, and consumer protection. In this regard, SBP and the World Bank (WB) have started a mapping exercise to take stock of existing initiatives and identify gaps for future interventions. Following the stock taking, SBP and WB will be conducting detailed consultations with all stakeholders to develop the NFIS.

36. **Trade Policy.** Trade policy reforms will increase consumer welfare and stimulate growth as a result of increased competition. Simplifying tariff rates, phasing out statutory regulatory orders (SROs) that establish special rates and/or nontariff trade barriers in some 4,000 product areas, and improving trade relations should deliver the much needed competitive environment.

- **Tariff simplification.** We are working on simplifying the tariff structure to move over three years to a simple, transparent framework, with four slabs between 0 and 25 percent rates with few exceptions. We are on track to finalize the design of the new system by end-May 2014. The phase-in of the revised tariff rates and phase-out of trade SROs would begin with effect in July 2014 (see also ¶14). For FY2014/15, we will move from eight tariff slabs to six by moving most items currently at 30 and 35 percent to the 25 percent rate. Implementation of the new tariff structure would be completed by July 2017.
- **Improved trade relations.** We are implementing a strategy to take full advantage of trade preferences available from the EU who have extended GSP plus benefits (i.e., 0 percent customs duty) from January 1, 2014 on a broad range of Pakistan's exports. We remain committed to promoting trade with regional countries, especially under various regional trade arrangements.

37. **Public Sector Enterprises.** We are working towards reforming or privatizing public sector enterprises (PSEs), focusing on limiting poor performance and improving public sector resource allocation. The Cabinet Committee on Privatization (CCOP) approved a list of 31 PSEs for action, and we have developed a plan to sequence the capital market and pre-privatization restructuring for these firms. The privatization program is aimed at offering and/or marketing one transaction in each quarter during the upcoming year.

- **Capital Market Transactions Roadmap.** We have identified eleven companies, (listed in the TMU), in the oil and gas, banking and insurance, and power sectors for block sales and primary or secondary public offerings. We hired three financial advisors for United Bank Limited (UBL), Pakistan Petroleum Limited (PPL) and Oil and Gas Development Company Limited (OGDCL) in May 2014. Subject to investor interest and global market conditions, we will offer minority shares in UBL and PPL to domestic and international investors by end-June 2014 (new structural benchmark). Furthermore, we will hire financial advisors for Allied Bank Limited (ABL) and Habib Bank Limited (HBL) by end-September 2014 to market minority stakes within six months thereafter.
- **Strategic Private Sector Participation.** Strategic partnerships will act as a catalyst in unlocking the potential of PSEs through their managerial and investment participation. They can also increase the value of Government's residual shareholding. We have identified 17 companies (listed in the TMU). For profitable PSEs, we will make efforts to balance the objectives of sale proceeds while adequately addressing labor market issues and social implications. We will hire a financial advisor for National Power Construction Co. (NPCC) by end-June 2014 to finalize the sale offer by end-December 2014. We will also appoint financial advisors for share sales of Faisalabad Electric Supply Company (FESCO) and Northern Power Generation Company Limited (NPGCL) by end-June 2014.
- **Restructuring.** We will continue our restructuring plans and hire professional chief executives and board members for those enterprises with a corporate structure in line with the corporate governance rules. We are developing medium-term action plans to restructure Pakistan International Airlines (PIA), Pakistan Steel Mill (PSM) and Pakistan Railways (PR). Specifically,

- **Pakistan International Airlines.** We will appoint a financial advisor by end-June 2014 (structural benchmark) to seek potential options for restructuring and strategic private sector participation in the company. In the meantime, PIA will continue leasing more efficient airplanes and rationalizing routes.
- **Pakistan Steel Mills.** We have appointed a professional board and approved a comprehensive restructuring plan in April 2014 to prepare for potential strategic private sector participation in the company.
- **Pakistan Railways.** Aging and shortage of equipment, overstaffing, and large debts continue to weigh on railway operations. Nevertheless, we have improved revenue in the first nine months of the year through rationalization of tariffs and expenditures and improved occupancy rates. We finalized a plan that identifies the needs of Pakistan Railways in April 2014 and are developing a comprehensive restructuring plan, which will include improvements in business processes and institutional framework, financial stability, and service delivery. The plan will be finalized by end-September 2014. We are also in the process of reviving the Railway Board and will finalize the appointment of Board members by end-July 2014.

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

	FY2012/13		FY2013/14						FY2014/15		
	end-June	end-September	end-December		end-March		end-June	end-September	end-December	end-March	
	Actual	First Review	Actual	Second Review	Actual	Third Review	Actual	Program	Projection	Projection	
Performance Criteria											
Floor on net international reserves of the SBP (millions of U.S. dollars) 2/, 3/ 4/	-2,437	-2,850	-3,154	-5,107	-4,547	-2,872	-2,140	1,800	3,000	3,500	4,500
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees) 5/, 6/	2,402	2,877	2,595	2,968	2,821	2,609	2,650	2,324	2,306	2,420	2,324
Ceiling on overall budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 7/	2,012	419	297	882	572	1,209	982	1,464	376	711	1,095
Ceiling on SBP's stock of net foreign currency swaps/forward position (millions of U.S. dollars)	2,255	2,255	1,775	2,255	2,650	2,255	2,135	2,150	1,900	1,775	1,775
Ceiling on net government borrowing from the SBP (including provincial governments, stock, billions of Pakistani rupees) 1/, 8/	2,168	2,690	2,521	2,560	2,611	2,390	2,227	2,240	2,070	2,000	1,905
Continuous Performance Criterion											
Accumulation of external public payment arrears by the general government (continuous)	0	0	0	0	0	0	0	0	0	0	0
Indicative Targets											
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees)	54	19	14	32	16	48	49	62	14	44	69

Sources: Pakistani authorities; and Fund staff estimates.

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

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

3/ End-December 2013 target of -4130 has been adjusted by -977 millions of U.S. dollars to reflect a shortfall in multilateral/bilateral disbursements to Pakistan.

4/ End-March 2014 target of -2750 has been adjusted by -122 millions of U.S. dollars to reflect a shortfall in multilateral/bilateral inflows to Pakistan.

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

6/ End-March 2014 NDA target of 2627 has been adjusted downward by 18 billions of PRs to reflect an excess in multilateral/bilateral disbursements to Pakistan

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

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

Table 2. Pakistan: Structural Benchmarks Under Extended Fund Facility

Item	Measure	Time Frame (by End of Period)	Comment
Prior Actions			
1	Finalize the determination and notification of electricity tariffs for FY2013/14.		
2	Complete a calendar to eliminate the vast majority of SROs granting tax exemptions or concessions and convert the remainder into regular legislation		
3	Send to parliament a FY2014/15 budget proposal consistent with the program objectives		
Structural Benchmarks			
Fiscal sector			
1	Develop and finish launching initiatives to enhance revenue administration for sales tax, excises, and customs similar to that prepared for income tax.	end-December 2013	Met
2	Announce a rationalization plan for gas prices which will involve a levy to generate 0.4 percent of GDP fiscal savings.	end-December 2013	Met
3	Increase the issuance of first notices (u/s 114) to 75,000 and follow up with a second notice (u/s 122c) to 75 percent of those who did not respond satisfactorily to their first notice within 60 days by end-March, 2014. Issue a provisional tax assessment to 75 percent of those who did not respond satisfactorily within 60 days to the second notice by end-March, 2014.	end-March 2014	Met
4	Eliminate exemptions and concessions granted through SROs for an amount consistent with the fiscal deficit reduction objective in the FY2014/15 budget.	end-June-2014	
5	Enact amendments to the relevant tax laws (as defined in the TMU) and submit amendments to the Anti-Money Laundering Act (AMLA) to Parliament	end-September 2014	
Monetary sector			
6	Enact the amendments to the SBP law to give SBP autonomy in its pursuit of price stability as its primary objective, while strengthening its governance and internal control framework, in line with Fund staff advice.	end-June 2014	
Financial sector			
7	Prepare detailed plans to achieve compliance of all banks that fall below minimum capital adequacy, including specific actions, end dates, and contingency arrangements. Also detail a plan for recapitalization, consolidation or liquidation of banks that fall below the minimum capital requirement but not CAR.	end-December 2013	Met at end-Feb, 2014
8	Enact the Deposit Protection Fund Act, in line with Fund staff advice.	end-June 2015	
9	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014	
Structural Policies			
10	Develop and approve PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by the Council of Common Interest (CCI).	end-September 2013	Met
11	Hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited).	end-November 2013	Met
12	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), advertise key staff positions, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013	Met at end-Feb, 2014
13	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013	Met
14	Initiate revenue based load shedding in six remaining electricity distribution companies .	end-January 2014	Met
15	Hire three financial advisors for three PSEs in the capital market transactions list and three financial advisors for the three PSEs in the strategic private sector enterprises list for privatization in the TMU.	end-March 2014	Partially met
16	Conduct a diagnostic study of the regulatory framework of the power sector and prepare an interim report.	end-April 2014	Met
17	Privatize 26 percent of PIA's shares to strategic investors.	end-December 2014	
New Structural Benchmarks			
18	Improve the internal operations of the SBP by: i) reestablishing an advisory monetary policy committee to advise the Board on its policy decisions; ii) establishing a Board committee to centralize and oversee risk management activities across the bank; and iii) begin publishing summaries of the monetary policy proceedings of the Board meetings and monetary policy committee deliberations.	end-August 2014	
19	Fill the vacancies in the NEPRA Board.	end-July 2014	
20	Offer the minority shares in United Bank Limited and Pakistan Petroleum Limited to domestic and	end-June 2014	
21	Approve an administrative order to consolidate the responsibilities of public debt management in the debt management office.	end-September 2014	

Attachment II. Technical Memorandum of Understanding (TMU)

June 19, 2014

For the purposes of monitoring under the program, all assets and liabilities as well as debt contracted, denominated in SDRs or in currencies other than the U.S. dollar, will be converted into U.S. dollars at the program exchange rates. Net external budget financing and external cash grants will be converted into Pakistani rupees at the program exchange rate. The program exchange rate of the Pakistani rupee to the U.S. dollar is set at 99.66 rupee per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

A. Quantitative Targets

1. **The program sets performance criteria and indicative targets** for defined test dates (Table 1 in the LOI). The program sets the following performance criteria:

Performance criteria

- Floor on the net international reserves (NIR) of the State Bank of Pakistan (SBP) (millions of U.S. dollars);
- Ceiling on the net domestic assets (NDA) of the SBP (stock, billions of Pakistani rupees);
- Ceiling on the overall budget deficit excluding grants (cumulative flows, billions of rupees);
- Ceiling on net borrowing from the SBP by the government (including provincial governments, stock, billions of rupees);
- Ceiling on SBP's stock of net foreign currency swap/forward contracts (millions of U.S. dollars);

Continuous performance criteria

- Ceiling on the accumulation of external payment arrears by the general government;

Indicative targets

- Floor on targeted cash transfers spending (BISP) (cumulative, billions of Pakistani rupees)

B. Definitions of Monitoring Variables

2. **The net international reserves** (stock) of the (SBP) are defined as the dollar value of the difference between usable gross international reserve assets and reserve-related liabilities, evaluated at the program exchange rates. On October 31, 2013, the NIR of Pakistan amounted to US\$4551 million.

3. **Usable gross international reserves** of the SBP are those readily available claims on nonresidents denominated in foreign convertible currencies and controlled by the monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes. Gross official reserves include (i) holding of foreign currencies, (ii) holdings of SDRs, (iii) the reserve position in the IMF, and (iv) holdings of fixed and variable income instruments. Excluded from usable reserves, inter alia, unless there is also a reserve-related liability associated with it, are: (i) claims on residents; (ii) assets in nonconvertible currencies; (iii) precious metals (iv) illiquid assets; (v) assets that are pledged or collateralized.

4. **Reserve-related liabilities** of the SBP include all foreign exchange liabilities to residents or nonresidents, including (i) foreign currency liabilities with remaining maturity of one year or less, (ii) any foreign exchange liabilities arising from derivatives (such as futures, forwards, swaps, and options) on a net outstanding basis—defined as the long position minus the short position, (iii) outstanding IMF credits to Pakistan, (iv) foreign exchange deposits with the SBP of foreign governments, foreign central banks, foreign deposit money banks, international organizations, and foreign nonbank financial institutions, as well as domestic financial institutions. General government foreign exchange liabilities at the SBP will not be included in reserve-related liabilities.

5. **Aggregate net position in the foreign exchange derivatives** is defined as the aggregate net positions in forward and futures in foreign currencies of the SBP vis-à-vis the domestic currency (including the forward leg of currency swaps). The SBP's aggregate position was –US\$2.3 billion at end-June 2013.

6. **Reserve money (RM)** is defined as the sum of: currency outside schedule banks (deposit money banks); schedule banks' domestic cash in vaults; schedule banks' required and excess rupee and foreign exchange deposits with the SBP; and deposits of the rest of the economy with the SBP, excluding those held by the federal and provincial governments and the SBP staff retirement accounts.

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

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

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

10. **External public debt arrears** are defined as all unpaid debt-service obligations (i.e., payments of principal and interest) of the general government (government, SBP, and state-owned enterprises) to nonresidents arising in respect of public sector loans, debt contracted or guaranteed, including unpaid penalties or interest charges associated with these obligations that are beyond 30 days after the due date. The definition of debt, for the purposes of the EFF, is set out in Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Executive Board Decision No. 6230–(79/140), last amended by Executive Board Decision No. 14416–(09/91), adopted August 31, 2009). The ceiling on external payment arrears is set at zero.

11. **The overall budget deficit (excluding grants)** will be monitored quarterly under the cash balance of the general government balance, excluding grants, including the operations of district governments financed from local funds. It will be measured below the line and will include:

- **Net external financing**, excluding valuation gains and losses.
- **Change in net domestic credit from the banking system**, excluding valuation gains and losses from deposits denominated in foreign currency.
- **Change in the net domestic nonbank financing**, excluding valuation gains and losses. These include (i) domestic privatization receipts transferred from the privatization accounts to the budget, (ii) the stock of issued government securities held outside the general government and the banking system, net of valuation changes, (iii) net deposits and reserves received by the government (public accounts deposits), (iv) any other government borrowing from domestic nonbank sources net of repayments, minus (v) government deposits with nonbank financial institutions.
- **Total external grants to the federal and provincial governments.** These are defined as the sum of project grants, cash external grants for budgetary support, capital grants reflecting the principal amounts of external debt cancellation or swaps, and other grants.

12. **Net external program financing** is defined to include external privatization receipts; budget support grants; budget support loans from multilateral (other than the IMF, but including World Bank and Asian Development Bank (ADB) budget support and program loans), official bilateral budget support loans, and private sector sources (e.g., bonds); rescheduled government debt service and change in stock of external debt service arrears net of government debt amortization due on foreign loans, the latter including any accelerated amortization including related to debt swaps or debt cancellation recorded as capital grants. It also includes foreign loans on lent to financial institutions and companies (public or private) and emergency relief lending. Program financing excludes all external financing counted as reserve liabilities of the SBP (defined above). Amounts projected for net external program financing and external grants are provided in Table 3.

13. **Net external budget financing** is defined as net external program financing minus privatization receipts, minus budget support grants, plus all other external loans for the financing of public projects or other federal or provincial budget expenditures, plus transfers of external privatization receipts from the privatization account to the budget.

14. **Structural Benchmark on hiring of six transaction advisors for end-March 2014 is defined as follows:** Three transaction advisors to undertake the sale of minority shares for three PSEs from the list of capital market transactions with at least one offering in the domestic and one offering in international markets. From the list of strategic private sector participation one transaction advisor for electricity distribution company and one generation company, and finally one transaction advisor to undertake the restructuring of Pakistan International Airlines Corp (PIAC) and will seek for a strategic investor.

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

16. **Electricity Tariff Pricing Formulas and Definitions (¶26 of the MEFP)**

(i) The increase in the weighted average tariffs by 4 percent on electricity consumers’ electricity consumption is defined as follows

Weighted Average Notified Tariff for electricity consumers =

(Changes in the Industrial Users Tariff Rate for each category x DISCOs’ estimated sales to Industrial Users for each category

+ Change in the Residential Users Tariff Rate for each category above 200kWh x DISCOs’ estimated sales to Residential Users for each category

+ Change in the Commercial Users Tariff Rate for each category x DISCOs’ estimated sales to Commercial Users for each category

+ Change in the Single Point Supply for further distribution Tariff Rate for each category x DISCOs’ estimated sales to Point Supply for further distribution Users for each category)

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

+ Change in the Other users’ Tariff Rate for each category x DISCOs’ estimated sales to Other Users for each category)

/ DISCO's total sales to Industrial, Residential Users consuming more than 200kWh, Commercial, Single Point Supply, Other Users and AJ&K Users

= 4 percent

- (ii) Current notified electricity tariffs for users at 0-50 kWh will be retained.

C. Adjustors

17. **The floor on NIR will be adjusted upward** (downward) by the cumulative excess (shortfall) of cash inflows from multilateral and bilateral creditors, Coalition Support Fund (CSF), and bond issuance relative to projected inflows (Table 2), the adjustor will be modified for the end-June 2014 to exclude the proceeds of the US\$2 billion Eurobond transaction. Cumulative cash inflows are defined as external disbursements (including grants) from official multilateral creditors (including, but not limited to Asian Development Bank, Islamic Development Bank, and World Bank), official bilateral creditors (including, but not limited to DFID, UK, USAID), and external bond placements that are usable for the financing of the central government budget.

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

19. **The ceiling on the consolidated overall budget deficit** (excluding grants) for FY13/14 and FY14/15 will be adjusted upward for the cumulative excess in net external program financing in rupee terms for up to PRs 15.0 billion at end-September, PRs 25.0 billion at end-December, PRs 42.0 billion at end-March, and PRs 50 billion at end-June. The ceiling for FY13/14 and FY14/15 will be adjusted downward for any shortfall in federal PSDP spending below PRs 25 billion at-end September, PRs 80 billion at end-December, PRs 243 billion at end-March and PRs 410 at end-June. The ceiling will be adjusted downward for any shortfall in the targeted cash transfers (BISP). The ceiling will be adjusted upward for over performance in the BISP up to PRs 12 billion from their indicative targets.

D. Public Sector Enterprises

List of Companies for **Capital Market Transactions**

- Oil and Gas Development Co. Ltd (OGDCL)
- Pakistan Petroleum Ltd (PPL)
- Mari Petroleum Ltd.
- Government Holding Private Ltd (GHPL)

- Pak Arab Refinery Ltd (PARCO)
- Habib Bank Limited (HBL)
- United Bank Limited (UBL)
- Allied Bank Limited (ABL)
- National Bank Limited (NBP)
- State Life Insurance Corp. (SLIC)
- Kot Addu Power Company Ltd. (KAPCO)

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

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

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

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

E. Program Reporting Requirements

20. **Performance under the program** will be monitored from data supplied to the IMF by the SBP, Ministry of Finance and Ministry of Water Power as outlined in the table below. The authorities will transmit promptly to IMF staff any data revisions as well as other information necessary to monitor the arrangement with the IMF.

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
State Bank of Pakistan (SBP)	SBP balance sheet	Summary	Weekly	First Thursday of the following week
	SBP balance sheet	Summary at program exchange rates; and by official exchange rates	Monthly	Within 15 days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks at actual official exchange rates	Monthly	Within the first three days of the following month.
	International reserves	By (i) program exchange rates; and (ii) at actual official exchange rates.	Daily	The following working day
	Foreign exchange market	Market exchange rates (buying and selling); weighted average customer exchange rate; monthly trade volume, and high and low exchange rate of the interbank, the KERB market.	Daily/ Monthly	Within one day/ monthly within 5 working day
	Foreign exchange market	SBP foreign exchange operations, and intervention,(volume)	Daily	Within one day
	Foreign exchange market	SBP operation against the domestic currency in swap/forwards by (volumes)	Daily	Within one day
	Foreign exchange market	Breakdown of short, long, counterparts, of the swap/forward contracts	Monthly	Third working day of the following month
	Foreign exchange market	Outstanding swap/forward positions by maturity buckets, and counterparties.	Monthly	Third working day of the following month
	Net International Reserves	Net International reserves at program exchange rates as defined in TMU, including a breakdown by currency and specification of <i>nostro</i> balances with foreign branches of National Bank of Pakistan.	Quarterly	Seventh working day after quarter end
	External financing	Foreign assistance received and projections for the coming four quarters. Please categorize all grants and loans by program/project, and the amounts received/expected in cash.	Quarterly	Within 15 days of the end of each quarter
	Interbank money market	Daily interbank repo volume and interest rate of trades	Daily	Within one day
	SBP operations	Repo (reverse repo) operations, open market operations,	Weekly	First Monday of the following week
	Bank liquidity	Excess reserves, in local currency	Bi-weekly	With a lag of 15 days
	T-bill and coupon bond financing, SBP securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Fortnightly	Last working day of the fortnight
Banking data	Sectoral distribution of loans and deposits; loans and deposits by local and foreign currency; deposit and lending rates,;	Monthly	Within 25 days of the end of each month.	
Banking data	Loan maturities	Quarterly	Within 45 days of the	

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
				following quarter
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions;	Quarterly	Within 45 days of the following quarter
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Quarterly	Within 60 days
	Transfers	Workers' remittances.	Monthly	Within 25 days of the following month
	Other monetary data	The SBP survey, ODCs and DCs published in IFS.	Monthly	Within 45 days of the end of each month
	Balance of payments	Detailed export and import data Detailed balance of payments data	Monthly	Within 28 days of the end of each month
	Privatization receipts	Balance on the PC Fund account; gross inflows into and outflows from the PC Fund account during the month, specifying the nature of each transaction	Quarterly	Within seven days of the end of each quarter
Ministry of Finance (MOF)	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the SBP, and state-owned companies; any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears.	Monthly	Within 25 days of the following month
	External financing	Foreign assistance received and projections for the coming four quarters. Please categorize all grants and loans by program/project, and the amounts received/expected in cash and in kind.	Quarterly	Within 15 days of the end of each quarter
	Federal government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Federal and provincial governments	Quarterly	Within 45 days of the end of each quarter
	Consolidated general government	Federal and provincial governments	Annual	Within 180 days of the end of each year
Pakistan Bureau of Statistics (PBS)	SPI, CPI, WPI	Detailed monthly price indices	Monthly	Within five days of the following month
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Tax arrears	By category	Quarterly	Within five days of each quarter
		By type of tax	Quarterly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
Federal Board of Revenue (FBR)	Revenue collection Tax credits	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions.	Monthly	Within 7 days of the end of each month
	VAT refund claims in arrears	For the 30 largest debtors	Quarterly	Within 30 days of the end of each quarter
	Automated VAT refunds	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues	Quarterly	Within 45 days of the end of each quarter
		Number of refunds that were processed automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund	Quarterly	Within 45 days of the end of each quarter
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax payer units (LTUs)	Quarterly	Within 45 days after the end of each quarter
	Import data	1. Total value of recorded imports 2. Total value of duty-paid recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving nonduty free recorded imports	Quarterly	Within 30 days of the end of each quarter
	Audits	Percentage of selected companies and identified revenue from audits	Quarterly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
Ministry of Water and Power		Key Power Sector Statistics (Please see the attached template) Cumulative Monthly Subsidy Position (Rs. Billion) PEPCO Month End Payables and Receivables Positions And Aging Schedule, Rs. Billion Receivables Positions - Total and DISCO-wise Break-up CPPA/PEPCO Month-wise Consolidated Cash Flow AT&C Statistics Monthly TDS Claims by DISCOs and Total Inter Corporate Circular Debt Sheet Prepared by Ministry of Finance DISCOs Consolidated Income Statement Net Electrical Output & Power Purchase Price by Source, GWh Generation, Demand and Shortfall for FY10 to date Net Electrical Output (MkWh) Plant and Fuel-wise Detail	Quarterly	Within 30 days

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		Working Capital Loans For each loan type		
	Domestic expenditure arrears	Energy arrears	Quarterly	Within 45 days of the end of each month for government arrears
		Determined and Notified Tariff's for each User and User Group (Please see template)	Annual	Within 30 days of determination and notification
Ministry of Petroleum and Natural Resources		Gas supply Gas prices	Quarterly on monthly frequency	Within 30 days from the end of the quarter
OGRA		UFG losses	Quarterly	Within 30 days from the end of the quarter
BISP	Targeted cash transfers	Coverage (number of beneficiaries paid) and payment by conditional and unconditional transfers.	Quarterly	Within 30 days from the end of the quarter

Table 1. Exchange Rates of the SBP
(as of June 28, 2013 in U.S. dollars per currency)

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

Table 2. Projected Disbursements to Pakistan
(In millions of U.S. dollars)

	Sep-13	Dec-13	Mar-14	Jun-14		Sep-14	Dec-14	Mar-15	Jun-15
				Projection	Revised Projection 3/				
Multilateral and bilateral disbursement	557	830	951	3,219	3,751	1,584	1,932	3,049	2,764
<i>of which: in cash 2/</i>	387	641	1,861	2,830	3,247	1,297	1,582	2,498	2,264
Euro Bond issuance	0	0	0	500	2,000	0	500	500	0
Coalition Support Fund	0	322	352	350	375	350	350	350	350
Other 1/	0	0	0	2,500	916	0	900	350	500
Gross Inflows	557	1,152	1,303	6,569	7,042	1,934	3,682	4,249	3,614
<i>of which: in cash</i>	962	963	2,213	6,180	6,538	1,647	3,332	3,698	3,114
Debt service	747	823	1,033	1,320	1,504	1,026	1,244	1,613	992
<i>Memorandum items</i>									
<i>Gross International Reserves</i>	4,694	3,478	5,366	9,308	8,676	10,325	10,931	12,196	13,326
<i>Program Net International Reserves</i>	-2,499	-4,130	-2,750	1,800	1,800	3,000	3,500	4,500	5,500

1/ Includes privatization and 3G licenses.

2/ Numbers need to be confirmed with the MoF.

3/ As of May 25, 2014.

Table 3. External Inflows to the General Government

(In millions of US dollars)

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Non Tax revenue	322	352	891	350	350	350	350
Coalition Support Fund	322	352	375	350	350	350	350
3G Licences	0	0	516	0	0	0	0
Grants	100	75	195	174	191	127	191
External interest payments	215	155	286	263	283	291	313
Net external debt financing	50	-115	4681	610	1302	2125	1905
Disbursements	645	760	5386	1371	2257	3445	2578
<i>of which budgetary support</i>	309	285	4540	1034	1812	2931	2270
Amortization	594	875	705	761	955	1320	673
Privatizations	0	0	400	0	900	350	500
Memorandum item							
<i>Program financing</i>	409	360	5135	1208	2903	3409	2961

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

Item	June 30, 2013	Prov.
		March 31, 2014
Central Government	5,561,994	6,232,568
Scheduled Banks	3,320,870	3,698,224
Government Securities	1,117,115	1,775,122
Treasury Bills	2,611,512	2,319,986
Government Deposits	-407,757	-396,884
State Bank	2,241,124	2,534,344
Government Securities	3,127	2,786
Accrued Profit on MRTBs	44,959	51,158
Treasury Bills	2,275,183	2,776,202
of which: MTBs created for replenishment of cash balances	2,274,675	2,775,693
Treasury Currency	8,653	8,653
Debtor Balances (Excl. Zakat Fund)		
Government Deposits	-96,260	-309,918
(Excl. Zakat and Privatization Fund)		
Payment to HBL on a/c of HC&EB	-287	-287
Adjustment for use of Privatization Proceeds for Debt Retirement	5,749	5,749
Provincial Governments	-315,607	-571,130
Scheduled Banks	-287,393	-314,702
Advances to Punjab Gov	1,024	1,024
Advances to Punjab Government for Cooperatives		
Government Deposits	-288,417	-315,726
State Bank	-28,214	-256,428
Debtor Balances (Excl. Zakat Fund)	13,715	816
Government Deposits (Excl. Zakat Fund)	-41,930	-257,243
Net Govt. Budgetary Borrowings from the Banking system	5,246,387	5,661,438
Through SBP	2,212,910	2,277,916
Through Scheduled Banks	3,033,477	3,383,522
Memorandum Items		
Accrued Profit on SBP holding of MRTBs	44,959	51,158
Scheduled banks' deposits of Privatization Commission	-5,433	-5,987
Outstanding amount of MTBs (Primary market; discounted value)	2,529,412	2,265,393
Net Govt. Borrowings (Cash basis)		
From Banking System	5,124,762	5,561,675
From SBP	2,167,951	2,226,758
From Scheduled Banks	2,956,811	3,334,916



INTERNATIONAL MONETARY FUND



Press Release No. 14/312
FOR IMMEDIATE RELEASE
June 27, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review Under the Extended Fund Facility Arrangement for Pakistan and Approves US\$555.9 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Pakistan's economic performance under a three-year program supported by an arrangement under the Extended Fund Facility (EFF). The completion of the review enables an immediate disbursement of an amount equivalent to SDR 360 million (about US\$555.9 million).

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

In completing the third review, the Board also approved the authorities' request for a waiver of non-observance of the end-March performance criterion on the ceiling of the net domestic assets of the State Bank of Pakistan, as well as modifications to adjust the end-June performance criterion on the net international reserves target and the end-June fiscal deficit target.

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

“Macroeconomic conditions are improving, but downside risks remain. The government has taken measures to address short-term macroeconomic vulnerabilities and advance structural reforms, including the energy sector reform, but continued efforts to safeguard the fragile economic recovery are needed.

“Fiscal consolidation remains broadly on track, but efforts to broaden the tax base and increase tax-to-GDP ratio should be accelerated. Eliminating tax concessions and exemptions will not only improve tax collections, but will also produce a fairer and simpler tax system and will improve the investment climate. Increasing the size and coverage of targeted cash transfers to protect the most vulnerable segments of the population is welcome.

“Efforts to boost foreign reserves are bearing fruit and should continue, including through spot purchases, greater exchange rate flexibility, and a prudent monetary policy. The policy interest rate should be set so as to bring inflation down over time. Revised legislation to enhance central bank independence will be an important component of improved monetary policy framework, complemented by greater transparency in monetary policy decision making and enhanced central bank internal controls.

“The banking sector remains financially stable and profitable. This stability will be further enhanced by ensuring compliance of the few banks that fall below minimum capital adequacy requirements, addressing the high level of non-performing loans (NPLs), and improving the Anti-Money Laundering/Combating the Fighting Terrorism (AML/CFT) regime.

“Continued energy policy reforms are welcome. Addressing the administrative constraints on the power sector’s regulatory framework and improving the operations and collections of energy companies are important. Efforts to reform public sector enterprises should continue. Plans for trade policy and business climate reforms are being developed, but firmer actions are needed to boost economic growth over time.”

**Statement by Jafar Mojarrad, Executive Director for Pakistan and Abdelali
Jbili, Senior Advisor to Executive Director
June 27, 2014**

Introduction

Our Pakistani authorities appreciate staff's hard work and the quality of the discussions during the third review under the three-year Extended Fund Facility (EFF), and thank management and the Executive Board for their continued support.

Performance under the EFF program was positive and the authorities have continued to deliver on policies aimed at revitalizing the economy, reducing fiscal and external vulnerabilities, and preserving financial stability. With unwavering resolve, the government has moved steadfastly to advance its reform agenda in energy, taxation, the monetary sector, as well as public sector enterprises (PSE). Cognizant of the challenges ahead despite the initial signs of economic recovery, the authorities remain fully committed to take further actions if so required, as laid out in the Letter of Intent and the Memorandum of Economic and Financial Policies (MEFP).

All quantitative performance criteria for end-March 2014 were observed, with the exception of the target on Net Domestic Assets of the State Bank of Pakistan (SBP), which was missed by a small margin. The authorities have since taken corrective action and are on track to meet the end-June 2014 target. Besides, three prior actions for this review have been completed and structural benchmarks on tax administration notices and audit of NEPRA for end-March and April 2014, respectively, were also met. However, the benchmark on hiring privatization advisors was partially met, as advisors for three, instead of six firms, could be hired. The authorities have agreed to a new benchmark for end-June 2014 to push forward the privatization process. Our Pakistani authorities are therefore requesting completion of the third review under the arrangement and a waiver for nonobservance of one performance criterion.

Recent Economic Developments and Outlook

As the fiscal year comes to a close in June 2014, provisional data published by the Pakistan Bureau of Statistics show that output expanded by 4.1 percent in FY 2013/14 on the back of a resurgence of growth in manufacturing, especially the large scale manufacturing, and services, spearheaded by reforms in the energy sector. A similar growth rate is projected in FY 2014/15. Annual headline inflation is forecast at 9½ percent for the current fiscal year, and is expected to

decline to 7½ percent in FY 2014/15, helped by prudent macroeconomic management and a favorable commodity outlook. The balance of payments situation is in line with program estimates, with the small current account deficit being more than covered by strong capital and grant aid inflows. This has helped boost SBP reserves and contributed to an appreciation of the rupee by 6.9 percent against the U.S. dollar in the third quarter of the year.

The medium-term outlook points to continued improvement in growth and reduced external vulnerabilities. The combined effects of fiscal adjustment, prudent monetary policy, energy sector reform, and improved business environment will help strengthen confidence and energize the private sector. Also, continued recovery in the reserves position will provide stronger cushion against external vulnerabilities, thereby easing the downside risks to growth which have begun to subside. The authorities are keenly aware of potential downside risks, including challenging security conditions and volatile food and oil prices, and remain vigilant to address them as needed to sustain the momentum of economic reform.

Fiscal Policy

The authorities remain firmly committed to bringing the overall deficit, excluding grants, to 3½ percent of GDP in FY 2015/16. For the first nine months of FY 2013/14, the program was on track to reduce the fiscal deficit from 5.7 percent of GDP to 4.8 percent for the year as a whole, even though revenue was slightly lower than envisaged. Steps to offset the revenue shortfall included an increase in Gas Infrastructure Development Cess (GIDC), which would yield 0.36 percent of GDP of additional revenues, across the board reduction in non-wage current expenditure, and a scaling back of the budgeted increase in capital expenditure. Moreover, the expected provincial fiscal surpluses will help cover the remaining fiscal shortfall.

For FY 2014/15, the budget proposals submitted to parliament envisage further fiscal adjustment by nearly 1 percent of GDP, which will bring the deficit closer to a sustainable level, as indicated in the report. Efforts on the revenue side will be significant (0.8 percent of GDP) involving steps to eliminate the Statutory Regulatory Orders (SROs), a further increase in the GIDC tax, and improvements in tax collection and compliance resulting from the ongoing reforms in this area (MEFP ¶12-13). The authorities believe that the revenue effort is in line with the program and takes into account their plans to phase in more permanent tax measures in FY 2015/16 to raise the revenue-to-GDP ratio.

On the expenditure side, current spending will be contained and further rationalization of subsidies is expected to yield budgetary savings of 0.5 percent of GDP. In line with the authorities' determination to pursue the National Energy Policy to phase out electricity subsidies over the life of the program, further savings equivalent of 0.3 percent of GDP are envisaged in FY 2015/16. This entails periodic increases in tariffs so as to bring them to cost recovery levels for all consumers, except the vulnerable groups of the population.

The authorities are confident that these measures, together with the improved growth outlook, will provide adequate fiscal space to increase capital spending and the targeted support for the poorest under the Benazir Income Support Program (BISP). In this regard, the indicative target for transfer payments under the BISP has been achieved and the authorities plan to increase the stipend paid to the poorest families and expand coverage to reach an additional 0.6 million families. Mindful of risks of shortfalls in the planned fiscal adjustment, the authorities have identified several contingent measures that could be taken to ensure that the fiscal adjustment targets are met (MEFP ¶10).

Provincial surpluses (about 0.8 percent of GDP) will continue to support fiscal consolidation, underpinned by last year's agreement under the Council of Common Interest and the incentives provided to the provinces to maintain surpluses. To ensure a better balance between devolution of revenue and expenditure responsibilities, the government will enter into new negotiations with the provinces to reach a new agreement to this effect and will seek technical assistance from international partners in this area.

Reflecting the authorities' commitment to enhancing the effectiveness of public debt management, the Medium-Term Debt Strategy (MTDS) has been finalized and will provide guidance to achieve a sustainable composition of government debt portfolio and enhance decision-making for government borrowing. The authorities also plan to transform the Debt Policy Coordination Office into a full-fledged operational debt management office.

Monetary and Exchange Rate Policies

As the SBP remains focused on ensuring medium term stability, monetary policy is geared towards reducing inflation and rebuilding reserves. In the face of volatile inflation developments in the course of the year, the SBP increased the policy rate by a cumulative 100 basis points in

September and November 2013. Since then, the rate has been kept unchanged at 10 percent, in view of the improvement in macroeconomic indicators and reasonably anchored inflation expectations going forward based on recent exchange rate appreciation, reduced government borrowing from the SBP, and a favorable commodity price outlook.

The SBP has also taken advantage of the current favorable foreign exchange market conditions to further accelerate the buildup of foreign reserves, and is on track to achieve the targeted increase in gross international reserves and the NIR target for end-June 2014. Pressures on the balance of payments are significantly lower as the capital and financial accounts have strengthened. The oversubscribed placement of US\$2 billion in Eurobonds, significant program disbursements from the World Bank and the Asian Development Bank, and two tranches of grant aid have further bolstered the reserve position. As indicated in the MEFP ¶6, the SBP is committed to taking additional policy actions as and when needed to achieve its reserve accumulation target and price stability objectives.

Financial Sector

The banking sector remains generally sound, with adequate liquidity, profitability, and largely stable asset quality. Most banks exhibit high capital adequacy ratios (CAR), and the SBP is taking the necessary measures to ensure compliance by a few banks that do not meet the minimum CAR requirement, even though the aggregate shortfall is small and does not pose systemic risks. NPLs have declined slightly, but remain relatively elevated, and provisioning is high (80 percent). New proposals by the SBP to address NPLs, in consultation with stakeholders, seek to strengthen the banking courts ability to facilitate the recovery of assets, which will help reduce NPLs. Work is advancing on other parts of the financial sector reform agenda, including draft legislation on deposit insurance scheme, bankruptcy and corporate restructuring, and the regulatory and supervisory framework (MEFP ¶23-24).

The authorities remain committed to enhancing the independence of SBP, and have submitted amendments to the SBP Act to parliament with the expectation of having them enacted by end-June 2014. The authorities will seek to ensure that the final law incorporates the recommendations of the IMF safeguards assessment mission. These amendments are expected to strengthen the monetary policy framework, reinforce the independence of the decision-making monetary policy committee, and establish stronger governance structure and enhanced

internal controls. Moreover, the government will be prohibited from direct borrowing from the SBP.

Structural reforms

The authorities are moving forward with their ambitious structural reform agenda, with a particular focus on energy sector reform, public enterprises, import tariffs, and the business climate. Wide-ranging steps in the power sector seek to address price distortions, improve collection, and strengthen governance and efficiency in the sector, as detailed in the report and the (MEFP ¶25-33). The authorities remain committed to reforming PSE, and progress has been made toward privatization of the 31 PSE that have been identified for action, including development of a plan to sequence the capital market and pre-privatization restructuring operations. A first transaction on the authorities' privatization agenda was completed on June 12, 2014 by the sale of the remaining equity share in UBL bank for \$386 million, as indicated in the report. Financial advisors will be hired to assist in the various steps along the lines of a clear timetable, as highlighted in MEFP ¶37.

Improving the business climate and simplifying the import tariff structure will help establish a level-playing field and unlock private sector potential. Having completed the design of the plan to simplify the tariff structure by end-May 2014, the authorities will move forward to reduce the number of tariff slabs, shift most items to a lower rate, and eliminate the trade related SROs. Other reforms to improve the business climate focus on simplifying procedures, reducing the cost for setting up businesses, addressing impediments to contract enforcement, and improving access to credit.

Conclusion

The authorities' strong commitment to the program objectives and their steadfast implementation are yielding tangible results, which will further enhance the momentum for continued progress on the remaining reform agenda. With strong determination and political will, they look forward to continue to work closely with their development partners to this effect.