MARKET SPOTLIGHT ON: IMF APPROVED EFF "US$ 6.64 Billion"

"BORROWED TIME STARTS":

The Executive Board of the International Monetary Fund (IMF) approved yesterday a 3-year arrangement under the Extended Fund Facility (EFF) for Pakistan in an amount equivalent to SDR 4.393 billion (**US$6.64 billion**, or 425 percent of Pakistan's quota) to support the country's economic reform program to promote inclusive growth. The Executive Board's approval enables an initial disbursement by the IMF of an amount equivalent to SDR 360 million (about **US$544.5 million**), and the remaining amount will be evenly disbursed over the duration of the program, subject to the completion of quarterly reviews. The Executive Board discussion on Pakistan, Ms. Nemat Shafik, Deputy Managing Director and Acting Chair, said: "Pakistan is facing serious economic challenges. Overall vulnerabilities and crisis risks are high, with subpar growth and unsustainable fiscal and balance of payments positions. In this context, the authorities' comprehensive economic program is timely and welcome".

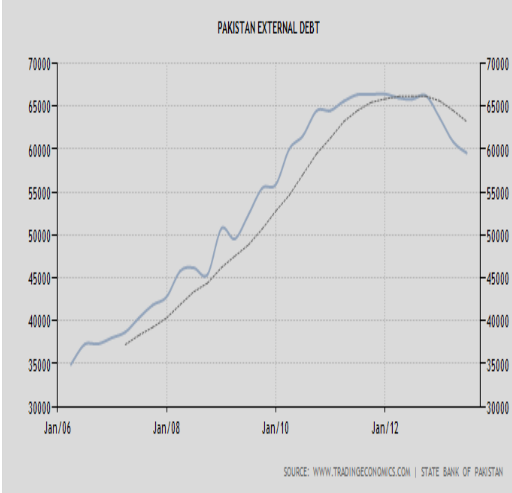
Economic Indicators

Forex Reserves	23-Aug-13	USD bn	10.39
CPI- MoM	1-Aug-13		1.20%
CPI- YoY	1-Aug-13		8.55%
M2 Growth	FY13 YTD		15.93%
SBP Policy Rate	FY13 YTD		9.00%
Current A/C	May-13	USD bn	-1.16
Average GDP Growth	FY13 YTD		3.59%
Government Spending	FY13		2.35
Home Remittance	July-13	USD bn	1.404

Source: State Bank of Pakistan & CNM Research

Will the package boost the economy: "Perhaps"

This time around, the government had to fulfill certain conditions set by the IMF. Pakistan faces a challenging economic outlook, compounded by an uncertain global and regional environment. Macroeconomic imbalances have combined with longstanding structural problems, particularly in the energy sector, to sap the country's growth potential. Growth has only averaged 3 percent over the past few years, well below that needed to provide jobs for the rising labor force and to reduce poverty. Technical and financial problems in the energy sector have led to large-scale power outages which have depressed output and imposed hardship on the public at large. A difficult business climate has contributed to a sharp fall in private investment. Weak performance in large public enterprises in key industries constitutes a drag on the public finances and on economic growth. Falling capital inflows have been insufficient to finance even a modest current account deficit, leading to large reduction in international reserves.



Effort Needed On The Ground:

The authorities have put in place an ambitious economic reform program aimed at reversing the current large fiscal deficits, fostering inclusive growth and addressing Pakistan's short and medium term problems. The determined measures are expected to reduce the government budget deficit to sustainable levels, reduce crowding-out of private investment and containing inflation over the medium-term.

Medium-term elements of the program:

- Raising growth gradually to near 5 percent by 2015/16 as macroeconomic stability is entrenched and structural reforms are pursued.
- Bringing inflation down to 6-7% range by 2015/16, from the current from the current level of 8.55%. Increasing central bank reserves to over 3 ½ months of imports by 2015/16.
- Reducing the fiscal deficit to 3 ½ percent of GDP by 2015/16 from an estimated 8.0 percent in 2012/13, with provisional governments contributing their fair share of the fiscal consolidation process.
- Liberalizing the trade regime and reforming public sector enterprises through restructuring and/or privatization.
- Improving the business climate.
- Strengthening the tax system.
- Protecting the most vulnerable from the direct and indirect impacts of reform measures.

<u>The conditions attached to the package are good for Pakistan "Depends":</u>

The government has to implement these measures anyway to fix the economy — with or without a fund loan facility. But many economists are deeply worried about the immediate impact of IMF's conditions, some of fear that these could result in stagflation – slow growth and high inflation – which will increase the cost of doing business and discourage fresh investment. The government, for instance, plans to boost tax revenue mainly by raising the share of indirect taxation which will burden the existing taxpayers. The removal of subsidies on electricity prices as well as making consumers bear the financial impact of electricity lost or stolen in the distribution system will put an additional financial burden on people. Others believe the major risk linked to the IMF loan lies in that it may raise the cost of bank borrowing for the government. But market sentiments is that central bank (SBP) will continue with its soft monetary stance to stimulate private spending and credit growth.

<u>Not fulfilling the IMF's demands will involve penalties "Not really":</u>

There will be no penalties as such, even if Pakistan fails to meet the loan conditions. It, however, may result in premature termination of the loan facility and cessation of financial assistance from other multilateral lenders. This is exactly what happened after the previous government dithered on implementing conditions attached to the last IMF loan. Previous IMF loans history with Pakistan shows that the fund's shareholders don't want Pakistan to go bankrupt regardless of whether it implements economic and financial reforms or not. The IEO review says that "the principal IMF shareholders (primarily the US), no matter how demanding they claimed to be on the substance of programmes, were not willing to take the risk of major turmoil in Pakistan that an interruption of IMF support might have caused.

Another factor that has contributed to this prolonged relationship is that the IMF seems more concerned about getting back its previous loans rather than anything else. Apparently, this factor has contributed immensely to the fund's decision to agree to provide yet another loan, that too on softer terms.