FOR AGENDA

EBS/09/35

CONFIDENTIAL

March 17, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Pakistan—Staff Report for the 2009 Article IV Consultation and First Review Under the Stand-By Arrangement**

Attached for consideration by the Executive Directors is the staff report for the 2009 Article IV consultation with Pakistan and the first review under the Stand-By Arrangement for Pakistan, which is tentatively scheduled for discussion on **Monday, March 30, 2009**. A draft decision appears on pages 24–25. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Pakistan indicating that they consent to the Fund's publication of this paper.

Questions may be referred to Mr. Mazarei (ext. 34902) and Mr. Wieczorek (ext. 37338) in MCD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Wednesday, March 25, 2009; and to the Asian Development Bank, the European Investment Bank, and the Islamic Development Bank, following its consideration by the Executive Board.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

PAKISTAN

Staff Report for the 2009 Article IV Consultation and First Review Under the Stand-By Arrangement

Prepared by the Middle East and Central Asia Department

(In consultation with other departments)

Approved by Juan Carlos Di Tata and Anthony Boote

March 16, 2009

- ***Discussions were held during February 14–26 in Islamabad and Dubai***. The staff met with Economic Advisor to the Prime Minister Tarin, State Bank of Pakistan (SBP) Governor Raza, Finance Secretary Khan, and other senior government and SBP officials.
- ***IMF staff team***. Messrs. Mazarei (Head), Kock, Wieczorek, and Ms. Morsy (all MCD), Mr. Sun (SPR), and Mr. Westphal (FAD). Mr. Ross (the Fund's resident representative in Pakistan) assisted the mission. Mr. Di Tata (MCD) participated in the initial meetings, and Mr. Geadah (MCM) participated in the discussions on financial sector issues. Mr. Ahmad (OED) also participated in the discussions. Ms. Kahkonen (World Bank) and Mr. Parvez (Asian Development Bank) participated in the discussions on structural issues.
- ***The last Article IV consultation was concluded on December 17, 2007***. Pakistan has accepted the obligations of Article VIII, Sections 2, 3, and 4. Since February 1, 2009, Pakistan's exchange regime has been classified as a float. An exchange restriction arising from a limit on advance payments for imports is to be eliminated by January 31, 2010. In addition, cash margin requirements (introduced in May 2008) on letters of credit (LCs) for certain imports give rise to an exchange restriction.
- ***On November 24, 2008, the Executive Board approved a 23-month Stand-By Arrangement (SBA) for Pakistan*** under the Emergency Financing Mechanism in the amount of SDR 5.169 billion, or 500 percent of quota. A first purchase of SDR 2.067 billion, or 200 percent of quota, was made on November 26. At end-January 2009, Fund credit and loans outstanding to Pakistan amounted to SDR 2.811 billion, or 272 percent of quota. All the end-December 2008 quantitative performance criteria and the structural benchmarks for the first review were met. On March 3, 2009, Pakistan imposed cash margin requirements on LCs for certain imports not previously subject to these requirements, which resulted in nonobservance of the continuous performance criterion against imposing or intensifying exchange restrictions. The authorities plan to reverse this intensification by end-June, 2009 and are requesting a waiver of nonobservance for the missed performance criterion. On this basis and on the strength of program commitments expressed in the attached Supplementary Memorandum of Economic and Financial Policies (SMEFP), staff recommends the completion of the first review and the approval of the second purchase under the SBA (SDR 568.54 million or 55 percent of quota).
- ***Data***. Pakistan has participated in the GDDS since 2003. Economic data are broadly adequate for surveillance and program monitoring.

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EXECUTIVE SUMMARY

In October 2008, the authorities embarked on a stabilization program for 2008/09–09/10 aimed at restoring financial stability while protecting the poor. This program, supported by an SBA arrangement, envisages a significant tightening of fiscal and monetary policies to bring down inflation and strengthen the external position, and includes several structural measures in the fiscal and financial sectors.

Initial developments since the approval of the program have been generally positive. The exchange rate has been broadly stable, enabling the State Bank of Pakistan (SBP) to buy foreign exchange on a net basis. As a result, gross reserves have strengthened from $3.5 billion at end-October to $6.7 billion as of February 20. Despite the somewhat improved confidence, credit and broad money demand growth have been lower than projected.

Policy implementation has been good and the program remains on track. All quantitative performance criteria and the structural benchmarks for the first program review were met. The end-December fiscal deficit target, which proved challenging, was achieved through a combination of revenue and expenditure measures. However, the recent modification of cash margin requirements on letters of credit (LCs) for certain imports resulted in nonobservance of the continuous performance criterion against imposing or intensifying exchange restrictions. The authorities plan to reverse this intensification by end-June and, on this basis, request a waiver of nonobservance for the missed performance criterion.

Banks have weathered the crisis well thus far, but should be monitored carefully. The worsening macroeconomic environment is affecting banks' asset quality and profitability.

The global economic and financial environment has deteriorated significantly since the start of the program. While oil import prices are lower, exports are falling, external financing is more difficult, and there are increasing risks to remittances.

The authorities agreed with the mission on a revised macroeconomic framework (with lower growth and inflation) and supporting policies for 2008/09 and beyond. The authorities will adhere to the program's fiscal target for 2008/09 and continue with further fiscal adjustment in 2009/10. There should be scope for the SBP to lower its discount rate if inflation abates, the external reserve position continues to improve, and the government can sell its T-bills to banks and nonbank private investors. Exchange rate flexibility will continue to facilitate external adjustment.

Pakistan needs additional external assistance to reduce risks, and provide for greater development and social spending. The upcoming donor meeting provides an important opportunity for mobilizing additional assistance.

In light of performance to date and the authorities' policy intentions, staff recommends the completion of the first program review and the approval of the waiver of nonobservance for the missed performance criterion.

I. Background

1. ***Following the successful implementation of two Fund-supported programs during 2000–04, Pakistan enjoyed a relatively robust economic performance***. During 2007, the country continued to perform well in terms of growth owing to favorable global economic and financial conditions and expansionary economic policies, but inflation rose and external imbalances began to emerge. At the conclusion of the 2007 Article IV consultation, Directors encouraged the authorities to strengthen the fiscal program for 2007/08[1] to complement monetary tightening, particularly by reducing energy subsidies and capital spending. Looking beyond 2007/08, Directors stressed that further fiscal consolidation would be required to reduce inflation and the external current account deficit while lessening pressures on real interest rates. They noted that the tax revenue-to-GDP ratio was low by international standards, and recommended to press ahead with reforms to increase revenue and enable a reduction in the fiscal deficit while allowing for higher spending on infrastructure and poverty alleviation. The authorities have generally responded positively to Fund advice but the implementation of advice on some structural reforms has been slow (Box 1).

Box 1. Effectiveness of Fund Advice

The Pakistani authorities have generally agreed with Fund advice, but implementation has been slow. In early 2008, the authorities started to adopt some of the policies recommended by the Fund to address Pakistan's macroeconomic imbalances, including monetary tightening and a fiscal consolidation, particularly by reducing energy subsidies and capital spending. But, various considerations, including political constraints, slowed their implementation, especially on tax reforms. In the fall of 2008, the authorities developed a home-grown adjustment program, very much in line with Fund policy advice.

2. ***The macroeconomic situation has deteriorated significantly since 2007/08 on account of both external and domestic factors***. The increase in oil and food prices, and adverse security developments exacerbated external imbalances. Growing fiscal deficits, owing in large part to increasing energy subsidies and financed by the central bank, fuelled inflation, while international reserves declined sharply and confidence waned.

3. ***In October 2008, the authorities embarked on a stabilization program for 2008/09–2009/10 aimed at restoring financial stability while protecting the poor***. This program, supported by the SBA approved on November 24, envisages a significant tightening of fiscal and monetary policies to bring down inflation and strengthen the external position, as well as several structural measures in the fiscal and financial sectors. Strengthening the social safety net is a key priority under the program.

[1] Fiscal year starts July 1^{st}.

4. ***In addition to stabilizing the macroeconomic situation, the program aims at addressing some of Pakistan's long-standing economic problems***. In particular, it calls for a comprehensive tax reform to raise budgetary revenue, and create greater fiscal space for public investment and social spending. The authorities also plan to phase out electricity subsidies, and to tackle the problem of inter-corporate (circular) debt in the energy sector.

II. Recent Developments

A. Overview

5. ***Initial developments since the approval of the program have been generally positive***.[2] The exchange rate has been broadly stable, enabling the SBP to buy foreign exchange on a net basis (Figure 1). As a result, gross reserves have strengthened from $3.5 billion at end-October to $6.7 billion as of February 20. There has also been a strong positive response from the T-bill market to the 200-basis point increase in the SBP discount rate implemented in mid-November, which brought the cumulative increase since January 2008 to 500 basis points. T-bill auctions through end-February have been consistently oversubscribed, with wide participation of banks, and enabled the government to retire some of its debt to the SBP. T-bill rates came down from a peak of 14 percent (weighted average) in mid-January to just below 13 percent at end-February.

6. ***Domestic activity has weakened while inflation has been falling more rapidly than expected, and the external current account deficit has been narrowing***. A combination of domestic factors (energy shortages, high interest rates) and external factors (weakening global demand for textiles) resulted in a decline of nearly 6 percent in large-scale manufacturing output during the first half of 2008/09 (Figure 2) and a sharp drop in exports in recent months. On the positive side, agricultural output will benefit from a bumper wheat crop in 2008/09, and significant increases in the rice and cotton crops should more than compensate for the decline in sugar cane production. With falling food and energy prices and lower economic activity, headline inflation has dropped faster than expected. In January, headline CPI inflation declined to 20.5 percent (year-on-year), its lowest point since May 2008. Although core inflation is still around 19 percent (year-on-year), monthly core inflation dropped from a peak of 2.3 percent in July to 1.1 percent in January.[3] Despite the decline in international oil spot prices, the external current account through December did not show a decisive improvement because of deferred payments for oil contracted at higher prices, but the trend in imports pointed to an underlying improvement in the current account,

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[2] For a detailed discussion of the early developments following the approval of the SBA, see the staff report for the Interim Review under the Emergency Financing Mechanism (EBS/09/15).

[3] The weekly Sensitive Price Index (SPI) which tracks utility rates, transportation, and prices of food and other household items for low-income groups increased at a year-on-year rate of 24 per cent (in late February), reflecting the lingering effect of large food price increases in the first half of 2008. This high increase in SPI is a source of concern for vulnerable groups.

notwithstanding lower exports. Also, inflows of remittances have thus far proven resilient, and capital outflows have been lower than projected.

7. ***In mid-December, the authorities removed the stock market price floor which had been in place for 3½ months***. The feared massive capital outflows did not materialize.[4] After the initial sharp drop, the Karachi Stock Exchange (KSE) 100 Index bottomed out in late January, following a cumulative decline of nearly 70 percent from its April 2008 peak. The stock market has since rebounded by about 20 percent but, like most other capital markets, is volatile. The recovery was supported only to a small extent by the National Investment Trust's State Enterprise Fund (NITSEF) of Rs. 20 billion (0.15 percent of GDP), which was created to buy shares in eight public enterprises. The NITSEF, which is funded through borrowing from domestic banks with government guarantee, has been active since early January, and as of mid-February it had invested Rs. 7 billion.

8. ***The global economic and financial environment has deteriorated significantly since the SBA approval***. To date, the global crisis has had mixed effects on Pakistan. As noted earlier, the decline in fuel and food prices has had a moderating impact on inflation and has helped strengthen the external current account. It has also contributed to the reduction of energy and food subsidies, but it has had an adverse impact on output, exports, fiscal revenue base, and current transfers. And, higher risk aversion will reduce foreign investment in Pakistan: privatization receipts of $1.7 billion projected in the 2008/09 budget (a major component of projected foreign financing) are unlikely to materialize, and market access remains constrained (Box 2).

B. Program Implementation

9. ***All quantitative performance criteria through December 2008 were met***. The authorities demonstrated an impressive degree of program ownership. Despite downward pressures on the revenue side, they maintained a tight fiscal policy stance to fend off the risk of resurging inflation and set the stage for a sustainable easing of interest rates down the road. At the same time, the SBP capitalized on the upward pressure on the rupee to build a cushion above the program net foreign assets (NFA) targets (SMEFP, Table 1).

10. ***The end-December fiscal deficit target, which proved challenging, was achieved through a combination of revenue and expenditure measures***. Additional revenue from the Petroleum Development Levy (PDL) largely compensated for the shortfall in revenue from direct taxes, excises, and the sales tax on imports collected by the Federal Board of Revenue

[4] Aggregate market capitalization (AMC) was Rs. 1.86 trillion or $23.5 billion on December 31, 2008; down by 61 percent (in rupee terms) from the peak of April 18, 2008; however, two-thirds of this drop was already reflected in the end-September 2008 AMC data.

Box 2. Pakistan and International Financial Markets

Investor perceptions of Pakistan's sovereign debt improved following the SBA approval, but the subsequent changes, while positive, have been modest. Secondary markets are relatively illiquid and primary debt markets remain virtually closed for countries rated below investment grade, making it difficult for Pakistan to reestablish its market access. There has been some recovery in the sovereign credit risk indicators as perceptions of liquidity risk have improved, but concerns about political uncertainty, the public finances, and external sustainability have not subsided. The adoption of the program and the broadly positive developments thus far have significantly reduced implementation risk, but the underlying risks to the economic and financial outlook remain high, and Pakistan's economic policies are expected to remain resource-constrained. Moreover, tail risks, including those related to the global economic environment, have increased significantly.

- The Pakistan's EMBIG spread moderated from the peak of 2222 bps in December to 1914 bps at end-February, but remain volatile (an average for February was 1964 bps).
- Five-year credit-default swaps (CDS) premium moderated from 3886 bps in mid-October to 2850 bps in early February but still indicates high default risk. However, the CDS market is relatively illiquid and does not reflect subtle changes in risk perception.
- Pakistan's sovereign debt rating by Moody's/S&P is B3/CCC+ (as of end-2008). Moody's rating, which puts Pakistan in the same category as Lebanon, was cut from B2 to B3 in October, and has been reconfirmed in December, but the outlook was changed to negative. S&P raised Pakistan's rating to CCC+ in December; this upgrade incorporated the first purchase under the SBA as a factor alleviating the prospects of near-term debt service stress.
- The amortization of the Eurobond in February ($500 million) was widely anticipated and any residual positive impact that could have occurred in its aftermath has been offset by recent political uncertainties, which sent the KSE into a temporary decline after several weeks of recovery.

(FBR).[5] More recently, the authorities have also introduced regulatory duties (10–25 percent) on several imported luxury and nonessential goods. In addition, the authorities maintained spending below the program's projections, particularly on development projects.

11. ***Despite the somewhat improved confidence, credit and broad money demand growth have been slower than originally envisaged*** (Figure 3). Although reserve money grew faster than projected (reflecting a strong build-up of NFA that offset a contraction in the net domestic assets (NDA) of the SBP due to fiscal consolidation), broad money and private

[5] Although, the authorities maintained a premium between domestic and international petroleum prices, the retail prices of petroleum products were significantly reduced to pass in part the benefit of lower oil prices to consumers. On December 1, the retail prices of gasoline and diesel were reduced by Rs. 9 and Rs. 4 per liter to Rs. 57.7 ($0.73) and Rs. 48.0 ($0.61), respectively.

sector credit growth were below program projections.[6] Specifically, private sector credit growth was just below 13 percent (year-on-year), compared with 17 percent in the program. Weak private sector growth reflects lower credit demand owing to the slowdown in economic activity, increased risk aversion by banks, and a flight to quality (a shift in lending to government and public enterprises) which has helped banks remain in a generally good financial condition (Box 3).

12. ***Measures taken to improve liquidity management and monetary policy implementation fostered demand for T-bills and ensured orderly market conditions***. The Ministry of Finance (MoF) and the SBP now issue a calendar of T-bill auctions with indicative volumes on a quarterly basis. Despite large oversubscription, the volumes of T-bill sold in primary auctions do not exceed significantly the announced volumes. Cut-off rates and allocation of T-bills among the 3-month, 6-month, and 12-month maturities (now being decided solely by the MoF) have been geared toward managing cost, minimizing the rollover risk, and building a yield curve. Open-market operations (OMOs) have been conducted mainly with a view to smoothing liquidity conditions, and the overnight repo rates have been markedly more volatile since September. Banks have accessed the SBP discount window for liquidity needs with increased frequency in recent weeks. In general, however, bank liquidity has been comfortable since October and, on a net basis, OMOs have recently been conducted to absorb excess liquidity.

C. Structural Reforms under the Program

13. ***All structural benchmarks for the first program review have been met*** (SMEFP, Table 2). The authorities also observed the World Bank's upfront conditionality for the proposed Poverty Reduction and Economic Support Operation (PRESO) loan, which raises expectations of an improved follow-through on structural reforms in general.[7]

- *The authorities adopted a tax policy and tax administration action plan*. The plan envisages the integration of the income tax and sales tax departments and the replacement of the current general sales tax with a broad-based Value-Added Tax (VAT). A technical assistance mission from the Fund (scheduled for April) will help with the design of the VAT law, the revisions in the income tax legislation, and the possible introduction of a carbon tax (SMEFP, ¶13–14).

[6] Reserve money grew by 6.5 percent (year-on year) through end-December (5.8 percent in the program), while broad money grew by 8.7 percent (9.6 percent in the program). Overall, the demand for rupee-denominated assets has strengthened since October 2008, as evidenced by an increase in rupee deposits relative to foreign-currency deposits. However, some of the effects observed through December reflected banks' efforts to improve performance indicators by the end of the financial year (which coincides with the calendar year). Preliminary figures for January show a drop in deposits and weaker broad money growth. Relatedly, the spreads between lending rates and deposit rates widened from 660 bps in January 2008 to nearly 780 bps in January 2009, with weighted average lending and deposit rates at 14.66 and 6.88 percent, respectively.

[7] The PRESO loan of $500 million is expected to be approved by the World Bank before end-March.

Box 3. Pakistan—Banking System Stability Assessment

Based on the recently conducted Financial Sector Assessment Program (FSAP) update, the banking system appears to be generally well-capitalized and liquid. Aggregate financial soundness indicators improved since the 2004 FSAP. However, the worsening macroeconomic environment affected adversely bank profitability and asset quality in 2008. Tighter provisioning requirements reduced profits in 2007, and interest margins in 2008 were squeezed by increases in the policy rate and the minimum deposit rate for savings accounts. Gross nonperforming loans (NPLs) rose from 7.7 percent of total loans in June 2008 to 9.1 percent in December 2008, mainly on account of growing non-performing consumer and textile sector loans. The ratio of net NPLs to net loans increased from 1.3 to 2.5 percent in the same period, and provisioning has remained generally adequate. This level of NPLs is manageable given the improved capital position of the banking system, with capital adequacy ratios (CARs) having risen from 12.1 to 12.2 percent of risk-weighted assets over the same period. The improvement in CARs reflected mainly the increased share of T-bills and other low-risk assets in bank portfolios. A few banks representing less than 10 percent of system assets face financial pressures, which are to be addressed through mergers or fresh injection of equity. Progress by these banks in resolving their problems is monitored closely by the SBP.

Stress tests conducted by the IMF/World Bank staffs with June 2008 data indicated that most banks—including all large banks—would remain solvent in severe crisis scenario. However, some small and mid-sized banks would face insolvency under these simulated crisis conditions. In the worst case scenario, the capital injection needed to restore the CAR of the twelve largest banks to the minimum regulatory CAR of 8 percent was 2.3 percent of GDP. This relatively benign outcome reflects the low credit-to-GDP ratio and the relatively high capital buffers prior to the simulated crisis. The main sources of risk for the vulnerable banks are a major deterioration in credit quality, mainly in the textile industry, and a sharp drop in equity prices. Default on the largest exposures puts significant strains on solvency given the large concentration of these exposures in some banks. The SBP has obtained similar results on the basis of end-September data.

Direct exposure of the banking system to currency depreciation was found to be generally small, and indirect exposures through the unhedged exposure of bank clients limited. Lending in foreign currencies is restricted to trade-related purposes by SBP regulation. Exporters have foreign currency cash flows to cover debt service, but importers may be vulnerable in the event of a sharp depreciation that depresses import demand. Residents' foreign-currency accounts constitute less than 8 percent of total deposits in commercial banks.

- *The authorities reached understandings with World Bank staff regarding the elimination of tariff differential subsidies by end-June 2009*. Electricity tariffs were increased by 1 percent effective February 1, and will be raised further by a cumulative 4 percent by end-June (SMEFP, ¶17).
- *The SBP has prepared a contingency plan for handling problem banks*. As required, the plan sets out criteria for liquidity support, assessment of problem banks, and intervention procedures. The SBP has actively encouraged the owners of the few problem banks to proceed with mergers or fresh capital injections (SMEFP, ¶22–24).

- *The provision of foreign exchange by SBP for imports of furnace oil ceased on February 1.* These transactions were moved back to the interbank market.[8]

14. ***Progress has also been made toward the end-March 2009 benchmarks***:[9]

- *The authorities and World Bank staff have agreed on reforming the Benazir Income Support Program (BISP)* by introducing a scorecard as an objective targeting mechanism for identifying poor households. The roll-out in 16 districts (pilot phase) has started, with the roll-out in all the 130 districts expected to be finalized between December 2009 and June 2010. BISP disbursements will start shortly, but delays in the BISP roll-out and the government's decision not to scale up Bait-ul-Mal (an existing cash transfer program) will likely result in lower-than-projected spending on social transfers in 2008/09 (Box 4; SMEFP, ¶12).
- *The authorities have accelerated the preparation of a plan to deal with the circular debt*. The circular debt (inter-corporate debt in the energy sector) has risen on a net basis from Rs. 51 billion (0.4 percent of GDP) in mid-October to close to Rs. 189 billion (1.5 percent of GDP) as of March 6. The authorities' plan involves the issuance of Term-Finance Certificates (TFCs) at Karachi Interbank Offered Rate (KIBOR) + 175 bps to cover Rs. 98 billion in outstanding liabilities of Pakistan Electric Power Company (PEPCO) to its suppliers, which should enable a significant increase in electricity production that is needed to help the recovery in the industrial sector. The TFCs will have a 5-year maturity with government guarantee. Financial schemes to raise funds through the sale/lease of government property are also being considered to cover the remainder of the circular debt (SMEFP, ¶18).

III. Policy Discussions

A. Near-Term Economic Outlook and the Macroeconomic Framework

15. ***The authorities and staff reached understandings on a revised macroeconomic framework for 2008/09–09/10***. The outlook for the remainder of 2008/09 remains difficult, in particular for the manufacturing sector. As a result, the growth projection for 2008/09 was revised downwards to 2.5 percent, from 3.4 percent in the original program. A further downward revision was deemed unwarranted at this stage, given the strength of agricultural output and the good performance of the services sector (Figure 4). Nevertheless, the revised growth projections are subject to significant downside risks and real GDP growth in

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[8] The interbank market supplied all foreign exchange for furnace oil imports (presently accounting for about 20 percent of petroleum product imports) prior to July 8, 2008.

[9] Regarding the structural benchmark for end-June 2009, the authorities indicated that a single treasury account had already been created but the consolidation of the government funds in that account would not be feasible by end-June. This issue will be taken up in the discussions for the second review.

Box 4. Social Protection in Pakistan

In spite of sustained economic growth over the last decade, poverty remains high. According to the World Bank, the poverty rate declined from 34 percent in 2001 to about a quarter of Pakistani households in 2005/06. The poor and non-poor alike remain vulnerable to risks such as health, disability, unemployment, and sharp increases in the price of food. Poverty reduction is complicated by the deficiencies in the social safety net, as well as under-investment in health and education.

In response, the government launched the Benazir Income Support Program (BISP) in September 2008 to provide cash grants to the poorest families. Under the BISP, each eligible family is to receive Rs. 1,000 per month. The FY 2008/09 budget allocated Rs. 34 billion (0.3 percent of GDP) to BISP. However, until recently BISP lacked an objective targeting mechanism, with beneficiaries being identified by the Members of the National Assembly.

In late January 2009, the authorities agreed with the World Bank on a reform of BISP through the introduction of an objective targeting mechanism. This reform is based on a scorecard system for identification of poor households. The roll-out of the scorecard system in at least 16 districts (a pilot phase) is expected to be completed by May 2009, while the roll-out to all 130 districts is to be completed between December 2009 and June 2010. The roll-out will need to be paced according to capacity and ability to implement in the face of political and security constraints. The number of benefiting families is to reach 5 million in 2009/10 and 7 million in 2010/11. To ensure proper targeting of BISP transfers, the authorities envisage using the new scorecard system to scrutinize beneficiaries that were identified under the pre-scorecard selection process.

In addition to BISP, there are two other nation-wide cash transfer programs with different modes of financing and delivery, but similar objectives:

- Bait-ul-Mal: Spending on Bait-ul-Mal has increased substantially over the last decade and the number of beneficiaries increased from about 200,000 in 1998 to about 1.4 million in 2007.
- Zakat: This program is financed by private contributions. However, these contributions have declined substantially over the last decade.

Also, there are several small programs that provide social welfare and care services to persons with disabilities, child laborers, and others. Moreover, a public works program provides employment opportunities in small-scale rural and urban projects. Pakistan also uses a wheat subsidy to address food price shocks. The province of Punjab has also recently launched its own cash transfer program.

The effectiveness of these programs is hampered by low coverage of the poorest households and substantial leakage of benefits to non-poor households. The World Bank estimates that these programs cover only 5 percent of the population. Moreover, around 32 percent of Zakat benefits and 25 percent of Bait-ul-Mal benefits accrue to non-poor households. Their effectiveness is further diminished by benefits being small and infrequent, and by governance issues.

Consolidation of safety net programs and better funding could help to enhance their effectiveness. Given the similar nature of BISP and Bait-ul-Mal, one option would be to merge the two programs in 2009/10, and use at least a part of the resources for Bait-ul-Mal to scale up BISP; another option would be to increase their complementarities.

2008/09–09/10 could be by 0.5–1.0 percentage points lower. With a continued strong performance in agriculture and electricity sector reforms, which are expected to improve supply conditions in the large-scale manufacturing, growth is projected to pick up to 4 percent in 2009/10.[10] Under conservative assumptions for the remainder of 2008/09 (food and energy prices remaining flat, and core inflation of one percent per month), year-on-year headline inflation would decline to 10 percent by June 2009 (compared with 20 percent in the program), and to 6.5 percent by June 2010. This accelerated pattern of disinflation will cause average annual inflation to drop from 20 percent in 2008/09 to 6 percent in 2009/10.[11]

Revised Macro Economic Program, 2008/09–2009/10

	2008/09		2009/10	
	Program	Revised	Program	Revised
Real GDP at factor cost (percentage change)	3.4	2.5	5.0	4.0
Consumer prices (end of period, percentage change)	20.0	10.0	6.0	6.5
External current account (in percent of GDP)	-6.5	-5.9	-5.7	-4.3

Source: Fund staff projections.

16. ***The external current account deficit is projected to narrow in 2008/09 and 2009/10, but there are downside risks***. The projected external current account in 2008/09 is slightly better than originally envisaged, with lower imports expected to outweigh a weaker export performance (Figure 5). A further improvement is expected in 2009/10, mainly on account of the full-year effect of lower oil prices. However, the projected improvement in the current account may not materialize if exports drop sharply or private transfers decline.

17. ***The financial account surplus is now expected to be slightly lower than originally projected, due mainly to the worsening environment for foreign direct investment (FDI) and privatization-related inflows***. Disbursements of official budget support from China, a commodity support loan from Saudi Arabia, and higher disbursements under short-term oil import facility from the Islamic Development Bank would offset delays in disbursements from the World Bank and the Asian Development Bank. In addition, net private capital flows would be better than envisaged as the expected sharp outflow of foreign capital from the stock market did not materialize. Consequently, the overall external balance for 2008/09 is now projected to be better than programmed by about $500 million, whereas, despite the

[10] The resolution of the circular debt is expected to boost electricity production, which at present is not capacity-constrained but the backlog of payments to power providers results in load-shedding. Significant investment will be needed to increase electricity production over the medium term (see ¶33). The authorities' plans emphasize tapping renewable energy sources, nuclear power, and cross-border provision of electricity within the region; see: http://www.mowp.gov.pk.

[11] The expectation of a rapid decline in inflation is also reflected in the yield curve, which remains flat, while 12-month T-bills were more heavily oversubscribed in recent auctions compared to shorter-term maturities.

large anticipated improvement in the current account, the balance-of-payments improvement projected for 2009/10 would be limited to $700 million because of the downward revision in the projected official and private capital inflows.

B. Policies for the Remainder of 2008/09 and 2009/10

18. ***The authorities agreed that consolidating the gains made in macroeconomic stabilization remains the key priority***. In this context, discussions focused on (i) the appropriateness of the fiscal program and the deficit targets for 2008/09 and 2009/10; and (ii) the monetary policy stance. The following considerations featured prominently in the policy discussions:

- *The availability of external financing.* Securing the programmed amount of external financing (mostly privatization proceeds) for the budget will be challenging (see ¶19). A donor conference, tentatively scheduled for April 17 in Tokyo to be co-hosted by the Government of Japan and the World Bank, will provide an opportunity to seek additional external assistance.
- *The scope and desirability of fiscal easing in light of the weakening economic activity.* The authorities do not see scope for relaxing the fiscal stance and have opted for an unchanged fiscal deficit target as a cornerstone of their stabilization efforts.
- *The scope for modifications in interest rate policy.* The discussions on interest rate policy sought to balance the objectives of further reducing the still high (albeit rapidly declining) inflation and ensuring non-SBP financing of the budget with the need to provide adequate credit to the slowing economy. The authorities agreed that it was premature to reduce interest rates at this stage, but saw the need to reassess interest rates down the road in order to stimulate a pick-up in economic activity.
- *The impact of the economic downturn on the banking sector*. The SBP has been monitoring conditions in the banking sector closely; concerns arise about bank asset quality because high interest rates and the economic slowdown have made banks vulnerable to an increase in nonperforming loans in their corporate loan portfolio.

Fiscal policy

19. ***In the near term, fiscal policy will be challenged by the shortfalls of revenue and external financing***. The slowdown in economic activity is affecting the revenue base and is likely to result in a shortfall in the Federal Board of Revenue (FBR) collections relative to the original 2008/09 program target.[12] The authorities indicated that they intended to limit this

[12] January revenue data indicate that the shortfall in revenue collected by FBR has increased, but PDL collection has been on track to meet the revised annual target. Preliminary FBR data for February indicate a further increase in the revenue shortfall.

shortfall through administrative measures, including tax audits;[13] additional revenues from the PDL; and possibly the introduction of a carbon tax (SMEFP, ¶9). To help increase the revenue-to-GDP ratio by 0.6 percentage points in 2009/10, the authorities are also planning to broaden the tax base across all sectors of the economy, including by reducing the scope of tax exemptions and zero-rating. However, the timing of these reforms will depend on the tax administration's capacity to process refunds. Other revenue measures, such as the introduction of a carbon tax or a gross asset tax, are under discussion, but are yet to be approved. *External budget financing (including project financing) will likely fall short* of the original program projections by $1.9 billion or 1.2 percent of GDP, due mainly to the absence of external privatization proceeds. As the global environment is not expected to improve rapidly, a similar shortfall is projected also for 2009/10. To compensate for this, the authorities will be seeking external bilateral support. In addition, the MoF intends to tap nonbank sources of domestic financing, following several successful placements of Pakistan Investment Bonds (PIBs) and Ijara Sukuks since September (SMEFP, ¶10).

20. ***The authorities recognize that in the current circumstances the room for countercyclical fiscal policy is very limited***. Consequently, they remain firmly committed to achieving the program's original nominal fiscal deficit (excluding grants) target for 2008/09 (Rs. 562 billion, or 4.3 percent of the revised GDP—Figure 6). The fiscal deficit target for 2009/10 has been set at 3.4 percent of GDP, consistent with the fiscal effort of 0.9 percentage point of GDP envisaged in the original program; any further adjustment would be overly procyclical and could only be justified if the risks of higher inflation or a of resurgence of SBP financing of the government were imminent.

21. ***The authorities indicated that they stood ready to further restrain spending in case this was necessary to offset any revenue shortfalls***. To this end, the authorities had begun to prioritize and rationalize development spending.[14] Further contingency measures may need to be identified to avoid last-minute expenditure compression in case of a larger-than-expected revenue shortfall. Development spending for 2009/10 will be reviewed in the context of the Medium-Term Budget Framework, which is under preparation (SMEFP, ¶16).[15] Room for expenditure cuts in other areas is very limited owing to the high share of interest and security spending, the need to provide for adequate operation and maintenance, and increased outlays under the strengthened social safety net (Box 4). Regarding the latter, cash transfers to the poor are projected to increase from 0.4 percent of GDP in 2008/09 to 0.6 percent in 2009/10. Moreover, the recently announced wheat procurement program for 2009–10 may involve expenditures that exceed Rs. 40 billion (0.3 percent of GDP) already included in the fiscal

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[13] The authorities have started implementing a comprehensive auditing system, targeting in a first step about 500 large taxpayers. It is also expected that strengthening of audits will improve voluntary compliance.

[14] About two-thirds of development spending in the 2008/09 budget are domestically-financed.

[15] The authorities remain in close consultation with the World Bank on the rationalization of development spending. In this regard, the MTBF is expected to take into account the recommendations of the ongoing public expenditure review (expected to be completed in March).

framework for 2009/10, unless international wheat prices rebound to the current price support level.[16]

Monetary Policy

22. ***Discussions focused on clarifying monetary policy objectives and measures to strengthen its effectiveness in the context of the reforms envisaged under the program***. Under crisis conditions, monetary policy has been subject to several competing pressures. The SBP has had to use its policy discount rate to defend its international reserves position, bring down inflation, and ensure that interest rates are high enough to encourage demand for T-bills. At the same time, it has used OMOs to stabilize bank liquidity. Measures taken under the program helped re-focus monetary policy on a narrower set of goals. Notably, the adoption of the pre-announced T-bill auction calendar has de-linked government debt management from monetary policy operations. Looking forward, the SBP staff indicated that this, together with steps to increase the operational independence of the central bank, would help establish short-term interest rates as the operational target and focus on price stability as the primary monetary policy objective.[17] To this effect, market conditions permitting, the SBP intends to implement an explicit corridor for short-term interbank rates effective August 1, 2009.

23. ***The authorities and the staff agreed that at this juncture there was no clear-cut case for an immediate change in interest rates***. In the November 2008 MEFP, the authorities had committed to considering a further increase in the discount rate in January 2009; however, given the evolving domestic and international economic situations, the SBP did not see the need for a further increase at that point.[18] At the same time, the SBP considers it premature to reduce the discount rate at this juncture, as core inflation remains elevated. In the discussions, the authorities hinted at the desirability of interest rate cuts—after further progress in reducing inflation—as a countercyclical measure. Staff agreed that there was no immediate need to increase interest rates and that current trends suggested that easing monetary conditions might be desirable and possible, provided that international reserves remain adequate, inflation continues to decline and the budget could be financed through T-bill placements in the commercial banks. Staff cautioned, however, that given the expected external financing shortfall, the authorities may need to raise more funds in the domestic market. They also remarked that large financing needs resulting from the wheat procurement

[16] The authorities envisage procurement of 6.5 million tons of wheat from the 2009 harvest (projected at 25 million tons) at the current support price of nearly $300 per ton (Rs. 950 per 40 kg). In February, international wheat prices in official bulk transactions were between $230 and $240 per ton (FOB).

[17] An interagency committee was established in January to review the proposed amendments to the SBP Act of 1956 with a view to strengthening the operational autonomy of the SBP.

[18] See SBP's Monetary Policy Statement for January–March 2009 (http://www.sbp.org.pk/m_policy/index.asp).

program and placements of TFCs to address the circular debt issue could also hinder the decline in interest rates.[19]

Exchange Rate

24. ***Notwithstanding a sizable nominal depreciation in 2008, the rupee remains slightly overvalued in real effective terms*** (Box 5). The real effective exchange rate (REER) depreciated steadily over the first three quarters of 2008, but has appreciated since September before stabilizing recently at end-2007 levels. The recent REER appreciation reflected large inflation differentials, as well as cross currency movements of the U.S. dollar against Pakistan's major trading partners since September. The macroeconomic balance approach suggests that in real effective terms the rupee is presently about 5–10 percent above the level consistent with Pakistan's current account deficit norm of 3.6 percent of GDP. Other approaches point to similar results.

25. ***Since the inception of the program, intervention in the foreign exchange market has been largely aimed at achieving the NFA targets, but more recently the focus has shifted somewhat toward exchange rate stability***. Staff recommended that the SBP continue to pursue a flexible exchange rate policy and intervene mainly to build up official reserves. As the program NFA targets for the remainder of 2008/09 appear well within reach, the SBP was encouraged to accumulate higher than programmed international reserves as a safety cushion against heightened risks to the balance-of-payments outlook. The authorities generally agreed with the staff's recommendation, but noted that setting over-ambitious reserve targets may adversely affect market expectations, given the increased uncertainty about balance-of-payment flows (including from official sources). Staff cautioned about creating firm expectations of exchange rate stability, and noted that excessive focus on exchange rate stability may clash with the introduction of the explicit interest rate corridor.

Financial sector issues

26. ***The authorities recognized the importance of risks from the deteriorating economic outlook and the need to continue monitoring developments in the banking system very closely***. Credit concentration among a few borrowers is a source of concern and stress tests clearly identified a deterioration in credit quality as an important risk, that may materialize as a result of the economic downturn, as it did in other countries. It was noted that the legislative changes aimed at strengthening the SBP's enforcement powers and the new bankruptcy law under preparation will contribute to enhancing financial sector stability (SMEFP, ¶26).

[19] Nonetheless, using TFCs to regularize the energy sector companies' relations with commercial banks is a positive development from the point of view of bank liquidity and credit availability.

Box 5. Pakistan—External Competitiveness and Exchange Rate Assessment

Pakistan's export growth has been broadly in line with its competitors in recent years. After a strong performance in the late 1990s, export growth has moderated. The growth of textiles and other traditional exports has slowed, but nontraditional exports have risen significantly in recent years. Since 2000, Pakistan's average annual export value growth has been about 12 percent, similar to that of Bangladesh and higher than Sri Lanka's, but below export growth in China and India.

Regional Growth in Merchandise Export Value
(In percent)

	Average 2000–08
Pakistan	11.68
Bangladesh	12.15
China, P.R.: Mainland	25.73
India	19.90
Sri Lanka	7.36

Source: World Economic Outlook

The Pakistani rupee is assessed to be slightly above equilibrium using CGER estimates. In real effective terms, the rupee is now close to its 2007 level, despite a large nominal depreciation against the U.S. dollar in 2008. Its more recent appreciation is less significant than that of most of its neighbors, and reflects in large part high inflation differentials with trading partners. The *macroeconomic balance (MB)* approach suggests that the current level of real exchange rate is about 5–10 percent above the level consistent with the equilibrium current account deficit ("current account norm") of around 3.6 percent of GDP. Preliminary estimates based on the *equilibrium real exchange rate* approach suggest that the rupee is around 2 percent above equilibrium. The *external sustainability* approach estimates that in real effective terms, the rupee is about 7 percent above the value needed for the current account deficit to decline to the level that stabilizes the ratio of Pakistan's net foreign liabilities to GDP at its 2007 level.[1]

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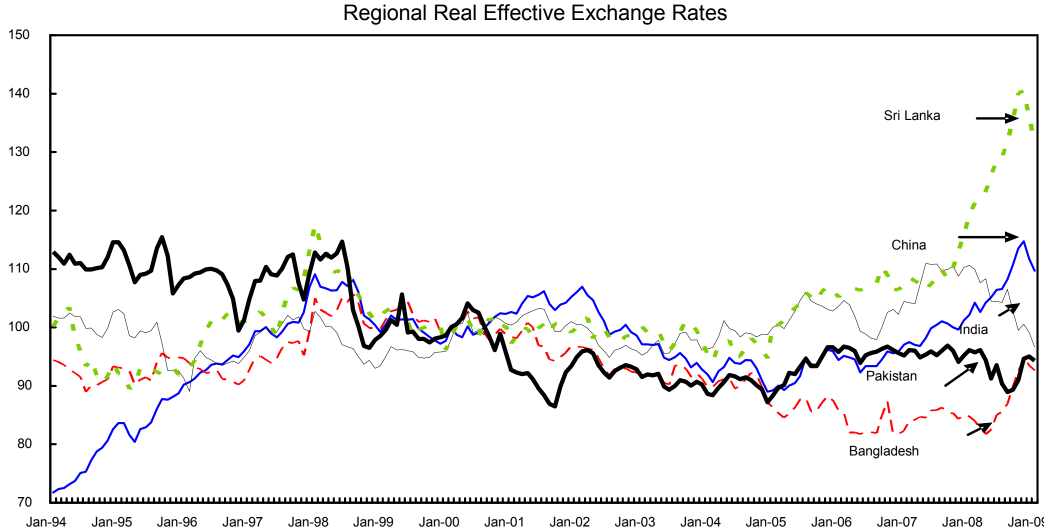
[1] The methodologies are described in detail in "Methodology for CGER Exchange Rate Assessments", which can be found at http://www.imf.org/external/np/pp/eng/2006/110806.pdf.

Regional Real Effective Exchange Rates



Source: IMF Information Notice System.

27. ***The discussions also focused on measures adopted recently by the SBP to help corporate borrowers service their debt to commercial banks***. Specifically, the SBP has announced a relief package for the industrial sector (mainly textiles) that allows the banks and development finance institutions (DFIs) to defer for one year the repayment of principal outstanding under Export-Oriented Projects schemes, including the Debt Swap Facility and the Long-Term Financing Facility (LTFF). Subsequently, the SBP also offered similar relief for the refinancing of loans under the SBP Export Finance Scheme (EFS). Staff cautioned the SBP on expanding the scope of its quasi-fiscal operations by relaxing the rules governing these schemes, and stressed the need for increased transparency in this area.

28. ***The authorities have also eased some regulatory provisions to help banks amortize the losses incurred during the KSE closure*** (SMEFP, ¶27–28). Staff expressed concern about a loosening of prudential regulations at a time when the economic downturn is likely to put stress on banks' financial positions.

C. Exchange Restrictions and Trade Policy

29. ***Cash margins on letters of credit give rise to an exchange restriction***. A measure establishing cash margin requirements on LCs for certain imports had been introduced in May 2008, prior to the approval of the SBA. This measure was recently modified to apply to LCs for imports of goods that were not previously subject to such requirements. Staff concluded that the imposition of cash margin requirements on LCs gives rise to an exchange restriction subject to Fund approval under Article VIII, Section 2(a) and that the recent modification of this measure results in an intensification of this restriction and in a breach of the continuous performance criterion against imposing or intensifying exchange restrictions. The authorities have been working with staff to address this matter and will issue a regulation to reverse this intensification by end-June 2009. On this basis, the authorities request a waiver for the nonobservance of the continuous performance criterion.

30. ***Pakistan's trade policy has been mainly geared towards export diversification in the nontraditional sector,*** by reducing the cost of doing business and enhancing productivity and competitiveness in manufacturing. The government has also made efforts to enhance market access for Pakistan's exports—particularly to development partners. Recent initiatives include duty free access to the U.S. market for goods manufactured in the designated Reconstruction Opportunity Zones, and more preferential access to the EU market.

D. Safeguards Assessment and AML/CFT Issues

31. ***The Safeguards Assessment update is substantially completed***. The update report indicates that the operational environment at the SBP has been strengthened since the last assessment, but that action is needed to address the absence of operational independence and to enhance controls over program data reporting. The safeguards assessment also pointed to the need to improve further the SBP's financial control systems. SBP staff acknowledged these concerns, which will be addressed gradually. Specifically, an inter-agency committee will

complete its work on how to strengthen the operational independence of the SBP by end-April 2009, and a new central bank law will be submitted to Parliament by December 2009. The SBP is also planning changes in the voting structure of its Audit Committee, steps to enhance internal controls, and the establishment of a Board committee to centralize risk management. SBP staff had some reservations regarding the implications of the International Financial Reporting Standards features that have not yet been adopted in Pakistan. In particular, they expressed concern that mark-to-market valuation requirements could expose the SBP to pressures for transferring unrealized profits to the budget. However, necessary mechanisms to preclude such distribution are proposed to be included in the forthcoming amendment of the SBP Act.

32. ***Pakistan faces significant risks of money laundering and terrorism financing***. Several steps have been taken to strengthen its anti money laundering and combating of financing of terrorism (AML/CFT) regime, but the scope of preventive measures needs to be expanded and enforcement should be more stringent. An Anti-Money Laundering Ordinance has been promulgated, a financial intelligence unit has been established, and a wide range of terrorism financing activities have been criminalized. The regulations issued by the SBP and the Securities and Exchange Commission provide a good basis to improve protection against money laundering and terrorism financing and enhance transparency. However, further efforts are needed to establish the autonomy of money laundering offenses and complete the list of predicate offences, Also the criminalization of financing of terrorism organizations (other than prohibited ones) remains ambiguous and the scope for freezing assets is too narrow. Further, available legal powers to prosecute money laundering and terrorism financing are not being properly used.

E. Medium-Term Outlook and Debt-Sustainability Analysis

33. ***The authorities laid out an ambitious medium-term framework but recognized that the economic downturn will delay the transition toward the targeted growth path***. Real GDP growth is projected to recover to 4 percent next year, and to 7 percent a year by 2013/14. Headline inflation is expected to decline rapidly to 6 percent by 2009/10. The current account deficit is envisaged to narrow to more sustainable levels as fiscal consolidation continues and the real effective exchange rate adjusts gradually to its equilibrium level. This, together with improved market access, a recovery in foreign direct investment, and increased financing from official sources would enable the SBP to maintain the reserve cover of about three months of imports over the medium term. Growth will be sustained by structural reforms and increased public investment, especially in the energy sector, and improved access to water for agriculture. With the current account adjustment dictated by external sustainability constraints, much of the investment will be financed from domestic sources. It is assumed that mobilization of private savings, in combination with a considerable increase in the revenue-to-GDP ratio (see below), will permit a significant increase in domestic investment, which would be facilitated by well-targeted public investment, public-private partnerships, and improved financial intermediation.

34. ***A significant increase in revenue as a share of GDP remains the cornerstone of the medium-term framework***. In this regard, the introduction of a broad-based VAT, which constitutes the most important tax policy reform, is scheduled for 2010/11. An increase in the revenue-to-GDP ratio to above 14 percent of GDP by 2013/14, together with a sharp reduction in subsidies and ill-targeted development spending, would be needed to create fiscal space for high quality public investment and an adequate increase in outlays on poverty reduction. In the context of the 2009/10 budget preparation cycle, the authorities are working on their first fully-fledged Medium-Term Budget Framework (MTBF); this should strengthen the predictability of funding and bring credibility and stability to their budget plans. The authorities intend to use the MTBF to determine the development budget envelope in the context of well-specified and fully-costed programs, including those aimed at alleviating poverty, as described in Pakistan's second Poverty Reduction Strategy Paper (SMEFP, ¶16).

35. ***Pakistan's debt dynamics did not change substantially compared with the assessment made at the time of approval of the SBA*** (Appendix I). Under the baseline scenario, the external debt outlook has improved slightly as a result of the lower current account deficits but the debt trajectory remains unchanged. Domestic public debt is expected to rise somewhat owing to lower privatization proceeds.

36. ***Downside risks to the relatively benign debt sustainability outlook are significant***. The external debt ratios are sensitive to higher current account deficits, lower FDI inflows, and large exchange rate depreciation. Domestic debt ratios are sensitive to shocks to the primary fiscal balance, growth, and interest rates, as well as to contingent fiscal liabilities that could arise during the projection period.

IV. Staff Appraisal

37. ***Pakistan's stabilization program is on track***. Fiscal consolidation and improved coherence between fiscal and monetary policies are bringing under control the factors that led to large imbalances in recent years. As a result, headline inflation has declined, the exchange rate has been broadly stable, the international reserve position has strengthened, and the demand for treasury bills has rebounded. Performance under the program has been satisfactory, and all the quantitative performance criteria through December 2008 were met.

38. ***Structural reforms have progressed broadly as envisaged***. A contingency plan for handling problem banks has been prepared and is being strengthened; an action plan to reform tax policy and administration has been adopted and will be implemented with technical assistance from the IMF and the World Bank; and tariff differential electricity subsidies will be fully eliminated by the end of June 2009. The authorities have also designed a plan to address the *stock* of circular debt, which should ease the constraints on economic growth originating in the energy sector. Stronger incentives are needed to arrest the *accrual* of circular debt.

39. ***Looking ahead, with the weaker global outlook and slower domestic activity, the risks to Pakistan's economic and financial prospects have risen notably***. While Pakistan is benefiting from the decline in petroleum prices and the external current account deficit is narrowing, the decline in the demand for exports and uncertainty about workers' remittances are important risks to the external outlook. Weakening bank credit to the private sector and dimmer prospects for external private finance are also constraining growth. Political risk is also higher.

40. ***Fiscal policy has come along well, but remains under pressure***. Staff recognizes that the fiscal targets for December 2008/09 were met with great effort under difficult circumstances. Staff commends the authorities for adhering to the program's fiscal target for 2008/09 and the fiscal adjustment for 2009/10. The fiscal program for these two years, however, contains ambitious revenue targets in the context of slowing economic activity. The widening revenue shortfall in the third quarter of 2008/09 suggests that meeting the revised revenue target for 2008/09 will be challenging. Accordingly, an early identification of additional contingent revenue and expenditure measures would help avoid the need for a sharp last-minute expenditure compression.

41. ***There is a pressing need to strengthen the social safety net***. Social protection is a key element of the authorities' program. The roll-out of the scorecard system under the BISP has started, and the number of families benefiting from BISP cash transfers should increase considerably in the coming two fiscal years. Looking ahead, it is important to review the other components of the social safety net to identify overlaps and gaps in the system. Consideration could also be given to merging the cash transfer component of the Bait-ul-Mal system with the BISP, as well as eliminating gaps and overlaps between the federal and provincial programs to free resources for scaling up BISP.

42. ***Over the medium term, higher budget revenues are critical for creating fiscal space for development and social spending***. Government revenue are low by international standards, which constrains capital accumulation, spending on maintenance, and social outlays. Against this background, a vigorous implementation of the government's ambitious tax reform agenda is essential. Specifically, the replacement of the General Sales Tax with a broad-based VAT in 2010/11 is a key reform. The establishment of the MTBF will also be an important step for strengthening the public finances.

43. ***The SBP's monetary policy stance is appropriate, and needs to remain flexible to address risks***. Staff agrees with the authorities' intention to keep interest rates on hold for the time being in order to lock in the gains made in lowering inflation and avoid financial pressures. Looking ahead, there should be scope for lowering interest rates, provided that inflation continues to decline, international reserves are further strengthened, and the government avoids recourse to SBP financing.

44. ***The envisaged strengthening of the SBP's policy framework is welcome***. Looking forward, the SBP will need to ensure that the introduction of the explicit interest rate corridor does not constrain the objective of strengthening its external international reserve position. In addition, the operational independence of the SBP needs to be enhanced, and its quasi-fiscal operations should be transparently accounted for and eventually eliminated.

45. ***The AML/CFT regime is not yet effective***. To ensure its effectiveness, Pakistan should prepare a ML/FT risk analysis, adopt a national AML/CFT strategy, and consolidate the institutional framework.

46. ***Exchange rate flexibility should continue to facilitate external adjustment***. The CGER estimates suggest that the Pakistani rupee is slightly overvalued. Arguably, the exchange rate has been too stable recently, and more flexibility may be needed in the future to deal with uncertain inflows. Intervention needs to remain largely geared to achieving the program's NFA targets but, conditions permitting, any excess NFA accumulation will constitute a useful self-insurance against risks to the balance-of-payments outlook.

47. ***Pakistan's financial system has weathered the crisis thus far, but needs to be monitored carefully***. The FSAP stress tests and the authorities' own updates are encouraging. Nevertheless, with the slowing in economic activity and rising NPLs, the risks to the system are rising. In this connection, the recent formulation of plans for dealing with problem banks is welcome. At the same time, care should be taken that the changes introduced to the regulatory framework and the extension of the refinancing period under the SBP's discount credit schemes do not prevent a timely assessment of potential problems and result in unintended regulatory forbearance.

48. ***Pakistan needs additional external assistance to reduce risks and provide some scope for countercyclical policies by allowing greater development and social spending***. The program is financed for 2008/09 and 2009/10, but financing constraints leave little room for countercyclical spending. The upcoming donor meeting provides an important opportunity for mobilizing additional assistance.

49. ***In light of performance to date and the policy intentions expressed by the authorities in the attached LOI and SMEFP, staff recommends the completion of the first review under the SBA***. Noting the authorities' commitment to reverse by end-June 2009 the intensification of the exchange restriction related to cash margin requirements on LCs for certain imports, staff supports the authorities' request for a waiver of nonobservance of the continuous performance criterion against imposing or intensifying exchange restrictions as the measure giving rise to the restriction is minor and temporary.

50. ***It is proposed that the next Article IV consultation for Pakistan take place within 24 months subject to the provisions of the decision on consultation cycles in program countries***.

PROPOSED DECISIONS

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

First Review under the Stand-By Arrangement

1. Pakistan has consulted with the Fund in accordance with paragraph 3(d) of the Stand-By Arrangement for Pakistan (EBS/08/127) in order to review program implementation.

2. The letter dated March 16, 2009 from the Advisor to the Prime Minister on Finance, Revenue, Economic Affairs and Statistics and the Governor of the State Bank of Pakistan (the "March 2009 Letter"), together with its Supplementary Memorandum on Economic and Financial Policies for 2008/09-2009/10 (the "March 2009 Supplementary MEFP") and Addendum to the Technical Memorandum of Understanding (the "March 2009 Addendum") shall be attached to the Stand-By Arrangement for Pakistan, and the letter dated November 20, 2008 from the Advisor to the Prime Minister on Finance and Economic Affairs and the Governor of the State Bank of Pakistan , shall be read as supplemented and modified by the March 2009 Letter and its attachments.

3. Accordingly, the following amendment shall be made to the Stand-By Arrangement for Pakistan:

a. Paragraph 3(a) shall be amended by replacing the terms "Table 1 of the MEFP" with the terms "Table 1 of the March 2009 Supplementary MEFP";

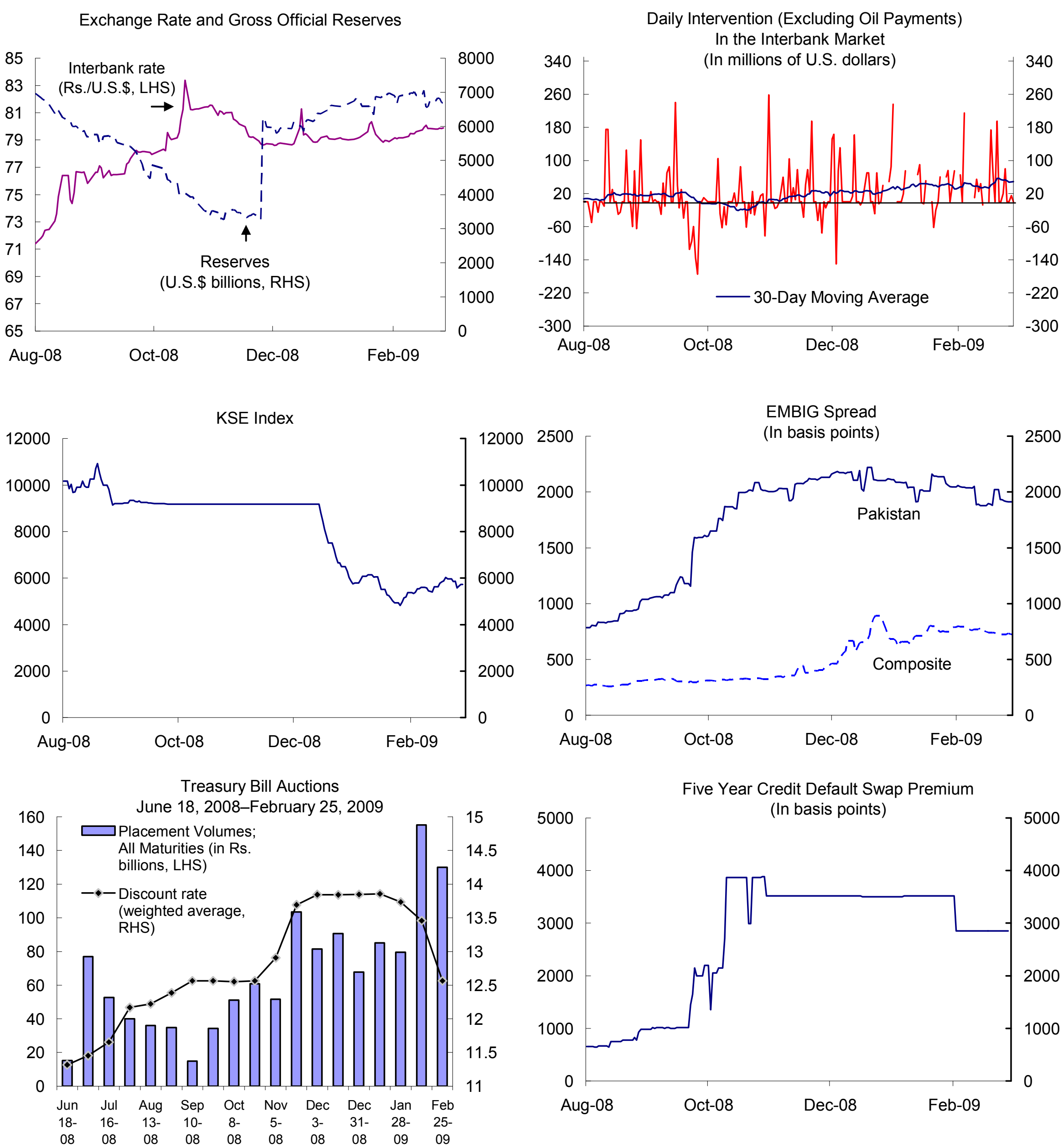
b. Paragraph 3(c)(i) shall be amended by replacing the terms "Table 1 of the MEFP" with the terms "Table 1 of the March 2009 Supplementary MEFP" and by adding the terms "and the March 2009 Addendum" after the terms "in the TMU".

c. Paragraph 3(c)(ii) shall be amended by replacing the terms “Table 1 of the MEFP” with the terms “Table 1 of the March 2009 Supplementary MEFP”.

4. The Fund decides that the first review, specified in paragraph 3(d) of the Stand-By Arrangement for Pakistan is completed and that Pakistan may make purchases under the Stand-By Arrangement, notwithstanding the non-observance of the continuous performance criterion on the non imposition or intensification of restrictions on the making of payments and transfers for current international transactions specified in paragraph 3(c)(iii) of the arrangement, on the condition that the information provided by Pakistan on performance under this criterion is accurate.

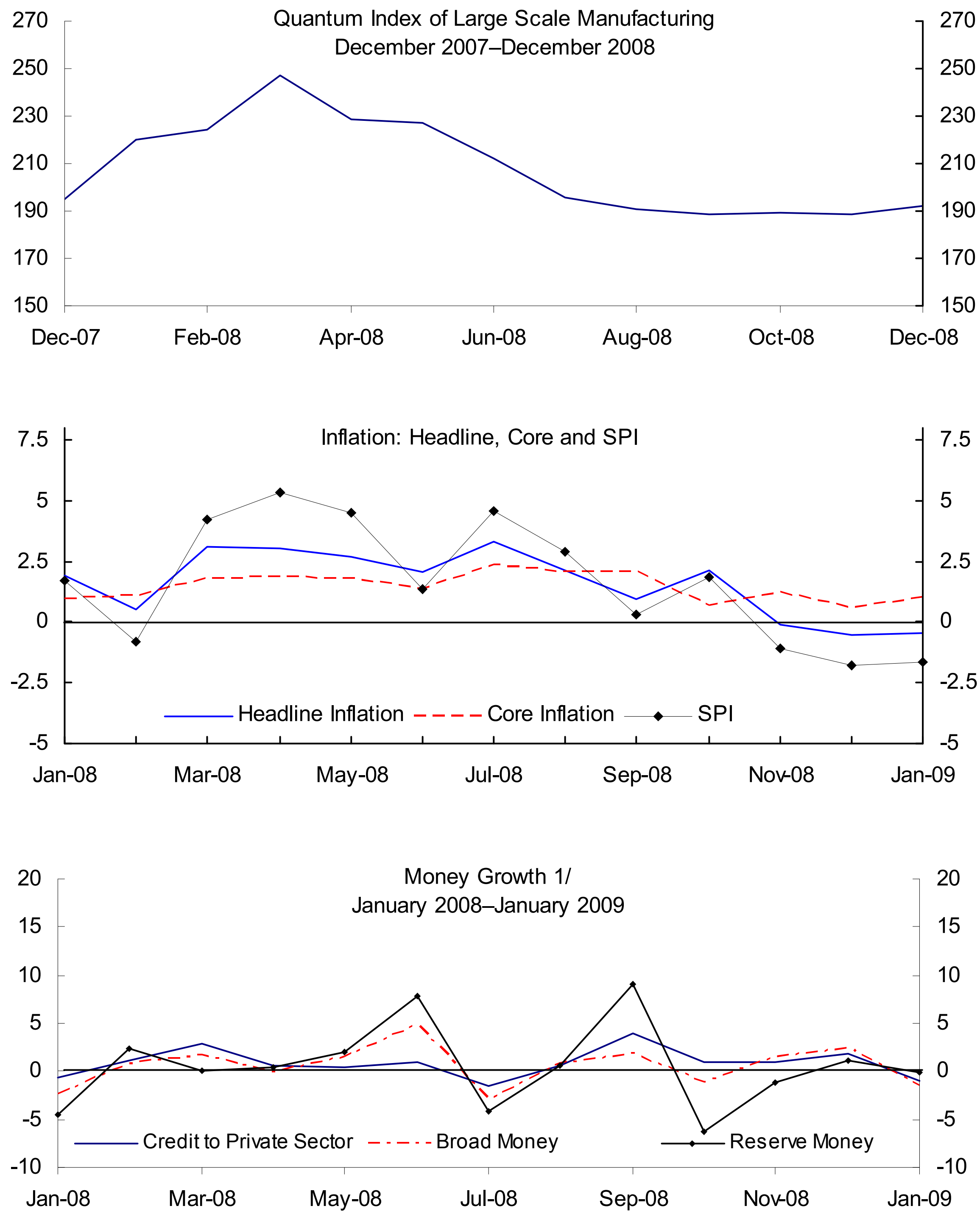
Figure 1. Pakistan: Financial Market Indicators

(August 2008–February 2009, unless otherwise indicated)



Sources: Pakistani authorities; and Bloomberg.

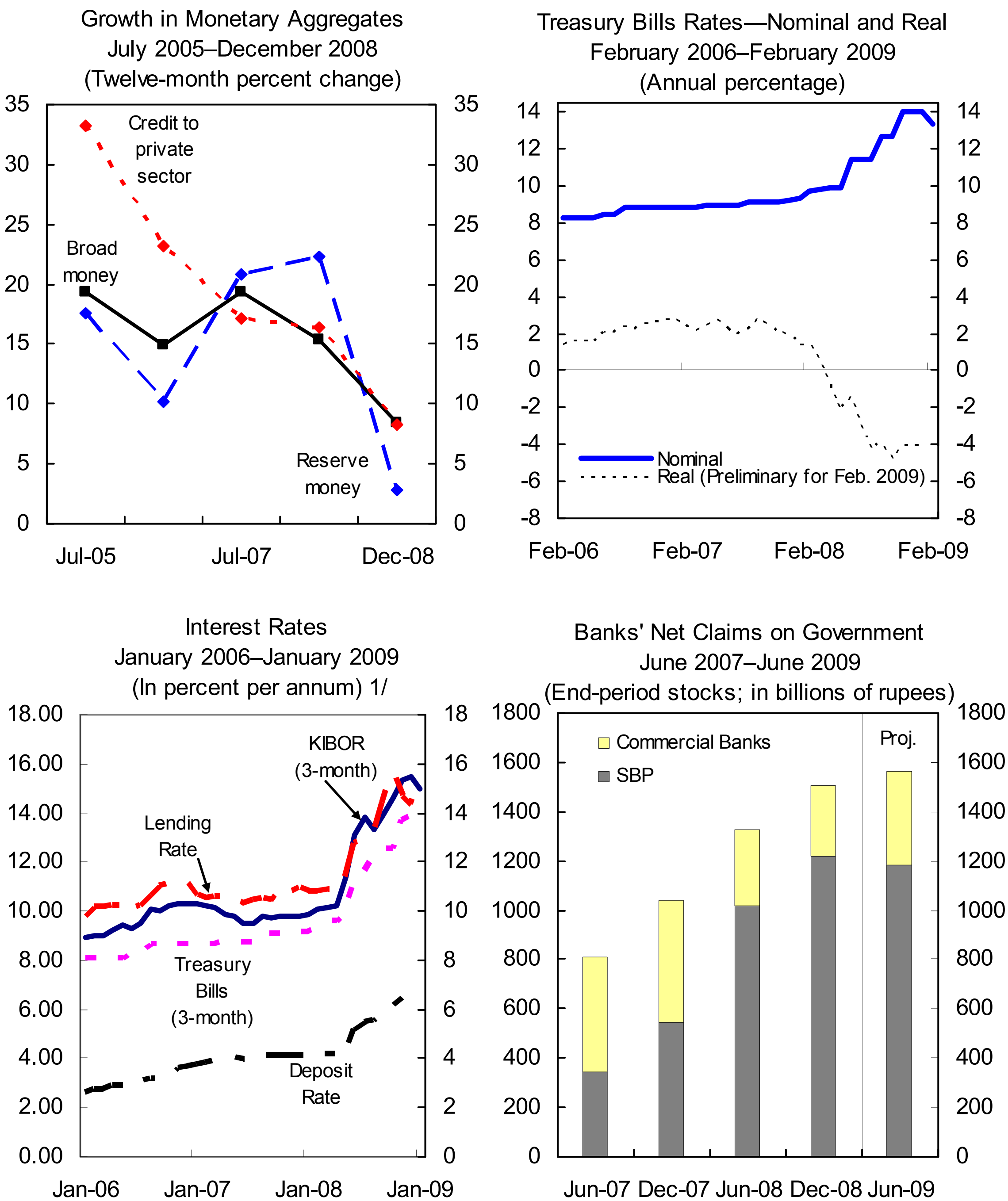
Figure 2. Pakistan: Monthly Macroeconomic Indicators



Source: Pakistani authorites.

1/ Through January 24, 2009.

Figure 3. Pakistan: Monetary and Credit Indicators

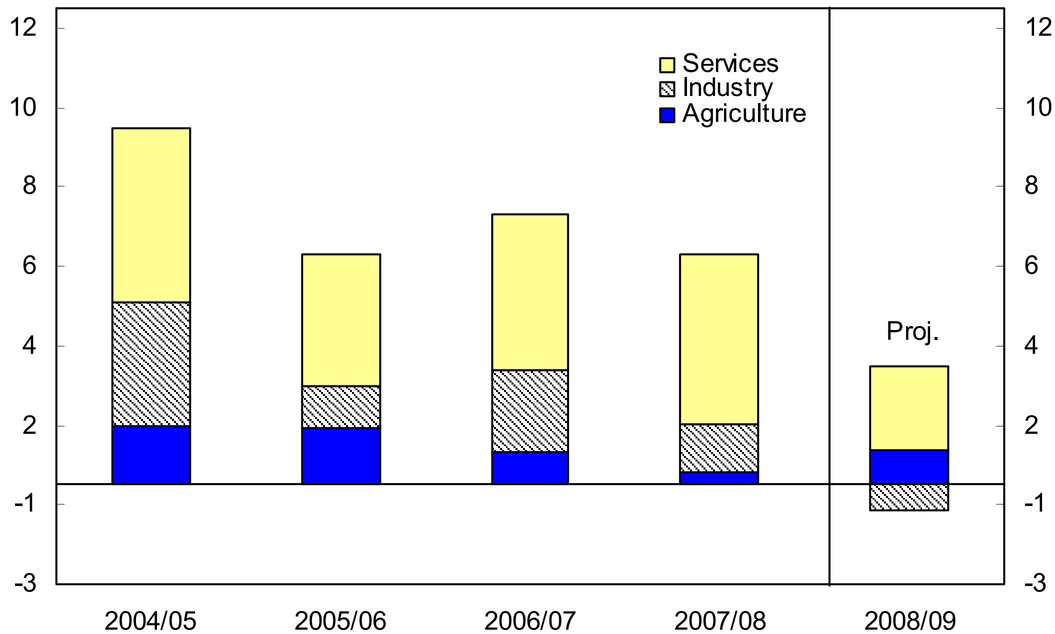


Sources: Pakistani authorities; and Fund staff projections.

1/ Lending and Deposit rates are weighted averages for all banks.

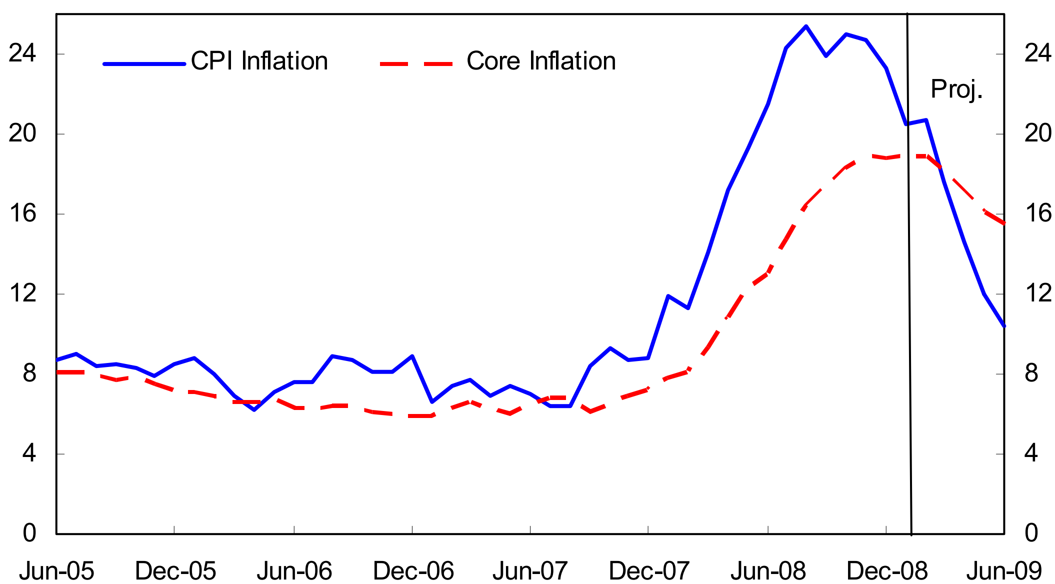
Figure 4. Pakistan: Output and Inflation Indicators 2004/05–2008/09

Sectoral Contribution to Real GDP 1/
(Annual growth; in percent)



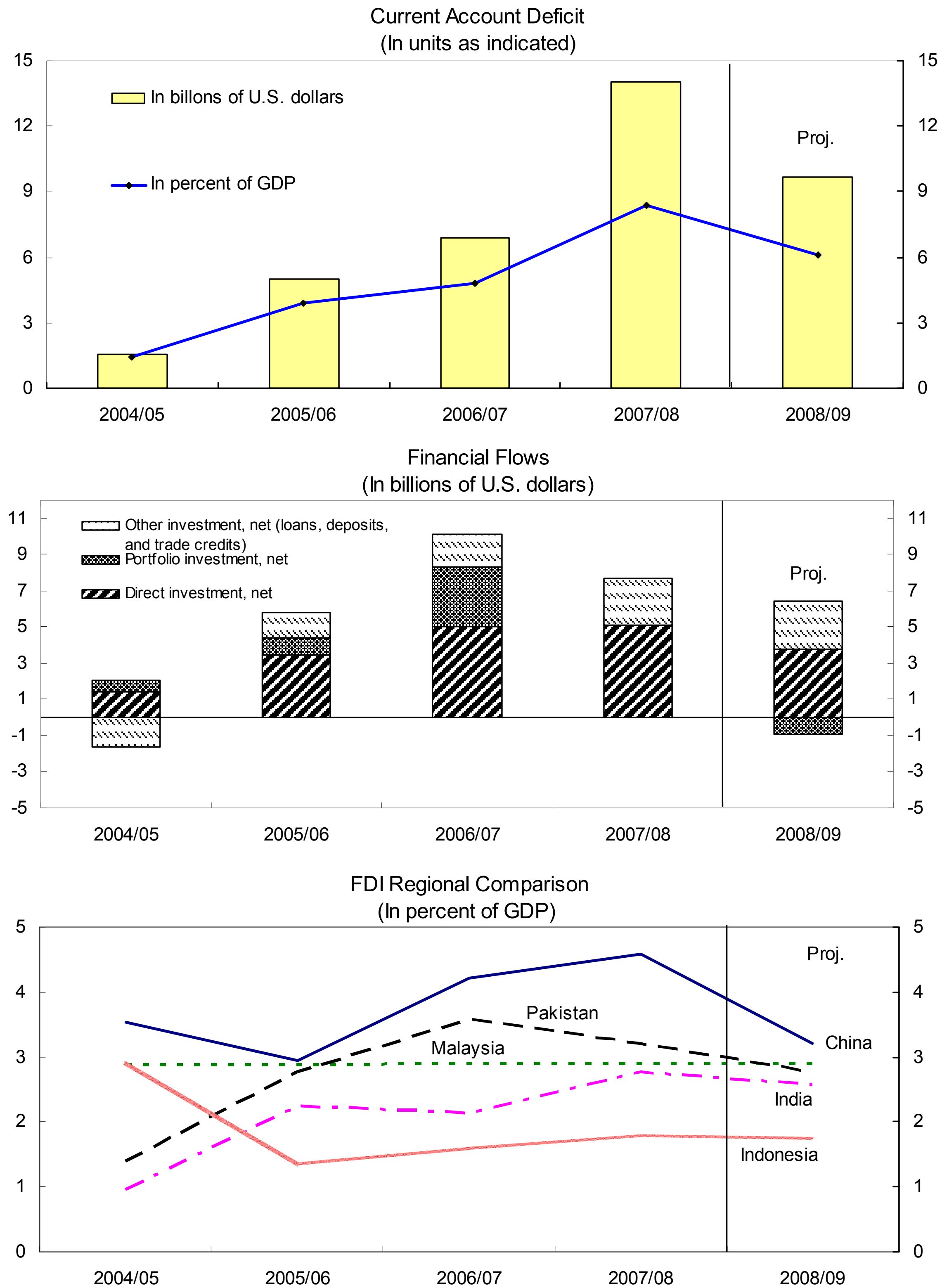
1/ At factor cost.

CPI Inflation
(Year-on-year change; in percent)



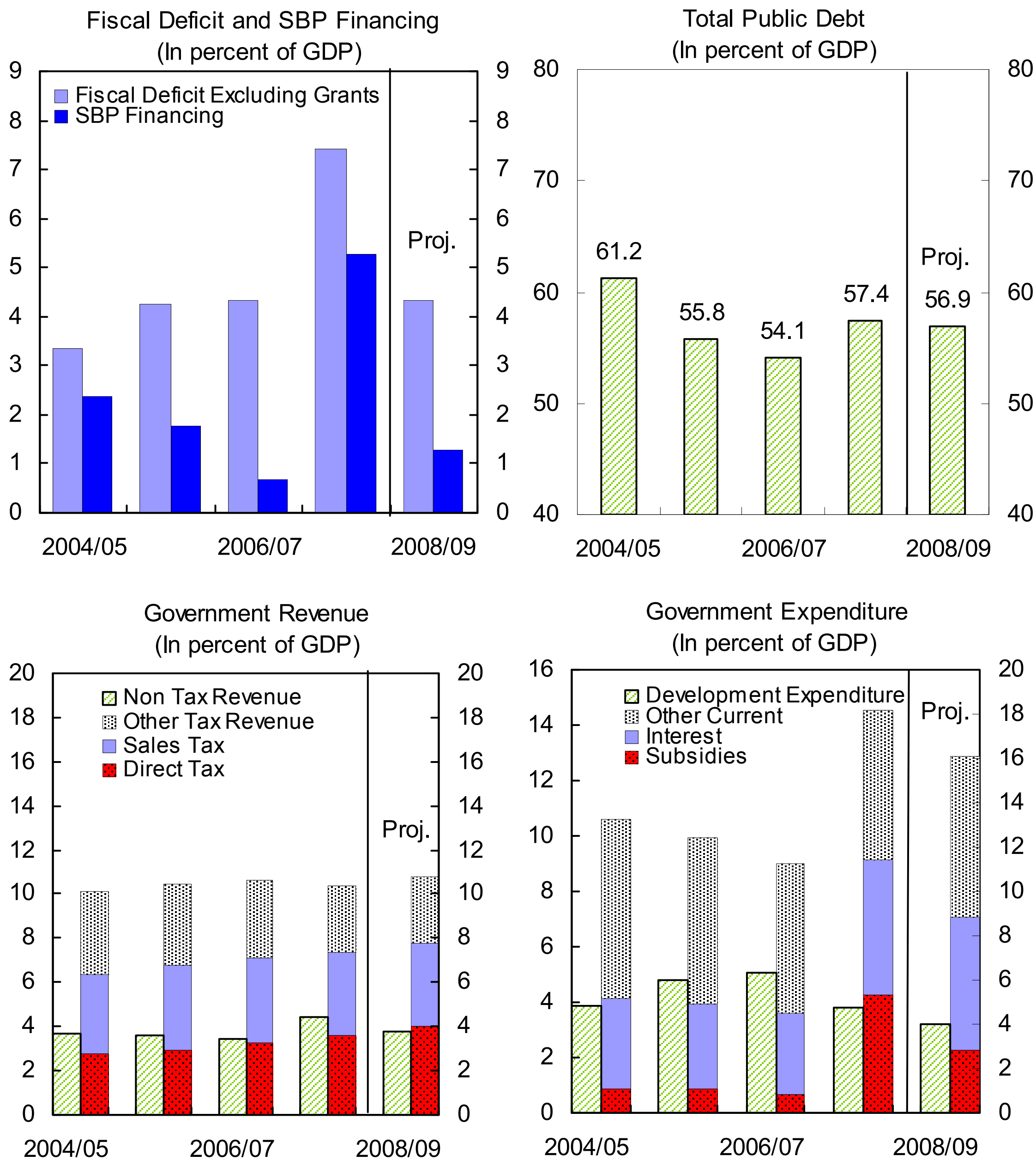
Sources: Pakistani authorities; and Fund staff projections.

Figure 5. Pakistan: External Sector Indicators, 2004/05–2008/09



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

Figure 6. Pakistan: Fiscal Policy Indicators, 2004/05–2008/09



Sources: Pakistani authorities; and Fund staff projections.

Table 1. Pakistan: Selected Economic Indicators, 2007/08–2009/10 1/

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

	2007/08	2008/09		2009/10	
		Prog.	Proj.	Prog.	Proj.
		(Annual percentage change)			
Output and prices					
Real GDP at factor cost	5.8	3.4	2.5	5.0	4.0
Partner country demand (WEO definition)	4.5	…	…	…	…
Consumer prices (period average)	12.0	23.0	20.0	13.0	6.0
Consumer prices (end of period)	21.5	20.0	10.0	6.0	6.5
Pakistani rupees per U.S. dollar (period average)	…	…	…	…	…
		(In percent of GDP)			
Saving and investment					
Gross saving	13.2	13.5	14.2	15.6	15.6
Government	-2.8	-1.1	-0.9	0.8	0.8
Nongovernment (including public sector enterprises)	16.0	14.5	15.1	14.9	14.8
Gross capital formation 2/	21.6	20.0	20.1	21.3	19.9
Government	4.3	3.0	3.2	3.8	4.0
Nongovernment (including public sector enterprises)	17.2	17.0	16.9	17.5	15.9
Public finances					
Revenue and grants	14.6	15.1	15.4	16.1	16.0
Expenditure (including statistical discrepancy) 3/	21.7	19.1	19.6	19.2	19.2
Budget balance (including grants)	-7.1	-4.0	-4.2	-3.1	-3.2
Budget balance (excluding grants)	-7.4	-4.2	-4.3	-3.3	-3.4
Primary balance	-2.5	0.6	0.6	1.6	1.5
Total government debt	57.4	54.6	56.9	52.4	55.4
External government debt	26.2	26.9	27.9	27.1	26.2
Domestic government debt	31.2	27.7	29.1	25.4	29.1
		(Annual changes in percent of initial stock of broad money, unless otherwise indicated)			
Monetary sector					
Net foreign assets	-7.8	-4.9	-3.4	1.8	-1.4
Net domestic assets	23.2	15.7	11.8	14.1	12.1
Broad money	15.3	10.8	8.4	15.9	10.6
Private credit (percentage change)	16.4	25.2	8.3	19.6	14.1
Six-month treasury bill rate (period average, in percent) 4/	9.6	12.7	…	…	…
External sector					
Merchandise exports, U.S. dollars (percentage change)	16.5	12.0	-5.5	11.0	1.6
Merchandise imports, U.S. dollars (percentage change)	31.2	1.1	-14.5	5.7	-5.5
Current account including official current transfers (in percent of GDP)	-8.4	-6.5	-5.9	-5.7	-4.3
		(In percent of exports of goods and services, unless otherwise indicated)			
External public and publicly guaranteed debt	169.7	160.0	186.3	154.2	189.0
Debt service	15.2	16.9	23.1	15.4	20.2
Implicit interest rate (in percent) 5/	5.0	2.4	2.4	3.2	2.4
Gross reserves (in millions of U.S. dollars) 6/	8,591	8,591	9,091	11,291	10,591
In months of next year's imports of goods and services	2.7	2.1	3.0	2.6	3.3
Memorandum items:					
Real effective exchange rate (annual average, percentage change)	-0.8	…	…	…	…
Terms of trade (percentage change)	-10.2	…	…	…	…
Real per capita GDP (percentage change)	4.1	1.6	0.9	3.3	2.4
GDP at market prices (in billions of Pakistani rupees)	10,478	13,384	12,970	15,880	14,298
GDP at market prices (in billions of U.S. dollars)	167.6	...	...	...	...

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

1/ Fiscal year ends June 30.
2/ Including changes in inventories. Investment data recorded by the Pakistan Federal Bureau of Statistics are said to underreport true activity.
3/ Expenditure on social assistance in 2008/09 is budgeted at 0.5 percent of GDP. The program will target an additional 0.3–0.5 percent of GDP.
4/ 2008/09: average for June–December 2008.
5/ Calculated as interest payments in percent of the end-of-period debt stock of the previous year.
6/ Excluding gold and foreign deposits of commercial banks held with the State Bank of Pakistan.

Table 2. Pakistan: Balance of Payments, 2007/08–2009/10

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

	2007/08	2008/09						2009/10	
		Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Year		Prog.	Proj.
		Act.	Act.	Proj.	Proj.	Prog.	Proj.		
Current account	-14,036	-3,774	-3,569	-1,767	-533	-10,622	-9,643	-9,738	-7,407
Balance on goods	-15,295	-4,122	-3,536	-2,300	-1,316	-13,273	-11,274	-12,848	-9,316
Exports, f.o.b.	20,122	5,714	4,482	4,400	4,420	22,537	19,015	25,016	19,311
Imports, f.o.b.	-35,417	-9,836	-8,018	-6,700	-5,736	-35,810	-30,290	-37,864	-28,627
Services (net)	-6,307	-1,217	-1,090	-950	-615	-6,164	-3,872	-6,410	-3,526
Services: credit	3,590	1,064	784	800	1,157	3,949	3,805	4,331	3,873
Services: debit	-9,897	-2,281	-1,874	-1,750	-1,772	-10,113	-7,677	-10,741	-7,399
Income (net)	-3,909	-1,118	-1,253	-934	-929	-3,704	-4,234	-4,251	-4,062
Income: credit	1,613	253	316	316	315	1,520	1,200	1,626	1,218
Income: debit	-5,522	-1,371	-1,569	-1,250	-1,244	-5,224	-5,434	-5,877	-5,279
Of which: interest payments	-2,161	-476	-667	-446	-569	-1,813	-2,158	-2,167	-1,873
Balance on goods, services, and income	-25,511	-6,457	-5,879	-4,184	-2,860	-23,141	-19,380	-23,508	-16,904
Of which: income on direct investment	-3,361	-895	-902	-804	-675	-3,411	-3,276	-3,710	-3,407
Current transfers (net)	11,475	2,683	2,310	2,417	2,327	12,519	9,737	13,770	9,497
Current transfers: credit, *of which:*	11,617	2,708	2,353	2,434	2,380	12,624	9,875	13,876	9,603
Workers' remittances	6,451	1,879	1,760	1,800	1,761	7,692	7,200	8,538	7,000
Other private transfers	4,666	752	556	600	592	4,759	2,500	5,235	2,500
Current transfers: debit	-142	-25	-43	-17	-53	-105	-138	-106	-106
Capital account	119	28	22	36	35	108	121	284	284
Capital transfers: credit	126	28	24	37	38	119	127	295	295
Of which: official capital grants	109	23	21	32	32	100	108	271	271
Capital transfers: debit	-7	0	-2	-1	-3	-11	-6	-11	-11
Financial account	7,657	615	1,703	1,348	1,793	6,158	5,459	9,109	6,628
Direct investment abroad	-75	-5	11	-5	-35	-100	-34	-80	-80
Direct investment in Pakistan	5,153	1,115	1,230	800	655	4,589	3,800	5,200	4,066
Of which: privatization receipts	133	0	0	0	0	639	0	500	266
Portfolio investment (net), *of which:*	36	-183	-37	-620	-116	28	-957	378	-322
Eurobond/GDR	-25	-2	-23	-500	0	600	-525	-122	-522
Other investment assets	-219	-43	141	-155	-388	-295	-445	-510	-95
General government	5	-1	3	0	3	5	5	5	5
Banks	276	-6	-79	-130	-135	-200	-350	-200	100
Other sectors	-500	-36	217	-25	-256	-100	-100	-315	-200
Other investment liabilities	2,762	-269	358	1,328	1,677	1,936	3,095	4,121	3,059
Monetary authorities	490	0	0	500	-500	0	0	0	0
General government, *of which:*	1,787	4	207	1,482	1,080	2,636	2,773	2,987	1,930
Disbursements (medium and long term)	2,549	718	531	1,645	1,303	4,146	4,197	4,077	3,287
Amortization (medium and long term)	-1,108	-526	-278	-313	-371	-1,342	-1,481	-1,075	-1,211
Banks	66	23	-110	-50	-75	200	-212	200	300
Other sectors	419	-296	261	-604	1,172	-900	534	934	829
Net errors and omissions	472	-560	156	0	0	0	-404	0	0
Reserves and related items	5,788	3,691	1,688	383	-1,295	4,355	4,467	345	495
Reserve assets, of which:	5,961	3,827	-1,404	-420	-2,191	-100	-188	-3,000	-1,850
Foreign exchange (State Bank of Pakistan)	5,711	3,414	-1,503	-320	-2,091	0	-500	-2,700	-1,500
Foreign exchange (deposit money banks)	250	413	99	-100	-100	-100	312	-300	-350
Use of Fund credit and loans	-173	-36	2,992	803	796	4,555	4,555	-230	2,345
Exceptional financing	0	-100	100	0	100	-100	100	3,575	0
Memorandum items:									
Current account (in percent of GDP; including official transfers)	-8.4	-2.3	-2.2	-1.1	-0.3	-6.5	-5.9	-5.7	-4.3
Current account (in percent of GDP; excluding fuel imports)	-2.1	...	...	...	...	0.1	-0.2	0.0	-0.3
Exports f.o.b. (growth rate, in percent)	16.5	...	...	...	...	12.0	-5.5	11.0	1.6
Imports f.o.b. (growth rate, in percent)	31.2	...	...	...	...	1.1	-14.5	5.7	-5.5
Imports f.o.b. (growth rate, in percent, excluding oil)	26.8	...	...	...	...	3.6	-15.4	12.1	2.2
Oil imports (in millions of U.S. dollars, cif)	10,496	...	...	...	...	10,304	9,250	9,710	6,957
Crude oil price ($/bbl)	87.0	...	...	...	...	85.4	80.0	72.8	45.8
Terms of trade (growth rate, in percent)	-10.2	...	...	...	...	...	...	...	...
Workers' remittances and other private transfers (growth rate, in percent)	9.9	...	...	...	...	12.0	-12.7	10.6	-2.1
External debt (in millions of U.S. dollars)	44,468	44,790	48,811	50,820	51,971	51,315	51,454	56,820	55,402
Gross financing needs (in millions of U.S. dollars) 1/	15,367	...	...	...	...	13,373	12,659	12,210	10,340
End-period gross official reserves (millions of U.S. dollars) 2/	8,591	5,177	6,680	7,000	9,091	8,591	9,091	11,291	10,591
(In months of next year's imports of goods and services)	2.7	...	...	...	...	2.1	3.0	2.6	3.3
(in percent of debt service)	246.0	...	...	...	...	….	175.7	….	220.4
GDP (in millions of U.S. dollars)	167,640	162,627	162,627	162,627	162,627	163,220	162,627	171,343	171,015

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

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

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

Table 3a. Pakistan: Consolidated Government Budget, 2007/08–2009/10

(In billions of Pakistani rupees)

	2007/08	2008/09										2009/10	
	Year	Jul.-Sep.		Oct.-Dec.		Jan.-Mar.		Apr.-Jun.		Year		Year	
		Prog.	Act.	Prog.	Est.	Prog.	Proj.	Prog.	Proj.	Prog.	Proj.	Prog.	Proj.
Revenue and grants	1,530	397	389.4	485	454	494	496	642	657	2,018	1,996	2,556	2,286
Revenue	1,499	392	385	479	450	490	490	634	649	1,995	1,974	2,521	2,255
Tax revenue	1,086	285	285	347	330	364	365	472	486	1,468	1,466	1,879	1,707
Federal	1,045	273	272	332	321	350	351	454	468	1,409	1,412	1,809	1,642
FBR revenue	1,007	261	264	320	291	338	314	441	431	1,360	1,300	1,753	1,516
Direct taxes	388	88.3	89.7	136	121	123	133	184	187	530	530	762	639
Federal excise duty	84	38	24	29	25	28	29	27	41	121	119	144	142
Sales tax	385	110	112	120	111	127	116	158	161	516	499	619	573
Customs duties	151	24	38	35	35	61	35	73	42	193	151	228	162
Petroleum surcharge	14	2	2	4	27	4	33	4	33	14	94	15	104
Gas surcharge and other	23	10	7	8	3	8	4	9	5	35	18	41	22
Provincial	41	12	13	15	9	14	14	18	18	59	54	70	66
Nontax revenue	414	107	100	132	119	126	126	163	163	527	507	642	547
Federal	336	87	92	107	103	106	106	133	133	432	433	520	457
Provincial	78	20	8	25	16	20	20	30	30	95	74	122	90
Grants	31	5	4	6	4	5	5	7	8	22	22	35	31
Expenditure	2,281	523	514	594	547	633	642	791	806	2,546	2,508	3,046	2,746
Current expenditure	1,858	462	456	521	482	537	531	623	619	2,147	2,088	2,435	2,176
Federal	1,420	366	341	387	361	402	396	471	473	1,630	1,571	1,771	1,581
Interest	490	142	142	161	158	149	154	161	165	618	619	752	678
Domestic	...	132	137	137	138	538	544	544	541	541	544	641	594
Foreign 1/	...	17	24	24	20	75	75	75	75	75	75	111	84
Other 2/	931	224	199	225	203	253	242	310	308	1,012	952	1,019	903
Of which: Subsidies and grants	…	108	75	99	85	121	108	163	161	492	429	320	326
Of which: Cash transfers to poor households 3/	...	...	1	...	2	...	21	...	26	82	46	...	83
Provincial	437	96	115	134	121	135	135	152	146	517	517	664	595
Development expenditure and net lending	423	61	58	74	64	96	111	168	187	399	420	612	569
Public Sector Development Program	452	61	57	73	65	96	111	168	187	397	419	610	568
Federal 2/	238	38	36	40	37	59	72.4	110	125	247	270	400	358
Of which: one-off expenditure	17	7	7	7	7	7	7	7	7	27	27	15	15
Provincial	214	23	21	33	28	36	38	58	62	150	149	210	210
Net lending	-28	0.0	0.9	0.5	-0.4	0.5	0.5	0.5	0.5	2	2	2	2
Statistical discrepancy ("+" = additional expenditure) 4/	-3	11	13	0	15	0	0	0	0	11	27	0	0
Underlying budget balance (excluding grants and earthquake)	-762	-135	-135	-108	-105	-137	-145	-150	-150	-535	-535	-510	-476
Underlying budget balance (including grants)	-731	-131	-130	-103	-101	-132	-140	-143	-142	-513	-513	-476	-445
Overall Deficit (excluding grants)	-779	-142	-141	-115	-112	-144	-152	-157	-157	-562	-562	-525	-491
Overall Deficit (including grants)	-748	-137	-137	-109	-107	-139	-147	-150	-149	-540	-540	-491	-460
Financing 1/	748	137	133	109	107	139	147	150	149	540	540	491	460
External	121	6	2	40	27	96	79	187	69	328	177	312	140
Of which: privatization receipts	0	0	0	11	1	22	0	115	0	148	1	46	31
Domestic	628	132	132	69	81	43	68	-37	79	211	363	179	320
Bank	520	105	105	38	76	12	36	-68	48	91	269	97	238
Nonbank	106	27	27	31	4	31	31	31	31	120	94	82	82
Privatization receipts	2	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:													
Expenditure 5/	2,295	541	533	601	568	640	649	798	813	2,584	2,562	3,061	2,761
Primary balance (excluding grants)	-289	0	1	46	46	5	2	4	8	56	57	226	187
Primary balance (including grants)	-259	5	5	52	51	10	7	11	16	78	79	261	219
Defense spending	285	77	82	74	66	76	83	82	87	308	318	375	351
Total government debt 6/	6,010	…	…	…	…	…	…	…	…	7,312	7,383	8,326	7,916
Domestic debt	3,266	…	…	…	…	…	…	…	…	3,710	3,769	4,029	4,164
External debt 6/	2,744	...	…	…	…	…	…	…	…	3,602	3,614	4,297	3,752
Nominal GDP (market prices)	10,478	13,384	12,970	13,384	12,970	13,384	12,970	13,384	12,970	13,384	12,970	15,880	14,298

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

1/ For 2007/08, financing figures are provided by the Ministry of Finance.
2/ In 2007/08, PR 23 billion (0.2 percent of GDP) of current expenditure has been reclassified as development expenditure.
3/ Comprises BISP, Bait-ul-Mal, and Pakistan Poverty Alleviation Fund.
4/ The statistical discrepancy is believed to arise mainly from double-counting of spending at the provincial level.
5/ Includes statistical discrepancy and spending related to the 2005 earthquake.
6/ Excludes military debt, commercial loans, and short-term debt.

Table 3b. Pakistan: Consolidated Government Budget, 2007/08–2009/10

(In percent of GDP; unless otherwise indicated)

	2007/08	2008/09										2009/10	
	Year	Jul.-Sep.		Oct.-Dec.		Jan.-Mar.		Apr.-Jun.		Year		Year	
		Prog.	Act.	Prog.	Est.	Prog.	Proj.	Prog.	Proj.	Prog.	Proj.	Prog.	Proj.
Revenue and grants	14.6	3.0	3.0	3.6	3.5	3.7	3.8	4.8	5.1	15.1	15.4	16.1	16.0
Revenue	14.3	2.9	3.0	3.6	3.5	3.7	3.8	4.7	5.0	14.9	15.2	15.9	15.8
Tax revenue	10.4	2.1	2.2	2.6	2.5	2.7	2.8	3.5	3.7	11.0	11.3	11.8	11.9
Federal	10.0	2.0	2.1	2.5	2.5	2.6	2.7	3.4	3.6	10.5	10.9	11.4	11.5
FBR revenue	9.6	1.9	2.0	2.4	2.2	2.5	2.4	3.3	3.3	10.2	10.0	11.0	10.6
Direct taxes	3.7	0.7	0.7	1.0	0.9	0.9	1.0	1.4	1.4	4.0	4.1	4.8	4.5
Federal excise duty	0.8	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.9	0.9	0.9	1.0
Sales tax	3.7	0.8	0.9	0.9	0.9	1.0	0.9	1.2	1.2	3.9	3.8	3.9	4.0
Customs duties	1.4	0.2	0.3	0.3	0.3	0.5	0.3	0.5	0.3	1.4	1.2	1.4	1.1
Petroleum surcharge	0.1	0.0	0.0	0.0	0.2	0.0	0.3	0.0	0.3	0.1	0.7	0.1	0.7
Gas surcharge and other	0.2	0.1	0.1	0.1	0.0	0.1	0.0	0.1	0.0	0.3	0.1	0.3	0.2
Provincial	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.4	0.4	0.4	0.5
Nontax revenue	3.9	0.8	0.8	1.0	0.9	0.9	1.0	1.2	1.3	3.9	3.9	4.0	3.8
Federal	3.2	0.7	0.7	0.8	0.8	0.8	0.8	1.0	1.0	3.2	3.3	3.3	3.2
Provincial	0.7	0.2	0.1	0.2	0.1	0.1	0.2	0.2	0.2	0.7	0.6	0.8	0.6
Grants	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.2	0.2	0.2
Expenditure	21.8	3.9	4.0	4.4	4.2	4.7	5.0	5.9	6.2	19.0	19.3	19.2	19.2
Current expenditure	17.7	3.5	3.5	3.9	3.7	4.0	4.1	4.7	4.8	16.0	16.1	15.3	15.2
Federal	13.6	2.7	2.6	2.9	2.8	3.0	3.1	3.5	3.6	12.2	12.1	11.2	11.1
Interest	4.7	1.1	1.1	1.2	1.2	1.1	1.2	1.2	1.3	4.6	4.8	4.7	4.7
Domestic	…	1.0	1.1	1.0	1.1	4.0	4.2	4.1	4.2	4.0	4.2	4.0	4.2
Foreign 1/	…	0.1	0.2	0.2	0.2	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.6
Other 2/	8.9	1.7	1.5	1.7	1.6	1.9	1.9	2.3	2.4	7.6	7.3	6.4	6.3
Of which: Subsidies and grants	…	0.8	0.6	0.7	0.7	0.9	0.8	1.2	1.2	3.7	3.3	2.0	2.3
Of which: Cash transfers to poor households 3/	…	…	0.0	…	0.0	…	0.2	…	0.2	0.6	0.4	…	0.6
Provincial	4.2	0.7	0.9	1.0	0.9	1.0	1.0	1.1	1.1	3.9	4.0	4.2	4.2
Development expenditure and net lending	4.0	0.5	0.4	0.5	0.5	0.7	0.9	1.3	1.4	3.0	3.2	3.9	4.0
Public Sector Development Program	4.3	0.5	0.4	0.5	0.5	0.7	0.9	1.3	1.4	3.0	3.2	3.8	4.0
Federal 2/	2.3	0.3	0.3	0.3	0.3	0.4	0.6	0.8	1.0	1.8	2.1	2.5	2.5
Of which: one-off expenditure	0.2	0.0	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.2	0.2	0.1	0.1
Provincial	2.0	0.2	0.2	0.2	0.2	0.3	0.3	0.4	0.5	1.1	1.1	1.3	1.5
Net lending	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy (“+” = additional expenditure) 4/	0.1	0.2	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.2	0.2	0.0	0.0
Underlying budget balance (excluding grants and earthquake)	-7.3	-1.0	-1.0	-0.8	-0.8	-1.0	-1.1	-1.1	-1.2	-4.0	-4.1	-3.2	-3.3
Underlying budget balance (including grants)	-7.0	-1.0	-1.0	-0.8	-0.8	-1.0	-1.1	-1.1	-1.1	-3.8	-4.0	-3.0	-3.1
Overall Deficit (excluding grants)	-7.4	-1.1	-1.1	-0.9	-0.9	-1.1	-1.2	-1.2	-1.2	-4.2	-4.3	-3.3	-3.4
Overall Deficit (including grants)	-7.1	-1.0	-1.1	-0.8	-0.8	-1.0	-1.1	-1.1	-1.1	-4.0	-4.2	-3.1	-3.2
Financing 1/	7.1	1.0	1.0	0.8	0.8	1.0	1.1	1.1	1.1	4.0	4.2	3.1	3.2
External	1.2	0.0	0.0	0.3	0.2	0.7	0.6	1.4	0.5	2.5	1.4	2.0	1.0
Of which: privatization receipts	0.0	0.0	0.0	0.1	0.0	0.2	0.0	0.9	0.0	1.1	0.0	0.3	0.2
Domestic	6.0	1.0	1.0	0.5	0.6	0.3	0.5	-0.3	0.6	1.6	2.8	1.1	2.2
Bank	5.0	0.8	0.8	0.3	0.6	0.1	0.3	-0.5	0.4	0.7	2.1	0.6	1.7
Nonbank	1.0	0.2	0.2	0.2	0.0	0.2	0.2	0.2	0.2	0.9	0.7	0.5	0.6
Privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure 5/	21.9	4.0	4.1	4.5	4.4	4.8	5.0	6.0	6.3	19.3	19.8	19.3	19.3
Primary balance (excluding grants)	-2.8	0.0	0.0	0.3	0.4	0.0	0.0	0.0	0.1	0.4	0.4	1.4	1.3
Primary balance (including grants)	-2.5	0.0	0.0	0.4	0.4	0.1	0.1	0.1	0.1	0.6	0.6	1.6	1.5
Defense spending	2.7	0.6	0.6	0.5	0.5	0.6	0.6	0.6	0.7	2.3	2.5	2.4	2.5
Total government debt 6/	57.4	…	…	…	…	…	…	…	…	54.6	56.9	52.4	55.4
Domestic debt	31.2	…	…	…	…	…	…	…	…	27.7	29.1	25.4	29.1
External debt 6/	26.2	…	…	…	…	…	…	…	…	26.9	27.9	27.1	26.2
Nominal GDP (market prices, billions of Pakistani rupees)	10,478.2	13,384	12,970	13,384	12,970	13,384	12,970	13,384	12,970	13,384	12,970	15,880	14,298

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

1/ For 2007/08, financing figures are provided by the Ministry of Finance.
2/ In 2007/08, PR 23 billion (0.2 percent of GDP) of current expenditure has been reclassified as development expenditure.
3/ Comprises BISP, Bait-ul-Mal, and Pakistan Poverty Alleviation Fund.
4/ The statistical discrepancy is believed to arise mainly from double-counting of spending at the provincial level.
5/ Includes statistical discrepancy and spending related to the 2005 earthquake.
6/ Excludes military debt, commercial loans, and short-term debt.

Table 4. Pakistan: Monetary Survey and Analytical Balance Sheet of the State Bank of Pakistan, 2007/08–2009/10

	2007/08	2008/09							2009/10	
		Sept.	Dec.		Mar.		Jun.		Prog.	Proj.
		Act.	Prog.	Act.	Prog.	Proj.	Prog.	Proj.		
	(In billions of Pakistani rupees)									
Monetary survey										
Net foreign assets (NFA)	668	486	295	376	229	370	438	509	530	436
Net domestic assets (NDA)	4,022	4,188	4,536	4,416	4,638	4,413	4,759	4,574	5,494	5,187
Net claims on government, *of which:*	1,473	1,578	1,593	1,692	1,596	1,742	1,535	1,803	1,642	2,051
Budget support	1,325	1,430	1,473	1,506	1,485	1,543	1,417	1,595	1,514	1,833
Commodity operations	127	113	100	138	91	179	137	227	147	237
Credit to nongovernment	3,018	3,172	3,410	3,283	3,573	3,318	3,794	3,340	4,522	3,805
Private sector	2,904	2,995	3,221	3,107	3,373	3,123	3,636	3,145	4,343	3,590
Public sector enterprises	114	177	189	175	200	195	159	195	179	215
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3
Other items, net	-466	-559	-463	-555	-528	-645	-567	-566	-667	-666
Broad money	4,689	4,674	4,831	4,792	4,867	4,783	5,197	5,082	6,024	5,623
Currency	982	1,107	1,168	1,124	1,190	1,226	1,156	1,192	1,301	1,245
Rupee deposits	3,443	3,279	3,369	3,391	3,372	3,271	3,737	3,587	4,379	4,035
Foreign currency deposits	263	287	295	276	305	286	303	303	343	343
State Bank of Pakistan (SBP)										
NFA	480	308	101	186	57	163	236	280	276	210
NDA	1,000	1,250	1,346	1,270	1,412	1,281	1,314	1,241	1,472	1,466
Net claims on government	1,015	1,240	1,273	1,236	1,273	1,221	1,167	1,167	1,167	1,167
Of which: budget support	1,016	1,227	1,274	1,222	1,274	1,222	1,181	1,181	1,181	1,181
Claims on nongovernment	-7	-7	-7	-7	-7	-7	-7	-7	-7	-7
Claims on scheduled banks	227	224	249	283	249	283	249	327	279	357
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3
Other items, net	-231	-204	-166	-238	-100	-213	-91	-242	37	-48
Reserve money, *of which:*	1,480	1,559	1,447	1,456	1,469	1,444	1,551	1,522	1,748	1,675
Banks' reserves	425	381	289	241	292	287	321	256	373	357
Currency	1,051	1,174	1,158	1,211	1,177	1,157	1,225	1,261	1,370	1,314
	(Annual percentage change, unless otherwise indicated)									
Broad money	15.3	13.4	9.6	8.7	10.4	8.5	10.8	8.4	15.9	10.6
NFA, banking system (in percent of broad money) 1/	-7.8	-10.2	-11.4	-9.8	-10.1	-7.4	-4.9	-3.4	1.8	-1.4
NDA, banking system (in percent of broad money) 1/	23.2	22.0	20.2	17.8	19.6	15.2	15.7	11.8	14.1	12.1
Budgetary support (in percent of broad money) 1/	12.5	11.7	9.0	9.8	7.5	8.9	1.9	5.7	1.9	4.7
NFA, banking system	-32.2	-49.5	-65.1	-55.5	-68.3	-48.7	-34.5	-23.8	20.9	-14.3
NDA, banking system	30.6	32.6	27.3	24.0	25.8	19.7	18.4	13.7	15.4	13.4
Budgetary support	62.4	61.6	41.8	45.0	32.7	37.9	6.9	20.3	6.9	14.9
Private credit	16.4	20.2	16.8	12.7	18.4	9.6	25.2	8.3	19.5	14.1
Currency	16.9	26.6	15.9	11.5	21.2	24.8	17.7	21.3	12.6	4.4
Reserve money	22.3	27.9	5.8	6.5	9.8	7.9	5.4	2.8	12.7	10.1
NFA, SBP (in percent of reserve money) 1/	-25.4	-30.7	-43.1	-37.0	-36.9	-30.2	-16.6	-13.5	2.6	-4.6
NDA, SBP (in percent of reserve money) 1/	47.7	52.5	48.6	43.1	45.8	37.5	22.0	16.3	10.2	14.7
Net claims on government (in percent of reserve money) 1/	56.9	59.3	51.7	48.8	36.9	34.0	10.3	10.3	0.0	0.0
Memorandum items:										
Velocity	2.2	...	...	...	...	...	2.6	2.6	2.6	2.5
Money multiplier	3.2	3.0	3.3	3.3	3.3	3.3	3.4	3.3	3.4	3.4
Currency to broad money ratio (percent)	20.9	23.7	24.2	23.5	24.5	25.6	22.2	23.4	21.6	22.1
Currency to deposit ratio (percent)	26.5	31.0	31.9	30.7	32.4	34.5	28.6	30.6	27.6	28.4
Reserves to deposit ratio (percent)	11.5	10.7	7.9	6.6	7.9	8.1	7.9	6.6	7.9	8.2
Budget bank financing (billions of Pakistani rupees), *of which:*	509	105	147	181	160	217	91	269	97	238
By commercial banks	-167	-106	-111	-26	-98	11	-74	104	97	238
By SBP	677	211	258	207	258	206	165	165	0	0
NFA of SBP (change from beginning of the year in U.S. dollar billions) 2/	-4.5	-2.2	-4.4	-3.7	-5.0	-3.9	-2.9	-2.4	0.4	-0.8
NFA of commercial banks (billions of Pakistani rupees)	187	177	193	189	172	207	201	228	254	226
NDA of commercial banks (billions of Pakistani rupees)	3,022	2,938	3,191	3,146	3,226	3,132	3,445	3,332	4,022	3,721

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

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

Table 5. Pakistan: Medium-Term Macroeconomic Framework, 2007/08–2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
		Projections					
				(In percent of GDP)			
Saving and investment							
Current account balance	-8.4	-5.9	-4.3	-4.3	-4.3	-4.2	-3.7
Gross national saving	13.2	14.2	15.6	17.3	18.6	19.7	21.5
Government saving	-2.8	-0.9	0.8	2.5	3.3	3.6	4.1
Non-government saving	16.0	15.1	14.8	14.7	15.3	16.0	17.4
Gross capital formation	21.6	20.1	19.9	21.6	22.9	23.9	25.2
Government	4.3	3.2	4.0	5.2	5.6	5.5	5.9
Nongovernment (including public sector enterprises)	17.2	16.9	15.9	16.4	17.3	18.3	19.3
		(In billions of U.S. dollars, unless otherwise indicated)					
Balance of payments							
Current account balance	-14.0	-9.6	-7.4	-7.8	-8.4	-8.7	-8.3
Net capital flows 1/	8.2	5.2	6.9	8.6	10.7	12.2	12.7
Of which: foreign direct investment 2/	5.2	3.8	4.1	4.4	5.2	5.8	6.1
Gross official reserves	8.6	9.1	10.6	11.1	11.9	11.9	12.9
In months of imports 3/	2.7	3.0	3.3	3.2	3.2	3.0	3.0
External debt (in percent of GDP)	26.5	31.6	32.4	32.2	31.3	29.5	27.7
				(In percent of GDP)			
Public finances							
Revenue and grants	14.6	15.4	16.0	16.8	17.4	17.6	17.9
of which: tax revenue	10.4	11.0	11.9	12.7	13.5	13.9	14.2
Expenditure (incl. stat. discr.), *of which:*	21.7	19.8	19.2	19.4	19.7	19.5	19.7
Current	17.7	16.0	15.2	14.2	14.1	14.0	13.8
Development	4.0	3.0	4.0	5.2	5.6	5.5	5.9
Primary balance 4/	-2.5	0.6	1.5	0.9	0.8	0.9	0.7
Overall fiscal balance 4/	-7.1	-4.2	-3.2	-2.6	-2.3	-1.9	-1.7
Underlying fiscal balance 5/	-7.3	-4.4	-3.3	-3.0	-2.7	-2.3	-2.1
Total government debt	57.4	56.9	55.4	54.1	52.1	49.9	47.5
				(Annual changes in percent)			
Output and prices							
Real GDP at factor cost	5.8	2.5	4.0	5.0	6.0	6.5	7.0
Consumer prices (period average)	12.0	20.0	6.0	5.5	5.5	5.5	6.0
Memorandum items							
Real per capita consumption (percentage change)	12.0	3.3	2.5	2.7	3.0	3.3	3.6

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

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

Table 6. Pakistan: Medium-Term Balance of Payments, 2007/08–2013/14
(In millions of U.S. dollars; unless otherwise indicated)

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
		Projections					
Current account	-14,036	-9,643	-7,407	-7,799	-8,356	-8,702	-8,277
Balance on goods	-15,295	-11,274	-9,316	-10,075	-10,572	-11,282	-11,633
Exports, f.o.b.	20,122	19,015	19,311	20,508	22,148	23,920	25,954
Imports, f.o.b.	-35,417	-30,290	-28,627	-30,583	-32,720	-35,202	-37,587
Services (net)	-6,307	-3,872	-3,526	-3,814	-4,200	-4,533	-4,854
Services: credit	3,590	3,805	3,873	4,117	4,440	4,798	5,206
Services: debit	-9,897	-7,677	-7,399	-7,931	-8,640	-9,331	-10,060
Income (net)	-3,909	-4,234	-4,062	-4,181	-4,549	-4,790	-4,653
Income: credit	1,613	1,200	1,218	1,235	1,273	1,337	1,407
Income: debit	-5,522	-5,434	-5,279	-5,416	-5,821	-6,127	-6,060
Of which: interest payments	-2,161	-2,158	-1,873	-1,826	-1,990	-2,050	-1,983
Balance on goods, services, and income	-25,511	-19,380	-16,904	-18,071	-19,321	-20,604	-21,141
Of which: income on direct investment	-3,361	-3,276	-3,407	-3,591	-3,831	-4,077	-4,361
Current transfers (net)	11,475	9,737	9,497	10,272	10,965	11,903	12,864
Current transfers: credit, *of which:*	11,617	9,875	9,603	10,380	11,073	12,011	12,972
Workers' remittances	6,451	7,200	7,000	7,280	7,717	8,334	9,043
Other private transfers	4,666	2,500	2,500	2,600	2,756	2,976	3,229
Current transfers: debit	-142	-138	-106	-108	-108	-108	-108
Capital account	119	121	284	277	200	206	212
Capital transfers: credit	126	127	295	288	211	217	223
Of which: official capital grants	109	108	271	179	100	100	100
Capital transfers: debit	-7	-6	-11	-11	-11	-11	-11
Financial account	7,657	5,459	6,628	8,320	10,470	11,954	12,510
Direct investment abroad	-75	-34	-80	-50	-10	-9	-8
Direct investment in Pakistan	5,153	3,800	4,066	4,400	5,200	5,800	6,100
Of which: privatization receipts	133	0	266	300	300	300	200
Portfolio investment (net), *of which:*	36	-957	-322	978	2,050	2,550	2,900
Eurobond/GDR	-25	-525	-522	478	1,500	1,600	1,700
Other investment assets	-219	-445	-95	-135	-147	-160	-173
General government	5	5	5	5	5	5	5
Banks	276	-350	100	100	100	100	100
Other sectors	-500	-100	-200	-240	-252	-265	-278
Other investment liabilities	2,762	3,095	3,059	3,127	3,377	3,772	3,691
Monetary authorities	490	0	0	0	0	0	0
General government, *of which:* 3/	1,787	2,773	1,930	1,960	2,269	2,645	2,584
Disbursements (medium and long term)	2,549	4,197	3,287	3,500	3,500	4,000	4,000
Amortization (medium and long term)	-1,108	-1,481	-1,211	-1,140	-1,231	-1,355	-1,416
Banks	66	-212	300	300	300	300	300
Other sectors	419	534	829	867	808	827	806
Net errors and omissions	472	-404	0	0	0	0	0
Reserves and related items	5,788	4,467	495	-798	-2,315	-3,458	-4,445
Reserve assets, *of which:*	5,961	-188	-1,850	-880	-1,200	-420	-1,450
Foreign exchange (State Bank of Pakistan)	5,711	-500	-1,500	-500	-800	0	-1,000
Foreign exchange (deposit money banks)	250	312	-350	-380	-400	-420	-450
Use of Fund credit and loans	-173	4,555	2,345	82	-1,115	-3,038	-2,995
Exceptional financing	0	100	0	0	0	0	0
Memorandum items:							
Current account (in percent of GDP; including official transfers)	-8.4	-5.9	-4.3	-4.3	-4.3	-4.2	-3.7
Current account (in percent of GDP; excluding fuel imports)	-2.1	-0.2	-0.3	0.2	0.5	0.9	1.4
Exports f.o.b. (growth rate, in percent)	16.5	-5.5	1.6	6.2	8.0	8.0	8.5
Imports f.o.b. (growth rate, in percent)	31.2	-14.5	-5.5	6.8	7.0	7.6	6.8
Imports f.o.b. (growth rate, in percent, excluding oil)	26.8	-15.4	2.2	4.1	4.3	5.9	6.3
Oil imports (in million of U.S. dollars, cif)	10,495	9,250	6,957	8,089	9,318	10,466	11,310
Crude oil price ($/bbl)	87.0	80.0	45.8	52.3	56.8	59.9	62.3
Terms of trade (growth rate, in percent)	-10.2	...	...	...	...	...	...
Workers' remittances and other private transfers (growth rate, in percent)	9.9	-12.7	-2.1	4.0	6.0	8.0	8.5
External debt (in millions of U.S. dollars)	44,468	51,454	55,402	58,161	60,484	61,240	61,957
Gross financing needs (in millions of U.S. dollars) 1/	15,367	12,659	10,340	9,940	11,026	13,418	13,011
End-period gross official reserves (millions of U.S. dollars) 2/	8,591	9,091	10,591	11,091	11,891	11,891	12,891
(In months of next year's imports of goods and services)	2.7	3.0	3.3	3.2	3.2	3.0	3.0
GDP (in millions of U.S. dollars)	167,640	162,627	171,015	180,762	193,106	207,428	223,959

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

1/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
2/ Excluding foreign currency deposits held with the State Bank of Pakistan (cash reserve requirements) and gold.
3/ For 2009/10–2013/14, includes unidentified disbursements from official creditors.

Table 7. Pakistan: Medium-Term Fiscal Framework, 2007/08–2013/14 1/

(In percent of GDP; unless otherwise indicated)

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
		Projections					
Revenue and grants	14.6	15.4	16.0	16.8	17.4	17.6	17.9
Tax revenue	10.4	11.3	11.9	12.7	13.5	13.9	14.2
Of which: Federal Board of Revenue	9.6	10.0	10.6	11.4	12.2	12.7	13.1
Nontax revenue	3.9	3.9	3.8	3.7	3.5	3.4	3.3
Grants	0.3	0.2	0.2	0.4	0.4	0.4	0.4
Expenditure	21.8	19.6	19.2	19.4	19.7	19.5	19.7
Current expenditure 2/	17.7	16.1	15.2	14.2	14.1	14.0	13.8
Interest	4.7	4.8	4.7	3.5	3.1	2.8	2.5
Other federal 2/	8.9	7.3	6.3	6.4	6.6	6.7	6.9
Provincial	4.2	4.0	4.2	4.3	4.4	4.5	4.5
Development expenditure 2/	4.3	3.2	4.0	5.2	5.6	5.5	5.9
Of which : one-off outlays 3/	0.2	0.2	0.1	0.0	0.0	0.0	0.0
Net-lending	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Overall balance							
Underlying (excluding grants and one-off outlays)	-7.3	-4.4	-3.3	-3.0	-2.7	-2.3	-2.1
Excluding grants	-7.4	-4.3	-3.4	-3.0	-2.7	-2.3	-2.1
Including grants	-7.1	-4.2	-3.2	-2.6	-2.3	-1.9	-1.7
Financing	7.1	4.2	3.2	2.6	2.3	1.9	1.7
External	1.2	1.4	1.0	1.5	2.1	2.0	1.8
Of which : privatization receipts	0.0	0.0	0.2	0.2	0.4	0.1	0.1
Domestic	6.0	2.8	2.2	1.1	0.2	0.0	0.0
Memorandum items:							
Primary balance							
Excluding grants	-2.8	0.4	1.3	0.5	0.4	0.5	0.4
Including grants	-2.5	0.6	1.5	0.9	0.8	0.9	0.7
Interest payments/revenue (ratio)	32.7	31.4	30.1	21.5	18.5	16.4	14.1
Total government debt 4/	57.4	56.9	55.4	54.1	52.1	49.9	47.5
External	26.2	27.9	26.2	26.2	26.3	26.3	26.0
Domestic	31.2	29.1	29.1	27.9	25.8	23.6	21.4
Nominal GDP (billions of Pakistani rupees)	10,478	12,970	14,298	15,838	17,712	19,901	22,572

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

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

2/ Projection for 2007/08 includes as development expenditure 0.3 percent of GDP corresponding to items classified as current expenditure in earlier years. Reclassification is maintained in all projection years.

3/ Spending related to the 2005 earthquake.

4/ Excludes military debt, commercial loans, and short-term debt.

Table 8. Pakistan: External Debt, 2007/08–2015/16

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

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
		Projections							
Total external debt	44,469	51,454	55,402	58,161	60,484	61,640	62,657	64,255	65,895
Public and public guaranteed debt (excl. IMF)	40,245	42,518	43,826	46,264	49,533	53,678	57,762	60,438	62,171
Medium- and long-term debt	39,432	41,648	43,102	45,940	49,209	53,354	57,438	59,914	61,647
Multilateral creditors	21,583	23,464	25,133	27,110	29,129	31,345	33,518	35,106	36,579
ADB	9,401	10,665	11,848	13,104	14,403	15,662	16,880	18,064	19,230
World Bank	11,532	12,186	12,792	13,546	14,297	15,282	16,267	16,701	17,036
Other	651	613	493	460	430	401	370	341	314
Bilateral creditors	15,181	16,030	16,440	16,823	17,073	17,503	17,914	18,302	18,661
Paris Club	13,936	13,790	13,660	13,521	13,370	13,201	13,011	12,796	12,549
Non-paris club	1,245	2,240	2,780	3,302	3,703	4,302	4,903	5,506	6,112
Bonds	2,650	2,150	1,528	2,006	3,006	4,506	6,006	6,506	6,406
Of which: Euro bond	2,650	2,150	1,528	2,006	3,006	4,506	6,006	6,506	6,406
Commercial banks and others	65	4	0	0	0	0	0	0	0
Short-term debt	813	870	724	324	324	324	324	524	524
IDB	713	870	724	324	324	324	324	524	524
Private sector debt	2,887	3,175	3,470	3,709	3,878	3,926	3,854	3,774	3,724
Of which:									
Multilateral creditors	322	…	…	…	…	…	…	…	…
Paris Club creditors	1,274	…	…	…	…	…	…	…	…
Non-paris club creditors	9	…	…	…	…	…	…	…	…
Other	1,007	…	…	…	…	…	…	…	…
IMF	1,337	5,761	8,106	8,188	7,074	4,036	1,041	42	0

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

Table 9. Pakistan: Gross Financing Requirements and Sources, 2007/08–2009/10

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

	2007/08	2008/09	2009/10
		Projections	
Gross external financing requirements	15,367	12,659	10,340
Current account deficit (if surplus = -)	14,036	9,643	7,407
Maturing short-term debt	25	813	870
Amortization of medium- and long-term debt	1,306	2,203	2,063
Medium and long-term to external private creditors	25	525	622
Medium and long-term to external official creditors	1,281	1,678	1,441
IMF	173	197	230
To other official creditors	1,108	1,481	1,211
Of which:			
Paris club	244	178	190
Asian Development Bank (ADB)	354	372	446
World Bank (WB)	422	392	398
Islamic Development Bank (IDB)	20	200	20
Available financing	15,367	12,659	10,340
Net FDI (including privatization receipts)	5,078	3,766	3,986
Roll-over of short-term debt	813	870	724
Medium- and long-term borrowing	2,549	8,949	5,862
GDRs (public)	0	0	0
Other net capital inflows	1,216	-426	1,268
Reserve accumulation (decrease = +)	5,711	-500	-1,500
Memorandum items:			
Use of Fund resources	…	4,752	2,575
Gross international reserves in US$ billions	8.6	9.1	10.6
In months of imports	2.7	3.0	3.3
In percent of short-term external debt	1,057	1,045	1,463

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

Table 10. Pakistan: Indicators of Fund Credit

(In millions of SDR unless otherwise specified)

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	Projected Debt Service to the Fund based on Existing and Prospective Drawings								
PRGF									
Principal 1/	137.7	155.1	172.3	163.7	120.6	51.7	17.2	0.0	0.0
Interest and charges 1/	4.0	3.1	2.2	1.4	0.6	0.2	0.0	0.0	0.0
Stand-by Arrangements									
Principal	0.0	0.0	0.0	587.9	1927.9	1967.9	656.4	28.4	0.0
Interest and charges	42.9	128.3	186.3	189.9	140.0	56.8	13.0	0.6	0.0
	Projected Level of Credit Outstanding based on Existing and Prospective Drawings								
Total	3885.0	5466.5	5521.7	4770.1	2721.6	702.0	28.4	0.0	0.0
PRGF Arrangements	680.5	525.4	353.2	189.5	68.9	17.2	0.0	0.0	0.0
Stand-by Arrangements	3204.5	4941.1	5168.5	4580.6	2652.7	684.8	28.4	0.0	0.0
	Projected Debt Service to the Fund based on Existing and Prospective Drawings								
Total 1/	184.6	286.4	360.8	942.8	2,189.1	2,076.6	686.7	29.0	0.0
Of which:									
Principal	137.7	155.1	172.3	751.6	2,048.5	2,019.6	673.6	28.4	0.0
Interest and charges	46.9	131.4	188.5	191.2	140.6	57.0	13.0	0.6	0.0
In percent of exports of goods and non-factor services	1.2	1.8	2.2	5.3	11.3	9.9	3.0	0.1	0.0
In percent of GDP	0.2	0.2	0.3	0.7	1.6	1.4	0.4	0.0	0.0
In percent of gross international reserves	3.0	4.0	4.8	11.8	27.3	23.9	6.8	0.2	0.0
Memorandum items									
Exports of goods and NFS (in millions of U.S. dollars)	22,820	23,184	24,624	26,588	28,718	31,160	33,807	36,512	39,433
Quota	1,034								
GDP (in millions of U.S. dollars)	162,627	171,015	180,762	193,106	207,428	223,959	244,244	266,367	290,494
Gross international reserves (in millions of U.S. dollars)	9,091	10,591	11,091	11,891	11,891	12,891	14,991	18,191	19,991

Source: Fund staff projections.

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

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

Review	Available Date	Action	Purchase in millions of SDRs	Purchase in percent of quota
	November 24, 2008	Board approval of SBA	2,067.40	200
First Review	March 30, 2009	Observance of end-December 2008 performance criteria, completion of first review	568.54	55
Second Review	June 15, 2009	Observance of end-March 2009 performance criteria, completion of second review	568.54	55
Third Review	September 15, 2009	Observance of end-June 2009 performance criteria , completion of third review	434.15	42
Fourth Review	December 15, 2009	Observance of end-September 2009 performance criteria, completion of fourth review	434.15	42
Fifth Review	March 15, 2010	Observance of end-December 2009 performance criteria, completion of fifth review	434.15	42
Sixth Review	June 15, 2010	Observance of end-March 2010 performance criteria, completion of sixth review	434.15	42
Seventh Review	September 15, 2010	Observance of end-June 2010 performance criteria, completion of seventh review	227.42	22
	Total		5,168.50	500

Source: Fund staff.

Table 12. Pakistan: Selected Vulnerability Indicators, 2007/08–2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
		Projections					
Key economic and market indicators							
Real GDP growth (market prices, in percent)	6.0	2.5	4.0	5.0	6.0	6.5	7.0
CPI inflation (period average, in percent)	12.0	20.0	6.0	5.5	5.5	5.5	6.0
Short-term (ST) interest rate (in percent)	11.5	...	...	...	...	...	...
Emerging market bond index (EMBI) secondary market spread (basis points, end of period) 1/	687	1920	...	...	...	...	...
Exchange rate PRs/US$ (end of period)	68.2	...	...	...	...	...	...
External sector							
Exchange rate regime				Floating since January 2008			
Current account balance (percent of GDP)	-8.4	-5.9	-4.3	-4.3	-4.3	-4.2	-3.7
Net FDI inflows (percent of GDP)	3.0	2.3	2.3	2.4	2.7	2.8	2.7
Exports (percentage change of U.S. dollar value; GNFS)	10.7	-3.8	1.6	6.2	8.0	8.0	8.5
Real effective exchange rate (2000=100, annual average)	97.1	...	...	...	...	...	...
Gross international reserves (GIR) in billions of U.S. dollars	8.6	9.1	10.6	11.1	11.9	11.9	12.9
GIR in percent of ST debt at remaining maturity (RM) 2/	441.5	316.1	414.2	746.3	764.6	708.3	741.0
GIR in percent of ST debt at RM and banks' foreign exchange (FX) deposits 1/	147.9	141.0	161.2	202.7	204.6	190.4	192.9
Total gross external debt (ED) in percent of GDP, *of which:*	26.5	31.6	32.4	32.2	31.3	29.5	27.7
ST external debt (original maturity, in percent of total ED)	1.8	1.7	1.3	0.6	0.5	0.5	0.5
ED of domestic private sector (in percent of total ED)	6.5	6.2	6.3	6.4	6.4	6.4	6.2
ED to foreign official sector (in percent of total ED)	93.5	93.8	93.7	93.6	93.6	93.6	93.8
Total gross external debt in percent of exports	187.5	225.5	239.0	236.2	227.5	213.2	198.8
Gross external financing requirement (in billions of U.S. dollars) 3/	15.4	12.7	10.3	9.9	11.0	13.4	13.0
Public sector 4/							
Overall balance (including grants, in percent of GDP)	-7.1	-4.2	-3.2	-2.6	-2.3	-1.9	-1.7
Primary balance (including grants, percent of GDP)	-2.5	0.6	1.5	0.9	0.8	0.9	0.7
Debt-stabilizing primary balance (percent of GDP) 5/	-2.1	-1.0	-0.5	-0.8	-1.5	-1.8	-2.4
Gross PS financing requirement (in percent of GDP) 6/	24.2	20.8	19.8	17.9	16.3	14.7	13.3
Public sector gross debt (in percent of GDP)	57.4	56.9	55.4	54.1	52.1	49.9	47.5
Public sector net debt (in percent of GDP) 7/	51.7	51.3	49.7	48.5	46.5	44.3	41.8
Financial sector 8/							
Capital adequacy ratio (in percent) 9/	12.1	...	...	...	...	...	...
Nonperforming loans (NPLs) in percent of total loans 9/	10.2	...	...	...	...	...	...
Provisions in percent of NPLs 9/	75.0	...	...	...	...	...	...
Return on average assets (in percent) 9/	1.7	...	...	...	...	...	...
Return on equity (in percent) 9/	16.7	...	...	...	...	...	...
FX deposits held by residents (in percent of total deposits)	7.1	7.8	7.8	...	...	...	...
Government debt held by FS (percent of total FS assets)	31.4	35.5	36.5	...	...	...	...
Credit to private sector (percent change)	16.4	8.3	14.1	...	...	...	...
Memorandum item:							
Nominal GDP (in billions of U.S. dollars)	167.6	162.6	171.0	180.8	193.1	207.4	224.0

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

1/ 2008/09: spread on March 4, 2009.
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/ Net debt is defined as gross debt minus government deposits with the banking system.
8/ Financial sector includes all commercial and specialized banks; for government debt also includes non-banks, but excludes State Bank of Pakistan.
9/ For 2005/06 data are on a calendar year basis (e.g., the value for 2005/06 denotes the observation for end-December 2005).

Table 13. Pakistan: Financial Soundness Indicators for the Banking System, 2002–08
(At end-December)

	2002	2003	2004	2005	2006	2007	2008
Capital adequacy							
Regulatory capital to risk-weighted assets	8.8	8.5	10.5	11.3	12.7	13.2	12.2
Tier I capital to risk-weighted assets	6.2	6.5	7.6	8.3	10.0	10.5	10.2
Capital to total assets	4.8	5.5	6.7	7.9	9.4	10.5	10.4
Asset composition and quality							
Nonperforming loans (NPLs) to gross loans	21.8	17.0	11.6	8.3	6.9	7.2	9.1
Provisions to NPLs	60.6	63.9	70.4	76.7	77.8	85.1	74.7
NPLs net of provisions to capital	85.5	54.4	29.2	14.3	9.7	5.6	13.6
Earnings and profitability							
Return on assets (after tax)	0.1	1.0	1.2	1.9	2.1	1.5	1.2
Return on equity (after tax)	3.2	20.0	20.3	25.8	23.8	15.5	11.3
Net interest income to gross income	67.1	59.2	62.8	72.0	70.9	68.3	70.7
Noninterest expenses to gross income	59.1	50.5	52.0	41.5	40.3	43.0	49.1
Liquidity							
Liquid assets to total assets	46.7	45.1	36.6	33.7	31.9	33.6	27.5
Liquid assets to total deposits	61.8	58.5	46.5	43.5	42.7	45.1	36.9

Source: Pakistani authorities.

Table 14. Pakistan: Millennium Development Goals, 1990–2007 1/

	1990	1995	2000	2005	2007
Goal 1: Eradicate extreme poverty and hunger					
Percentage share of income or consumption held by poorest 20 percent	...	...	6.6	...	...
Population below US$1 a day (in percent)	47.8	...	17.0	...	...
Population below minimum level of dietary energy consumption (in percent)	24.0	19.0	...	24.0	...
Poverty gap ratio at US$1 a day (incidence x depth of poverty)	14.6	...	3.1	...	...
Poverty headcount, national (in percent of population)	26.1	28.6	32.6	23.9	...
Prevalence of underweight in children (under five years of age)	40.2	38.2	35.0	...	...
Goal 2: Achieve universal primary education					
Net primary enrollment ratio (in percent of relevant age group)	33.0	...	57.2	52.0	65.6
Primary completion rate, total (in percent of relevant age group)	...	...	..	72.0	61.8
Proportion of pupils starting grade 1 who reach grade 5	...	...	..	72.0	30.0
Youth literacy rate (in percent ages 15–24)	47.4	...	57.0	...	61.3
Goal 3: Promote gender equality and empower women					
Proportion of seats held by women in national parliament (in percent)	10.0	...	2.0	21.3	...
Ratio of girls to boys in primary and secondary education (in percent)	...	...	69.0	0.85 (P) 0.83 (S)	78.0
Ratio of young literate females to males (in percent ages 15–24)	49.0	...	...	67.0	...
Share of women employed in the nonagricultural sector (in percent)	6.6	7.5	7.4	10.0	...
Goal 4: Reduce child mortality					
Immunization, measles (in percent of children ages 12–23 months)	50.0	47.0	56.0	77.0	80.0
Infant mortality rate (per 1,000 live births)	100.0	93.0	85.0	73.0	77.8
Under 5 mortality rate (per 1,000)	130.0	118.0	108.0	100.0	97.2
Goal 5: Improve maternal health					
Births attended by skilled health staff (in percent of total)	18.8	18.0	23.0	48.0	31.0
Maternal mortality ratio (modeled estimate, per 100,000 live births)	550.0	...	500.0	400.0	320.0
Goal 6: Combat HIV/AIDS, malaria, and other diseases					
Contraceptive prevalence rate (in percent of women ages 15–49)	14.0	23.9	27.6	36.0	...
Incidence of tuberculosis (per 100,000 people)	181.0	181.0	181.0	160.0	...
Number of children orphaned by HIV/AIDS	...	...	...	...	...
Prevalence of HIV, total (in percent of population aged 15–49)	...	...	...	...	0.1
Tuberculosis cases detected under DOTS (in percent)	...	1.0	2.8	40.0	
Goal 7: Ensure environmental sustainability					
Access to an improved water source (in percent of population)	83.0	...	90.0	...	90.0
Access to improved sanitation (in percent of population)	38.0	...	54.0	54.0	...
Access to secure tenure (in percent of population)	...	...	...	...	...
CO2 emissions (metric tons per capita)	0.6	0.7	0.8	0.8	0.8
Forest area (in percent of total land area)	3.3	...	2.7	...	2.5
GDP per unit of energy use (Value added in Rs 1980/81 per ton of oil equivalent)	3.9	4.0	4.2	...	4.5
Nationally protected areas (in percent of total land area)	9.1	...	...	11.3	...
Goal 8: Develop a global partnership for development					
Aid per capita (current U.S. $)	10.5	6.7	5.4	11.0	...
Debt service (in percent of exports)	21.3	26.5	25.2	19.7	...
Fixed line and mobile phone subscribers (per 1,000 people)	7.8	17.7	24.3	116.0	516.0
Internet users (per 1,000 people)	0.0	0.0	2.2	67.0	107.8
Personal computers (per 1,000 people)	1.4	3.7	4.3	...	...
Unemployment, youth female (in percent of female labor force ages 15–24)	1.3	18.1	29.2	14.9	...
Unemployment, youth male (in percent of male labor force ages 15–24)	5.7	7.6	11.1	11.0	...
Unemployment, youth total (in percent of total labor force ages 15–24)	5.1	8.9	13.3	11.7	...
Other					
Fertility rate, total (births per woman)	5.8	5.2	4.7	3.5	...
GNI per capita, Atlas method (current U.S. $)	420	490	480	690	...
GNI, Atlas method (current U.S. $, billions)	45.5	59.8	66.5	107.3	...
Gross capital formation (in percent of GDP)	18.9	18.5	17.4	16.8	22.9
Life expectancy at birth, total (years)	59.1	60.9	63.0	65.0	...
Literacy rate, adult total (in percent of people ages 10 and above)	35.4	...	43.0	53♦	...
Population, total (millions)	108.0	122.4	138.1	155.8	...
Trade (in percent of GDP)	32.6	30.8	28.4	35.2	...

Sources: Pakistani authorities; Pakistan Millennium Development Goals Report (2004–06); World Development Indicators database (2007); and Fund staff estimates.

1/ When data for a particular year are missing, the value reported corresponds to the closest year where data for that indicator are available.

*Aged 10 and above

*Aged 15 and above

Appendix I. Pakistan: Debt Sustainability Analysis

A. External Debt Sustainability Analysis

1. ***Pakistan's external debt burden has been relatively moderate in recent years as a result of successive debt relief undertaken in the late 1990s and early 2000s***. At end FY 2007/08, external debt stock stood at around 26½ percent of GDP (Table 1), and debt service was about 15 percent of exports of goods and services. Most of its debt were public sector debt—owed largely to official creditors, and there were limited private sector debt.

2. ***The debt ratio is projected to rise temporarily due to significant increase in external financing from official creditors (including the Fund) to help Pakistan with the recent balance of payments pressure***. The debt stock would be around 32½ percent of GDP during 2008/09–2010/11, and then gradually decline about 27½ percent of GDP by 2013/14.

3. ***The debt service burden would increase but remain manageable during the projection period***. Debt service as a ratio of exports of goods and receipts is projected to increase to 20 percent under the baseline scenario. This increase is sizable but debt service burden will decline markedly following repurchase of outstanding Fund credits.

4. ***The relatively benign debt outlook under the baseline scenario is subject to serious downside risks***. They include risks from higher non-interest current account deficit, lower growth, higher depreciation, higher interest rates, as well as lower FDI flows (Figure 1). The standard bound tests show that debt ratios are sensitive to shocks to higher current account deficits, large depreciation of exchange rate, and lower FDI inflows given the large financing needs. For example, if non-interest current account deficits are higher by half of the ten-year standard deviation, the debt as a ratio to GDP would rise sharply and be over 10 percentage points higher than under the baseline scenario. Combined shocks to growth, current account, and depreciation could vault the end-period debt stock to around 45 percent of GDP, significantly higher than under the baseline scenario.

B. Public Sector Debt Sustainability Analysis

5. ***Pakistan's public sector debt burden declined through 2006/07, but has been rising since then, reflecting the expansionary fiscal stance***. At end FY 2007/08, the public sector debt stock stood at 57.4 percent of GDP (Table 2), with domestic public debt (31.2 percent of GDP) slightly exceeding external public debt (26.2 percent of GDP). Interest payments (4.7 percent of GDP) are a significant burden for the budget, accounting for 32.6 percent of total revenue (excluding grants) and 26.3 percent of current expenditures. Interest payments on domestic debt accounted for only 12 percent of total interest expenditure, partially reflecting that official creditors account for the bulk of total external debt.

6. ***The public debt ratio is projected to decline gradually, reflecting fiscal consolidation and lower interest rates in line with macroeconomic stabilization***. The stock

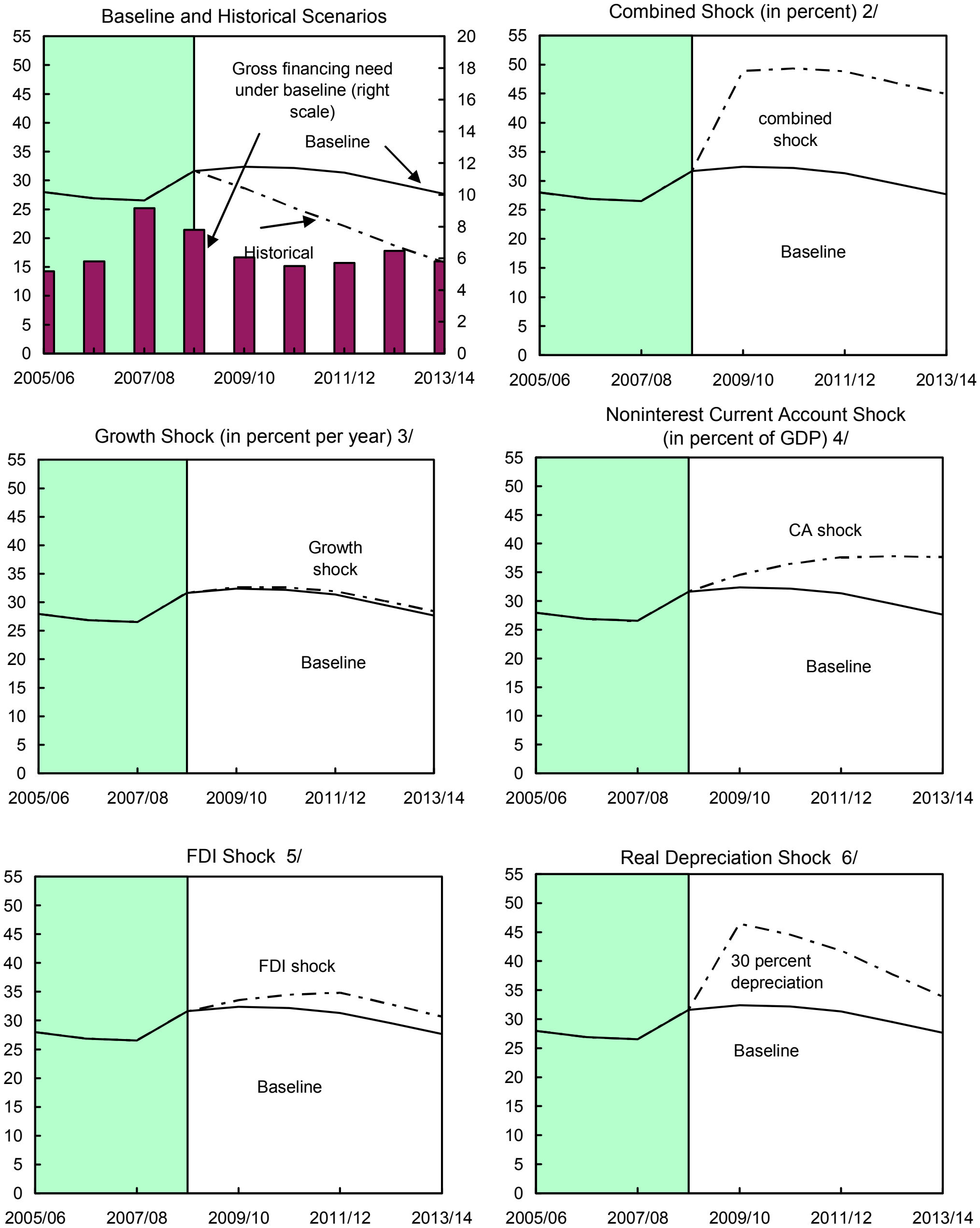
of external public debt will increase temporarily in 2008/09 owing to external financing from official creditors (including the Fund) to address Pakistan's recent balance of payments pressure. The total stock of public debt is projected to decline gradually to 47½ percent of GDP by 2013/14.

7. ***The burden of interest payments on the budget would be halved***. The ratio of interest payments to total revenue (excluding grants) would decline from 31 percent in 2008/09 to 14 percent in 2013/14, despite an increase in interest expenditure on external public debt by about 65 percent in U.S. dollar terms.

8. ***The relatively benign outlook for public sector debt under the baseline scenario is subject to significant downside risks***. The standard bound tests show that risks from shocks resulting from higher interest rates or lower growth are moderate, as they would slow down rather then reverse the medium-term decline in the public debt ratio (Figure 2). However, a primary balance shock as well as a 30 percent devaluation and a contingent liabilities shock would lead to a perceptible increase in the public debt ratio.

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

(External debt in percent of GDP)



Sources: Historical data from Pakistani authorities; and Fund staff estimates and projections

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

2/ Combined impact of shocks to growth, current account, FDI, and real depreciation.

3/ Growth rate lower than the baseline scenarion by half of the ten-year standard deviation.

4/ Current account deficit higher than the baseline scenario by half of the ten-year standard deviation.

5/ Net flows of foreign direct investment are 50 percent lower than in the baseline scenario.

6/ One-time real depreciation of 30 percent occurs in 2009/10.

Table 1. Pakistan: External Debt Sustainability Framework, 2004/05–2013/14

(In percent of GDP, unless otherwise indicated)

	Actual				Projections							Debt-stabilizing noninterest current account 7/
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14		
Baseline: External debt	31.1	28.0	26.9	26.5	**31.6**	**32.4**	**32.2**	**31.3**	**29.5**	**27.7**		**-4.7**
Change in external debt	-3.0	-3.1	-1.1	-0.3	5.1	0.8	-0.2	-0.9	-1.8	-1.9	0.0	
Identified external debt-creating flows (4+8+9)	-3.7	-3.5	-3.6	1.5	3.2	0.6	0.1	-0.7	-1.2	-1.7	0.0	
Current account deficit, excluding interest payments	0.5	2.9	3.8	7.1	4.6	3.2	3.3	3.3	3.2	2.8	4.7	
Deficit in balance of goods and services	7.1	10.1	9.6	12.9	9.3	7.5	7.7	7.6	7.6	7.4		
Exports	16.2	15.9	14.9	14.1	14.0	13.6	13.6	13.8	13.8	13.9		
Imports	23.4	26.0	24.5	27.0	23.3	21.1	21.3	21.4	21.5	21.3		
Net non-debt-creating capital inflows (negative)	-1.5	-3.1	-5.2	-3.1	-2.1	-2.6	-2.7	-3.2	-3.5	-3.5	-3.5	
Automatic debt dynamics 1/	-2.6	-3.4	-2.2	-2.5	0.6	-0.1	-0.5	-0.8	-0.9	-1.0	-1.2	
Contribution from nominal interest rate	0.9	1.0	1.0	1.3	1.3	1.1	1.0	1.0	1.0	0.9	0.8	
Contribution from real GDP growth	-2.3	-1.6	-1.5	-1.4	-0.7	-1.2	-1.5	-1.8	-1.9	-1.9	-1.8	
Contribution from price and exchange rate changes 2/	-1.2	-2.7	-1.7	-2.4	...	...	...	...	...	...	-0.3	
Residual, incl. change in gross foreign assets (2-3) 3/	0.7	0.4	2.5	-1.8	1.9	0.2	-0.3	-0.1	-0.6	-0.2	0.0	
External debt-to-exports ratio (in percent)	191.2	175.5	180.7	187.5	225.5	239.0	236.2	227.5	213.2	198.8		
Gross external financing need (in billions of US dollars) 4/	3.5	6.6	8.3	15.4	12.7	10.3	9.9	11.0	13.4	13.0		
In percent of GDP	3.2	5.2	5.8	9.2	7.8	6.0	5.5	5.7	6.5	5.8		
Scenario with key variables at their historical averages 5/					**31.6**	**28.7**	**25.2**	**22.1**	**18.7**	**15.8**		**-2.3**
Key Macroeconomic Assumptions Underlying Baseline											For debt stabilization	
Real GDP growth (in percent)	7.7	6.2	6.0	6.0	2.5	4.0	5.0	6.0	6.5	7.0	7.0	
GDP deflator in US dollars (change in percent)	3.8	9.6	6.6	9.9	-5.4	1.1	0.7	0.8	0.9	0.9	0.9	
Nominal external interest rate (in percent)	3.1	3.7	4.0	5.6	4.9	3.6	3.3	3.4	3.4	3.2	3.2	
Growth of exports of goods and services (U.S. dollar terms, in percent) 6/	17.9	14.2	5.4	10.7	-3.8	1.6	6.2	8.0	8.0	8.5		
Growth of imports of goods and services (U.S. dollar terms, in percent) 6/	44.7	29.6	6.3	28.4	-16.2	-5.1	6.9	7.4	7.7	7.0		
Current account balance, excluding interest payments	-0.5	-2.9	-3.8	-7.1	-4.6	-3.2	-3.3	-3.3	-3.2	-2.8		
Net non-debt-creating capital inflows	1.5	3.1	5.2	3.1	2.1	2.6	2.7	3.2	3.5	3.5		

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

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

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

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

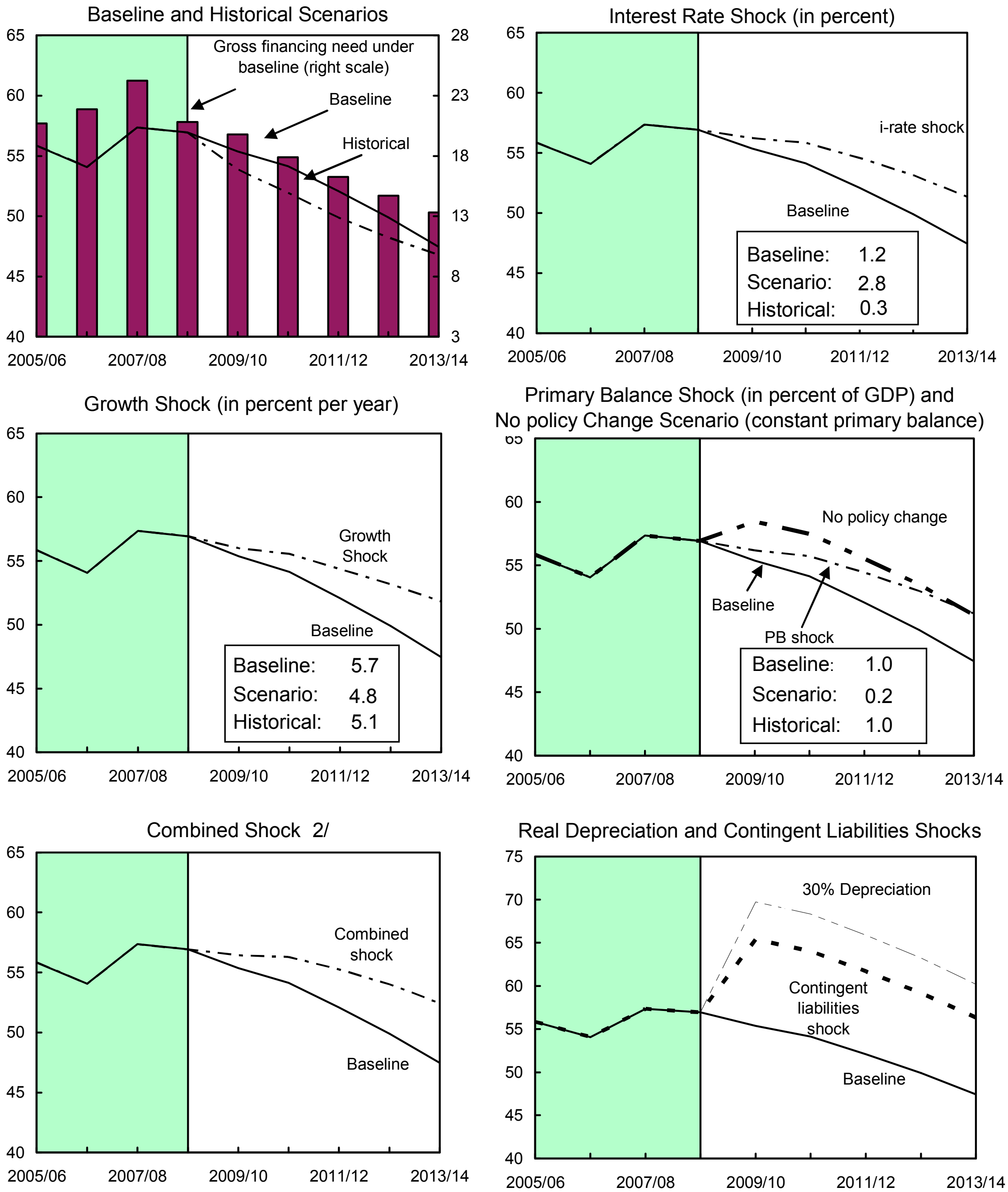
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

6/ Exports and imports of goods and services

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

Figure 2. Pakistan: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



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

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

Table 2. Pakistan: Public Sector Debt Sustainability Framework, 2004/05–2013/14

(In percent of GDP, unless otherwise indicated)

	Actual				Projections						Debt-stabilizing primary balance 9/
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	
Baseline: Public sector debt 1/	61.2	55.8	54.1	57.4	**56.9**	**55.4**	**54.1**	**52.1**	**49.9**	**47.5**	**-1.6**
Of which: foreign-currency denominated	28.1	25.4	24.3	26.2	27.9	26.2	26.2	26.3	26.3	26.0	
Change in public sector debt	-6.6	-5.4	-1.8	3.3	-0.4	-1.6	-1.2	-2.1	-2.2	-2.4	
Identified debt-creating flows (4+7+12)	-4.3	-4.9	-3.0	1.7	-0.4	-1.8	-2.4	-3.2	-3.3	-3.6	
Primary deficit	-0.2	0.6	-0.2	2.5	-0.6	-1.5	-0.9	-0.8	-0.9	-0.7	
Revenue and grants	14.1	14.7	15.2	14.6	15.4	16.0	16.8	17.4	17.6	17.9	
Primary (noninterest) expenditure	14.0	15.3	15.0	17.1	14.8	14.5	15.9	16.5	16.7	17.2	
Automatic debt dynamics 2/	-5.0	-5.7	-2.7	-1.7	-0.9	-0.5	-1.9	-2.6	-2.9	-3.4	
Contribution from interest rate/growth differential 3/	-5.7	-5.9	-2.8	-4.4	-6.2	-0.5	-1.9	-2.6	-2.9	-3.4	
Of which contribution from real interest rate	-1.2	-2.7	0.1	-1.7	-5.1	1.5	0.6	0.3	0.1	-0.4	
Of which contribution from real GDP growth	-4.5	-3.2	-2.9	-2.7	-1.2	-2.1	-2.5	-2.9	-3.0	-3.1	
Contribution from exchange rate depreciation 4/	0.8	0.2	0.1	2.7	5.4	...	...	...	...	...	
Other identified debt-creating flows	0.9	0.2	-0.1	0.9	1.1	0.3	0.4	0.2	0.5	0.6	
Privatization receipts (negative)	-0.4	-1.3	-0.8	0.0	0.0	-0.2	-0.2	-0.4	-0.1	-0.1	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Build-up of bank deposits	1.3	1.5	0.7	0.9	1.1	0.5	0.5	0.6	0.6	0.7	
Residual, including other asset changes (2-3) 5/	-2.3	-0.5	1.3	1.6	0.0	0.2	1.2	1.2	1.2	1.1	
Public sector debt-to-revenue ratio 1/	432.7	379.8	355.4	392.8	369.9	346.3	322.7	300.2	283.0	264.8	
Gross financing need 6/	19.0	20.7	21.9	24.2	20.8	19.8	17.9	16.3	14.7	13.3	
In billions of U.S. dollars	20.8	26.4	31.5	40.6	33.8	33.8	32.3	31.4	30.5	29.8	
Scenario with key variables at their historical averages 7/					**56.9**	**53.9**	**51.9**	**49.9**	**48.2**	**46.8**	**-0.4**
Scenario with no policy change (constant primary balance) in 2009/10–2013/14					**56.9**	**58.4**	**57.5**	**55.5**	**53.5**	**51.1**	**-1.7**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline											
Real GDP growth at market prices (in percent)	7.7	6.2	6.0	6.0	2.5	4.0	5.0	6.0	6.5	7.0	
Average nominal interest rate on public debt (in percent) 8/	5.5	6.0	8.7	10.4	10.3	9.2	7.1	6.5	6.1	5.6	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-1.5	-4.5	0.7	-3.0	-10.5	3.2	1.6	1.0	0.6	-0.4	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-2.5	-0.9	-0.5	-11.4	…	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	7.0	10.5	7.9	13.4	20.8	6.0	5.5	5.5	5.5	6.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	16.5	16.3	3.9	20.7	-11.3	1.7	15.3	10.5	7.6	10.0	
Primary deficit	-0.2	0.6	-0.2	2.5	-0.6	-1.5	-0.9	-0.8	-0.9	-0.7	

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

1/ General government gross debt.

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

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

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

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

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

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

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

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

ATTACHMENT I. PAKISTAN: LETTER OF INTENT

March 16, 2009

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

Dear Mr. Strauss-Kahn:

The Pakistani authorities held discussions with Fund staff for the first review under the Stand-By Arrangement (SBA) and the 2009 Article IV consultation. Based on these discussions, we have updated our economic program for the remainder of 2008/09 and 2009/10, as reflected in the attached Supplementary Memorandum of Economic and Financial Policies (SMEFP). In support of this program, our authorities request the Executive Board of the Fund completes the first review and approve the second purchase under the SBA of SDR 568.54 million.

Although our economic stabilization program is off to a good start, we are fully aware of the challenges ahead. The sharply deteriorating global environment will affect Pakistan's domestic economy, trade, and external financing. The government believes that the policies set out in the attached SMEFP are adequate to achieve the objectives of the program. However, it stands ready to take additional measures appropriate for this purpose, and will consult with the Fund in accordance with the policies of the Fund on such consultations. The Government of Pakistan will provide the Fund with information it may request to monitor progress in implementing its economic and financial policies.

We have recently modified cash margin requirements on letters of credit for certain imports, which resulted in nonobservance of the continuous performance criterion against imposing or intensifying exchange restrictions. We will issue a regulation to eliminate this restriction by end-June, 2009 and, on this basis, we request a waiver of nonobservance for the missed performance criterion.

We also consent to the publication of this letter, the attached SMEFP, the addendum to the Technical Memorandum of Understanding, and the related staff report.

Sincerely yours,

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

/s/
Syed Salim Raza
Governor
State Bank of Pakistan

Attachments:
Supplementary Memorandum of Economic and Financial Policies
Addendum to the Technical Memorandum of Understanding

Attachment II. Pakistan: Supplementary Memorandum On Economic And Financial Policies For 2008/09–2009/10

March 16, 2009

I. Introduction

1. **This memorandum supplements our Memorandum on Economic and Financial Policies (MEFP) for 2008/09–09/10 of November 20, 2008**. It describes policy implementation to date and lays out additional policies agreed in the context of the first review under the Stand-By Arrangement (SBA).

II. Recent Economic Developments

2. **Our stabilization program is off to a positive start**. Headline inflation has decreased from 25 to 20½ percent, the exchange rate has been broadly stable, the international reserves position has strengthened and, following the November discount rate increase, demand for Treasury bills has rebounded. All quantitative performance criteria through end-December 2008 (Table 1) were met and the implementation of the structural reform agenda is broadly on track (Table 2).

3. **The deteriorating global economy is posing additional challenges for Pakistan**. The world economy has slowed more quickly than envisaged, reducing demand for exports and carrying a risk of declining capital flows. Further, domestic economic activity has weakened. As a result both internal and external factors have made the environment for our economic stabilization program less favorable.

4. **There are pressures on the budget**. As a result of the slowdown in imports and domestic demand, budget revenues have been lower than projected in the first half of 2008/09 and this trend is expected to continue, however, this was largely offset by revenues from Petroleum Development Levy (PDL). Disbursement of multilateral program financing has been slow and projected privatization receipts for the 2008/09 budget are unlikely to materialize.

5. **The State Bank of Pakistan (SBP) has tightened the monetary stance to reduce inflation and strengthen the external position**. Increased confidence and improved terms of trade have helped stabilize the rupee at around Rs. 80 per U.S. dollar since mid-October 2008 and enabled the SBP to rebuild its gross international reserves to $6.9 billion at end-January, well above target.

III. Policies for the Remainder of 2008/09 and for 2009/10

6. **The government and the SBP remain committed to address Pakistan's economic problems despite the challenges posed by the global economic and financial crisis**. Consolidating macroeconomic stabilization is essential for the economy, and financing constraints leave little room for countercyclical fiscal policy to counter slowing economic activity given the inherited economic imbalances. Hence, although growth is expected to be

lower, and inflation is trending downwards, policies will continue to be geared to reducing the fiscal deficit, lowering inflation, and strengthening the external position. Nevertheless, improving and expanding the social safety net will continue to be central to the program. These policies will set the stage for higher investment and growth over the medium term and ensure vulnerable groups are protected. The success of our program also hinges on timely and generous support from the international community.

7. The program is built around the following revised economic parameters:

- Real GDP growth of 2½ percent in 2008/09 and 4 percent in the following year;
- Annual average consumer price inflation of 20 percent in 2008/09 and 6 percent in 2009/10; and
- A current account deficit of 6 percent of GDP in 2008/09 and 4½ percent in 2009/10.

A. Fiscal Policy

8. **We plan to maintain the path of fiscal adjustment in 2008/09–09/10**. Our budget deficit target for 2008/09 remains unchanged. The shortfall in tax revenue will be compensated by additional revenue and expenditure measures to achieve an unchanged deficit target of Rs. 562 billion (4.3 percent of revised GDP). Fiscal consolidation will continue in 2009/10; the budget deficit is to be reduced by 0.9 percentage points to 3.4 percent of GDP. This consolidation is facilitated by the elimination of the fuel and electricity subsidies in 2008/09. Further, tax policy measures and the ambitious tax administration reform will increase the revenue and assure achievement of the 2009/10 deficit target, while creating fiscal space for strengthening our social safety net.

9. **Revenue effort will play a key role in achieving the deficit target**. The Federal Board of Revenue is targeting collection of Rs. 1,300 billion (10.0 percent of revised GDP) in 2008/09 including an additional yield of Rs. 65 billion on account of stepped-up auditing and enforcement. The authorities are also considering the levy of a carbon tax. Any shortfall in tax revenues will be compensated by revenues from the PDL, tax administration measures, and expenditure control measures.

10. **The government will use non-SBP domestic sources to meet its financing needs**. This approach is based on careful advance planning of quarterly budgetary borrowing requirements. Moreover, the Ministry of Finance (MoF) has taken several measures, in coordination with the SBP, to expand and enhance available financing options for the budget. To this end the MoF also successfully issued three Ijara Sukuks, 3 to 30 year tenor Pakistan Investment Bond, and interest rates on National Savings Scheme instruments have been increased, which have resulted in significant extra demand. In addition, T-bill auctions have been successful with significant reductions in the cut-off yields.

11. **Treasury-bill auction management has improved**. To increase transparency and planning, Treasury-bill auction calendars were issued in November and December, and will

continue to be issued on a quarterly basis. As a step toward separation of public debt management from monetary policy operations, a volume-based auction approach has been adopted. Pre-announced auction volume targets will be observed and the accepted amount will generally be in line with the target to provide market participants with confidence to plan their investment. This approach complements the government's planning of its budgetary borrowing requirement and facilitates liquidity management by the SBP.

12. **Strengthening the social safety net is a key program objective**. To this end, a poverty scorecard has been adopted to improve targeting of the Benazir Income Support Program (BISP).

- The roll-out of the scorecard system for the selection of beneficiary families has started, and is expected to be completed in 16 districts as a pilot program by end-May 2009. The roll-out of the scorecard to all 130 districts is planned to be completed between December 2009 and June 2010. As the roll-out of BISP turned out to be more complicated than originally envisaged, BISP disbursements did not take place in the first half of the fiscal year. However, we have now approved 1.5 million beneficiary families using the pre-scorecard targeting system and expect to disburse the budgeted amount of Rs. 34 billion. In addition, we are continuing the implementation of Bait-ul-Mal with a budget of Rs. 6.7 billion and the province of Punjab has commenced its own cash transfer program with an envelope of Rs. 17 billion in FY 2008/09. The Small Public Works Programs of Rs. 28 billion also provide a social safety net for the rural and urban poor through small-scale employment opportunities.
- Looking forward, the number of families benefiting from BISP cash transfers will be increased to 5 million in 2009/10 using the new scorecard system, implying budgetary expenditure of Rs. 65 billion. For 2010/11, an increase in the number of beneficiary households to 7 million is envisaged. In addition, the province of Punjab is expected to continue its own program in FY 2009/10. The government is also considering reforming other components of the social safety net system, including the merger of the cash transfer component of Bait-ul-Mal with the BISP.

13. **An action plan to strengthen tax administration was adopted in January and steps to improve revenue collection have already been taken**. Most notably, the sales tax and income tax administrations were integrated on functional lines at the HQ level to enhance the effectiveness of tax administration. The full integration at the field level will be completed by end-December 2009. A detailed integration plan is being prepared as stipulated in the Action Plan. Other measures include the introduction of a unique tax payer identification number, strengthening of the Large Taxpayer Unit, and improved tax audits. The World Bank is providing technical assistance to implement further tax administration reforms, including strengthening of the refunds system for the General Sales Tax (GST).

14. **The government is pursuing a major tax reform agenda**. A key step will be the replacement, starting in 2010/11, of the GST with a broad-based VAT. At the same time, the government is exploring options to increase revenue in 2009/10. In particular, sales, excise,

and income tax laws will be reviewed to minimize exemptions and zero-rating. The timing of these reforms hinges on the capacity of the tax administration to process refunds. To support tax policy reforms, the government has requested Fund and World Bank technical assistance.

15. **The MoF has taken measures to strengthen payment control while work on a Single Treasury Account is progressing**. A key improvement is the introduction of a system preventing accumulation of unspent balances in accounts outside the Federal Consolidated Fund (FCF). All new budget releases are made through assignment accounts that are part of the FCF. To avoid destabilizing outflow of deposits from the banking system, remaining unspent balances (outside the FCF) will be allowed to be gradually reduced and eliminated. This process will take longer than earlier expected and will not be completed by June 30, 2009.

16. **The MoF is working to establish a Medium-Term Budget Framework (MTBF).** A calendar for the preparation of the MTBF has been established and the initiating document for medium-term budget preparation has been submitted to line Ministries. The MTBF will be submitted to the Cabinet in March/April 2009 together with the draft strategy paper. The document will provide a framework for the budget process, inform its strategic directions, establish resource envelopes, and identify policy reforms needed to fulfill the medium term fiscal consolidation objectives.

17. **In collaboration with the World Bank, the government has finalized a schedule for electricity tariff adjustments to eliminate tariff differential subsidies by end-June, 2009**. As a first step under this plan, tariffs were increased by 1 percent effective February 1, 2009. Tariffs will be raised further to result in a cumulative increase of 4 percent by end-June. Changes in the fuel cost component of electricity tariffs (the fuel adjustment surcharge) will continue to be reviewed on a monthly basis and adjusted as needed. The Asian Development Bank is also supporting power sector reforms jointly with the World Bank.

18. **We plan to resolve inter-corporate debt in the energy sector (circular debt)**. As a first step, we have prepared an issue of government-guaranteed Term Financing Certificates by Pakistan Electric Power Company (PEPCO) to settle amounts it owed to banks and suppliers. Further, we are preparing a plan to address ongoing losses on account of operational and collection losses of distribution companies, PEPCO and an independent power producer.

B. Monetary and Exchange Rate Policy

19. **Monetary policy will aim at lowering inflation**. The SBP will calibrate monetary policy to balance concerns about the slowdown in economic activity, subject to the overall objective of lowering inflation. Provided that the expected decline in inflation materializes and market confidence remains positive, there could be scope for a more accommodative monetary policy stance. However, the SBP stands ready to adjust policies if inflation resurges or if international reserves come under pressure. We will continue to avoid SBP financing of the budget.

20. **The SBP will further improve its monetary policy framework**. Market conditions permitting, the SBP remains committed to introduce in July 2009 an explicit corridor for overnight money market rate to enhance market signaling, strengthen the effectiveness of liquidity management, and reduce volatility in short-term market interest rates (see ¶19 in the MEFP). Use of an explicit interest rate corridor in support of the operational target will improve the transmission of a change in the policy rate (SBP discount rate) to the economy and so help achieve the objective of price stability.

21. **The SBP will continue to pursue a flexible exchange rate policy**. The exchange rate will continue to reflect market conditions and facilitate adjustments to achieve a sustainable external balance and macroeconomic stability. Interventions will be largely aimed at achieving the program's net foreign asset targets. The flexible exchange rate policy will be facilitated by phasing out SBP provision of foreign exchange for oil imports, according to the schedule in the program. As a first step, the SBP has ceased providing foreign exchange for the import of furnace oil as of February 1, 2009.

C. Financial Sector and Safeguards Issues

22. **Stress tests by the Financial Sector Assessment Program Update mission, using June 2008 data, and updated by the SBP using September data, indicated that banking system in general was resilient**. Most banks, including all large banks, would remain solvent, but some non-systemic banks would face insolvency under a severe crisis scenario. The capital injection needed to restore the capital adequacy ratio of the twelve largest banks to the minimum regulatory capital adequacy ratio of 8 percent was 2.3 percent of GDP in the worst case scenario. This relatively low level reflects the low credit-to-GDP ratio and the relatively high capital buffers. The main sources of risk for the vulnerable banks were a major deterioration in credit quality, mainly in the textile industry and exposure to the equity market. Default of the largest exposures put significant strains on solvency given the large concentration of exposures in some banks. The SBP has obtained similar results on the basis of end-September data. A few banks representing less than 10 percent of system assets face financial pressures, which are being addressed by the SBP and their owners through mergers or fresh injection of equity. Progress by these banks in resolving their problems is being monitored closely by the SBP.

23. **The financial sector has so far weathered the storm well, but the outlook calls for careful monitoring**. Provisional figures for December 2008 show gross non-performing loans (NPLs) have increased from 7.7 percent of total loans in June 2008 to 9.1 percent in December 2008, while net NPLs to net loans increased from 1.3 to 2.5 percent in the same period. However, the capital position of the banking system has improved, with the capital adequacy increasing from 12.1 to 12.2 percent of risk-weighted assets.

24. **Measures to improve banking resolution and banking supervision are being implemented**. In December 2008, the SBP adopted a problem bank management and contingency plan for dealing with problem banks. The document includes criteria for liquidity support, assessment of bank problems, criteria for use of scarce resources,

assessment of existing legal powers and intervention procedures. The effectiveness of the SBP's powers to enforce its banking supervision policies will also be strengthened and amendments to the banking legislation to this end have been drafted and will be submitted to Parliament before end-June 2009.

25. **A draft revision of the SBP law has been prepared and it will form the basis for strengthening the operational independence of the central bank**. The recently established inter-agency committee, which includes the MoF, is expected to propose measures to strengthen the operational independence of the SBP, based on the draft SBP law, by end-April 2009. A new central bank law will be submitted to Parliament by December 2009.

26. **A new bankruptcy law is under preparation**. It will help rehabilitation of viable companies and expeditious resolution of other highly indebted companies thus paving way for banks to clear their long outstanding loans. A review committee is finalizing the draft law which it will submit to the MoF by end-July 2009.

27. **The SBP has adjusted the rules on collateral and valuation of securities**. Regarding recognition of Forced Sale Value (FSV) of certain collateral, in 2007, SBP withdrew the benefit of the FSV for determining provisioning requirements in order to create a cushion in the balance sheet of banks. Recognition of FSV of collateral is permissible in most countries. In 2009, SBP has allowed partially the FSV benefit (up to 30 percent) of pledged stock as well as residential and commercial properties. Regarding valuation of securities, the imposition of a floor on the stock prices at stock exchanges last August, impeded price discovery for 3½ months in 2008. Accordingly, the Securities and Exchange Commission of Pakistan (SECP) allowed companies to delay recognition of any losses on securities (available for sale) in their income statements until end-December 2009. Losses need to be recognized immediately in capital positions, without routing them through their income statements. Any gains or delays in loss recognition from this treatment cannot be used to pay cash or stock dividends. Further, companies are also required to gradually realize losses in their income statement on quarterly basis and ensure full realization of the impairment by end-2009. SBP has allowed the banks the option to follow instructions issued by SECP regarding recognition of impairment on their capital position, but encouraged early recognition in income statements.

28. **The National Investment Trust's State Enterprise Fund (NITSEF), created to take advantage of market conditions to invest in eight government-owned/controlled companies, has begun its operations**. It has an initial capital of Rs. 20 billion. The participating institutions comprise banks, the State Life Insurance Company and the Employees Old Age Benefits Institution, which lent funds to NITSEF against a government guarantee. As of mid-February, the NITSEF had invested Rs. 7 billion. The NITSEF makes its purchases through the Stock Exchange at best available price. It will disclose its financial statements, investment strategy, and purchases on a quarterly basis on a dedicated website.

29. **The safeguards assessments of the SBP's financial control systems pointed to the need to improve SBP's internal controls further**. It recommended changes in the voting structure of the Audit Committee, improving internal controls, and establishing a Board committee to centralize risk management across all bank activities. The SBP intends to implement changes in these areas to change the voting structure of its Audit Committee in April 2009, to improve its internal controls by end-June 2009, and establish a Board Committee to centralize risk management by end-December 2009.

IV. Program Risks and Monitoring

30. The program remains subject to considerable risks. The economic situation in trading partner countries could deteriorate further and result in lower demand for exports, workers' remittances, and private capital flows. The recovery of domestic and external demand could take longer than anticipated, which would further undermine the revenue targets. As economic activity weakens, the risks to the domestic financial sector increase.

31. The program will remain subject to quarterly program reviews and quarterly performance criteria as specified in Table 1 for the remainder of 2008/09. The attached addendum to the Technical Memorandum of Understanding adds a definition of external payments arrears and provides for reporting of information on new liabilities incurred or guaranteed by the government in settling the circular debt, The adjustors, defined in the TMU, dated November 20, 2008, remain applicable.

V. Program Financing

32. The program requires additional financing to reduce its risks and enhance growth prospects. As noted, while the program is financed for 2008/09, financing constraints leave little room for countercyclical policy and there is a need for additional financing to finance social safety expenditure, development spending and enhanced security needs. The upcoming donor meeting in late March/April is pivotal for mobilizing additional financing, supporting our adjustment efforts, and reducing risks to the program.

Table1. Pakistan: Quantitative Targets, December 2008–June 2010

	Outst. Stock end-Sept. 2008	end-Dec. 2008 2/	Prog. end-Mar. 2009	Prog. end-Jun. 2009
Floor on net foreign assets of the SBP* (stock, in millions of U.S. dollars)	3,953	1,165	671	2,782
Adjusted target	...	882		
Actual	...	2,355		
Ceiling on net domestic assets of the SBP* (stock, in billions of Pakistani rupees)	1,250	1,346	1,412	1,314
Adjusted target	...	1,356		
Actual	...	1,270		
Ceiling on net government borrowing from SBP* (stock, in billions of Pakistani rupees)	1,227	1,274	1,274	1,181
Adjusted target	...	1,274		
Actual	...	1,222		
Ceiling on overall budget deficit* (cumulative flow, in billions of Pakistani rupees)	142	261	405	562
Adjusted target	...	262		
Actual	...	253		
Ceiling on outstanding stock of short-term public and publicly guaranteed external debt* (in millions of U.S. dollars)	515	1,500	1,500	1,500
Actual	...	813		
Cumulative ceiling on contracting of nonconcessional medium- and long-term public and publicly guaranteed external debt* (in millions of U.S. dollars) 1/	9,500	9,500	9,500	9,500
Actual	...	1,000		
Accumulation of external payments arrears (continuous performance criterion during the program period)* (in millions of U.S. dollars)	0	0	0	0
Actual	...	0		
Continuous ceiling on SBP's foreign currency swaps and forward sales* (in millions of U.S. dollars)	1,900	2,750	2,750	2,750
Actual	...	1,850		
Memorandum items:				
Net external program financing (cumulative, in millions of U.S. dollars)	-166	-120	406	779
External project grants (in millions of U.S. dollars)	24	47	113	192
Foreign Exchange cash reserve requirement (CRR, incl. special CRR) deposits in SBP (in millions of U.S. dollars)	832	727	850	850
Weekly cash reserve requirement ratios (in percentage points)				
Rupee deposits (less than one year maturity)	9	5	5	5
Rupee deposits (more than one year maturity)	0	0	0	0
Foreign currency deposits CRR	5	5	5	5
Foreign currency deposits special CRR	15	15	15	15

Notes:
* denotes performance citeria.

1/ Excludes IMF.

Table 2. Pakistan: Structural Performance Criteria and Benchmarks

I. Structural Performance Criteria	Deadline	Status
Amendments to the banking legislation will be submitted to Parliament to enhance the effectiveness of SBP enforcement powers in the area of banking supervision.	end-June 2009	
The government will submit draft legislative amendments to parliament to harmonize the income tax and GST laws, including for tax administration purposes, and to reduce exemptions for both taxes.	end-June 2009	
II. Structural Benchmarks		
A contingency plan for handling problem private banks will be finalized.	end-Dec. 2008	Met
A full description of required reforms in the area of tax administration, including an action plan for harmonizing the GST and income tax administration will be finalized.	end-Dec. 2008	Met 1/
In close collaboration with the World Bank, the government will finalize the schedule for further electricity tariff adjustments during 2008/09,	end-Dec. 2008	Met
with a view to eliminating tariff differential subsidies.	end-June 2009	
The SBP's provision of foreign exchange for furnace oil will be eliminated.	Feb. 1, 2009	Met
In close collaboration with the World Bank, the government will develop a strategy and a time-bound action plan for the adoption of specific measures to strengthen the social safety net and improve targeting to the poor.	end-March 2009	Underway
The government will prepare a plan for eliminating the inter-corporate circular debt.	end-March 2009	Underway
The transition to a single treasury account will be completed.	end-June 2009	

1/ The action plan was adopted in January 2009.

ATTACHMENT III. PAKISTAN: ADDENDUM TO THE TECHNICAL MEMORANDUM OF UNDERSTANDING

March 16, 2009

1. The Technical Memorandum of Understanding (TMU) of November 20, 2008 will remain in effect except for the changes described below.

2. The following definition is added to Section I:

- External payment arrears are defined as unpaid debt service by the government beyond the due date under the contract and any grace period.

3. The following program reporting requirement is added to Section III:

- Information on new liabilities incurred or guaranteed by the government in settling the circular-debt, including government guarantees of Term Financing Certificates (TFCs) issued by Pakistan Electric Power Company (PEPCO). The information will include the size of the government exposure, the duration of the guarantee or claim, and any other provisions relevant for the government's exposure.

4. The attached table replaces Table 2 in the TMU.

Table 1. Pakistan: External Program Financing For Budget for 2008/09
(In millions of U.S. dollars)

	Jul.-Sep. Act.	Oct.-Dec. Act.	Jan.-Mar. Proj.	Apr.-Jun. Proj.	Total Proj.
Program Loans	494	811	1,390	900	3,595
World Bank	0	0	500	300	800
ADB	494	100	240	500	1,334
IDB	0	561	100	100	761
Bilateral support	0	0	500	0	500
Short-term commercial	0	150	50	0	200
Budgetary Grants	40	30	0	21	91
Privatization	0	0	0	0	0
GDRs	0	0	0	0	0
Amortization	700	795	864	548	2,907
Medium and Long-term	538	253	814	398	2,003
Euro bonds	22	0	500	0	522
IDB>1 year	200	0	0	0	200
Other	316	253	314	398	1,281
Short-term	162	542	50	150	904
IDB	162	426	0	150	738
Commercial	0	116	50	0	166
Net program financing (Budget)	-166	46	526	373	779
Amortization of government guaranteed debt	10	19	10	17	56
Net program financing (BoP)	-176	27	516	356	723

Sources: Pakistani authorities; and Fund staff projections.

ATTACHMENT IV. DRAFT PUBLIC INFORMATION NOTICE

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 08/xx
FOR IMMEDIATE RELEASE
[Month, dd, yyyy]

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2009 Article IV Consultation with Pakistan

On March 30, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Pakistan.[1]

Background

Since the last Article IV Consultation in December 2007, Pakistan has been facing significant economic difficulties. With sharp increases in oil and food prices, and adverse security developments, Pakistan has experienced a significant widening of the fiscal deficit, owing in large part to increasing energy subsidies, and major pressures on its balance of payments. As a result, inflation rose considerably and international reserves declined sharply.

To address these challenges, in October 2008, the authorities embarked on a stabilization program for 2008/09–09/10 aimed at restoring financial stability while protecting the poor. This program, supported by a Stand-By Arrangement (SBA), envisages a significant tightening of fiscal and monetary policies to bring down inflation and strengthen the external position, and includes several structural measures in the fiscal and financial sectors.

Initial developments since the approval of the program have been generally positive. The exchange rate has been broadly stable, enabling the State Bank of Pakistan to buy foreign exchange on a net basis. As a result, gross international reserves have strengthened from $3.5 billion at end-October to $6.7 billion as of February 20. Despite the somewhat improved

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

confidence, credit and broad money demand growth have been slower than envisaged under the program.

Policy implementation has been good and the program remains on track. All quantitative performance criteria and the structural benchmarks for the first program review were met. The end-December fiscal deficit target, which proved challenging, was achieved through a combination of revenue and expenditure measures.

Social protection is a key element of the program. In this context, the authorities pressed ahead with the strengthening of the Benazir Income Support Program (BISP) providing cash grants to the poorest families. The expansion of BISP will increase the spending on social transfers from 0.4 percent of GDP in 2008/09 to 0.6 percent of GDP in 2009/10.

Banks have weathered the crisis well thus far, but should be monitored carefully. Based on the recently conducted Financial Sector Assessment Program (FSAP) update, the banking system appears to be generally well-capitalized and liquid. Aggregate financial soundness indicators improved since the 2004 FSAP, although the worsening macroeconomic environment affected adversely bank profitability and asset quality in 2008. Gross nonperforming loans rose from 7.7 percent of total loans in June 2008 to 9.1 percent in December 2008 but capital adequacy ratios stayed around 12 percent of risk-weighted assets over the same period.

The global economic and financial environment has deteriorated significantly since the start of the program. In light of this outlook, the authorities agreed with the mission on a revised macroeconomic framework (with lower growth and inflation) and supporting policies for 2008/09 and beyond. The authorities have chosen to adhere to the program’s fiscal target for 2008/09 and continue with further fiscal adjustment in 2009/10. There should be scope for the State Bank of Pakistan to lower its discount rate if inflation abates, the external reserve position continues to improve, and the government can sell T-bills to banks and nonbank private investors.

Pakistan needs additional external assistance to reduce risks, and greater development and social spending. The upcoming donor meeting planned for April provides an important opportunity for mobilizing additional assistance.

Executive Board Assessment

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Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Table 1. Pakistan: Selected Economic Indicators, 2007/08–2009/10 1/

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

	2007/08	2008/09		2009/10	
		Prog.	Proj.	Prog.	Proj.
	(Annual percentage change)				
Output and prices					
Real GDP at factor cost	5.8	3.4	2.5	5.0	4.0
Partner country demand (WEO definition)	4.5	…	…	…	…
Consumer prices (period average)	12.0	23.0	20.0	13.0	6.0
Consumer prices (end of period)	21.5	20.0	10.0	6.0	6.5
Pakistani rupees per U.S. dollar (period average)	…	…	…	…	…
	(In percent of GDP)				
Saving and investment					
Gross saving	13.2	13.5	14.2	15.6	15.6
Government	-2.8	-1.1	-0.9	0.8	0.8
Nongovernment (including public sector enterprises)	16.0	14.5	15.1	14.9	14.8
Gross capital formation 2/	21.6	20.0	20.1	21.3	19.9
Government	4.3	3.0	3.2	3.8	4.0
Nongovernment (including public sector enterprises)	17.2	17.0	16.9	17.5	15.9
Public finances					
Revenue and grants	14.6	15.1	15.4	16.1	16.0
Expenditure (including statistical discrepancy) 3/	21.7	19.1	19.6	19.2	19.2
Budget balance (including grants)	-7.1	-4.0	-4.2	-3.1	-3.2
Budget balance (excluding grants)	-7.4	-4.2	-4.3	-3.3	-3.4
Primary balance	-2.5	0.6	0.6	1.6	1.5
Total government debt	57.4	54.6	56.9	52.4	55.4
External government debt	26.2	26.9	27.9	27.1	26.2
Domestic government debt	31.2	27.7	29.1	25.4	29.1
	(Annual changes in percent of initial stock of broad money, unless otherwise indicated)				
Monetary sector					
Net foreign assets	-7.8	-4.9	-3.4	1.8	-1.4
Net domestic assets	23.2	15.7	11.8	14.1	12.1
Broad money	15.3	10.8	8.4	15.9	10.6
Private credit (percentage change)	16.4	25.2	8.3	19.6	14.1
Six-month treasury bill rate (period average, in percent) 4/	9.6	12.7	…	…	…
External sector					
Merchandise exports, U.S. dollars (percentage change)	16.5	12.0	-5.5	11.0	1.6
Merchandise imports, U.S. dollars (percentage change)	31.2	1.1	-14.5	5.7	-5.5
Current account including official current transfers (in percent of GDP)	-8.4	-6.5	-5.9	-5.7	-4.3
	(In percent of exports of goods and services, unless otherwise indicated)				
External public and publicly guaranteed debt	169.7	160.0	186.3	154.2	189.0
Debt service	15.2	16.9	23.1	15.4	20.2
Implicit interest rate (in percent) 5/	5.0	2.4	2.4	3.2	2.4
Gross reserves (in millions of U.S. dollars) 6/	8,591	8,591	9,091	11,291	10,591
In months of next year's imports of goods and services	2.7	2.1	3.0	2.6	3.3
Memorandum items:					
Real effective exchange rate (annual average, percentage change)	-0.8	…	…	…	…
Terms of trade (percentage change)	-10.2	…	…	…	…
Real per capita GDP (percentage change)	4.1	1.6	0.9	3.3	2.4
GDP at market prices (in billions of Pakistani rupees)	10,478	13,384	12,970	15,880	14,298
GDP at market prices (in billions of U.S. dollars)	167.6	...	...	...	...

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

1/ Fiscal year ends June 30.
2/ Including changes in inventories. Investment data recorded by the Pakistan Federal Bureau of Statistics are said to underreport true activity.
3/ Expenditure on social assistance in 2008/09 is budgeted at 0.5 percent of GDP. The program will target an additional 0.3–0.5 percent of GDP.
4/ 2008/09: average for June–December 2008.
5/ Calculated as interest payments in percent of the end-of-period debt stock of the previous year.
6/ Excluding gold and foreign deposits of commercial banks held with the State Bank of Pakistan.