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INFORMATION

February 26, 1985

To: Members of the Executive Board
From: The Secretary
Subject: Pakistan - Staff Report for the 1984 Article IV Consultation

The attached supplement to the staff report for the 1984 Article IV consultation with Pakistan has been prepared on the basis of additional information.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion on Wednesday, February 27, 1985, they should contact Mr. Jakubiak (ext. 7109).

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INTERNATIONAL MONETARY FUND

PAKISTAN

Staff Report for the 1984 Article IV Consultation
Supplementary Information

Prepared by the Staff Representatives for the
1984 Consultation with Pakistan

Approved by A.S. Shaalan and S. Kanesa-Thanan

February 25, 1985

Since the issuance of the Staff Report (SM/85/29), some additional information has been received from the Pakistan authorities. The information indicates a good performance in the agricultural sector, but confirms that the 1984/85 fiscal and balance of payments positions will show a deterioration in comparison with the 1983/84 results and the authorities' original forecasts for this year.

With regard to the 1984/85 cotton and rice crops, the latest post-harvest output estimates are, respectively, 5.5 million bales and 3.5 million tons; these estimates are in line with the authorities' targets. Production at these levels would represent a near doubling of cotton output from the depressed level of 1983/84 and a 3 percent gain in rice output, with output of both crops reaching historic peaks.

In the area of public finance, only partial information is available on the results for the first six months of 1984/85. For this period the authorities have indicated that federal government tax receipts were somewhat lower than would have been expected on the basis of past experience, that nonbank domestic financing for the budget was less than one quarter of the estimate for the whole year, and that budgetary expenditures were higher than expected due in part to the depreciation of the rupee against the U.S. dollar.

In view of these developments, the authorities have revised their forecasts for the 1984/85 budget (Appendix Table 1). In the revised budgetary projections, total revenue is now projected to be 2 percent below the original estimate, while total expenditure is estimated to be 2 percent above budget. As a result, the overall deficit would amount to PRs 30.7 billion, or 6.3 percent of GDP compared with the 5.6 percent forecast in the budget. With respect to financing, the authorities project a higher rupee value for external borrowing. This is more than offset, however, by a sharp reduction in nonbank domestic borrowing which is now forecast to amount to only 73 percent of the budget estimate; this is due in particular to a substantial decline in receipts from sales of

prize bonds. ^{1/} As a result of all these factors, domestic bank financing of the budget is now projected at PRs 12.7 billion, equivalent to 2.6 percent of GDP (the highest ratio since 1979/80), compared with 1.2 percent projected in the budget. As of January 24, 1985 domestic bank borrowing for budgetary support had reached PRs 12.0 billion, which is 95 percent of the forecast for the year.

In the external sector, export receipts over July-December 1984 were 21 percent below earnings from exports during the same period of 1983, while workers' remittances at US\$1.2 billion were also 12 percent lower; import payments were 4 percent higher. At end-January 1985 gross official external reserves (excluding gold) were US\$947 million, which was equivalent to 7.3 weeks of projected 1984/85 imports (c.i.f.); this represents a reserves loss of US\$785 million (or 45 percent) since end-June 1984.

The authorities have revised their balance of payments forecast for 1984/85 (Appendix Table 2). The major features of the revision were a lowering of the export growth rate from 11 percent to zero, a lowering of the import growth rate from 9 percent to 4 percent, and a lowering of the remittances growth rate from a 2.5 percent increase to a decline of 10 percent. As a result, the current account deficit is now expected to reach US\$1.6 billion, equivalent to 4.4 percent of GNP compared with 3.2 percent originally. Since in the aggregate the capital account forecast has not been revised, the overall deficit is forecast to be US\$658 million (nearly US\$500 million larger than the original projection). The authorities' estimate indicates essentially no further loss of official reserves in the January-June 1985 period.

With regard to this revised balance of payments forecast, the authorities have explained that they expect exports in the second half of 1984/85 to be US\$546 million higher than in the first half of the year. Of this amount, US\$160 million would be accounted for by higher raw cotton and rice exports, and US\$100 million would be accounted for by nontraditional exports. Of the remaining amount, the major contribution would come from exports of cotton textile products which have benefited from low domestic cotton lint prices and favorable product prices in world markets. The authorities believe that the new export forecast is cautious. While their expectation is that the recovery of exports in the second half of 1984/85 will continue into 1985/86, some policy options are under consideration to enhance export performance.

With regard to the new lower import forecast, the authorities explained that this was attributable to a US\$150 million savings on petroleum import payments, lower project imports financed from abroad, lower U.S. dollar costs for edible oil imports, and a more moderate growth rate for private sector imports. The revised forecast for

^{1/} The authorities believe that this shortfall reflects in large part the doubling of the mandatory retention period for these bonds at the start of the year.

workers' remittances for the second half of the year was about equivalent to the actuals for the first six months; the authorities believe that the shortfall from the original target may well turn out to be less.

The monetary data for the first half of the 1984/85 fiscal year indicate that domestic liquidity rose by 5 percent over this period compared with 9 percent during the comparable period of the previous year (Appendix Table 3). This lower rate of monetary expansion was essentially due to the substantial balance of payments deficit which characterized the first half; the growth rate of net domestic assets was similar in both periods. The staff has estimated the monetary outcome for 1984/85 on the basis of the authorities' revised forecasts for the budget and the balance of payments and a use of credit by the nongovernment sector on a net basis which proceeds along the lines envisioned in the Government's credit plan. These estimates suggest a monetary expansion similar to that projected in the original plan (11 percent), although the growth rates for net credit to the Government and net domestic assets would now be substantially higher than originally anticipated. For the July-December 1984 period, the consumer price index was 6.7 percent higher on a period average basis than in the same period in the previous year; in the first half of 1983/84, the comparable inflation rate was 9.2 percent.

As of February 16, 1985, the exchange rate for the rupee was PRs 15.79 per U.S. dollar, representing an 11 percent depreciation in terms of the U.S. dollar since end-June 1984, and a 37 percent depreciation since end-1981. The staff estimates that in 1982 the rupee depreciated in real effective terms by 20 percent, and that between end-1982 and end-October 1984, the last month for which reasonably full price data are available, the real appreciation of the rupee was 7 percent.

In the staff's view, recent financial developments in Pakistan are disquieting. The revised budget estimates provided by the authorities forecast a substantial deterioration in the fiscal position from last year's results and the outcome originally envisioned for 1984/85. The new estimates underline the need for urgent budgetary measures in the remaining months of this year and for substantive fiscal reforms, in particular tax reforms, in the 1985/86 budget. The authorities have revised their balance of payments estimates and these estimates now agree with those of the staff. Recent balance of payments developments reinforce the staff's view regarding the need for measures to strengthen external sector performance.

Table 1. Pakistan: Summary of Public Finance, 1983/84-1984/85

	Prov. <u>Actual</u> 1983/84	Original Budget <u>Estimate</u> 1984/85	Revised <u>Estimate</u>
(In billions of Pakistan rupees)			
Revenue	<u>73.2</u>	<u>80.0</u>	<u>78.5</u>
Tax	<u>58.4</u>	<u>63.9</u>	<u>62.4</u>
Nontax	<u>14.8</u>	<u>16.1</u>	<u>16.1</u>
Surplus of autonomous bodies	<u>2.6</u>	<u>2.6</u>	<u>2.6</u>
Expenditure	<u>101.1</u>	<u>109.9</u>	<u>111.8</u>
Current	<u>73.6</u>	<u>78.1</u>	<u>79.7</u>
Development	<u>27.5</u>	<u>31.8</u>	<u>32.1</u>
Overall deficit(-)	<u>-25.4</u>	<u>-27.3</u>	<u>-30.7</u>
Financing	<u>25.4</u>	<u>27.3</u>	<u>30.7</u>
External (net)	<u>6.0</u>	<u>6.8</u>	<u>7.3</u>
Domestic nonbank	<u>11.5</u>	<u>14.7</u>	<u>10.7</u>
Banking system	<u>7.9</u>	<u>5.8</u>	<u>12.7</u>
Memorandum items:			
Domestic bank financing	<u>6.6</u>	<u>5.6</u>	<u>12.5</u>
Budgetary support	<u>7.9</u>	<u>5.8</u>	<u>12.7</u>
Commodity operations	<u>-1.3</u>	<u>-0.2</u>	<u>-0.2</u>
GDP at current market prices	<u>419.8</u>	<u>485.2</u>	<u>485.2</u>
(As percent of GDP at current market prices)			
Tax revenue	13.9	13.2	12.9
Total revenue	17.4	16.5	16.2
Expenditure	24.1	22.7	23.0
Overall deficit	6.0	5.6	6.3
Domestic bank financing	1.6	1.2	2.6
Of which:			
Budgetary support	(1.9)	(1.2)	(2.6)

Source: Ministry of Finance and Economic Affairs.

Table 2. Pakistan: Balance of Payments, 1983/84-84/85

	Provisional Actual 1983/84	Prov. Actual July-Dec. 1984	Official Projection Original 1984/85	Revised
(In millions of U.S. dollars)				
Trade balance	-3,334	-1,944	-3,564	-3,601
Exports, f.o.b.	2,668	1,058	2,953	2,662
Imports, f.o.b.	-6,002	-3,002	-6,517	-6,263
Services (net) 1/	-713	-459	-710	-815
Private transfers (net)	3,018	1,422	3,092	2,785
Of which: workers' remittances	2,737	1,224	2,805	2,450
Current account balance	-1,029	-981	-1,182	-1,631
Long-term capital (net)	768	331	1,002	953
Gross official disbursements	1,234	585	1,418	1,369
Amortization 2/	-555	-265	-517	-517
Other (including private long-term capital) 3/	89	11	101	101
Errors and omissions (net) (including private short-term capital)	42	-138	--	-42
SDR allocations	--	--	--	--
Balance requiring official financing	-219	-788	-180	-720
Exceptional financing	152	77	12	62
IMF Trust Fund	-14	-10	-21	-21
Debt relief	28	--	25	25
Official short-term capital (net)	37	70	8	58
Other official financing	--	--	--	--
Foreign currency deposits	101	17	--	--
Overall balance	-67	-711	-168	-658
Net foreign assets (increase-)	67	711	168	658
Net use of Fund credit	-15	-38	-90	-88
Other central bank and commercial banks	82	749	258	746
Memorandum items:				
Total long-term capital (net) 4/	782	321	1,006	957
Gross official reserves (in weeks of projected imports, c.i.f.)	12.7	...	10.9	7.0
(In percent)				
Growth rates				
Exports, f.o.b.	1.6	...	10.7	-0.2
Imports, f.o.b.	6.9	...	8.6	4.3
Workers' remittances	-5.2	...	2.5	-10.5
Current account deficit/GNP	3.0	...	3.2	4.4

Source: Ministry of Finance and Economic Affairs.

1/ Includes actual and rescheduled debt service payments.

2/ Excludes IMF Trust Fund.

3/ Excludes foreign currency deposits.

4/ Includes long-term capital (net), IMF Trust Fund, debt relief, and other official financing.

Table 3. Pakistan: Factors Affecting Changes in Money and Quasi-Money, 1983/84-1984/85 ^{1/}

	1983/84	July-December 2/ 1983/84 1984/85		Official Original Projection	Staff Revised Projection
				1984/85	1984/85
(In billions of Pakistan rupees)					
Money and quasi-money	16.6	13.5	8.2	18.1	17.7
Foreign assets	-2.3	0.8	-7.2	-2.6	-9.9
Domestic assets (net)	18.9	12.6	15.4	20.7	27.6
Claims on Government (net)	6.3	4.4	5.1	5.6	12.5
Budgetary support	(7.9)	(6.4)	(9.2)	(5.8)	(12.7)
Commodity support	(-1.3)	(-1.5)	(-3.8)	(-0.2)	(-0.2)
Government deposits with scheduled banks	(0.2)	(-0.4)	(-0.3)	(--)	(--)
Zakat Fund deposits at SBP	(-0.5)	(-0.2)	(--)	(--)	(--)
Claims on nongovernment sectors	18.8	10.5	8.4	17.6	17.6
Claims on private sector	(15.2)	(8.6)	(7.3)	(13.6)	(13.6)
Claims on public enterprises	(3.6)	(1.9)	(1.2)	(4.0)	(4.0)
Counterpart funds	0.3)			--	--
Other items (net) (increase-)	-6.5)	-2.3	1.9	-2.5	-2.5
(Changes in percent)					
Money and quasi-money	11.4	9.2	5.0	11.1	10.9
Domestic assets (net)	13.5	9.1	9.7	13.1	17.4
Claims on Government (net)	8.8	6.2	6.5	7.2	16.1
Claims on nongovernment sectors	21.7	12.1	8.0	16.6	16.6
Claims on private sector	(24.2)	(13.7)	(9.3)	(17.4)	(17.4)
Claims on public enterprises	(15.1)	(7.9)	(4.3)	(14.4)	(14.4)
Memorandum items:					
GDP (at current market prices)	15.4	15.6	15.6
Velocity	3.6	4.1	4.2

Sources: State Bank of Pakistan and staff estimates.

^{1/} Fiscal years ended June 30.^{2/} The change has been taken with respect to the stock values at end-June of the previous fiscal year. Data for 1984/85 are for the July 1-December 27 period.