

IMF Programme

Pakistan closes in on the IMF Programme after Staff-Level Agreement

Pakistan has finally clinched a staff-level agreement with the IMF, with the successful conclusion of the combined 7th and 8th reviews. The EFF loan has been extended until June 2023 and its size has been enhanced by US\$1bn to US\$7bn. Pakistan will be able to obtain US\$1.18bn upon the IMF Executive Board's approval, which will help unlock additional funding and enable Pakistan in overcoming the estimated external funding requirement of US\$45bn until June 2023. We expect a more timely Board approval, unlike the last time when it took nearly three months to release the tranche, as most prior actions appear to have been taken already.

Budget implementation is key

The IMF requires a primary surplus of 0.4% of GDP. Despite revised tax measures targeting 29% higher collection in FY23, the revised budget document only targets a primary surplus of 0.2% of GDP (see annexure). We believe this will largely require restraining current expenditure (only up 5% in the budget) and perhaps further revenue generating measures, as also highlighted in the IMF communique. Pakistan has historically seen heavy slippages on the primary surplus target, and it will have to demonstrate strong fiscal discipline (at both the federal and provincial levels) if it is to remain compliant with the IMF's requirements, while duly focusing on social safety and development projects.

Interest & exchange rates

The IMF has expressed satisfaction at the SBP's recent 125bps increase in the Policy Rate to 15.0%, and continues to advocate a proactive and prudent monetary policy. As a result, while domestic interest rates may arguably have peaked, the monetary easing cycle may not commence until mid-2023, in our view. At the same time, the IMF has stressed upon the continued need to adhere to a market-determined exchange rate. The current REER level of 93.6 suggests room for the PKR to strengthen to less than 200 vs. the USD, but the gradual buildup of FX reserves may keep the exchange rate on the stickier side.

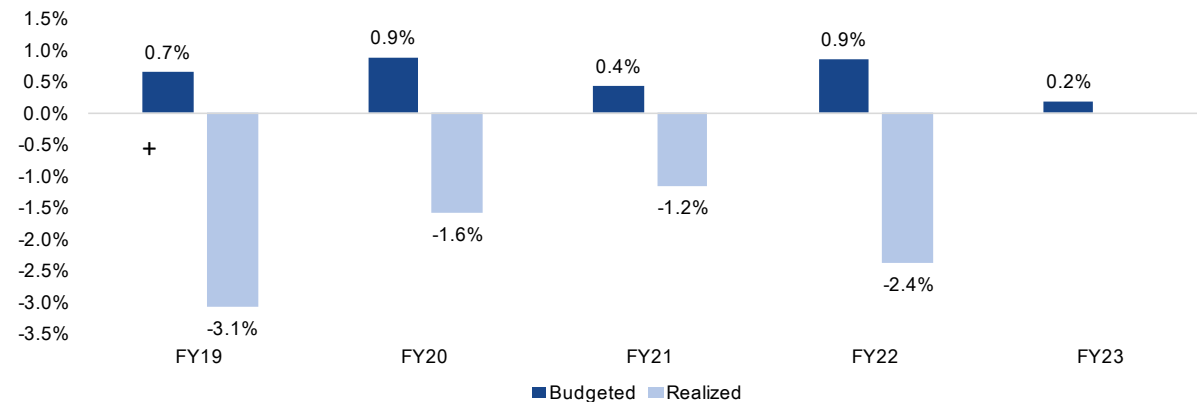
Power sector reforms

Pakistan witnessed a rise of PKR 850bn in circular debt in FY22. However, the subsidy allocated to the power sector has now been reduced to a large extent. The ongoing gas price rationalization, along with expectations of a c.50% hike in the base electricity tariff will enable Pakistan to slow down the accumulation of circular debt. As per the IMF, a quicker mechanism needs to be deployed to overcome the administrative roadblocks that tariff revisions face.

Re-rating is overdue

The KSE100 has gained 2.4% (PKR terms) in the previous two trading sessions. Valuations continue to remain attractive where forward P/E is 4.3x vs. the last 10yr average of 8.1x, and market capitalization-to-GDP is 13% vs. the last 10yr average of 19.4%. Risks emanate from politics and an economy that has little shock absorption capacity. In this regard, the upcoming by-elections on 20 seats vacated by the PTI in Punjab will give a sense of the popularity of incumbent government, although, a further test will come from the IMF's fresh requirement of enhancing governance and anticorruption measures. In the near-term, the resumption of the IMF programme will help rescue Pakistan from the brink of default and continue the bounce in equities.

Pakistan has a legacy of primary surplus slippages



Source: Ministry of Finance, IMS Research

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Annexure

Federal Budget outlay envisages primary surplus of 0.2% of GDP

Receipts (PKRbn)	FY22B	FY22R	FY23B	FY23R (IMF)	vs FY23B	vs FY22R
FBR Tax Revenue	5,829	6,050	7,004	7,470	7%	23%
Direct Taxes	5,829	6,000	7,004	7,470	7%	25%
Non Tax Revenue	2,080	1,315	2,000	1,935	-3%	47%
Gross Revenue	7,909	7,365	9,004	9,405	4%	28%
less: Provincial Share	3,412	3,541	4,100	4,373	7%	23%
Net Revenue	4,497	3,824	4,904	5,032	3%	32%
Capital Receipts	1,241	2,508	1,996	1,996	0%	-20%
External Receipts	1,246	1,383	533	861	62%	-38%
Provincial Surplus	570	570	800	750	-6%	32%
Bank Borrowing	681	849	1,172	843	-28%	-1%
Privatization Proceeds	252	-	96	96	0%	n/a
Total Receipts	8,487	9,133	9,502	9,579	1%	5%
Federal budget deficit	(3,990)	(5,309)	(4,598)	(4,547)		
Fiscal deficit	(3,420)	(4,739)	(3,798)	(3,797)		
Primary deficit	(360)	(1,596)	152	153		
Nominal GDP (PKRbn)	66,950	66,950	78,197	78,197		

Source: Ministry of Finance, IMS Research

Expenditure (PKR bn)	FY22B	FY22R	FY23B	FY23R (IMF)	vs FY23B	vs FY22R
Interest Payments	3,060	3,144	3,950	3,950	0%	26%
Pension	480	525	530	609	15%	16%
Defence Affairs & Services	1,370	1,480	1,523	1,563	3%	6%
Grants and Transfers	1,168	1,090	1,242	1,174	-5%	8%
Subsidies	682	1,515	699	664	-5%	-56%
Running of Civil Govt.	479	530	550	553	1%	4%
Provision for Pay & Pension	160	-	100	-	n/a	n/a
Provision for contingencies	25	-	-	-	n/a	n/a
Provision for Disaster/Emergency/COVID	100	232	100	195	95%	-16%
Current Expenditure	7,523	8,516	8,694	8,708	0%	2%
Federal PSDP	900	550	727	727	0%	32%
Net Lending	64	67	81	144	78%	115%
Other Dev. Expenditure	-	n/a	-	-	n/a	n/a
Development Expenditure	964	617	808	871	8%	41%
Total Expenditure	8,487	9,133	9,502	9,579	1%	5%
- budget deficit % of GDP	-6.0%	-7.9%	-5.9%	-5.8%		
- fiscal deficit % of GDP	-5.1%	-7.1%	-4.9%	-4.9%		
- primary deficit % of GDP	-0.5%	-2.4%	0.2%	0.2%		

The revised Budget FY23 seeks foreign assistance of USD30bn

Foreign Assistance (PKRbn)	FY21B	FY21R	FY22B	FY22R	FY23B	FY23R(IMF)	FY23R(USDbn)
For PSDP	239	257	292	272	297	296	1.59
Outside projects	45	58	23	119	13	13	0.07
Program Loans	504	440	438	656	722	1,243	6.68
ADB	143	150	134	137	141	494	2.66
AIIB	83	40	48	-	-	84	0.45
IBRD	23	59	183	21	116	200	1.07
IDA	252	188	64	181	160	160	0.86
IFAD	-	3	2	2	3	3	0.02
Time Deposits	-	-	-	-	-	-	-
Pakistan Certificate	-	-	-	307	303	303	1.63
OFID	-	-	8	9	-	-	-
Other Loans	1,436	1,532	1,995	2,881	2,134	3,994	21.47
IBD (Short-term)	165	129	160	232	223	223	1.20
Saudi Arabia (Oil facility)	-	-	-	70	-	149	0.80
Saudi Arabia (Short-term)	165	-	-	530	149	558	3.00
Euro Bond/Int'l Sukuk	248	403	560	343	372	372	2.00
Commercial Banks	647	762	779	822	1,390	1,390	7.47
China Safe Deposits	-	161	-	700	-	744	4.00
IMF Loan for Budgetary Support	211	77	496	184	-	558	3.00
Total Foreign Assistance	2,223	2,287	2,748	3,928	3,166	5,546	29.82

Source: Ministry of Finance, IMS Research

Energy subsidies revised downward as reforms remain key

Subsidies (PKRbn)	FY21B	FY21R	FY22B	FY22R	FY23B	FY23R(IMF)
Subsidy to WAPDA/PEPCO	124	350	511	989	490	455
<i>IPPs</i>	-	-	136	434	180	180
Subsidy to Petroleum	10	12	20	377	71	71
Subsidy to KESC	16	16	85	83	80	80
Subsidy to USC	3	8	6	21	17	17
Subsidy to PASSCO	7	7	7	7	7	7
Subsidy to NFS&RD	-	-	-	-	-	-
Others*	50	37	53	38	34	34
Total Subsidies	209	430	682	1,515	699	664

Source: Ministry of Finance, IMS Research

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Buy	Total return expectation of $\geq 15\%$ or expected to outperform the KSE-100 index
Neutral	Total return expectation of $> -5\%$ or expected to match the return of KSE-100 index
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*Based on 12 month horizon unless stated otherwise in the report.

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Risks: (i) Not applicable

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