INTERNATIONAL THE NEWS

09th May, 2019

Pakistan, IMF work out $10-$11 bn financing gap

ISLAMABAD: Pakistan and the IMF have worked out financing gap of $10 to $11 billion for the next financial year 2019-20 as the current account deficit is projected to curtail at $8 billion.

The IMF usually pitched GDP growth and Current Account Deficit (CAD) on lower side during the negotiation process. Initially the IMF was pitching the CAD at the range of $4 to $6 billion but now both sides have moved towards evolving consensus at $8 billion CAD for next fiscal year under the IMF programme.

“The financing gap for next fiscal year has been projected at $10-$11 billion,” top official sources confirmed to The News here on Wednesday. The most critical part of the finalising staff level agreement included IMF demand for upfront hike in policy rate by 100 to 200 basis points, envisaging quarterly NIR (Net International Reserves) to build up foreign exchange reserves and slapping additional taxes of Rs700 billion in the upcoming budget.

Pakistan and the IMF have agreed to hike electricity and gas tariff, making regulator National Electric Power Regulatory Authority (Nepra) fully independent and gradual doing away with tax exemptions of Rs700 billion in two years. In first fiscal year, the tax exemption of Rs350 billion will be abolished. Pakistan and the IMF team will have to conclude staff level agreement till Friday (tomorrow) as the Fund team is scheduled to depart to its headquarters Washington DC on Friday.

Topline Securities Pakistan in its research report on Wednesday stated that given the ongoing discussions with the International Monetary Fund (IMF) team and recent changes in key government positions, they are of the view that Pakistan will likely enter into IMF programme by June.

It argued that Pakistan's case is not as acute as Egypt as Real Effective Exchange Rate (REER) index is around 100 (Egypt was 130 before programme) and there is no subsidy on fuel (in Egypt fuel subsidy still continues).

Tax revenue and budget deficit target will likely be the sticking points in the ongoing IMF negotiations as 10-month tax revenues show shortfall of around Rs345 billion (0.9 percent of GDP) while budget deficit is expected to exceed 7 percent in FY19 after a gap of 5 years.

Once again IMF will demand Pak Rupee (PKR) to be free-floated and they expect the PKR to settle in the range of Rs160-165 by Dec 2019 given expectations of REER below 100. Given increased taxation measures to shore up revenues, reduction in subsidies and devaluation, they expect inflation to average in low double digits in FY20. “We expect Central Bank’s policy rates to peak at 12 percent during 2019.

The IMF programme is expected to include key technical benchmarks including Net Domestic Assets (NDA) and Net International Reserves (NIR) targets, which will serve to reduce borrowing from Central Bank and increase FX reserves respectively.

The government will have to increase focus towards privatisation and restructuring of loss making state owned enterprises. Further, energy sector reform and resolution of outstanding circular debt will also likely be part of the IMF programme.

Pakistan has a long history of signing IMF programmes. To note, benchmark KSE-100 index rallied on average by 37 percent in 12 months post IMF deal based on last 3 IMF programmes. “We attribute the improvement in market sentiment during IMF programme to improved external account situation on receipt of foreign flows and stabilisation on macroeconomic front.

Now based on the assumption that Pakistan will get a new IMF loan soon they are maintaining index target range of 40,000-45,000, providing total return of 12-26 percent from here.

As expected, the newly appointed finance adviser is making his own team. Over the last few days, the government has appointed a new Central Bank Governor, Reza Baqir, who has worked with the IMF for the last 18 years and was last heading the IMF mission in Egypt.

Reza Baqir has overseen the implementation of the current IMF programme in Egypt, which was approved in November 2016 and will end later in 2019. The Egyptian programme had two key contours, that is, free float of currency and reduction in energy subsidy.

The government has appointed Shabbar Zaidi, a seasoned tax consultant and former partner of A F Ferguson & Co, as head of other key institution, Federal Board of Revenue (FBR). “These two changes, we believe, are a desperate move to get IMF package and implement tough economic reforms.”

“We expect IMF programme will likely be approved this month or next month. We expect IMF bailout package to be an Extended Fund Facility (EFF) for a period of 3 years. Though the previous finance minister was expecting a $6-8 billion package, we think the size of the programme should be bigger ($10bn+) considering upcoming debt repayments.

With IMF’s support, other lending agencies will also feel comfortable to provide funding to Pakistan. There are news reports of World Bank (WB) and Asian Development Bank (ADB) to extend their support to Pakistan to the tune of $6-8 billion once Pakistan enters IMF programme.

“We may see major steps towards fiscal, monetary and structural reforms in next few weeks either with or before the budget that is expected to be announced in next few weeks. These may include PKR devaluation/free float, further hike in interest rates, increase in energy prices, elimination of subsidies, new and more taxes, aggressive privatisation policy among others, it concluded.

Mehtab Haider