CREDENDO 10 YEARS

PAKISTAN: LIKELY IMF SUPPORT TO MITIGATE EXTERNAL PRESSURES

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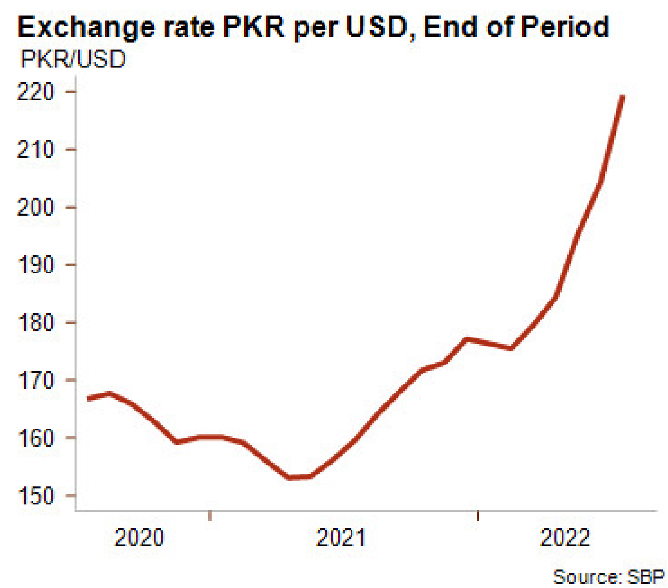
Pakistan is likely to be granted an extension of its stalled IMF programme (Extended Fund Facility) until mid-2023 and an increase of the total loan from USD 6 to 7 bn. The IMF board is expected to approve these measures by the end of August, which would result in a quick disbursement of USD 1.2 bn. At the end of June, China had announced it would lend Pakistan an extra USD 2.3 bn.

IMPACT

The Chinese loan and probable upcoming IMF loan disbursement should ease external pressures and risks of sovereign default, at least temporarily. Pakistan is currently in a deep economic crisis, which high commodity prices have much exacerbated. The macroeconomic context is grim, with dwindling foreign exchange reserves (which nearly halved during the first half of 2022) and a sharply depreciated rupee (-25% between January and 7 August 2022), resulting in huge inflation (24.9% in July), high interest rates (raised to 15% in July, a 14-year high) and external debt pressures.



On top of that, the country is facing high political instability, particularly since ex-PM Imran Khan was ousted from power after a no-confidence vote in parliament in April. Since then, and in a context of wide social tensions fuelled by high food and fuel prices, Khan has been rallying mass protests in a call for snap elections, which PM Shehbaz Sharif is rejecting. Lastly, Khan's Pakistan Tehreek-e-Insaf (PTI) party has been strengthened by electoral wins in the key province Punjab. At the same time, however, a recent ruling from the Pakistan's election commission stated that Khan's PTI party received illegal external funds, which could threaten his political future. In this context, political tensions could further escalate and make the implementation of the IMF programme uncertain, especially given Sharif's fragile coalition. High living costs and austerity measures are severe socio-political instability risks, which might lead to snap elections as energy prices might stay high in the near term (despite mitigation from a potential sharp global economic slowdown) whereas food prices are not going to ease in the near term. After the general elections, still scheduled for October 2023, and depending on who becomes the new PM, the request for a new IMF bail-out will certainly be on the table at some point to continue to support liquidity and repair balance of payments imbalances.

Indeed, the macroeconomic situation is not likely to improve substantially with commodity prices expected to persist at high levels and widening the current account deficit. The latter would have soared from 0.6% of GDP in FY 2021 (ending in June) to 5.4% of GDP in FY 2022, thereby putting permanent pressures on foreign exchange reserves. At this stage, even though there are many similarities with Sri Lanka, it is not accurate to say that Pakistan might follow Sri Lanka in defaulting on its debt. Pakistan's situation still vis 1202% for Sri Lanka). Moreover, Pakistan cannot only count on IMF liquidity support – something Colombo has rejected for a long time – but also on the financial support from its strategic economic and political ally China, which owns a high share of its debt. In addition, the expected deal with the IMF might indicate the start of a warming up of ties with the USA, with the consent of the influential Pakistani army. Therefore, although the debt service for 2022 is higher than the amount of foreign exchange reserves,

Pakistan is not expected to be left in a public debt default position. However, although the Chinese and likely IMF liquidity support will bring temporary oxygen, Pakistan's short-term political risk rating is expected to move shortly to category 5/7. Indeed, the outlook remains negative and challenging due to political instability and continuing considerable imports (food and energy, and the impact of a low rupee) that weigh on liquidity. The outlook is negative as well for the medium- to long-term political risk (the rating is currently in category 6/7).

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