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BNU Center for Policy Research

THE POLICY BEACON

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IMF PROJECTIONS FOR 2023-24 BY DR. HAFIZ A. PASHA

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ABOUT BNU CENTER FOR POLICY RESEARCH

In recognition of the growing need to continue contributing to the stock of knowledge through enquiry, research and interaction, Beaconhouse National University (BNU) set up the Center for Policy Research (BCPR) as the hub for policy-oriented research. Originally focused on applied socio-economic areas, the Center's remit has been expanded to include the entire spectrum of disciplines and fields of inquiry studied at BNU.

BCPR seeks to foster a culture of rigorous, policy-relevant research and analysis. In keeping with the interdisciplinary approach of BNU, the center explores new avenues by taking an integrated view of Pakistan's policy issues in the context of our economic, political and social realities, their changing dynamics and global developments. It is also a platform for interacting with organizations, academia, think tanks and related institutions in Pakistan and abroad.

Thriving under the patronage of eminent personalities including the Center's Director, Dr. Hafiz A. Pasha, BCPR is in a strategic position to benefit the policy research and practice communities from the unique experience of its diverse faculty. The BNU community has already been contributing extensively to the policy debate in the country and their counsel has been regularly sought by successive governments in their respective disciplines, both through formal institutional structures and informal exchanges.

Using cutting-edge analytical and critical thinking techniques, often developed indigenously by our experts over the years, BCPR shall furnish evidence-based research to develop specific proposals and recommendations to all relevant stakeholders for informed and inclusive policy making in Pakistan.

BCPR envisions formulating its recommendations from the lens of its likely beneficiaries, making them primary stakeholders in policy-making exercises. It aims to elicit research to contribute to the ever-evolving narrative for human development and sustainable growth, eventually benefiting the citizens of Pakistan.

> "The Policy Beacon is BCPR's Policy Brief series in which authors analyze contemporary challenges and present recommendations for decision makers. The series covers all disciplines taught at BNU."

KEY HIGHLIGHTS

- The IMF projections indicates continuation of severe ‘stagflation’ in Pakistan in the year 2023-24, that is rising unemployment and continued high incidence of poverty.
- IMF has revised the projections of GDP growth rate for 2022-23 to -0.5% and expects GDP growth rate to be at 2.5% in the year 2023-24.
- The average rate of inflation reported by the IMF in 2022-23 is 29.6% and it will remain high to 26% in 2023-24. Among the many factors, imported inflation will contribute to 30% and the inflationary expectations to 29.2% in the overall inflation.
- The unemployment rate has jumped to 8.5% in the year 2022-23 with 2 million labour force becoming unemployed.
- The paper estimates unemployment to be 9.1% as opposed to 8% projected by the IMF in the year 2023-24 due to an additional 1.7 million people entering in the labour force making it a total of 76.6 million from 69.5 million implying a high incidence of poverty close to 38% of population.
- The IMF reports that the budget deficit will be at 7.6% of the GDP in 2022-23 and the primary balance at negative 1% of the GDP, whereas it will be 7.5% of the GDP in 2023-24.
- The key projections are about the current account deficit which is estimated to be 1.2% of the GDP in 2022-23, approximately $4 billion and 1.8% of GDP for 2023-24 equivalent to approximately $6.5 billion.
- The IMF has targeted for an increase in the foreign exchange reserves of $9 billion by the end of 2023-24, thereby representing import cover at 1.4 months implying the need to enter a new three-year Extended Fund Facility soon after the completion of the Stand-By Facility.
- The report suggests that minimization of risks will require aggressive use of exchange rate and interest rate policies.

> “Foreign exchange reserves are expected to be inadequate in 2023-24 despite IMF facility.”

> “IMF projects sizable 29.2% imported inflation in 2023-24 based on exchange rate depreciation.”

The press release by the IMF of 12th of July 2023 announcing approval by the IMF Executive Board of the Stand-By Arrangement of $3 billion with Pakistan, also contains projections of selected economic indicators for 2023-24. Some of these projections will effectively act as performance criteria or indicative targets during the tenure of the Stand-By Facility. There is a need to carefully analyze these projections and derive their implications.

We first look at the benchmark estimates for 2022-23. The IMF has changed its earlier estimate of the GDP growth rate of 0.5% in 2022-23 to a negative 0.5%. This is also in contrast to the preliminary estimate by the PBS of 0.3%. The IMF now apparently feels that the negative impact of the floods has been somewhat larger.

The negative GDP growth rate in 2022-23 has led to an estimated jump in the unemployment rate from 6.2% to 8.5%. This is an appropriate estimate by the IMF and indicates that the number of unemployed workers has increased by almost 2 million in 2022-23.

The average rate of inflation reported by the IMF in 2022-23 is 29.6%. It was actually 29.2%, due to lower inflation in June 2023. Consequently, the end-period rate of inflation was 29.6%, significantly smaller than the 34% reported by the IMF.

Detailed estimates are given on the likely state of public finances in 2022-23. The IMF reports that the budget deficit will be at 7.6% of the GDP and the primary balance at negative 1% of the GDP. This reveals that the debt servicing to GDP ratio has risen sharply from 4.8% of the GDP in 2021-22 to 6.6% of the GDP in 2022-23, due to the big hike in the policy rate in 2022-23 by the SBP.

Other estimates by the IMF are of money and credit and the balance of payments. The current account deficit in 2022-23 is estimated at 1.2% of the GDP, equivalent to approximately $4 billion. Foreign exchange reserves at the end of 2022-23 are at only $4.056 billion.

"Investment fell 18.2% in 2022-23, projected to grow 6% in 2023-24 but still below 2021-22 level."

"Exports declined 9.3% in 2022-23, expected to grow 11.9% in 2023-24 with more competitive exchange rate."

Turning now to the IMF projections for 2023-24, they present a picture largely of continuation of the worst form of 'stagflation' that we saw in 2022-23. The GDP growth rate is expected to be low at 2.5% and the inflation rate to remain high at close to 26%. In fact, the IMF has now painted a grimmer picture of the economy of Pakistan. In its earlier projection in the World Economic Outlook in April 2023, it had anticipated the GDP growth rate at 3.5% and the rate of inflation at 21.9% in 2023-24.

The IMF has brought down its GDP growth rate expectation despite the positive impact of the 'low base effect' of negative growth last year. Also, if no physical restraint will be exercised on imports, then this should enable higher industrial production, which has declined by as much as 4% in 2022-23 (see Table 1 in the Statistical Annex). Similarly, the output of Kharif crops should be significantly higher in relation to the depressed levels last year due to damage by the floods.

> "Imports fell 18.5% in 2022-23 due to restrictions, projected to rebound 17% in 2023-24 as restrictions eased."

However, with high interest rates the level of investment will remain even below the level attained in 2021-22 and the trade deficit in goods and services will be significantly larger (see Table 2). Therefore, slower growth in aggregate demand will limit the GDP growth rate to 2.5% in 2023-24 as per the IMF projections.

The IMF has also revised its rate of inflation projections upwards by 4 percentage points. The likeliest explanation for this is that it expects a quantum depreciation in the exchange rate as the market-based exchange rate policy is proposed as the primary instrument for limiting the size of the trade deficit, with no resort to physical controls over imports. As such, the rate of inflation projection of 25.9% in 2023-24 is likely to be linked to a higher rate of imported inflation (see Table 3). The underlying projection of the nominal exchange rate depreciation in 2023-24 may be as high as 30% to 35%. Also, it is unlikely that the rate of inflation will fall to 16.2% by June 2024, as per the IMF projection. Further, administered prices of energy and fuel will rise by close to 25%.

An optimistic projection by the IMF is that the unemployment rate will come down from 8.5% in 2022-23 to 8% in 2023-24. With the projected low GDP growth rate of 2.5%, the likely increase in the number employed is 1 million, whereas the labor force will expand by almost 1.7 million (see Table 4). The consequent increase in the number of unemployed of 0.7 million will raise the unemployment rate from 8.5% to 9.1%. This also implies that there will continue to be a high incidence of poverty in 2023-24, at close to 38% of the population.

Turning to the budgetary outlook, the expected growth rate in revenues of the federal and provincial governments combined is very high at almost 39% (See Table 5). This is much bigger than the growth rate achieved in 2022-23 of 21%. The prospects for growth are better because of the likely faster expansion in the tax base of the rupee value of imports.

"Debt servicing grew 53.1% in 2022-23, projected to jump further by 57.6% in 2023-24 due to higher interest rates."

Rapid increases in revenue are anticipated with over Rs400 billions of taxation proposals, full year impact of the enhancement in the GST rate to 18%, hike in the rate of petroleum levy and large increase in the SBP profits due to higher interest rates. Nevertheless, there may still be some shortfall which will necessitate a minibudget during the tenure of the Stand-By Facility.

The growth rate of total public expenditure is also expected to be high at 35% in 2023-24, as compared to 21% in 2022-23. The primary reason is the projected increase in debt servicing of as much as 58%. Other expenditure is budgeted to rise by 23%, including the cost of the big increase announced in pay and pensions of government employees.

The IMF now expects the consolidated budget deficit in 2023-24 to be higher by 1% of the GDP at 7.5% of the GDP, as compared to the budget deficit estimate by the Ministry of Finance. This is due to the provision for higher debt servicing by the IMF of Rs 8.7 trillion, as compared to Rs 7.3 trillion in the 2023-24 budget. Clearly, the IMF expects the level of interest rates to be very high in 2023-24, perhaps even above the peak rate of 22% in 2022-23.

The key set of projections by the IMF for 2023-24 relate to the external balance of payments. The current account deficit is estimated at 1.8% of the GDP, equivalent to approximately $6.5 billion (see Table 6). This is in comparison to the outcome in 2022-23 of $2.5 billion.

The projected current account deficit by the IMF is probably based on a number of assumptions. First, exports will show some recovery of over $4 billion due to a market-based exchange rate contributing to higher profitability and with no shortage of imported inputs. Exports could rise in volume terms by almost 15%. Second, with the removal of physical restrictions, imports could increase by almost $10 billion.

The deficit of trade in services and the net outflow of primary income are likely to be higher by almost $1.5 billion and $2.5 billion respectively, following the resumption of uninterrupted outflows. Fourth, with much less difference between the inter-bank rate and the open market exchange rate, remittances could rise by over $6 billion, including the normal growth of $2 billion. With these changes, the current deficit can be limited to $6.5 billion in 2023-24. Needless to say, this will require an aggressive exchange rate policy.

> "Remittances could increase over $6 billion in 2023-24 with reduced gap between interbank and open market exchange rates."

The IMF has targeted for an increase in the foreign exchange reserves of $4.3 billion to almost $9 billion by the end of 2023-24, thereby representing a somewhat safer level of import cover at 1.4 months, although still not adequate. Achievement of this target will require a financial account surplus in the balance of payments in 2023-24 of $9.3 billion, besides the $3 billion forthcoming from the IMF during the year as part of the Stand-By facility.

The expected level of foreign direct investment is under $1 billion. Therefore, the net external borrowing by the government will need to be over $8 billion. The estimated external debt repayment is likely to be $9.5 billion, net of roll-overs. Therefore, the IMF probably anticipates a total new inflow of assistance of $17.5 billion. This will become clearer when the detailed estimates of external financing requirements and the sources of this financing are released in the Staff Report and Statement on the $3 billion Stand-By Arrangement.

The above first estimate of $17.5 billion of external financing requirements is relatively high compared to under $9.5 billion new inflows in 2022-23. There is some improvement in Pakistan's credit-rating and reduction in the discount on sovereign bonds. Will Pakistan now be able to achieve the target flotation level of $1.5 billion of Euro/Sukuk bonds and new borrowing of $4.5 billion from international commercial banks, as per the budget estimates in 2023-24? If not, then the pressure will be to limit the size of the current account deficit, which will lead to even greater depreciation of the rupee and higher interest rates.

Overall, the above analyses represent an attempt to assess the macro-economic projections by the IMF for 2023-24. The IMF projections indicate the continuation of severe 'stagflation' in Pakistan, with rising unemployment and persistence of high incidence of poverty. The economy will continue to be vulnerable, even in the presence of the IMF Stand-By Facility, and minimization of risks will require aggressive use of exchange rate and interest rate policies. Also, even if the external financing targets are met, the foreign exchange reserves will be only half the safe level and Pakistan will need to enter a new three-year Extended Fund Facility soon after the completion of the Stand-By Facility.

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Table 1 Likely GDP Growth Rate by Sector in 2023-24

	2022-23		2023-24	
	Sectoral Value Added*	Growth Rate (%)	Sectoral Value Added	Growth Rate (%)
Agriculture	8,848	0.7	8,998	1.7
Industry	7,133	-3.7	7.384	3.5
Services	22,633	0.0	23,198	2.5
GDP at factor Cost	38,614	-0.5	39,580	2.5

*Amended from PBS estimates to yield GDP growth rate of -0.5%.

Table 2 Projected GDP Growth Rate by Expenditure in 2023-24

	2022-23		2023-24	
	Level	Growth Rate (%)	Level	Growth Rate (%)
Household Consumption Expenditure	36,198	0.9	37,750	4.3
Government Consumption Expenditure	4,118	-8.1	4,320	4.9
Investment (Public +Private)	4,803	-18.2	5,090	6.0
Exports of Goods and Services	3,789	-9.3	4,420	11.9
Less Imports of Goods and Services	7,616	-18.5	8,910	17.0
GDP at Market Prices	41,292	0.9	42,490	2.9
GDP at factor cost	38,614	-0.5	39,585	2.5

Table 3	Likely Magnitude of Factors Contributing* to the Rate of Inflation in 2023-24
	%
GDP Growth Rate	2.5
Growth Rate of Money Supply (Lagged One Year)	13.3
Inflationary Expectations (Lagged Rateof Inflation)	29.2
Increase in Administered Prices	25
Imported Inflation	30

*Overall IMF Expectation of Rate of Inflation in 2023-24 25.9%

Table 4 Likely Unemployment Rate in 2023-24

Million

	Labor Force	Employed	Unemployed	Unemployment Rate (%)
2021-22	73.3	68.8	4.5	6.1
2022-23	74.9	68.5	6.4	8.5
2023-24	76.6	69.5	7.1	9.1

Table 5 Projection of Key Budgetary Magnitudes (consistent with the IMF projections)

(Rs. billion)

Federal + Provincial Governments	2021-22	2022-23	g (%)	2023-24	g (%)
Revenues	8,061	9,793	21.4	13,594	38.8
Expenditure	13,324	16,187	21.5	21,883	35.2
Budget Balance	-5,263	-6,394		-8,289	
Debt Servicing	3,198	5,538	73.1	8,731	57.6
Primary Balance	-2,065	-856		442	

Table 6 **Projection of the Balance of Payments in 2023-24**

($ billion)

	Projections		
	2022-23	2023-24	g (%)
A. CURRENT ACCOUNT DEFICIT	-2.5	-6.5	
Balance of Trade in Goods	-24.1	-30.0	
Exports of Goods	27.9	32.0	14.7
Imports of Goods	52.0	62.0	19.2
Balance of Trade in Services	-0.7	-2.0	
Exports of Services	7.3	8.5	16.4
Imports of Services	8.0	10.5	31.2
Net Primary Income	-5.7	-8.0	
Net Secondary Income	28.0	33.5	19.6
B. FINANCIAL ACCOUNT	-1.6	9.3	
C. BALANCE OF PAYMENTS	-4.2	+2.8	
Net Inflow from IMF	-1.0	2.2	
D. CHANGE IN RESERVES	-5.2	5.0	

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