Governor’s Statement No. 5

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Statement by the Hon. **JAMEEL AHMAD,**
Governor of the Fund for **PAKISTAN**

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Honorable Chairperson,

Fellow Governors, Ladies and Gentlemen,

I would like to begin my statement by briefly discussing the recent global economic conditions and policy developments. I will then highlight major economic developments and policy achievements in Pakistan. And finally, I will discuss key challenges and lay out a few proposals for the IMF and the World Bank to reorient their roles in the evolving global economic landscape.

Global Economy

The global economy is currently in a better position than it was a year ago when concerns about elevated inflation, higher-for-longer policy rates and fragile economic recovery were on top of the agenda of policymakers. Since then, inflationary pressures have moderated considerably, largely due to aggressive monetary policy responses by the central banks around the globe.

More recently, the receding inflationary pressures and cooling-off of labor markets have allowed Advanced Economies (AEs) to commence monetary easing, whereas Emerging and Developing Economies (EMDEs) were already lowering their policy rates earlier on. Now, the policy question that central banks are faced with is about the pace of monetary easing. Aggressive monetary policy easing carries the risk of rekindling inflationary pressures, while easing it at a slower pace can unduly constrain economic growth. This requires that the central banks around the globe should maintain a cautious approach while pursuing their ongoing monetary easing to keep the potential risks of inflationary pressures under check. Encouragingly, the global experience so far is largely in line with this approach.

Recent Economic Developments in Pakistan

Pakistan has experienced significant economic challenges during the last three years. Similar to other countries, we suffered through the effects of post-pandemic supply disruptions, commodity super-cycle and tight global financial conditions. The impact of these global shocks were further accentuated by the devastating floods of 2022. These shocks led to a slowdown in economic activity and unprecedented surge in inflation. To address these challenges, Pakistan embarked on a path of policy and structural reforms.

The State Bank of Pakistan tightened the monetary policy stance to bring inflation down to its medium-term target. At the same time, the government pursued the necessary fiscal consolidation and achieved a significant improvement in the primary balance over the past two years that has improved public debt dynamics.

These tough policy choices did not come without a cost. Economic growth has remained subdued and below its potential in recent period. However, the policy response is yielding the desired results. CPI inflation fell within the medium-term target of 5-7 percent in September 2024, from its peak of 38 percent in May 2023. Moreover, reforms in the foreign exchange market and incentives to attract workers' remittances through formal channels, amidst robust export growth, have kept the current account at manageable levels. This supported substantial increase in FX buffers and stability in the financial markets.

At this juncture, the sharp decline in inflation and easing external account pressures have allowed the SBP to gradually reduce the policy rate by 450 bps since June 2024, to 17.5 percent currently.

Going forward, the monetary policy adjustments shall remain prudent and data driven, aimed at keeping potential inflationary pressures in check, while remaining supportive of sustainable economic growth.

In this regard, to support the home-grown economic reform agenda and achieve sustained economic recovery, Pakistan has entered into a 37-month IMF Extended Fund Facility (EFF). The government and the SBP are fully committed to the targets and reform agenda, including improved revenue collection, privatization of state-owned enterprises, maintaining prudent monetary and exchange rate policies, and transitioning towards a viable energy sector.

Global Challenges and Way Forward

Overall, after years of painful adjustments, it is encouraging to see signs of improvement across both AEs and EMDEs over the past 12 months. Yet, there are significant policy challenges and trade-offs ahead, especially in the context of already debt stressed EMDEs. I would like to discuss few key challenges here:

1. **Geopolitical tensions:** The economic and humanitarian crises in the Middle East have escalated significantly in recent months. It is also a major source of uncertainty gripping the commodity markets, particularly crude oil. Any disruption in crude oil supplies could once again induce inflationary pressures and adversely impact the balance of payments position of EMDEs.

2. **Climate Shocks:** Climate change-induced weather events and resultant supply shocks threaten economic activity and pose inflationary risks to many EMDEs. The impact could be higher, as the external and fiscal buffers of EMDEs have already weakened in combating successive adverse economic shocks since the pandemic.

3. **Trade fragmentation:** The escalating fragmentation of global trade has intensified since the onset of the Russia-Ukraine conflict. The fragmented global trade could unevenly affect the low income and vulnerable economies, as it may result in loss of efficiency and specialization, stretch supply lines, and limit technology spillovers to EMDEs. Trade protectionism and fragmentation also pose risks to food security. If not addressed, this may increase commodity prices, reduce global economic output and exert undue pressure on EMDEs currencies.

4. **Adoption of artificial intelligence**: The rapid adoption of artificial intelligence (AI) across various sectors of the economy and its enormous transformative potential carries major implications for the global economy. AI clearly offers an unparalleled opportunity to enhance labor productivity. At the same time, it poses heightened risks for current labor market structures. While AEs are poised to benefit more from enhanced productivity, EMDEs are likely to reap limited benefits mainly due to lack of necessary infrastructure, skilled workforce, and financial resources. If not addressed timely, this could further increase income divergences across countries.

Role of World Bank Group and the IMF

I would like to conclude my statement by appreciating the commendable role of Multilateral Development Banks (MDBs), like the IMF and World Bank, in the constantly evolving global economic landscape. The wide range of global challenges cannot be navigated alone by vulnerable economies, and the financing and advisory roles of the MDBs must be acknowledged.

Further to enhance the roles of these MDBs, I would like to make some recommendations:

- The IMF should broaden the scope of the Resilience and Sustainability Trust (RST) and Poverty Reduction and Growth Trust (PRGT) and relax their conditionality. Further, the Bretton Woods Institutions should consider introduction of a program, similar to their earlier initiatives, like debt relief for heavily indebted poor countries and multilateral debt relief initiatives, which offer debt relief in exchange of climate actions. Such initiatives are much warranted today in allowing the vulnerable economies to have the needed fiscal space for enhancing their climate resilience.

- The IMF should also consider both relative contributions and vulnerability to climate change in the quota determination during the upcoming 17th Quota Review. This would assist in alignment of the IMF's interests with the imminent need for climate transition and also allow a greater representation of climate vulnerable economies in global decision making.

- There is a need for more trade integration instead of fragmentation, particularly at a time when food and energy security is threatened in various vulnerable economies. This could benefit the global economy with more technology spillovers and affordable consumer goods. Therefore, MDBs should make maximum efforts to promote more trade openness and urge the member countries to reduce trade barriers.

- In the face of rapid global adoption of AI, MDBs should introduce frameworks, aimed at improvement of related infrastructure and capacity building in emerging world, so that the EMDEs could also reap potential benefits of AI transformation, similar to AEs.

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