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Fitch upgrades Pakistan's rating to 'CCC+' from 'CCC'

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International credit rating agency Fitch on Monday upgraded Pakistan's long-term foreign currency issuer default rating (IDR) from CCC to CCC+. The upgrade signifies an improvement in Pakistan's external liquidity and funding conditions, strengthened by the recent IMF agreement. Fitch highlighted the strong performance under the previous IMF arrangement, which helped Pakistan narrow its fiscal deficits and rebuild foreign exchange reserves. However, the agency warned that Pakistan's large funding needs could leave it vulnerable if challenging reforms are not implemented, potentially undermining program performance and funding. Fitch expects IMF board approval for the $7 billion, 37-month program by the end of August. However, the government must secure new funding assurances from bilateral partners, mainly Saudi Arabia, the UAE, and China, totalling about $4-5 billion over the duration of the EFF. "We believe this will be achievable, given the strong past record of support and significant policy measures in the recent budget for the fiscal year ending June 2025 (FY25)," Fitch noted. Under the previous IMF program, Pakistan successfully completed its nine-month Stand-by Arrangement in April. Over the past year, the government raised taxes, cut spending, and increased electricity, gas, and petrol prices. It also nearly eliminated the gap between the interbank and parallel market exchange rates through a crackdown on the black market and regulation of exchange houses. Fitch does not assign outlooks to sovereigns rated CCC+ or below. The agency forecasts that the current account deficit (CAD) will remain relatively contained at about $4 billion (about 1% of GDP) in FY25, after about $700 million in FY24. This is attributed to tight financing conditions and subdued domestic demand. On the external front, Fitch noted that Pakistan's foreign exchange reserves have recovered but remain low. The State Bank of Pakistan (SBP) is rebuilding FX reserves amid new funding inflows and limited CADs, with official gross reserves, including gold, rising to over $15 billion by June 2024. This is expected to increase to nearly $22 billion by the end of FY26, approaching their 2021 peak. Fitch pointed out that the SBP's net liquid FX reserves, excluding gold and FX reserve deposits of banks, recovered to over $9 billion by June 2024. The SBP has reduced its forward liabilities to local banks and is nearing a balanced net foreign asset/liability position. On the fiscal front, Fitch stated that half of the revenue efforts under the EFF are frontloaded in the FY25 budget, which was prepared in collaboration with IMF staff. The budget projects a headline deficit of 5.9% of GDP and a 2.0% primary surplus. Fitch's forecasts assume partial implementation, projecting a primary surplus of 0.8% of GDP and an overall fiscal deficit of 6.9% of GDP in FY25, improving to 1.3% of GDP and 6% of GDP, respectively, in FY26. Politically, Fitch expressed concerns that the close outcome of the February elections delivered a weaker-than-expected mandate for Prime Minister Shehbaz Sharif's PMLN party. "PMLN and its allies command only a slim majority in the National Assembly after a recent Supreme Court ruling re-allocating reserved seats in favour of independents linked with former prime minister Imran Khan's PTI party. Khan has been in prison since May 2023 but remains popular," Fitch noted.