DEBT POLICY STATEMENT

2013-14

Debt Policy Coordination Office
Ministry of Finance

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Table of Contents

Acknowledgements

This Policy Statement has been prepared to fulfil the requirement laid out under Section 7 of the Fiscal Responsibility and Debt Limitation Act 2005. I would like to acknowledge the input of various Ministries, Departments, Divisions and Agencies, particularly, timely data provision by Budget Wing (MoF), Economic Affairs Division. I would like to recognize the efforts put in by Mr. Muhammad Ikram, Deputy Secretary (DPCO), Mr. Muhammad Umar Zahid, Financial Analyst (DPCO), Mr. Arsalan Ahmed, Financial Analyst (DPCO), Ms. Myra Qazi, Consultant (DPCO) and Ms. Rabia Tabassum, Internee (DPCO) in the realization of this comprehensive document.

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Ministry of Finance

Lists of Tables & Figures

1.0 Introduction

1.1 A formal debt policy is essential for effective financial management. It improves the quality of decisions, provides justification of structure of debt issuance, identifies policy goals and demonstrates a commitment to long term financial planning. In a broader macroeconomic context, governments need to ensure that both the level and rate of growth in their public debt are fundamentally sustainable and can be serviced under different circumstances while meeting cost and risk objectives.

1.2 The process of establishing and executing a strategy for managing the government's debt, required for its funding, achieve its risk and cost objectives has become a priority area for many developed and transitional economies. The recent persistent and incessant global financial turbulences call for formulating a more reliable and robust debt management strategy along with fiscal and monetary policies. The absence of prudent debt strategy has forced myriad countries to give priority to debt servicing instead of providing them with fresh resources. High and unsustainable levels of debt have serious repercussions for the economy in terms of heavy debt servicing and decreased developmental expenditures, essential to carry on the growth process. As developing countries are growing faster than developed ones, making it easier for the former to satisfy the condition and ride on declining debt trajectory, leading to debt acting as a catalyst in the course of growth.

1.3 In Pakistan's case, due to unavailability of sufficient external financing, the composition of public debt has shifted towards domestic debt and furthermore into shorter duration instruments which is a source of vulnerability and entails high rollover and refinancing risk. In such a case, an increase in interest rates would have adverse fiscal impact. Maintaining exchange rate stability is also essential as depreciation of Pak Rupee would affect both the stock of the government debt as well as the debt servicing flows. Going forward, it highlights the importance of gradually lengthening the maturity profile of domestic debt, maintaining exchange rate stability and regaining growth momentum to reduce the impact of growing indebtedness.

1.4 Government of Pakistan has embarked upon a policy necessary for fiscal consolidation and debt management incorporated in Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005. Such fiscal consolidation is marked by persistent structural reforms to public finances over myopic fiscal measures. According to it, the following statement put out the total public debt in detail and highlights the portions where the government had been successful or failed in achieving the targets.

2.0 Debt Policy Statement

2.1 The Debt Policy Statement is presented to fulfill the requirement in Section 7 of the Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005 which states that:

(1) The Federal Government shall cause to be laid before the National Assembly, the Debt Policy Statement by the end of January of each year.

(2) The purpose of the Debt Policy Statement is to allow the assessment of the Federal Government's debt policies against the principles of sound fiscal and debt management and debt reduction path.

(3) In particular and without prejudice to the provisions of sub-section (2) the Debt Policy Statement shall, *inter alia*, contain –

- (a) Assessment of the Federal Government's success or failure in meeting the targets of total public debt to estimated gross domestic product for any given year as specified in the debt reduction path;
- (b) Evaluations of external and domestic borrowing strategies and provide advice on these strategies;
- (c) Evaluations of the nominal and real costs of external and domestic borrowing and suggest ways to contain these costs;
- (d) Analysis of the foreign currency exposure of Pakistan's external debt;
- (e) Consistent and authenticated information on public and external debt and guarantees issued by the government with ex post facto

budgetary out-turns of all guarantees and those of other such claims and commitments;

(f) Information of all loan agreements contracted, disbursements made thereof and repayments made thereon, if any, by the government during the fiscal year; and

(g) Analysis of trends in public debt and external debt and steps taken to conform to the debt reduction path as well as suggestions for adjustments, if any, in the Federal Government's overall debt strategy.

3.0 Principles of Sound Debt Management

3.1 The modern theory for public debt sustainability discerns a fundamental relationship between economic stability and debt sustainability in a country. The inadequate debt management and a permanent and unlimited growth of debt to GDP ratio may result in negative tendencies and changes in main macroeconomic indicators, like crowding out of investment, financial system instability, inflationary pressures, exchange rate fluctuations etc. There are also social and political implications of unsustainable debt burden. Persistent and high public debt calls for a large piece of budgetary resources for debt servicing. Therefore, the conventional wisdom focuses the management of debt, rather debt itself.

3.2 Debt is not a stigma in itself, yet the management of debt is important. Debt is an important measure of bridging the financing gaps. Prudent utilization of debt leads to higher economic growth and it also helps the government to accomplish its social and developmental goals. Comprehensive debt management is required on the part of government not only to keep the current levels of debt under control but also to fulfill the future repayment obligations. This does not subvert the importance of vigilant fiscal and monetary policies. The management of public debt also requires effective coordination with macroeconomic policies, including reserve management and exchange rate policy.

3.3 Domestic and external debt should be treated separately. Domestic debt is a charge on budget and must be serviced through government revenues and/or additional borrowings whereas external debt (both public and private), in addition to charge on revenues, is also a charge on balance of payment and must be serviced from foreign exchange earnings, reserve drawdown, and additional borrowings. Therefore the two should be managed separately to ensure fiscal and external account solvency. Each of these types of debt has its own benefits and drawbacks, with a trade-off between costs of borrowing and exposure to various types of risks that needs to be balanced in order to ensure ample and timely access to cost efficient funding. A comprehensive approach to managing domestic debt must place a high priority on the development of domestic capital markets, and avoid the crowding-out of the private sector.

3.4 As a rule of thumb, as long as the real growth of revenue is higher than the real growth of debt, the debt to revenue ratio will not increase. Crucially, future levels of debt hinge around the primary balance of the government. Mathematically, if the primary balance (fiscal deficit before interest payments) is zero and the growth in revenue is higher than the cost of invested funds, the debt burden will ease. Bridging the gap between revenues and non-interest expenditure, and ensuring a reduction (generation) in primary deficit (surplus) is an essential pre-requisite that facilitates debt management efforts.

3.5 Managing the levels of external debt and the risks associated with them pose a different set of challenges. In this case, if the growth in Foreign Exchange Earnings (FEE) exceeds the growth in External Debt & Liabilities (EDL), the ratio of EDL-to-FEE will continue to decline. Although external debt expressed as a percentage of GDP and export earnings depicts the levels and burden of external debt, a clear insight in to the future path of debt is gained by analyzing the non-interest current account deficit. A nil current account deficit before interest payment and higher growth in FEE compared to the interest rate paid on EDL will ensure a decline in EDL-to-FEE over time. Focusing on limiting the non-interest current account deficit, while ensuring that the cost of borrowing is kept at a minimum restricts the increases in debt levels in the medium to long-term; while partially mitigates the inherent risks of external borrowing.

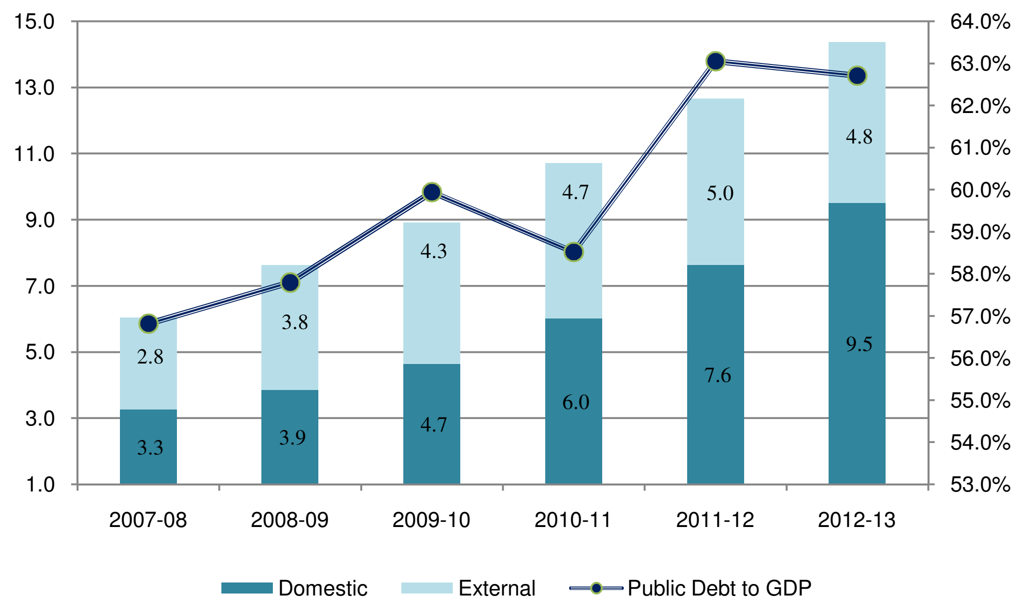
4.0 Review of Public Debt

4.1 The portion of total debt which has a direct charge on government revenues is taken as public debt. Public debt is a measure of government indebtedness. It includes debt denominated in rupee as well as in foreign currency. Each of these types of debt has its own benefits and drawbacks, with a trade-off between costs of borrowing and exposure to various types of risks, which need to be balanced, in order to ensure ample and timely access to cost efficient funding.

4.2 Public debt stock as on June 30, 2013 reached at Rs.14,366 billion representing an increase of Rs.1,699 billion or 13 percent higher with that of last fiscal year. This built-up in public debt was mainly attributed to increase in domestic debt by Rs.1,880 billion, whereas, external debt witnessed a decline of Rs.181 billion. With external source of funding shrinking over the past few years, it was the hefty repayments against IMF loans and translation gain on account of appreciation of US Dollar against Japanese Yen which led to fall in the external debt during 2012-13. Although, in dollar terms, external public debt decreased by around US$ 4.6 billion, however 5.4 percent depreciation of Pak Rupee against US Dollar narrowed this effect in rupee term.

4.3 Over the past few years, government relied mainly on the domestic borrowing which resulted in gradual increase of its share to around 66 percent of the total public debt compared to 51 percent in 2008-09. The built-up in domestic debt is mainly attributed to large fiscal deficits and absence of sufficient external inflows during past few years. Increased demand on government budget for the purpose of interest servicing, security and subsidies which consumed around 63 percent of the revenues signifies that expenditures were fairly rigid even in the face of a committed effort to curtail the fiscal deficit. The evolution of funding mix adopted during last few years showed an implicit borrowing strategy that increasingly relied on short-term domestic borrowing owing to insufficient external financing.

Fig-1: Evolution of Public Debt
(in trillion of PKR and percent of GDP)



4.4 Public debt was recorded at Rs.15,334 billion as on September 30, 2013 registering an increase of Rs.968 billion or 7 percent in first three months of the current fiscal year. This rise in public debt is attributed to increase in domestic debt by Rs.641 billion and external debt by Rs.327 billion. The government was able to contain fiscal deficit at 1.1 percent of GDP for first quarter of 2013-14 largely because of Rs.92 billion provincial budget surpluses.

4.5 The first quarter of the current fiscal year noticed a translational loss of US$ 665 million on account of cross-currency movement against US Dollar. This loss is mainly due to depreciation of US$ against SDR (US$ 329 million), Japanese Yen (US$ 140 million) and Euro (US$ 160 million). In spite of this translational loss, external public debt declined marginally in US Dollar term as compared to end-June, 2013 owing to net negative external financing. However, in Pak Rupee terms, it increased by Rs.311 billion owing to 6.4 percent depreciation of Pak Rupee against US Dollar.

Table-1: Public Debt

	2008	2009	2010	2011	2012(P)	2013(P)	2014(P)*
(Rs. in billion)							
Domestic Debt	3,266	3,852	4,651	6,016	7,637	9,517	10,158
External Debt	2,788	3,776	4,260	4,685	5,030	4,849	5,176
Total Public Debt	**6,044**	**7,629**	**8,911**	**10,700**	**12,667**	**14,366**	**15,334**
(In percent of GDP)							
Domestic Debt	30.7	29.2	31.3	32.9	38.0	41.5	39.1
External Debt	26.1	28.6	28.7	25.6	25.0	21.2	19.9
Total Public Debt	**56.8**	**57.8**	**59.9**	**58.5**	**63.0**	**62.7**	**59.0**
(In percent of revenues)							
Domestic Debt	217.8	208.1	223.8	267.0	297.6	319.1	---
External Debt	185.3	204.0	205.0	208.0	196.0	162.6	---
Total Public Debt	**403.1**	**412.2**	**428.8**	**475.0**	**493.6**	**481.7**	**---**
(In percent of total debt)							
Domestic Debt	54.0	50.5	52.2	56.2	60.3	66.2	66.2
External Debt	46.0	49.5	47.8	43.8	39.7	33.8	33.8
Memo:							
Foreign Currency Debt (US$ in billion)	40.7	46.4	49.8	54.5	53.2	48.7	48.8
Exchange Rate (Rs./US$, End of Period)	68.3	81.4	85.5	86.0	94.5	99.7	106.1
GDP[(a)] (Rs. in billion)	10,638	13,200	14,867	18,285	20,091	22,909	26,001
Total Revenue (Rs. in billion)	1,499	1,851	2,078	2,253	2,567	2,982	---

P:Provisional *end-September, 2013

[(a)]The base of Pakistan's GDP has been changed from 1999-00 to 2005-06

Source: State Bank of Pakistan, Economic Affairs Division, Budget Wing and Debt Policy Coordination Office Staff Calculations

5.0 Dynamics of Public Debt Burden

5.1 Borrowing is beneficial for economic development of any country as long as the economic returns are higher than the cost of invested funds. Developing countries need to borrow to facilitate their development process and accelerate the pace of growth. Debt problems for governments arise if debt-servicing capacity does not keep pace with growth of debt. This may also be expressed as debt exceeding sustainable levels. High and unsustainable levels of debt have serious repercussions in terms of heavy debt servicing and decreased developmental expenditures, essential to carry on the growth process.

Table-2: Selected Public Debt Indicators (in percentage)

	2008	2009	2010	2011	2012	2013
Real Growth of Public Debt	11.5	4.6	5.5	0.5	12.4	5.5
Real Growth of Revenues	2.3	2.3	1.4	(9.3)	8.2	8.1
Real Growth of Debt Burden	9.2	2.3	4.1	9.8	4.2	(2.6)
Revenue Balance / GDP*	(3.1)	(1.2)	(1.7)	(3.3) (b)	(4.5) (c)	(2.8) (d)
Primary Balance / GDP*	(2.4)	(0.1)	(1.6)	(2.5) (b)	(4.2) (c)	(3.6) (d)
Fiscal Balance / GDP	(7.3)	(5.2)	(6.2)	(6.5) (b)	(8.8) (c)	(8.0) (d)
Real Growth in Non Interest Expenditure	21.1	(12.2)	12.8	(2.8)	5.2	16.7
Public Debt / GDP	56.8	57.8	59.9	58.5	63.0	62.7
Public Debt / Revenue	403.1	412.2	428.8	475.0	493.6	481.7
Debt Service / Revenue	37.2	46.6	40.4	38.0	39.9	40.5
Debt Service / GDP	5.2	6.5	5.6	4.7	5.1	5.3

*Adjusted for grants

(b) includes arrears of electricity subsidies amounting Rs.120 billion or 0.7 percent of GDP

(c) includes "one off" payment of Rs.391 billion on account of debt consolidation or 1.9 percent of GDP

(d) includes payment for the resolution of the circular debt amounting Rs.322 billion or 1.4 percent of GDP

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

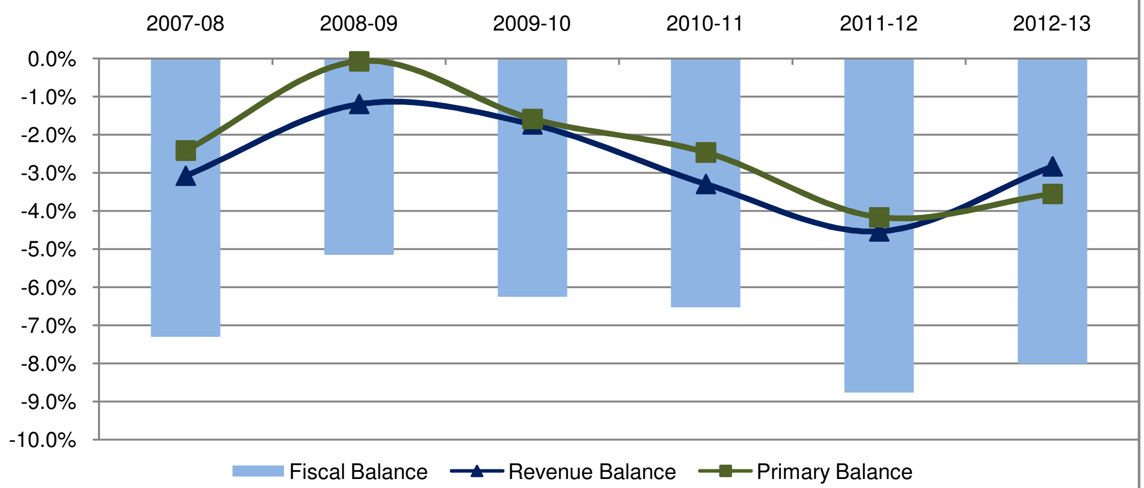
5.2 Revenue balance is the total revenues less current expenditure. Zero revenue balance means borrowings are only utilized towards financing the development needs of the country. Revenue deficit stood at Rs.649 billion or 2.8 percent of GDP in 2012-13. This revenue shortfall over current expenditure is a reflection of non-availability of fiscal space for undertaking development spending which implies that the borrowed money was mostly spent to finance current expenditures and not the development needs.

5.3 Primary balance is the total revenues minus non-interest expenditure or fiscal deficit before interest payments. A negative primary balance essentially implies that the government is borrowing to pay interest on the debt stock which results in debt trap. Primary deficit stood at Rs.814 billion or 3.6 percent of GDP in 2012-13. Hence, there is strong need to improve revenue collection along with austerity measures and reforming those sectors which are causing drainage of resources to control current expenditure to facilitate debt management efforts.

5.4 Pakistan's fiscal deficit over the last few years saw significant variation from its original targets. The fiscal deficit during 2012-13 was recorded at 8 percent of

GDP (including payment of Rs.322 billion on account of settlement of circular debt) against the budgeted estimate of 4.7 percent. The deviation from initial estimates was mainly on account of three factors: (i) higher than budgeted subsidies; (ii) higher than budgeted interest payments owing to increased domestic borrowings; (iii) lower than target FBR tax revenues. This higher fiscal deficit is adding on public debt and consuming a major chunk of revenues to service it. Moreover, financing mix of deficit is an area of concern as it is skewed towards domestic sources particularly on the shorter duration instruments.

Fig-2: Trends in Fiscal, Revenue and Primary Balance
(In percent of GDP)



5.5 Public debt to GDP was recorded at 62.7 percent as on June 30, 2013 which is above the threshold of 60 percent as prescribed in the Fiscal Responsibility and Debt Limitation Act, 2005. Crossing of this threshold by 2.7 percent was mainly due to the actual deficit being higher than projected.

5.6 It is a common practice to measure the public debt burden as a percentage of GDP, however, it makes more sense to measure debt burden in terms of revenues because earning potential reflects more accurately on repayment capacity. Public debt levels around 350 percent of government revenues are generally believed to be within the bounds of sustainability. Pakistan's total public debt as a percentage of revenues stood at 482 percent during 2012-13. Government is required to make concerted efforts to increase its revenues and rationalize current expenditures to reduce debt burden and improve the debt carrying capacity of the country to finance the growing development needs.

6.0 Servicing of Public Debt

6.1 Public debt services provides information of the resources that a country has to allocate to servicing its debts and the burden it may impose through crowding out other uses of financial resources. Comparing debt service to a country's repayment capacity yields the best indicator for analyzing whether a country is likely to face debt-servicing difficulties in the current period.

6.2 During 2012-13, public debt servicing reached at Rs.1,209 billion against the budgeted estimate of Rs.1,178 billion. Public debt servicing consumed nearly 41 percent of revenues. Ideally, this ratio should be below 30 percent to allow government to allocate more resources towards social and poverty related expenditures.

Table-3: Public Debt Servicing - (2012-13)

	Budgeted	Actual (P)	Percent of Revenue	Percent of Current Expenditure
	(Rs. in billion)			
Servicing of External Debt	80.2	70.6	2.4	1.9
Repayment of External Debt	252.0	217.9	7.3	6.0
Servicing of Domestic Debt	845.6	920.4	30.9	25.1
Servicing of Public Debt	1,177.8	1,208.9	40.5	33.0

P: Provisional

Source: Budget Wing and Debt Policy Coordination Office Staff Calculations, Finance Division

6.3 As most of the borrowing was arranged from domestic sources specifically through banks, therefore, major deviation from budget was witnessed in domestic debt servicing which exceeded the budgeted amount by approximately Rs.75 billion. Further analysis revealed that the deviation from budgeted amount was majorly witnessed in Treasury Bills and Pakistan Investment Bonds for the amount of Rs.48 billion and Rs.21 billion respectively.

Table-4: Break-up of Domestic Debt Servicing - (2012-13)

	Budgeted	Actual
	(Rs. in billion)	
1- Permanent Debt	**165.7**	**194.9**
- Prize Bonds	26.0	32.7
- Pakistan Investment Bonds	97.0	117.8
- Government Ijara Sukuk	40.9	42.8
- Others	1.8	1.7
2- Floating Debt	**429.7**	**479.4**
- Treasury Bills	257.2	304.7
- Market Related Treasury Bills	172.5	174.7
3- Unfunded Debt	**248.7**	**241.0**
- National Saving Schemes	237.7	236.2
- Others (Postal Life Insurance, Provident Funds etc.)	12.5	10
Total (1+2+3)	**845.6**	**920.4**

Source: Budget Wing, Finance Division

6.4 Out of total repayment of foreign loans, government paid Rs.112 billion and Rs.31 billion to multilateral and bilateral donors respectively.

7.0 <u>Domestic Debt</u>

7.1 With drying up of external financing, the onus of financing fell entirely on domestic sources – specifically the banking system. Government borrowing from domestic sources in 2012-13 was actually higher than the overall fiscal deficit as net external debt payments had to be paid from domestic sources owing to insufficient fresh external inflows. In effect, Pakistan's domestic debt increased by Rs.1,880 billion and reached at the level of Rs.9,517 billion or 41.5 percent of GDP at end-June, 2013 compared with 38 percent at the end of last fiscal year. Government relied heavily on short term domestic borrowing which further increased its exposure to refinancing and interest rate risks. The outstanding volume of floating debt (Treasury Bills and Market Related Treasury Bills) reached at Rs.5,196 billion or 36 percent of total public debt compared with around 25 percent at the end of 2008-09.

Table-5: Outstanding Domestic Debt (Rs. in billion)

	2008	2009	2010	2011(P)	2012(P)	2013(P)	2014(P) *
Permanent Debt	**616.8**	**685.9**	**797.7**	**1,125.6**	**1,696.9**	**2,179.2**	**2,177.5**
Market Loans	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Government Bonds	9.4	7.3	7.2	0.7	0.7	0.7	0.7
Prize Bonds	182.8	197.4	236.0	277.1	333.4	389.6	407.8
Foreign Exchange Bearer Certificates	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Bearer National Fund Bonds	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Federal Investment Bonds	1.0	1.0	0.0	0.0	0.0	0.0	0.0
Special National Fund Bonds	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign Currency Bearer Certificates	0.0	0.0	0.0	0.0	0.0	0.0	0.0
U.S. Dollar Bearer Certificates	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Special U.S. Dollar Bonds	8.3	7.7	2.7	1.0	0.9	4.2	4.4
Government Bonds Issued to SLIC	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Pakistan Investment Bonds (PIB)	411.6	441.0	505.9	618.5	974.7	1,321.8	1,301.8
Government Bonds issued to HBL	0.0	0.0	0.0	0.0	-	-	-
GOP Ijara Sukuk	0.0	27.8	42.2	224.6	383.5	459.2	459.2
Floating Debt	**1,637.4**	**1,904.0**	**2,399.1**	**3,235.4**	**4,143.1**	**5,196.2**	**5,812.9**
Treasury Bills through Auction	536.4	796.1	1,274.1	1,817.6	2,383.4	2,921.0	2,788.0
Rollover of Treasury Bills discounted SBP	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Market Related Treasury Bills (MRTBs)	1,100.4	1,107.3	1,124.4	1,417.3	1,759.2	2,274.7	3,024.4
Unfunded Debt	**1,020.4**	**1,270.5**	**1,457.5**	**1,655.8**	**1,798.0**	**2,146.5**	**2,172.1**
Defence Savings Certificates	284.6	257.2	224.7	234.5	241.8	271.7	273.4
Khas Deposit Certificates and Accounts	0.6	0.6	0.6	0.6	0.6	0.6	0.6
National Deposit Certificates	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Savings Accounts	27.7	16.8	17.8	17.2	21.2	22.3	19.5
Mahana Amadni Account	2.5	2.4	2.2	2.1	2.0	2.0	2.0
Postal Life Insurance	67.1	67.1	67.1	67.1	67.1	67.1	67.1
Special Savings Certificates and Accounts	227.6	377.7	470.9	529.1	537.4	734.6	742.1
Regular Income Scheme	51.0	91.1	135.6	182.6	226.6	262.6	267.6
Pensioners' Benefit Account	87.7	109.9	128.0	146.0	162.3	179.9	183.3
Bahbood Savings Certificates	229.0	307.5	366.8	428.5	480.8	528.4	539.4
National Savings Bonds	-	-	3.6	3.6	3.6	0.2	0.2
G.P. Fund	42.5	40.1	39.9	44.3	54.5	73.1	73.1
Short Term Savings Certificates	-	-	-	-	-	4.0	3.8
Total Domestic Debt	**3,274.5**	**3,860.4**	**4,654.3**	**6,016.7**	**7,638.1**	**9,521.9**	**10,162.5**
Total Domestic Debt (excluding foreign currency debt included in external debt)	**3,266.0**	**3,852.5**	**4,651.4**	**6,015.5**	**7,637.0**	**9,517.4**	**10,158.0**

P: Provisional
*end-September,2013

State Bank of Pakistan, Budget Wing and Debt Policy Coordination Office Staff Calculations

7.2 Government could only adhere to keep its net quarterly borrowing from the State Bank of Pakistan at zero during the first quarter of 2012-13 as market conditions were more supportive and government mopped-up more than targeted amount from the commercial banks. Market dynamics changed in the subsequent quarters as banks were sensing higher interest rates in view of large funding needs of the government. Government was unable to finance its maturing amount from commercial banks especially in second quarter of 2012-13 due to which financing burden fell on SBP. The problem was further compounded by higher than expected fiscal slippage which further increased the government reliance on the SBP.

7.3 The composition of domestic debt has been transformed from a high dominance of unfunded debt to an increasing dependence on floating component of the domestic debt over past few years. The unfunded category comprising about 33 percent of the aggregate domestic debt stock in 2001-02 has declined to 23 percent at end-June 2013. Contrary to this, the share of floating debt to total domestic debt has reached 55 percent at end-June 2013 as compared with 31 percent in 2001-02.

7.4 The growing share of floating debt in total domestic debt in recent years reflects that domestic debt portfolio is exposed to significant refinancing risk i.e. the redemption profile on domestic debt is frontloaded with more than Rs.6 trillion. In such cases, an increase in interest rates could adversely impact the debt servicing and debt stock. Debt structures that are too short or allow for bumps in the maturity profile can potentially generate confidence crises, fuelled by investors' concerns that the government will not have sufficient funds to repay its obligations when they fall due. There is need to develop a long-term debt capital market to rebalance the maturity profile of Pakistan's domestic debt portfolio.

7.5 As on end-June 2013, average maturity of domestic debt stood at 1.8 years. Out of total domestic debt, 64 percent of total domestic debt has maturity of less than a year as of end June, 2013 which is causing lower duration and also raises the rollover or refinancing risk for the government. This average maturity estimate may be a little inconsistent owing to the non-availability of actual maturity profile of National Savings Schemes (NSS) and manual operations of Central Directorate of National Savings (CDNS). A behavioral analysis was undertaken to estimate the maturity of NSS instruments.

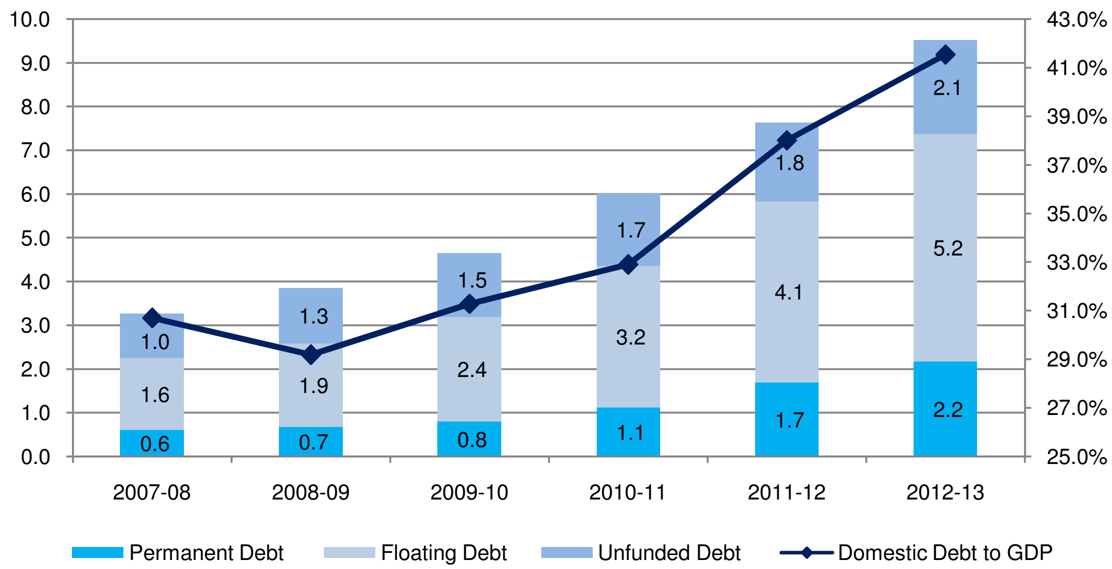


Fig-3: Evolution of Domestic Debt
(in trillion of PKR and percent of GDP)

The following sections highlight the developments in the various components of domestic debt during 2012-13.

I. Permanent Debt

7.6 The amount of permanent debt in the government's total domestic debt stood at Rs. 2,179 billion as at end-June 2013 registering an increase of Rs.482 billion compared with last fiscal year. The stock of permanent debt recorded a 28 percent increase mainly on account of higher mobilization through Pakistan Investment Bonds (PIBs) i.e. Government mopped-up net of retirement Rs.347 billion through PIBs. Initially, it was expected that accommodative monetary policy would continue to incentivize banks to invest in PIBs. However, banks shifted away from PIBs, as market sentiments changed due to growing fiscal borrowings and unfavorable external account. Resultantly, the realized amounts were short of target during second and third quarter of 2012-13.

7.7 An unanticipated steep fall in Consumer Price Index (CPI) in the last quarter of 2012-13 once again made long term investment more attractive and consequently mobilization through PIBs exceeded the target. Government also mobilized net of retirement Rs.76 billion through Government Ijara Sukuk (GIS) and Rs. 56 billion through prize bonds.

II. Floating Debt

7.8 The share of floating debt in overall public debt and domestic debt stood at 36 percent and 55 percent respectively as at end-June 2013. During 2012-13, the floating debt grew by Rs.1,053 billion or 25 percent. Around 56 percent of the total increase in government domestic debt stock was contributed by floating debt. Most of the proceeds accrued through Treasury Bills as Rs.538 billion was added in the stock of June 30, 2012. On the other hand, government borrowed Rs.516 billion through Market Related Treasury Bills.

III. Unfunded Debt

7.9 Mobilization through unfunded debt witnessed a sizeable growth as the Government mopped-up Rs.349 billion during 2012-13 compared with 142 billion during the same period last year. In terms of composition, more than half of the incremental mobilization went into Special Savings Certificates and Accounts.

7.10 Central Directorate of National Savings (CDNS) played an important role in mobilizing retail savings in the economy. CDNS offered various schemes which met the savings and investment needs of various eligible investors, particularly the fixed income group. Even after three downward revisions in the profit rates on National Savings Schemes during 2012-13, these savings schemes offer the best fixed income return in the country.

7.11 Over past few years, government took various measures to rationalize the National Savings Schemes including linkage of profit rates on major NSS instruments with PIBs yield, levy of withholding tax on profits, service charges/penalty interest on early redemption and introduction of several new schemes to meet the diverse investor base demand. However, the rate setting on NSS should be more dynamic and closely aligned to the domestic market yield curve to avoid interest rate arbitrage. NSS instruments also need to be integrated into mainstream capital markets by making them tradable and by withdrawing the implicit put option, which is a potential source of liquidity problems for the government. A pre-requisite in this regard, however, is restructuring – capacity building and conversion of CDNS into vibrant customer centric distribution channel for government debt instruments – and complete automation of CDNS operations. Given the huge potential of mobilizing domestic savings, a restructured and well-equipped CDNS can be strategically used to promote outreach of financial services to remote areas.

Table-6: Causative Factors in Change in Stock of Domestic Debt (Rs. in billion)

	Stock	Stock	Receipts	Repayments	Net Investment
	2011-12	2012-13	(in 2012-13)		
Permanent Debt	**1,696.9**	**2,179.2**	**754.3**	**272.0**	**482.3**
Market Loans	2.9	2.9	-	-	-
Government Bond	0.7	0.7	-	-	-
Prize Bonds	333.4	389.6	155.0	98.8	56.2
Foreign Exchange Bearer Certificates	0.1	0.1	-	-	-
Bearer National Fund Bonds	0.0	0.0	-	-	-
Federal Investment Bonds	0.0	0.0	-	-	-
Special National Fund Bonds	0.0	0.0	-	-	-
Foreign Currency Bearer Certificates	0.0	0.0	-	0.0	- 0.0
U.S. Dollar Bearer Certificates	0.0	0.0	-	-	-
Special U.S. Dollar Bonds	0.9	4.2	3.4	0.0	3.4
Government Bonds Issued to SLIC	0.6	0.6	-	-	-
Pakistan Investment Bonds (PIBs)	974.7	1,321.8	505.8	158.8	347.1
Government Bonds issued to HBL	-	-	-	-	-
GOP Ijara Sukuk	383.5	459.2	90.0	14.4	75.6
Floating Debt	**4,143.1**	**5,196.2**	**9,555.3**	**8,502.3**	**1,053.1**
Treasury Bills through Auction	2,383.4	2,921.0	5,636.8	5,099.2	537.6
Rollover of Treasury Bills discounted SBP	0.5	0.5	-	-	-
Treasury Bills purchased by SBP (MRTBs)	1,759.2	2,274.7	3,918.5	3,403.0	515.5
Outright Sale of MTBs	-	-	-	-	-
Unfunded Debt	**1,798.0**	**2,146.5**	**890.2**	**541.7**	**348.5**
Defence Savings Certificates	241.8	271.7	67.5	37.6	29.9
Khas Deposit Certificates and Accounts	0.6	0.6	-	0.0	(0.0)
National Deposit Certificates	0.0	0.0	-	0.0	(0.0)
Savings Accounts	21.2	22.3	219.7	218.6	1.1
Mahana Amdani Account	2.0	2.0	0.1	0.2	(0.1)
Postal Life Insurance	67.1	67.1	-	-	
Special Savings Certificates and Accounts	537.4	734.6	343.4	146.2	197.2

Table-6: Causative Factors in Change in Stock of Domestic Debt (Rs. in billion)

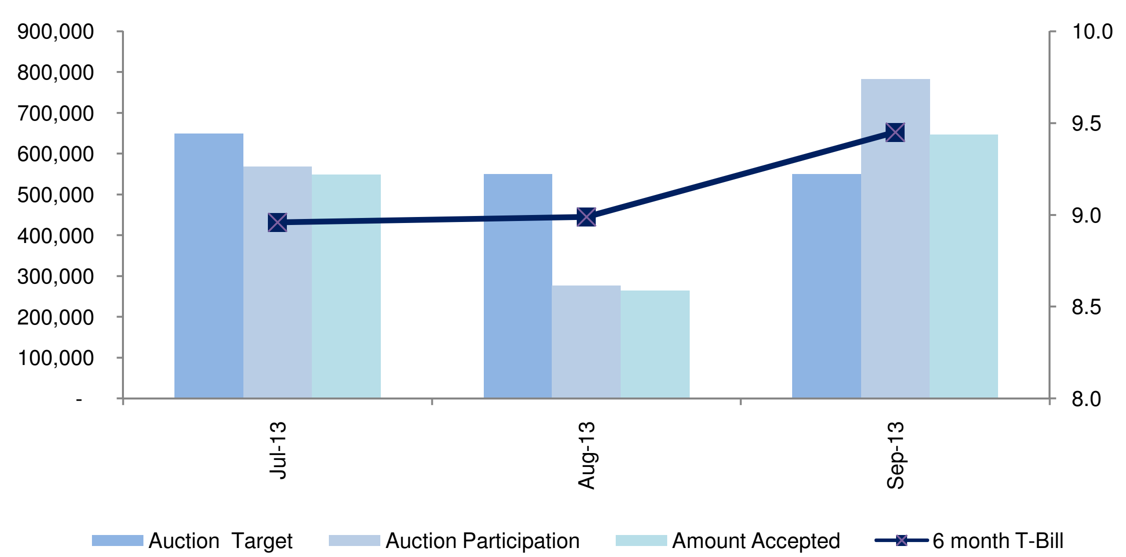
	Stock	Stock	Receipts	Repayments	Net Investment
	2011-12	2012-13	(in 2012-13)		
Regular Income Scheme	226.6	262.6	77.9	41.8	36.0
Pensioners' Benefit Account	162.3	179.9	36.8	19.3	17.5
Bahbood Savings Certificates	480.8	528.4	114.6	67.0	47.6
National Savings Bonds	3.6	0.2	-	3.4	- 3.4
G.P. Fund	54.5	73.1	20.8	2.2	18.6
Short Term Savings Certificates	-	4.0	9.3	5.3	4.0
Total Domestic Debt	**7,638.1**	**9,521.9**	**11,199.8**	**9,316.0**	**1,883.8**

Source: Budget Wing, Finance Division

7 (i) Domestic Debt during July - September, 2013

7.12 The domestic debt stood at Rs.10,158 billion at the end of the first quarter of 2013-14, representing an increase of Rs.641 billion over end-June, 2013. This incremental domestic debt has a very short duration as major part of the financing was arranged through floating debt. Furthermore, within the floating debt, majority of the participation were received in three months Treasury Bill owing to rising interest rate expectations. Auction profile of first quarter of 2013-14 is depicted through Fig-4.

Fig-4: Auction Profile 1st Quarter - 2013-14 - T-Bills, PIBs & GIS
(in PKR billion and Average Yield in Percent)



7.13 During first quarter of 2013-14, public debt servicing was Rs.376 billion against the annual budgeted estimate of Rs.1,561 billion. During first quarter, public debt servicing consumed nearly 45 percent of revenues. Domestic debt servicing stood at Rs. 286 billion or 76 percent of total debt servicing.

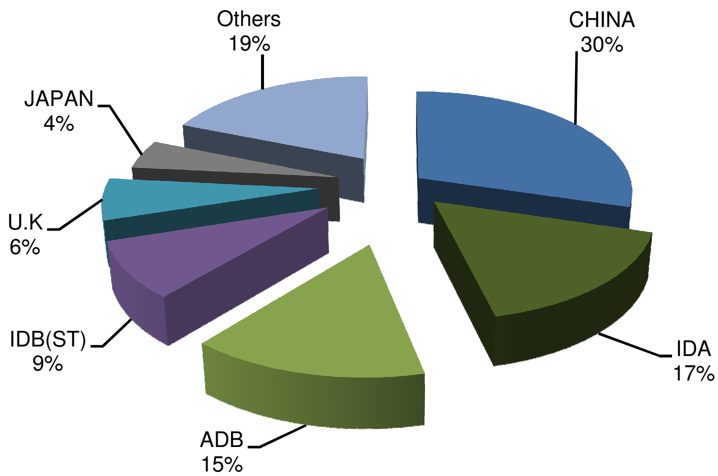
8.0 External Debt and Liabilities

8.1 Pakistan's external debt and liabilities include all foreign currency debt contracted by the public and private sector as well as foreign exchange liabilities of the Central Bank. As on June 30, 2013, EDL was dominated by Public and Publically Guaranteed Debt having share of 74 percent. These loans were mainly obtained from multilateral and bilateral donors. Debt obligations of the private sector are fairly limited and have been a minor proportion of EDL (5 percent). Borrowing from IMF contributed 7 percent in EDL Stock as compared with 11 percent at the end of 2011-12 owing to repayments during 2012-13.

8.2 EDL stock was recorded at US$ 59.8 billion at end-June 2013 out of which external public debt amounted to US$ 48.7 billion. EDL stock witnessed a decline of US$ 5.7 billion which is a largest ever drop in a single year mainly due to around US$ 3 billion repayment to the IMF and translation gain of US$ 2.7 billion on account of appreciation of US Dollar against Japanese Yen. Notwithstanding this decrease in EDL stock, the country's external debt repayment capacity weakened as foreign exchange earnings could not keep pace with the external debt repayment in 2012-13. As a percentage of GDP in dollar terms, EDL stock was down by around 381 percentage points as compared to end-June 2012 and approximated to 25.3 percent of GDP.

8.3 During 2012-13, disbursements including loans and grants of US$ 2,855 million were for project aid (US$ 2,071 million), budgetary support (US$ 466 million), relief (US$ 268 million) and non-food (US$ 51 million). Project aid accounted for 73 percent of the total disbursements. The highest disbursement was from China which accounted for 30 percent of total disbursements.

Fig-5: Donor Wise Breakup of Disbursements
(in percent of total)



8.4 EDL stock was recorded at US$ 60.4 billion as on September 30, 2013. Out of total EDL, public external debt amounted to US$ 48.8 billion. IMF approved three years Extended Fund Facility program for Pakistan on September 04, 2013 for SDR 4.4 (US$ 6.6) billion against which US$ 545 million was disbursed in the first quarter of current fiscal year. Total disbursements excluding IMF during the 1st quarter of current fiscal year were US$ 611 million. During the first quarter of 2013-14, Pakistan external debt portfolio witnessed a translational loss of US$ 665 million on account of cross-currency movement against US Dollar.

Table-7: Pakistan External Debt and Liabilities

	2008	2009	2010	2011	2012(P)	2013(P)	2014(P)*
	(US Dollar in billion)						
1. Public and Publically Guaranteed Debt	**40.6**	**42.6**	**43.1**	**46.5**	**46.3**	**44.4**	**44.9**
i) Public Debt	**40.4**	**42.4**	**42.9**	**46.4**	**46.1**	**43.5**	**44.1**
A. Medium and Long Term(>1 year)	**39.7**	**41.8**	**42.1**	**45.7**	**45.7**	**43.5**	**43.9**
Paris Club	13.9	14.0	14.0	15.5	15.0	13.5	13.8
Multilateral	21.4	23.0	23.7	25.8	25.4	24.2	24.3
Other Bilateral	1.1	1.4	1.8	1.9	2.5	2.9	3.0
Euro Bonds/Saindak Bonds	2.7	2.2	1.6	1.6	1.6	1.6	1.6
Military Debt	0.0	0.2	0.2	0.1	0.1	0.1	0.1
Commercial Loans/Credits	0.1	0.2	-	-	-	-	-
Local Currency Bonds	0.0	-	0.0	0.0	-	0.0	0.0
Saudi Fund for Development	-	-	0.2	0.2	0.2	0.2	0.2
SAFE China Deposits	-	0.5	0.5	0.5	1.0	1.0	1.0
NBP/BOC Deposits	0.4	0.3	0.2	0.1	-	-	-
B. Short Term (<1 year)	0.7	0.7	0.9	0.6	0.4	0.0	0.2
IDB**	0.7	0.7	0.8	0.6	0.4	-	0.1
Local Currency Securities (T-Bills)	0.0	-	0.1	0.0	0.0	0.0	0.1

Table-7: Pakistan External Debt and Liabilities

	2008	2009	2010	2011	2012(P)	2013(P)	2014(P)*
ii) Publicly Guaranteed Debt	**0.2**	**0.2**	**0.2**	**0.1**	**0.2**	**0.9**	**0.8**
A. Medium and Long Term(>1 year)	0.2	0.2	0.2	0.1	0.2	0.9	0.8
Paris Club	-	-	-	-	-	-	-
Multilateral	0.1	0.1	0.1	0.0	0.0	0.3	0.3
Other Bilateral	0.1	0.1	0.0	0.0	0.2	0.6	0.6
Commercial Loans/Credits	0.0	-	0.1	-	-	-	-
Saindak Bonds	-	-	-	-	-	-	-
B. Short Term (<1 year)	-	-	-	-	-	-	-
IDB	-	-	-	-	-	-	-
2. Private Non-Guaranteed Debt (>1 year)	**1.9**	**2.4**	**3.8**	**4.4**	**3.6**	**3.1**	**3.1**
3. Public Sector Enterprises (PSEs Debt)	**1.0**	**0.9**	**1.4**	**1.3**	**1.3**	**1.2**	**1.2**
4. IMF	**1.3**	**5.1**	**8.1**	**8.9**	**7.3**	**4.4**	**4.2**
of which Central Government	-	-	1.1	2.0	1.9	1.7	1.4
Monetary Authorities	1.3	5.1	7.0	6.9	5.4	2.7	2.7
5. Banks	**-**	**-**	**0.7**	**1.1**	**1.8**	**1.6**	**1.9**
Borrowing	-	-	0.2	0.4	0.9	0.7	1.0
Nonresident Deposits (LCY & FCY)	-	-	0.6	0.7	1.0	0.8	0.9
6. Debt liabilities to direct investors - intercompany debt	**-**	**-**	**1.9**	**1.6**	**2.7**	**2.8**	**2.9**
Total External Debt (1 through 6)	**44.9**	**51.1**	**59.0**	**63.8**	**63.1**	**57.5**	**58.1**
7. Foreign Exchange Liabilities	1.3	1.3	2.6	2.6	2.4	2.3	2.3
Total External Debt & Liabilities (1 through 7)	**46.2**	**52.3**	**61.6**	**66.4**	**65.5**	**59.8**	**60.4**
(of which) Public Debt	**40.7**	**46.4**	**49.8**	**54.5**	**53.2**	**48.7**	**48.8**
Official Liquid Reserves	8.6	9.1	13	14.8	10.9	6.0	4.6
(In percent of GDP)							
Total External Debt (1 through 6)	**26.4**	**30.4**	**33.2**	**29.8**	**28.0**	**24.2**	**23.0**
1. Public and Publically Guaranteed Debt	23.9	25.3	24.3	21.7	20.6	18.8	17.8
A. Medium and Long Term(>1 year)	23.4	24.8	23.7	21.4	20.3	18.4	17.4
B. Short Term (<1 year)	0.4	0.4	0.5	0.3	0.2	0.0	0.1
2. Private Sector Debt	1.1	1.4	2.1	2.0	1.6	1.3	1.2
3. Public Sector Enterprises (PSEs) Debt	0.6	0.5	0.8	0.6	0.6	0.5	0.5
4. IMF	0.8	3.1	4.6	4.2	3.3	1.9	1.7
5. Banks	0.0	0.0	0.4	0.5	0.8	0.7	0.7
6. Debt liabilities to direct investors - Intercompany debt	0.0	0.0	1.1	0.8	1.2	1.2	1.1
7. Foreign Exchange Liabilities	0.8	0.8	1.5	1.2	1.1	1.0	0.9
Total External Debt & Liabilities (1 through 7)	**27.1**	**31.1**	**34.7**	**31.0**	**29.1**	**25.3**	**24.0**
Official Liquid Reserves	5.0	5.4	7.3	6.9	4.8	2.6	1.8
Memo:							
GDP (Rs. in billion)	10,638	13,200	14,867	18,285	20,091	22,909	26,001
Exchange Rate (Rs./US$, Period Average)	62.5	78.5	83.8	85.5	89.2	96.9	103.1
Exchange Rate (Rs./US$, End of Period)	68.3	81.4	85.5	86.0	94.5	99.7	106.1
GDP (US$ in billion)	170.1	168.2	177.4	213.9	225.1	236.5	252.3

P: Provisional *end-September,2013

**: The amount of short term debt from IDB rolled over in Dec 2011 for more than one year has been reclassified under the category of long term government debt from multilateral donors.

Source: State Bank of Pakistan, Economic Affairs & Debt Policy Coordination Office Staff Calculations

8 (i) - External Debt & Liabilities Servicing

8.5 The servicing of EDL recorded a significant increase of 19 percent during 2012-13 which was led by repayments of around US$ 3 billion against IMF loans. The total EDL servicing was US$ 7,185 million during 2012-13. A segregation of this amount showed payment of US$ 5,553 million against maturing EDL stock while interest payments were US$ 933 million and US$ 700 million was rolled-over.

8.6 Among the principal repayments, US$ 1,155 million of multilateral debt and US$ 2,899 million of IMF accounted for most of the share. This was the first time the country made such large principal repayments in a single year. The external debt servicing is expected to be on the higher side in the coming years as heavy repayments to the IMF will go on till 2014-15.

Table-8: Pakistan's Public External Debt Servicing

Years	Actual Amount Paid	Amount Rolled Over	Total
(US Dollar in million)			
2007-08	3,182.6	1,200.0	4,382.6
2008-09	4,747.2	1,600.0	6,347.2
2009-10	4,607.0	1,723.0	6,330.0
2010-11	3,947.7	1,488.0	5,435.7
2011-12	4507.7	1,543.0	6,050.7
2012-13	6,485.1	700.0	7,185.1
2013-14*	1,800.8	-	1,800.8

*July-September, 2013

Source: Source: State Bank of Pakistan and Debt Policy Coordination Office Staff Calculations

8.7 During first quarter of 2013-14, the servicing on external debt was recorded at US$ 1,801 million. Out of this total, principal repayments were US$ 1,609 million and interest payments were US$ 191 million.

8 (ii) Performance of 2016, 2017 & 2036 Eurobond

8.8 Pakistan’s bonds performed well in the secondary market in 2013. Yields on Pakistan’s Eurobonds ranged from 9.3 percent to 12.8 percent at the beginning of 2013. Just prior to the elections, yields on Pakistan’s Eurobonds were in the context of 10.1 percent to 12.1 percent. Pakistan’s election results were well received by the credit markets. Immediately, following the election, Pakistan’s secondary yields on its Eurobonds fell by approximately 2 percent. Since then, rates increased in September in line with the broader Emerging Market bond selloff, but have again came down in October/November, 2013, remained below 2012 averages.

Table-9: Selected Secondary Market Benchmarks

Issuer	Ratings (Moody's/S&P)	Coupon (%)	Maturity	Yield (%)
Pakistan	Caa1/B-	7.125	Mar 2016	7.584
Pakistan	Caa1/B-	6.875	Jun 2017	7.196
Pakistan	Caa1/B-	7.875	Mar 2036	9.691

Source: Bloomberg, as at November 05, 2013

Fig-6: Performance of Pakistan Eurobond

8 (iii) - Currency Movements and Translational Impact

8.9 External loans are contracted in various currencies and disbursements are effectively converted into Pak Rupee. As Pak Rupee is not an internationally traded currency, the other currencies are bought and sold via selling and buying of US Dollar. Hence, the currency exposure of foreign debt originates from two sources: US Dollar/other foreign currencies and Pak Rupee/US Dollar. This two-pronged exchange rate risk has been a major source of increase in the stock of EDL over a period of time in contrast to actual inflows.

8.10 During 2012-13, appreciation of the US Dollar against other major currencies caused the foreign currency component of public debt to decrease by US$ 2.7 billion, however, it was restrained by depreciation of Pak Rupee against US Dollar by 5.4 percent. On the contrary, first quarter of 2013-14 witnessed two-pronged translational loss on external debt portfolio:

I. Translational loss of US$ 665 million on account of cross-currency movement against US Dollar.

II. Translational loss of PKR 311 billion owing to depreciation of Pak Rupee against US Dollar by 6.4 percent.

8.11 Managing foreign exchange risk is a fundamental component of a prudent debt management strategy. A comprehensive foreign exchange risk management programme requires establishing and implementing sound and prudent foreign exchange risk management policies and control procedures. It is imperative to install a sophisticated currency hedging framework within the government keeping in view historical losses borne by Pakistan on its external debt portfolio.

8 (iv) - <u>External Debt Sustainability</u>

8.12 Creation of debt is a natural consequence of economic activities. The objective of external debt sustainability analysis (DSA) is to evaluate a country's capacity to finance its policy objectives and service the ensuing external debt. In crisis situations, countries can have recourse to debt restructuring or reduction, but such action cannot be a regular means of dealing with external financing problems, as it affects access to new financing. Thus, a good tracking system, in the form of sustainability analysis, based on key macroeconomic indicators can predict and prevent debt problems.

8.13 A key component of external DSA is to estimate the path of a country's external debt stock (position) over time. The increase in interest rates, depreciation of exchange rate and higher current account deficit can increase stock of external debt. EDL expressed as a percentage of GDP might be a common means of measuring the indebtedness of an economy, but repayment capacity is more accurately captured through expressing the levels of debt as a percentage of the economy's foreign exchange earnings and reserves. In order to ensure sustainability, government can assign threshold levels to the debt stock as a ratio of economic indicators and comparison with international thresholds which provides insight into a country's debt position.

Table-10: External Debt Sustainability

(In percent)	2008	2009	2010	2011	2012	2013
Non-Interest Current Account / GDP	(6.9)	(4.4)	(1.4)	0.8	(1.3)	(1.2)
Growth in Exports	18.2	(6.4)	2.9	28.9	(2.6)	0.4
Growth in Imports	31.2	(10.3)	(1.7)	14.9	12.8	(0.6)
Growth in EDL	14.9	13.4	17.6	7.8	(1.3)	(8.7)
Growth in FEE	12.8	(5.1)	7.9	25.1	1.1	4.1
Growth in Non Interest Foreign Currency Payments	27.2	(12.8)	(4.9)	13.3	11.4	0.4
EDL/FEE (times)	1.2	1.5	1.6	1.4	1.4	1.2
EDL/FER (times)	4.0	4.2	3.7	3.6	4.3	5.4
EDL/GDP	27.1	31.1	34.7	31.0	29.1	25.3
EDL Servicing/FEE	11.8	18.0	16.6	11.4	12.5	14.3

FEE: Foreign Exchange Earnings; **EDL:** External Debt and Liabilities; **FER:** Foreign Exchange Reserves

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

8.14 Due to improved trade balance (higher cotton prices) in 2010-11, non interest current account showed a surplus of 0.8 percent of nominal GDP. Afterwards, there is a downward trend in 2011-12 and 2012-13 by recording a deficit of 1.3 percent and 1.2 percent respectively of nominal GDP owing to high value of oil imports.

8.15 EDL as a percentage of Foreign Exchange Earnings (FEE) gives a measure of a country's debt repayment capacity by comparing levels of external debt to the sum of exports, services receipts, and private unrequited transfers. A generally acceptable threshold requires a country's EDL to remain below 2 times of FEE. Improvement was observed in the EDL-to-FEE ratio, which remained 1.4 times in 2010-11 and 2011-12 compared to 1.6 in 2009-10 at the back of strong workers' remittances and a positive turn-around in export earnings. The improvement of this ratio suggests that Pakistan's stock of EDL is growing at a slower rate than its foreign exchange earnings. During 2012-13, this indictor further improved and recorded at 1.2 times of FEE.

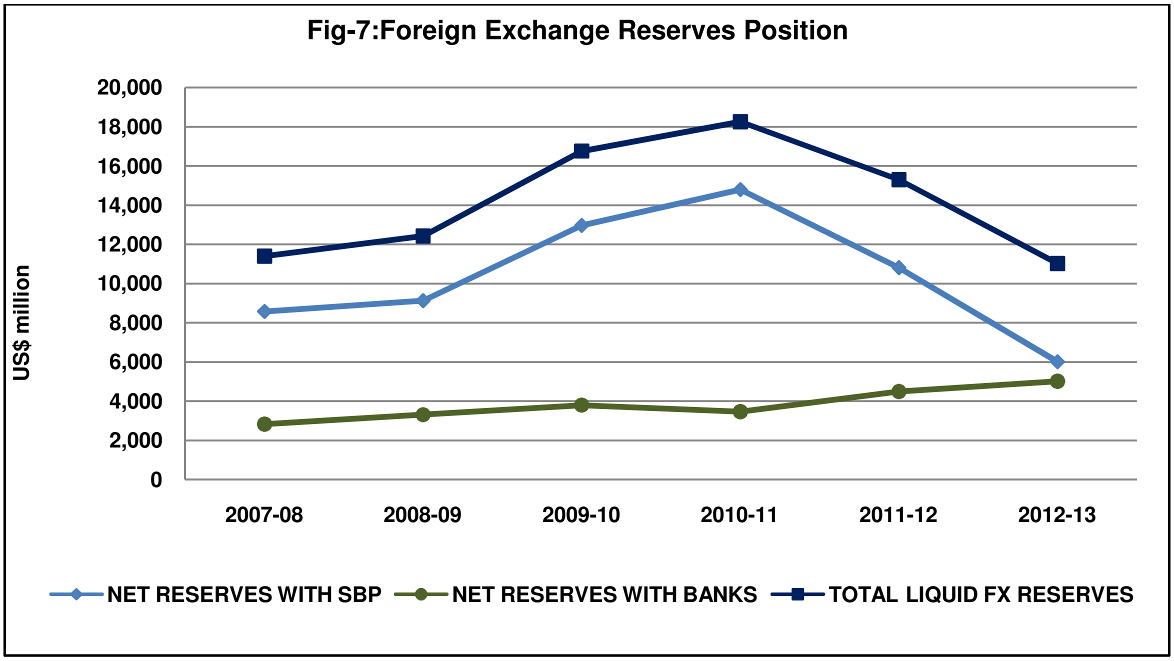
8.16 A decrease in EDL in relation to foreign exchange reserves reflects the consolidation of foreign exchange reserves and a general improvement of the country's repayment capacity or vice versa. On the onset of IMF-SBA, the ratio declined to 3.7 in 2009-10 as EDL growth slowed and foreign exchange reserves shored up. The ratio improved slightly in 2010-11 mainly because of stagnation in reserves and lower growth in EDL stock. However, it showed downward trend during last two years and recorded at 5.4 times as on June 30, 2013 mainly because of drawdown on reserves owing to repayments to IMF and other lower non-debt creating flows.

8.17 A major improvement has been witnessed in EDL-to-GDP ratio as it improves from 34.7 percent in 2009-10 to 31 percent in 2010-11. By end-June 2013, EDL as a percent of GDP further improved and stood at 25.3 percent. This improvement was mainly due to repayment against IMF loans, translational gain on account of US Dollar appreciation against other major currencies and faster growth in nominal GDP.

8.18 External Debt Servicing as a percentage of FEE stood at 14.3 percent during 2012-13. Pakistan is gradually approaching the international threshold of acceptable percentage (20 percent) in terms of this indicator. The current levels of servicing are bound to increase as heavy repayments against IMF-SBA are due in 2013-14. Serious efforts should be made to enhance the export earnings if Pakistan is to remain under the accepted threshold.

8 (v) - <u>External Sector Assessment</u>

8.19 Pakistan's Balance of Payment remained under stress during 2012-13 owing to heavy repayments against IMF loans, net outflow to other International Financial Institutions (IFIs) and subdued foreign investments. In absence of sufficient financial inflows, the financing of external deficit amounting US$ 2 billion and IMF SBA repayments of US$ 2.5 billion was done through liquid foreign exchange reserves due to which SBP reserves fell down from US$ 10.8 billion at the start of the year to around US$ 6 billion at the end of 2012-13.



8.20 The balance of payment remained under stress despite the improvement in the current account which posted a deficit of US$ 2.5 billion in 2012-13 which was nearly the half of the deficit recorded last year. The current account was supported by inflows of US$ 1.8 billion under CSF and a decline in trade deficit. Improvement in trade account was entirely on account of recovery in exports mainly from food, textiles and jewelry. On the other hand, imports decreased compared to last year's level because of the decline in the imports of food, transport, POL, and other agriculture items which offset the rise in the import of machinery, textile and metal.

8.21 Inflows under current transfers continued to compensate the deficits recorded in trade, services and income account. Over the past few years, worker remittances have become the most important source of foreign exchange receipts. The launch of Pakistan Remittances Initiative (PRI) has helped in increasing the remittances coming through official sources considerably from 75 percent in 2009-10 to 90 percent in 2012-13.

Table-11: Summary of Balance of Payments (US Dollar in billion)

	2011-12	2012-13
I - Current Account Balance (A+B+C+D)	(4.7)	(2.5)
Trade Deficit	(15.8)	(15.4)
(i) Exports	24.7	24.8
(ii) Imports	40.5	40.2
Services	(3.2)	(1.5)
of which		
Transportation	(2.0)	(2.0)
Government	0.9	2.5
Of which: Coalition Support Fund	0.0	1.8
Services	(3.2)	(3.7)
Payments include		
Repatriation of profits by oil firm	1.5	1.7
IMF Charges & interest on off. external debt	0.8	0.7
Current Transfer	(17.5)	(18.1)
of which: Worker remittances	13.2	13.9
II - Capital Account	0.2	0.3
III - Financial Account	1.3	0.3
(i) Net Foreign Investment	0.6	1.3
FDI	0.7	1.3
Portfolio	(0.1)	0.0
(ii) Other Investment (net)	0.7	(1.0)
Net acquisition of financial assets	0.0	(0.5)
Net incurrence of liabilities	0.7	(0.5)
IV - Errors and Omissions	(0.1)	(0.1)
V - Overall balance (I+II+III+IV)	(3.3)	(2.0)

Source: State Bank of Pakistan

8.22 Capital account showed increase of 44 percent mainly owing to increase in project grants up from US$ 180 million during 2011-12 to US$ 250 million. The surplus in the financial account declined substantially owing to net repayment of external debt, which offset nominal increase in foreign investment during the year. Net foreign investments picked up in 2012-13 to reach at US$ 1.3 billion compared with just US$ 0.6 billion last year. However, the level of FDI remained low mainly due to security concerns and vulnerability of Pakistan's external account. On the other hand, Pakistan was unable to attract portfolio inflows despite the strong performance of domestic stocks.

8.23 Despite sharp fall in foreign exchange reserves in 2012-13, the depreciation of Pak Rupee was limited to 5.4 percent compared with 9 percent in 2011-12. Moreover, movement in exchange rate was also less volatile especially in the second half of the year. This improvement was mainly due to reduction in current account deficit in 2012-13 which reduced the pressure on the Pak Rupee. Nominal depreciation in Pak Rupee, coupled with the decline in headline inflation, led to an improvement in the Real Effective Exchange Rate (REER) during the year. Compared with the appreciation of 4.5 percent last year, the REER depreciated by 2 percent in 2012-13, which if sustains, may increase the competitiveness of goods and services.

9.0 Cost & Risk Indicators for Public Debt

9.1 The cost and especially risks of the debt portfolio can be described with a few key parameters. However it is better to consider more than one indicator as risks to debt composition have several dimensions. Normally, three kinds of indicators are used for analyzing public debt's risk level – measurement of risk that current economic conditions generate over public debt (foreign currency risk); evaluation of government's ability to face upcoming contingencies considering certain expected circumstances (refinancing risk); financial indicators which show the liabilities' of market performance (interest rate risk).

9.2 The cost of current debt portfolio of Pakistan is determined by the weighted average interest rate which stands at 7.6 percent (including NSS). This number is a combination of average interest rate of 1.8 percent on external debt and about 10.7 percent on domestic debt. While interest rates on domestic debt are almost 6 times higher than those on external debt, this differential can be adjusted by changes in exchange rate. For instance, Pak Rupee depreciated against US Dollar on average by 8 percent in the past 5 years which resulted in increase in external debt in local currency. This capital loss on foreign currency debt, however, is mitigated by the strong concessionality element associated with Pakistan's external loans. Hence, the cumulative cost of adverse currency movement and existing external debt rate is still lower than the cost of domestic debt by 0.9 points.

Table-12: Public Debt Cost and Risk Indicators

Risk Indicators		External Debt	Domestic Debt	Public Debt
Amount (Rs. in billion)		4,849	9,517	14,366
Nominal Debt as Percentage of GDP		21.2	41.5	62.7
Cost of Debt	Weighted Average IR (%)	1.8	10.7	7.6
Refinancing Risk	Average Time to Maturity (ATM) - Years	9.5	1.8	4.5
	Debt Maturing in 1 Year (% of total)	12.8	64.2	46.6
Interest Rate Risk	Average Time to Re-Fixing (ATR) - Years	8.7	1.8	4.2
	Debt Re-Fixing in 1 year (% of total)	25.3	67.2	52.8
	Fixed Rate Debt (% of total)	84.4	39.6	54.9
Foreign Currency Risk (FX)	Foreign Currency Debt (% of total debt)			34.2
	Short Term FX Debt (% of reserves)			104.3

Source: Debt Policy Coordination Office Staff Calculations

9.3 Refinancing risk is probably the most significant in Pakistan's debt portfolio, driven primarily by the concentration of domestic debt in short maturities. The Average Time to Maturity (ATM) of total public debt is 4.5 years, with payment of about Rs.6 trillion of domestic debt is due in 2013-14. Therefore, in the absence of sufficient external financing inflow and the current unfavorable Balance of Payment position, refinancing of such a huge amount will further accentuate the economic situation, thus compelling the Government to revert to SBP. The ATM of domestic debt is 1.8 years with NSS instruments further compounding the refinancing risk owing to embedded put option. In contrast, ATM of external debt is 9.5 years, indicating limited exposure. Nonetheless, given the challenging Balance of Payment situation and already pressure on foreign exchange reserves, payment of USD 6.2 billion due in 2013-14 may become a challenge if external position further tightens.

9.4 Around 34 percent of total public debt stock is denominated in foreign currencies, exposing Pakistan's debt portfolio to exchange rate risk. Adjusted for Special Drawing Rights (SDR), the main exposure of exchange rate risk comes from

USD denominated loans (14 percent of total debt), followed by Japanese Yen (9 percent) and loans denominated in Euro (7 percent). The amount of foreign loans maturing in 2013-14 is equal to 104 percent of official liquid reserves resulting in high exposure to exchange rate risk. Depreciation of Pak Rupee would affect both the stock of government debt as well as debt servicing flows.

Fig-8: External Debt Redemption Profile
(US Dollar in billion)

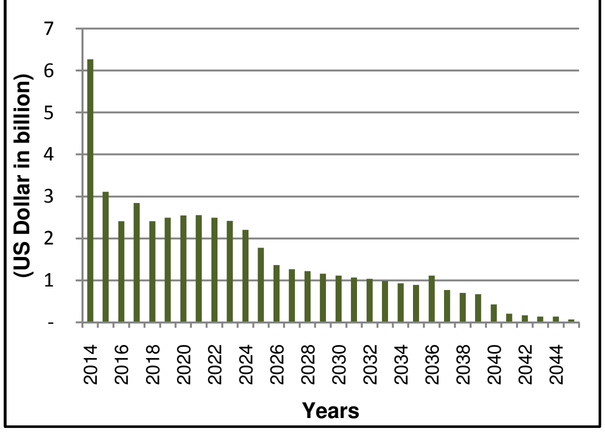
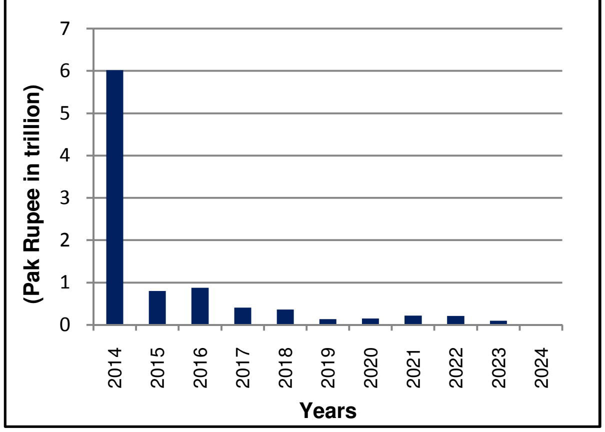


Fig-9: Domestic Debt Redemption Profile
(Pak Rupee in trillion)



9.5 Exposure to interest rate changes is a substantial risk given the short term nature of domestic securities and external borrowing in floating rates. Around 67 percent of total domestic debt is exposed to interest rate re-fixing within 1 year as compared to 25 percent of external debt. This implies that a relatively large share of external debt has been contracted in variable rates. Average time to Re-Fixing (ATR) for domestic debt stands at 1.8 years, comparable to ATM for domestic debt, while ATR on external debt is significantly longer at 8.7 years.

10.0 <u>Guarantees</u>

10.1 Guarantees are contingent liabilities that come into play on the occurrence of an event not wholly within the control of the government. Guarantees are not added to the overall debt of the country, therefore, public disclosure of information about guarantees is an essential component of fiscal transparency. It is more important to reflect the impact of financial risk associated with guarantees in the fiscal account.

10.2 The sovereign guarantee is normally extended to improve financial viability of projects or activities undertaken by government entities with significant social and economic benefits. It allows public sector companies to borrow money at lower costs or on more favorable terms and in some cases, allows to fulfill the requirement where sovereign guarantee is a precondition for concessional loans from bilateral/ multilateral agencies to sub-sovereign borrowers.

10.3 Nevertheless, there are costs associated with the provision of government guarantees. In the case of Pakistan, these include explicit and implicit guarantees issued to Public Sector Enterprises (PSEs) and unfunded losses of these entities. During 2012-13, the Government issued fresh/rollover guarantees aggregating to Rs.136 billion or 0.6 percent of the GDP. Total outstanding stock at the end of June 30, 2013 amounted to Rs.626 billion. The rupee guarantees accounted for 57 percent of the total guarantees stock.

Table-13: Guarantees Outstanding as of June 30, 2013 (Rs. in billion)

Outstanding guarantees extended to PSEs	**626**
-Domestic Currency	355
-Foreign Currency	271
Memo:	
Foreign Currency (US$ in million)	2,716

During 2012-13, the Government of Pakistan issued fresh/rollover guarantees aggregating to Rs.136 billion or 0.6 percent of GDP.

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

Table-14: New Guarantees Issues (2012-13) – Rs. in billion

Name of Organization	Amount
Pakistan Steel Mills	20.0
Power Holding (Pvt) Limited	103.0
NIT	12.0
Machine Tool Factory	1.0
Total	**136**
In percent of GDP	**0.6%**

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

10.4 Other than the publically guaranteed debt of PSEs, Government Issue counter guarantees against the commodity financing operations undertaken by TCP, PASSCO, and provincial governments. Commodity financing is secured against hypothecation of commodities and Letter of comfort from the Finance Division. These are self liquidating, thus should not create a long term liability for the government. As of June 30, 2013, the outstanding stock issued against commodity operations was Rs. 571 billion.

10.5 At the end of first quarter of 2013-14, Government issued fresh/rollover guarantees amounting to Rs.54 billion or 0.2 percent of the GDP. Total outstanding stock at the end of September 30, 2013 amounted to Rs.677 billion. The outstanding stock issued against commodity operations, in the same mentioned period was Rs.513 billion.

Table-15: Guarantees Outstanding as of Sep 30, 2013 (Rs. in billion)

Outstanding guarantees extended to PSEs	**677**
-Domestic Currency	379
-Foreign Currency	298
Memo:	
Foreign Currency (US$ in million)	2,814

The stock of outstanding guarantees include issue of new guarantees during the year 2013-2014 constituting 0.2% of GDP

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

11.0 Report on Compliance with FRDL Act 2005

The Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005 approved on 13 June 2005, requires that the federal government take measures to reduce total public debt and maintain it within prudent limits thereof. The following sections identifies the various limits prescribed by the FRDL Act, 2005 and reports on progress thereof.

The FRDL Act, 2005 requires the following:

(1) Reducing the revenue deficit to nil not later than the thirtieth June, 2008 and thereafter maintaining a revenue surplus

Revenue balance has been in negative since 2005 because of increasing exogenous and endogenous challenges including campaign against extremism, fragile law and order situation, continued energy shortages, narrow tax base, non-materialization of sufficient external inflows, unprecedented calamity of floods in 2010, torrential rains in Sindh in 2011 and increasing debt servicing requirement.

Table-16: Revenue Balance (Percent of GDP)

Revenue Balance*	2008	2009	2010	2011	2012	2013
	(3.1)	(1.2)	(1.7)	(3.3) [e]	(4.5) [f]	(2.8) [g]

*Adjusted for grants
[e]includes arrears of electricity subsidies amounting Rs.120 billion or 0.7 percent of GDP
[f]includes "one off" payment of Rs.391 billion on account of debt consolidation or 1.9 percent of GDP
[g] includes payment for the resolution of the circular debt amounting Rs.322 billion or 1.4 percent of GDP

(2) Ensure "that within a period of ten financial year, beginning from the first July, 2003 and ending on thirtieth June, 2013, the total public debt at the end of the tenth financial year does not exceed sixty percent of the estimated gross domestic product for that year and thereafter maintaining the total public debt below sixty percent of gross domestic product for any given year."

Public debt to GDP was recorded at 62.7 percent as on June 30, 2013. Crossing of this threshold by 2.7 percent was mainly due to the actual deficit being higher than projected. The public debt also includes loans from IMF amounting to US$ 4.4 billion or 1.9 percent of the GDP as on June 30, 2013. The borrowing from IMF is only utilized towards Balance of Payment support and is reflected in foreign currency reserves of the country.

Table-17: Debt to GDP (Rs. in billion)

	2008	2009	2010	2011	2012	2013
Domestic Currency Debt	3,266	3,852	4,651	6,016	7,637	9,517
Foreign Currency Debt	2,788	3,776	4,260	4,685	5,030	4,849
Total Public Debt	**6,044**	**7,629**	**8,911**	**10,700**	**12,667**	**14,366**
GDP	10,638	13,200	14,867	18,285	20,091	22,909
Total Public Debt (as percent of GDP)	**56.8**	**57.8**	**59.9**	**58.5**	**63.0**	**62.7**

(3) Ensure "that in every financial year, beginning from the first July, 2003, and ending on the thirtieth June 2013, the total public debt is reduced by no less than two and a half percent of the estimated gross domestic product for any given year, provided that social and poverty alleviation related expenditures are not reduced below 4.5 percent of the estimated gross domestic product for any given year and budgetary allocation to education and health, will be doubled from the existing level in terms of percentage of gross domestic

product during the next ten years.”

The condition of reducing debt to GDP by 2.5 percent annually was envisaged in the FRDL Act, 2005 to achieve the core objective of reducing Debt to GDP below 60 percent by the end of 2012-13. As the government achieved this landmark in 2005-06 and remained within the threshold of 60 percent, the sub-limit of annual reduction of 2.5 percent was no more applicable.

Social and poverty alleviation related budgetary expenditures remained at 8.3 percent of GDP. Additionally, expenditures on health and education stood at 0.7 percent and 2.1 percent of GDP. The FRDL Act, 2005 stipulates that the spending on health and education shall be doubled to 1 percent and 3.2 percent respectively in ten years beginning from 1st July, 2003, hence, this target was not achieved.

Table-18: Social Sector Expenditure

	2008	2009	2010	2011	2012	2013
Social sector and poverty related expenditure (as percent of GDP)	9.8	7.4	7.5	8.3	9.6	8.3
Expenditure on education (as percent of GDP)	1.8	1.8	1.7	1.8	2.0	2.1
Expenditure on health (as percent of GDP)	0.6	0.6	0.6	0.6	0.7	0.7

(4) Not issue “new guarantees, including those for rupee lending, bonds, rates of return, output purchase agreements and all other claims and commitments that may be prescribed, from time to time, for any amount exceeding two percent of the estimated gross domestic product in any financial year: Provided that the renewal of existing guarantees shall be considered as issuing a new guarantee.”

New guarantees including rollovers, issued by the government in 2012-13 amounted to Rs.136 billion or 0.6 percent of GDP.

Table-19: New Guarantees Issued

(Rs. in billion)	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
New guarantees issued	139	276	224	62	203	136
(as percent of GDP)	**1.3**	**2.1**	**1.5**	**0.3**	**1.0**	**0.6**

Pakistan’s public debt position deteriorated during past few years owing to higher interest payments, large subsidies specially food and energy, growing security spending needs, narrow tax base and rising international commodity prices. Given the severity of these constraints, the government was unable to fully comply with some provisions of FRDL Act, 2005. However, the government remains fully committed to adhere to all the provisions of FRDL Act, 2005 in future.

12.0 Debt Management Strategy

12.1 Debt management strategy lays down different ways to finance the borrowing requirements of the government while meeting cost and risk objectives. The trend of shifting towards short term domestic lending sources continued in 2012-13 due to non availability of sufficient external inflows which led to further shortening the maturity profile of domestic debt. This costly borrowing, due to higher debt servicing in view of higher domestic interest rates and having crowding out effect on the private sector credit demands, is being looked into by the government through development of Medium Term Debt Management Strategy (MTDS).

12.2 Keeping in view to improve the quality of debt management operations, government initiated a process of preparing a comprehensive Medium Term Debt Strategy based on technical footing in consultation with all stakeholders, with the aim to guide the Federal Government to tap specific financing sources at possible lowest cost, after giving due consideration to the cost-risk analysis. The strategy will contain a policy advice on an appropriate mix of financing from all sources with the spirit to uphold the integrity of the FRDL Act, 2005 and ensure compliance with its provisions. The strategy will facilitate the strategic decisions for new borrowing, including the appropriate mix between domestic and external loans to finance the budget deficit. The strategy will cover all the funding requirements and payment obligations during the medium term, so more beneficial as it will enable the government to:

i) Evaluate the cost risk trade-off;
ii) Identify and manage risks;
iii) Facilitate coordination with monetary and fiscal authorities;

iv) Identify constraints;

v) Increase transparency

12(i) Potential Funding Sources

I - Multilateral/Bilateral Agencies

12.3 A set of reforms initiated by the government to improve the fiscal health of the economy which was supported by IMF under the Extended Finance Facility (EFF) will bring strong support from multilateral and bilateral creditors. This arrangement is expected to strengthen confidence and catalyze additional support from these development partners during the coming years.

II - International Debt Capital Markets

12.4 Pakistan has not tapped this source since 2007. In presence of ample liquidity in the International Debt Capital Markets, government is considering launching Eurobonds and securing commercial loans.

III - Domestic Wholesale Markets

12.5 At present, these markets are key source of funding for the government. However, the real absorption capacity of the domestic market for the government debt appears to have already been experiencing difficulty. Nevertheless, the domestic debt market would be able to contribute to the country's fiscal stability by enhancing its efficiency and facilitating adjustments in the maturity profile and product mix of the debt portfolio.

IV - Retail Markets

12.6 Presently, government is taping this source through Central Directorate of National Savings (CDNS). CDNS is a major source for Government to mobilize domestic retail savings which contributed 26 percent of total domestic debt at the end of 2012-13. However, CDNS has limited reach with only 380 branches. CDNS is a national asset and needs support and resources to restructure and convert into a vibrant customer centric distribution channel for government debt instruments for retail investors.

12(ii) <u>Proposed Strategy</u>

The proposed strategy will help in spurring the economic growth and provide needed support to balance of payment with the following salient elements:

– **Lengthening of maturity profile**

12.7 Government is aiming to gradually lengthen the maturities of domestic debt by increasing the share of one year T-bill, rebuilding the stock of 3 years Government Ijara Sukuk, 5 and 10 year Pakistan Investment Bonds etc. It will gradually reduce the refinancing risk and alleviate the pressure on the domestic market. The pre-requisite for successful extension of debt maturities is macroeconomic stability and efficient secondary market. As a first step, government is in a process of listing its debt instruments (Treasury Bills, Pakistan Investment Bonds and Government Ijara Sukuk) on the Stock Exchanges which will enable the rapid placement of necessary infrastructure for secondary market trading of government securities.

– **Diversify Investor Base**

12.8 The widening and diversification of the investor base is necessary to reduce government borrowing demand from the wholesale markets. This initiative by the government has taken to strengthen the marketing campaign of T-Bills, PIBs and Government Ijara Sukuk to retail investors through the branches of commercial banks across the country to reduce its borrowing demand from the wholesale market.

– **Borrowing from Multilateral / Bilateral Donors**

12.9 With the improved macroeconomic indicators, adequate inflows from multilateral (mainly from the World Bank and Asian Development Bank) and key bilateral sources are expected. Average yearly financial support from these development partners is expected to reach around US Dollar 6 billion during next few years. It will help boosting the State Bank reserves and bringing the large fiscal deficit down to a manageable level. Under these circumstances, a higher external borrowing will allow reducing the rollover/refinancing risk of domestic debt and will possibly helps reviving the appetite for medium and long term domestic securities.

– **International Debt Capital Market and Commercial Financing**

12.10 The government is contemplating further potential of external financing sources by tapping international Bond Market and securing commercial loans. The government envisages issuing Eurobond every year until 2017-18, with the maturity, interest rate type, and repayment structure dependent upon the investors' appetite. Furthermore, commercial loans are being considered as a short-term financing source.

– **Strengthening Pakistan Remittance Initiative**

12.11 It is estimated that with better policy coordination between Ministry of Finance and State Bank of Pakistan, the monthly remittances flows can be considerably increased in the medium term from monthly average of US$ 1.2 billion during 2012-13. The increase in remittances will assist Pakistan in meeting the external obligations.

12(iii) <u>Development of Domestic Debt Capital Markets</u>

The objectives of debt management cannot be achieved in the absence of vibrant and liquid secondary debt capital markets. Following are the key ingredients for development of debt capital markets which are being considered for effective implementation:

– **Consistent and Transparent Debt Management Strategy**

12.12 The medium term debt strategy will be translated into an annual borrowing plan. The annual borrowing plan will specify types of instruments, volume and distribution of financing throughout the year etc. A detailed borrowing plan is especially important for domestic borrowing, where transparency and predictability are essential for the well-functioning of auctions and also for the secondary market.

- **Level Playing Field for All Investor Groups**

12.13 Government has to a greater extent addressed the issues concerning National Saving Schemes (NSS) to eliminate the interest rate arbitrage. Government is committed towards providing equitable treatment to all investor groups which would facilitate the development of debt capital market.

- **Comprehensive Disclosure of Government Fiscal Position**

12.14 Government has started comprehensive disclosure of fiscal accounts on quarterly basis with a time lag of 1-2 months. This has helped markets to accurately predict government borrowing needs.

- **Liquidity in Government Benchmark Securities:**

12.15 It has been greatly addressed as Government is ensuring ample liquidity in benchmark issues. Furthermore, since last few years, only one issue of bond is auctioned during the entire fiscal year to ensure ample issue liquidity.

12(iv) Centralization of Debt Management Operations

12.16 There is a need to formulate and adopt a holistic debt management strategy, a critical prerequisite of which is the centralization of debt management operations, i.e. decision making and implementation. By doing so, the government will be able to enhance policy coordination, and provide guidelines for the levels of debt as well as constitute strategic benchmarks for an optimal government debt portfolio. Government realizes the need and accordingly taking steps to centralize the decision making process in the initial phase.

13.0 Conclusion

13.1 Pakistan's public debt position deteriorated during past few years. A host of internal and external factors contributed to this deterioration. Higher interest payments, large subsidies specially food and energy, growing security spending needs, narrow tax base and rising international commodity prices coupled with energy crises have resulted in large twin account (i.e. fiscal and current account) deficits. These deficits are adding to public debt and consuming a major chunk of revenues for debt service. Financing mix of deficit is also an area of concern as it is skewed towards domestic sources particularly on bank borrowing which is conducive to inflationary pressures, crowding out the private sector credit demands and at the same time, translates into higher debt servicing in view of higher domestic interest rates.

13.2 Government is witnessing negative revenue and primary balance for many years. The continuous revenue shortfall over current expenditure is a reflection of non-availability of fiscal space for undertaking development spending for which the government needs to generate a revenue surplus. The government may exploit other avenues in terms of revenue mobilization and regulate current expenditure to overcome revenue deficit. Similarly, it is necessary for the government to reduce the gap between revenue and non-interest expenditure, which is an essential pre-requisite for public debt reduction. The sooner Pakistan achieves and maintains a primary surplus, the better it is for stabilizing the country’s debt burden.

13.3 Soundness of Pakistan’s debt position, as given by various sustainability ratios, remained higher than the internationally accepted thresholds. Total Public debt levels around 3.5 times and debt servicing below 30 percent of government revenue are generally believed to be within the bounds of sustainability. Government is making concentrated efforts to increase the revenues and rationalize current expenditure to reduce the debt burden and improve the debt carrying capacity of the country to finance the growth and development needs.

13.4 Pakistan’s external debt and liabilities and its servicing in terms of foreign exchange earnings stood within the acceptable threshold of 2 times and debt servicing below 20 percent of foreign exchange earnings. Government is focusing on increasing export receipts and other foreign currency non-debt creating flows above and beyond the growth of foreign exchange payments and growth of external debt and liabilities. Moreover, given the impact of exchange rate movements have historically had on external debt, and the significant translational losses suffered in the past, the government should take measures to mitigate the market risk factor of external borrowing by planning to implement a broad-based currency and interest rate hedging strategy and ensuring exchange rate stability.

13.5 Debt reduction to sustainable levels cannot be achieved without persistent economic growth. The slowdown in growth has resulted in rising debt burden and simultaneously impacted the debt servicing capacity of the country. It is important for the government to adopt an integrated approach for economic revival and debt reduction strategy, which will require some difficult trade-offs in the short-term, thus implementing structural reforms that boost potential growth is a key to ensure debt sustainability.