Debt Policy Statement

2014-15

Debt Policy Coordination Office
Ministry of Finance

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1.0 <u>Introduction</u>

1.1 Effective debt management is essential for developing a viable and stable debt portfolio, mitigating the risks of refinancing, exchange rate fluctuations and debt accumulation that could impede economic growth and stability. Prudent utilization of debt leads to higher economic growth and helps the government to accomplish its social and developmental goals. The absence of such prudence results in high and unsustainable debt levels that plagues economic growth by lowering the development expenditure due to heavy debt servicing requirement. Given Pakistan's developing status, the need for effective debt management is of utmost importance as the country requires borrowing to enable its development agenda, accelerate the pace of economic growth without ignoring the intergenerational impact.

1.2 Historically, numerous economies have witnessed debt levels high or even higher than those prevailing today primarily due to persistent low growth, higher fiscal and current account deficits, unfavorable exchange rates movements and higher contingent liabilities. A brief analysis of their history suggests three primary lessons. First, debt reduction to sustainable levels cannot be achieved without persistent economic growth and fiscal consolidation. Second, fiscal consolidation aiming to reform structural weaknesses preferred over myopic measures. Third, realizing the fact that debt reduction is bound to be time consuming.

1.3 Pakistan public debt dynamics witnessed various positive developments during 2013-14. The pace of debt accumulation slowed down and improvement was observed in almost all public debt sustainability indicators. In addition, composition of public debt improved substantially mainly due to significant substitution of short term floating debt with medium to long term permanent debt, higher disbursements from International Financial Institutions and successful issuance of Eurobonds.

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. This fiscal consolidation is marked by persistent structural reforms to public finances over myopic fiscal measures. According to it, the following statement puts 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 of 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 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 policy 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. 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 owing to their different implications. Domestic debt is a charge on budget and must be serviced through government revenues and/or additional borrowings whereas external debt, 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 need to be balanced in order to ensure sufficient and timely access to cost efficient funding. A comprehensive approach in 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 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 into 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. Focus on limiting the non-interest current account deficit and ensuring that the cost of borrowing is kept at a minimum, restricts the increase in debt level 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 as well as the debt obtained from the IMF is defined as public debt. Pakistan's public debt has two main components, namely domestic debt (which is incurred principally to finance fiscal deficit) and external debt (which is raised primarily to finance development expenditure).

4.2 The composition of public debt witnessed major changes in the past few years with increased reliance on domestic debt due to persistent large fiscal deficits and unavailability of sufficient external funding. The composition of domestic debt portfolio itself undergone a transformation from a high dominance of unfunded debt to an increasing dependence on short term floating debt which was a source of vulnerability as it entailed high rollover and refinancing risk. Besides, the cost and stock of external public debt increased due to depreciation of Pak Rupee against US Dollar. The present government soon after assuming the charge took measures to manage its public debt portfolio effectively. Some of the significant actions taken by the government are as follow:

- Government developed its first Medium Term Debt Management Strategy (2014-18) that is closely linked to fiscal framework to guide the borrowing activities (Box-1). The focus of the strategy is lengthening the maturity profile to reduce the refinancing risk along with sufficient provision of external inflows in the medium term to reduce the pressure on domestic resources keeping in view cost-risk tradeoffs. Over the medium term, the strategy is expected to result in longer average time to re-fixing due to less exposure to interest rate risk along with reducing the pressure on domestic resources through more external inflows. Accordingly, the composition of public debt improved in 2013-14 mainly due to (a) higher disbursements from International Financial Institutions (IFIs); (b) successful issuance of Eurobonds; and (c) the significant substitution of Treasury bills (T-bills) with Pakistan Investment Bonds (PIBs);
- With increased external inflows, the government was able to boost its foreign exchange reserves vis-a'-vis improving exchange rate of Pak Rupee against major international currencies. This also contributed in reducing external public debt in rupee term;
- To broaden the investor base and have a liquid government securities

market, trading of government debt instruments (Treasury Bills, Pakistan Investment Bonds and Government Ijara Sukuk) commenced on the stock exchanges which provided an additional investment channel to retail investors.

Box-1

Medium Term Debt Management Strategy (2014-18)

It is imperative to have a comprehensive debt management strategy aiming at debt sustainability and enhancing the debt servicing capacity of the country. Owing to its vital importance and indispensable nature, the government developed its first Medium Term Debt Management Strategy (MTDS) which has following main objectives:

- Fulfill the financing needs of the government;
- Minimize the cost of debt while maintaining the acceptable level of risks;
- Facilitate the development of domestic debt market.

MTDS provides alternative strategies to meet financing requirements of the government. Four different borrowing strategies have been assessed with associated costs and risks analysis under the alternative interest and exchange rates scenarios (Fig-1 and Fig-2). The cost and risk analysis is based on the existing debt cash flows, market and macroeconomic projections and alternative borrowing strategies. The robustness of alternative debt management strategies was evaluated by applying stress/shock scenarios for interest rates and exchange rates.

Strategy 1 (S1: Planned Strategy)

This strategy represents the borrowing from external and domestic sources as planned by the government for 2014 onwards. Gross external borrowing accounts on average 7 percent mainly through Eurobonds, commercial sources and project loans. The remaining 93 percent borrowing need is expected to be met by Market Treasury Bills (MTBs), Pakistan Investment Bonds (PIBs), 3 year Government Ijara Sukuk (GIS), National Savings Schemes (NSS) instruments and Market Related Treasury Bills (MRTBs).

Strategy 2 (S2: Lengthening of Maturity Profile - Fixed Rate Instruments)

This strategy represents the cost and risk scenario of debt portfolio by shifting part of MTBs to 10 year PIBs and increasing the external funding slightly at the same time. The additional external financing will be sought as per official estimate i.e. the higher project loans as compared to S1.

Strategy 3 (S3: Reliance on Short Term Domestic Instruments)

S3 assumes more reliance on domestic market and reduced external funding. Under this strategy, it is assumed that on an average, 97 percent of financing requirements would be derived from domestic sources mainly by issuance of MTBs and MRTBs.

Strategy 4 (S4: Lengthening of Maturity Profile - Floating Rate Instruments)

This strategy is similar to S2 in terms of share of domestic and external financing except a new instrument having 10 years maturity with floating rate is included.

The outcome of the above strategies is depicted through graphs below:

Fig-1: Debt to GDP
(as at end of 2017-18)

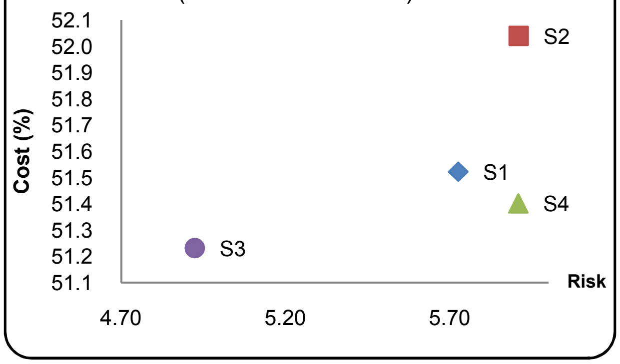
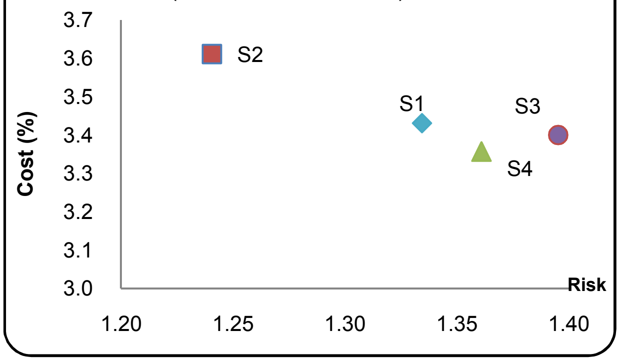


Fig-2: Interest to GDP
(as at end of 2017-18)



On the basis of cost and risk analysis of alternative strategies, a strategy, such as Strategy 3 (S3), with an increased reliance on domestic short term sources is least attractive. Strategy 2 (S2) and Strategy 4 (S4) assume lengthening of maturity profile by issuing fixed and floating rate instruments, respectively. Moreover, S2 and S4 have similar risk trend for debt to GDP as both have same share of external funding and thus foreign exchange risk is similar. Both S2 and S4 are targeting the reduction in refinancing risk. However, S2 is expected to result in greater average time to re-fixing i.e. there is less interest rate risk in case of S2 as compared with S4 owing to more financing through issuance of fixed interest rate instruments. In the light of above mentioned facts, S2 seems to be a preferential strategy for the government.

4.3 Following an improvement in fiscal deficit, the pace of debt accumulation slowed down in 2013-14. Public debt stock as on June 30, 2014 was recorded at Rs.15,996 billion representing an increase of Rs.1,704 billion or 12 percent higher than the last fiscal year. Unlike last fiscal year, where entire increase in public debt was contributed by domestic debt, external debt contributed around 18 percent of the total increase in public debt in 2013-14. In fact, external public debt recorded an increase of US$ 3.5 billion despite hefty repayments of around US$ 5 billion made during 2013-14 against external public debt. Government decision to re-engage with the IMF facilitated the resumption of inflows from IFIs as evident from increase in multilateral loans by US$ 1.6 billion in 2013-14. Further, Pakistan successfully tapped international capital markets after a gap of 7 years and mobilized US$ 2 billion through the issuance of Eurobonds. The increase in external public debt was also contributed by the translation loss amounting to US$ 571 million on account of depreciation of US Dollar against other major currencies.

4.4 The composition of public debt also improved mainly due to substitution of short term T-bills with medium to long term PIBs in 2013-14. Government mopped up net of retirement Rs.1,902 billion through PIBs which resulted in increase in share of permanent debt to 37 percent of total domestic debt at the end of 2013-14 compared with 23 percent last year. This re-profiling of domestic debt was envisioned in MTDS and accordingly exposure of government to refinancing risk has reduced. However, in terms of cost, the government is required to make more interest payments in future as PIBs carries higher interest rates compared with the shorter maturity T-bills.

Table-1: Public Debt

	2009	2010	2011	2012	2013(P)	2014(P)	2015(P)*
			(Rs. in billion)				
Domestic Debt	3,860.4	4,654.3	6,016.7	7,638.1	9,521.9	10,920.0	11,105.6
External Debt	3,871.0	4,351.9	4,750.2	5,057.2	4,771.0	5,076.5	5,129.6
Total Public Debt[(a)]	**7,731.4**	**9,006.2**	**10,766.9**	**12,695.3**	**14,292.9**	**15,996.5**	**16,235.2**
			(In percent of GDP)				
Domestic Debt	29.2	31.3	32.9	38.1	42.3	43.0	38.2
External Debt	29.3	29.3	26.0	25.2	21.2	20.0	17.6
Total Public Debt	**58.6**	**60.6**	**58.9**	**63.3**	**63.6**	**63.0**	**55.8**
			(In percent of revenues)				
Domestic Debt	208.6	224.0	267.1	297.6	319.3	300.2	---
External Debt	209.1	209.4	210.9	197.0	160.0	139.6	---
Total Public Debt	**417.7**	**433.4**	**477.9**	**494.7**	**479.2**	**439.8**	**---**
			(In percent of total debt)				
Domestic Debt	49.9	51.7	55.9	60.2	66.6	68.3	68.4
External Debt	50.1	48.3	44.1	39.8	33.4	31.7	31.6
Memo:							
Foreign Currency Debt (US$ in billion)	47.6	50.9	55.3	53.5	47.9	51.4	50.0
Exchange Rate (Rs./US$, End of Period)	81.4	85.5	86.0	94.5	99.7	98.8	102.6
GDP[(b)] (Rs. in billion)	13,200	14,867	18,276	20,047	22,489	25,402	29,078
Total Revenue (Rs. in billion)	1,851	2,078	2,253	2,567	2,982	3,637	---

P:Provisional *end-September, 2014

[(a)]The public debt amounts are shown in accordance with the revised public debt definition i.e. the portion of total debt which has a direct charge on government revenues as well as the debt obtained from the IMF is defined as public debt

[(b)]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

4.5 Public debt was recorded at Rs.16,235 billion as at end September 2014, registering an increase of Rs.239 billion or 1.5 percent during first quarter of 2014-15. This increase in public debt was almost quarter of the increase seen in the same period last year. The maturity profile of domestic debt further improved as the government was able to mobilize more through PIBs. Despite year-on-year increase in fiscal deficit during first quarter of 2014-15, the net addition to domestic debt stock was actually lower than the budgetary borrowing from domestic sources. This disconnect is attributed to utilization of the government deposits kept with SBP.

4.6 External public debt decreased by US$ 1.4 billion during first quarter of 2014-15 and recorded at US$ 50 billion. This reduction in external public debt was mainly contributed by translational gain of US$ 1.8 billion on account of appreciation of US Dollar against other major currencies. However, despite this translational gain, external public debt increased in Pak Rupee terms by Rs.53 billion and recorded at Rs.5,130 billion owing to depreciation of Pak Rupee against US Dollar by around 4 percent.

5.0 Dynamics of Public Debt Burden

5.1 Developing countries hinge in a delicate balance; they need to borrow in order to facilitate their development objectives while borrowing should also be allocated efficiently in view of their repayment ability. The borrowing should facilitate the government priorities to overcome the structural bottlenecks with the linkages to increase productivity. The economic rationale for debt creation is that borrower can earn a higher economic return than the cost of invested funds and those economic returns can be translated into financial returns. 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. The debt burden can be described with many parameters and there is no single threshold for debt ratios that can delineate the “bad” from the “good”.

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

	2009	2010	2011	2012	2013	2014
Revenue Balance / GDP*	(1.2)	(1.7)	(3.3) [(a)]	(4.5) [(b)]	(2.9) [(c)]	(0.7)
Primary Balance / GDP*	(0.1)	(1.6)	(2.5) [(a)]	(4.2) [(b)]	(3.6) [(c)]	(0.2)
Fiscal Balance / GDP	(5.2)	(6.2)	(6.5) [(a)]	(8.8) [(b)]	(8.2) [(c)]	(5.5)
Public Debt / GDP	58.6	60.6	58.9	63.3	63.6	63.0
Public Debt / Revenue	417.7	433.4	477.9	494.7	479.2	439.8
Debt Service / Revenue	46.6	40.4	38.0	39.9	40.5	40.1
Debt Service / GDP	6.5	5.6	4.7	5.1	5.4	5.7

*Adjusted for grants
[(a)]includes arrears of electricity subsidies amounting to Rs.120 billion or 0.7 percent of GDP
[(b)]includes "one off" payment of Rs.391 billion on account of debt consolidation or 2 percent of GDP
[(c)] includes payment for the resolution of the circular debt amounting to Rs.322 billion or 1.4 percent of GDP

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

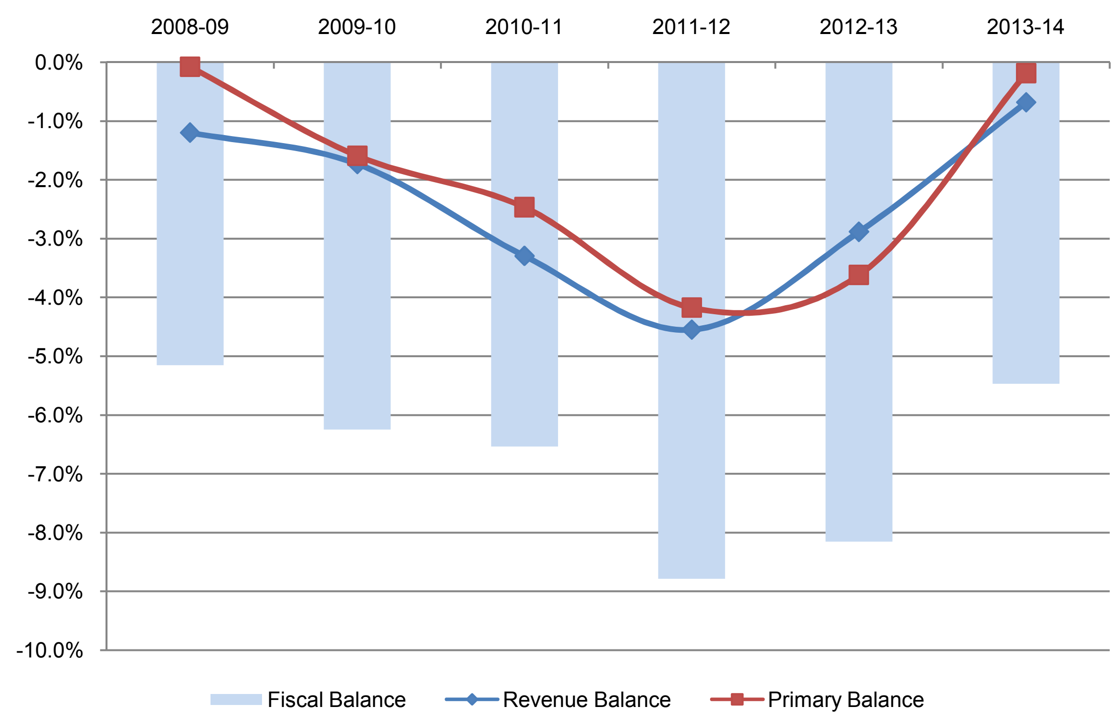
5.2 Revenue balance is the total revenues minus current expenditure. The persistence of revenue deficit indicates that the government is not only borrowing to finance its development expenditure, but partially to finance its current expenditure. Revenue deficit was recorded at Rs.173 billion or 0.7 percent of GDP in 2013-14 compared with Rs.649 billion or 2.9 percent in last fiscal year. Despite this significant improvement, there is a need to bring revenue deficit to nil as envisaged under Fiscal Responsibility and Debt Limitation Act, 2005 so that borrowing is used to supplement development activities which will enhance repayment capacity of the country.

5.3 Primary balance is the total revenues minus non-interest expenditure or fiscal deficit before interest payments. Primary balance is an indicator of current fiscal efforts since interest payments are predetermined by the size of previous deficits. Achieving a primary surplus is normally viewed as important, being usually necessary for reduction in public debt to GDP ratio. Primary deficit improved significantly in 2013-14 and recorded at Rs.47 billion or 0.2 percent of GDP compared with Rs.814 billion or 3.6 percent in last fiscal year.

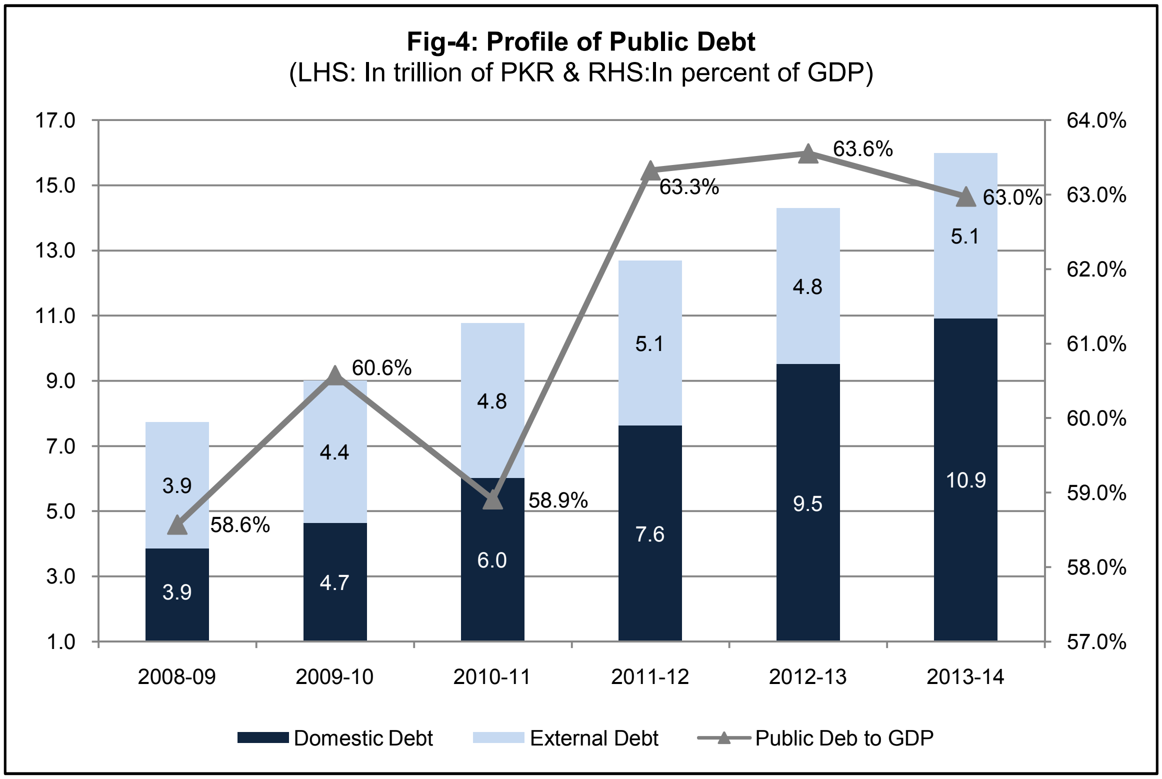
5.4 Pakistan's fiscal balance was significantly improved in 2013-14 as compared with last fiscal year. The actual fiscal deficit of 5.5 percent was not only lower than 8.2

percent last year but also lower than its budgeted target of 6.5 percent. This improvement in fiscal deficit has slowed down the pace of public debt accumulation. Apart from this reduction in fiscal deficit, another positive development was shift in financing mix of fiscal deficit i.e. around 37 percent of fiscal deficit was financed from external sources which not only reduced the pressure on the banking system, but also left space for commercial banks to finance the private sector.

Fig-3: Trends in Fiscal, Revenue and Primary Balance (In Percent of GDP)



5.5 Public debt to GDP ratio recorded a decline of 60 basis points and stood at 63 percent at the end of 2013-14 compared with 63.6 percent at the end of last fiscal year. This improvement in public debt to GDP ratio was mainly contributed by reduced fiscal deficit and appreciation of Pak Rupee against US Dollar. The government has not only been able to reduce its public debt to GDP ratio presently but is also committed to reduce it further in the medium term to bring it below 60 percent as prescribed in Fiscal Responsibility and Debt Limitation Act, 2005.



5.6 It is a common practice to measure the public debt burden as a percentage of GDP, a better approach is to scale public debt levels against actual government revenues as this ratio measures debt repayment capacity of the country. There was 39 percentage point reduction in public debt to government revenues, indicating some easing in government indebtedness. Despite this improvement, public debt to government revenue ratio still stood at 440 percent against the generally acceptable threshold of 350 percent. Government needs 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 A rising debt burden has implications for the economy in the shape of a greater amount of resource allocation towards debt servicing in the future. 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 a given period.

6.2 During 2013-14, public debt servicing recorded at Rs.1,460 billion against the budgeted estimate of Rs.1,561 billion. Public debt servicing consumed 40 percent of revenues. Ideally, this ratio should remain below 30 percent to allow the government to allocate more resources towards social and poverty related expenditures.

Table-3: Public Debt Servicing - (2013-14)

	Budgeted	Actual (P)	Percent of Revenue	Percent of Current Expenditure
	(Rs. in billion)			
Servicing of External Debt	89.0	75.0	2.1	1.9
Repayment of External Debt	407.7	312.1	8.6	7.8
Servicing of Domestic Debt	1,064.5	1,072.8	29.5	26.8
Servicing of Public Debt	1,561.2	1,459.9	40.1	36.5

P: Provisional

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

6.3 The domestic interest payments were recorded at Rs.1,073 billion with an increase of Rs.152 billion as compared with last fiscal year. This increase in domestic interest payments was mainly contributed by the increasing volume of domestic debt, increase in interest rates during first half of the year and an upward adjustment in profit rates on National Savings Schemes (NSS) instruments. Further, weak cash management also contributed towards increase in interest payments as government deposits with State Bank of Pakistan (SBP) witnessed an increase of around Rs.287 billion during the year i.e. if these deposits were utilized towards retirement of some of the borrowing from SBP, net interest payments would have been much lower. Going forward, the need for effective cash management can hardly be overemphasized.

7.0 Domestic Debt

7.1 There was a notable improvement in maturity profile of domestic debt in 2013-14 mainly due to substitution of short term T-bills with medium to long term PIBs. Further, the pace of domestic debt accumulation slowed down in 2013-14 as compared with the last fiscal year mainly owing to:

I. The actual fiscal deficit of 5.5 percent of GDP was not only lower than 8.2 percent last year but also lower than its budgeted target of 6.5 percent.

II. Around 37 percent of the fiscal deficit was financed through external sources in 2013-14 compared with last fiscal year where onus of entire financing fell on domestic sources. 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.

7.2 Domestic debt increased by Rs.1,398 billion and recorded at Rs.10,920 billion at end June 2014. There was a marked shift in composition of domestic debt as share of permanent debt increased to 37 percent of total domestic debt at the end of 2013-14 compared with 23 percent last year. Correspondingly, the share of floating debt declined from 55 percent of total domestic debt to 42 percent as at end June 2014.

Fig-5: Evolution of Domestic Debt
(LHS: In trillion of PKR & RHS: In percent of GDP)

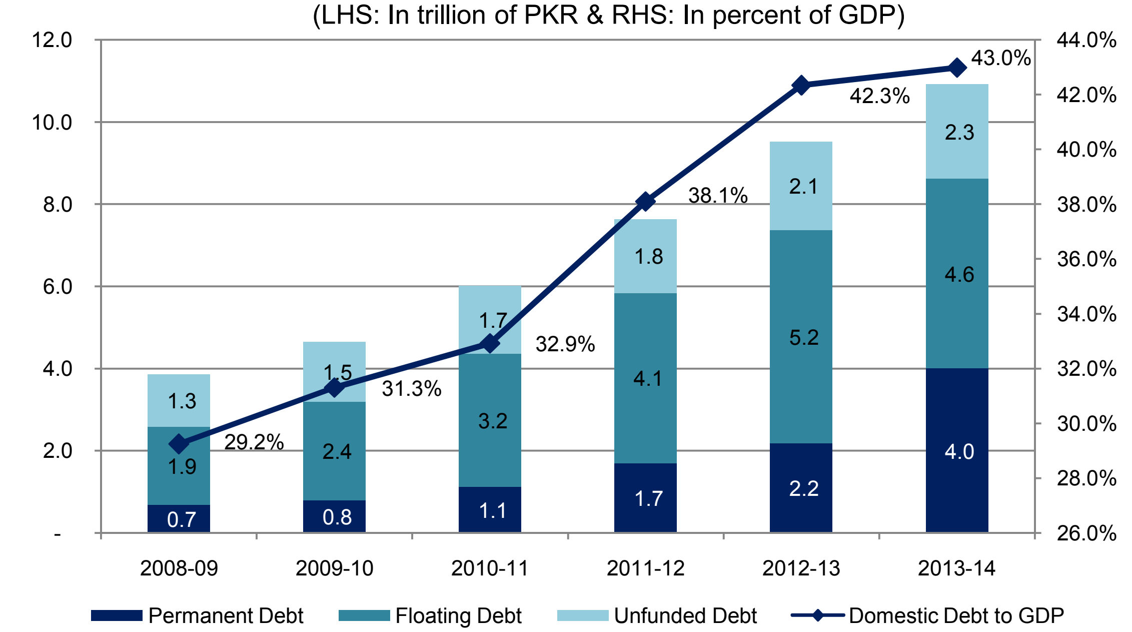


Table-4: Outstanding Domestic Debt - (Rs. in billion)

	2009	2010	2011	2012(P)	2013(P)	2014(P)	2015(P) *
Permanent Debt	**685.9**	**797.7**	**1,125.6**	**1,696.9**	**2,179.2**	**4,005.3**	**4,253.3**
Market Loans	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Government Bonds	7.3	7.2	0.7	0.7	0.7	0.7	0.7
Prize Bonds	197.4	236.0	277.1	333.4	389.6	446.6	460.6
Foreign Exchange Bearer Certificates	0.2	0.1	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	0.0	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	7.7	2.7	1.0	0.9	4.2	4.4	4.3
Government Bonds Issued to SLIC	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Pakistan Investment Bonds (PIB)	441.0	505.9	618.5	974.7	1,321.8	3,223.5	3,457.6
Government Bonds issued to HBL	-	-	-	-	-	-	-
GOP Ijara Sukuk	27.8	42.2	224.6	383.5	459.2	326.4	326.4
Floating Debt	**1,904.0**	**2,399.1**	**3,235.4**	**4,143.1**	**5,196.2**	**4,610.9**	**4,494.4**
Treasury Bills through Auction	796.1	1,274.1	1,817.6	2,383.4	2,921.0	1,758.6	1,858.9
Rollover of Treasury Bills discounted SBP	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Market Related Treasury Bills (MRTBs)	1,107.3	1,124.4	1,417.3	1,759.2	2,274.7	2,851.8	2,635.0
Unfunded Debt	**1,270.5**	**1,457.5**	**1,655.8**	**1,798.0**	**2,146.5**	**2,303.8**	**2,358.0**
Defence Savings Certificates	257.2	224.7	234.5	241.8	271.7	284.6	287.8
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	16.8	17.8	17.2	21.2	22.3	22.6	23.2
Mahana Amdani Account	2.4	2.2	2.1	2.0	2.0	1.9	1.8
Postal Life Insurance	67.1	67.1	67.1	67.1	67.1	67.1	67.1
Special Savings Certificates and Accounts	377.7	470.9	529.1	537.4	734.6	738.8	753.5
Regular Income Scheme	91.1	135.6	182.6	226.6	262.6	325.4	340.0
Pensioners' Benefit Account	109.9	128.0	146.0	162.3	179.9	198.4	202.3
Bahbood Savings Certificates	307.5	366.8	428.5	480.8	528.4	582.4	597.6
National Savings Bonds	-	3.6	3.6	3.6	0.2	0.2	0.2
G.P. Fund	40.1	39.9	44.3	54.5	73.1	80.5	82.5
Short Term Savings Certificates					4.0	1.3	1.3
Total Domestic Debt	**3,860.4**	**4,654.3**	**6,016.7**	**7,638.1**	**9,521.9**	**10,920.0**	**11,105.6**

P: Provisional *end-September,2014

Source: Budget Wing, Finance Division

7.3 The lower than targeted budget deficit along with shift in source of deficit financing reduced the pressure on domestic sources especially on the banking sector. In fact, the budgetary borrowing of around Rs.324 billion from the banking sector was only 22 percent of the borrowed amount a year earlier which created the space for banks for private sector credit.

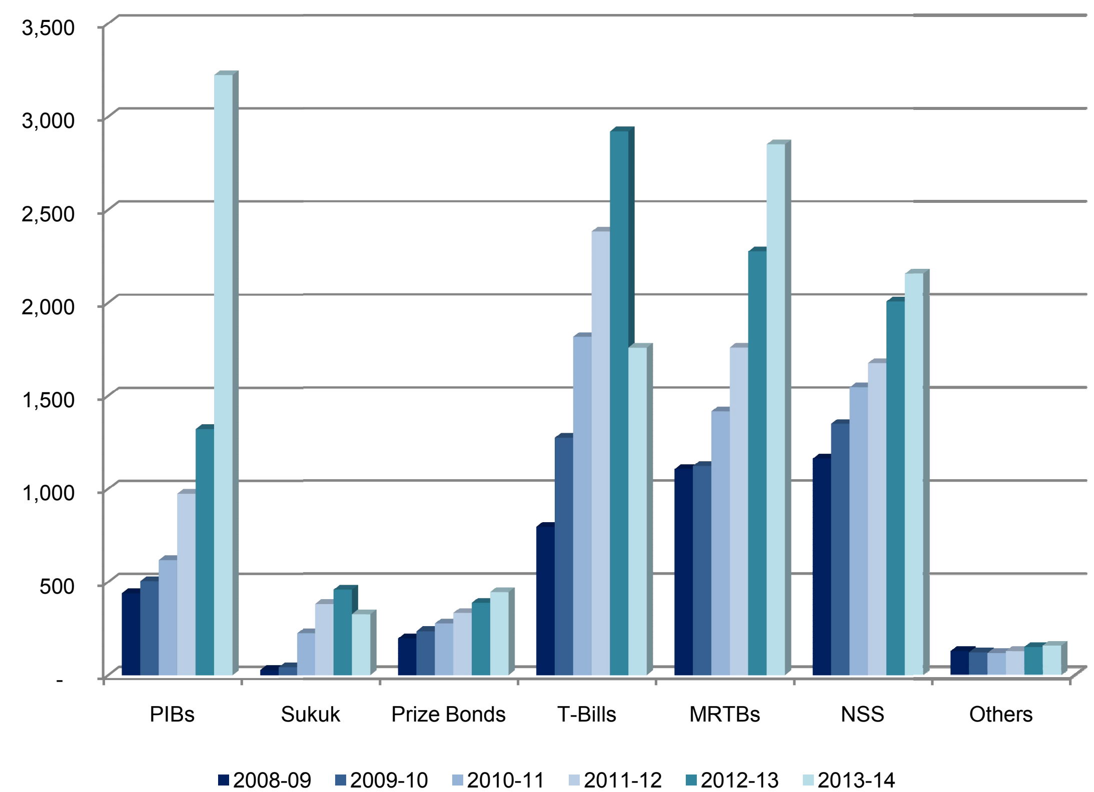
7.4 Within the banking sector, although budgetary borrowing from both SBP and commercial banks declined, the government could only adhere to keep its net quarterly borrowing from the State Bank of Pakistan at zero in one quarter. The government was also able to adhere to meet its ceiling on net budgetary borrowing from SBP in two quarters as envisaged under IMF Program. In this context, following factors influenced this outcome:

- The net external inflows were only available in the fourth quarter of 2013-14 due to which onus of deficit financing fell on domestic sources in first three quarters. Within the domestic sources, the government mainly borrowed from banking system during first half of the year as funding from non-banking sector (especially inflows from National Savings Schemes) remained subdued. However, budgetary borrowing from the banking sector during first half of the year remained lower than the corresponding period of 2012-13 as a result of better fiscal management.
- The commercial banks were sensing higher interest rates in first few months of the year and accordingly they were not only reluctant to fully rollover the maturing T-bills amount but their offered amounts were also concentrated in 3-months T-bills. Further, the government was also unable to realize the targeted amounts through PIBs over the same period. Thus, the government relied on SBP to fulfill the financing requirements.
- The market sentiments changed after November 2013 following a notable fall in year-on-year inflation (driven primarily by a sharp dip in food inflation) and improvement in external account. Thus, appetite for medium

to long term PIBs revived. Specifically, banks offered around Rs.1.9 trillion in PIBs auction against the pre-auction cumulative target of Rs.480 billion. This not only helped in improving the maturity profile of domestic debt but also made it easier for the government to meet the ceiling targets on its borrowing from SBP.

– During last quarter of 2013-14, the government was able to mobilize US$ 2 billion through issuance of Eurobonds. Further, availability of external funding from multilateral and bilateral development partners helped reducing the reliance on domestic sources. Thus, the government not only borrowed less in 2013-14 but its borrowing from commercial banks also reduced. More importantly, re-profiling of domestic debt in the form of substitution of T-bills with PIBs reduced the rollover and interest rate risk on domestic debt portfolio.

Fig-6: Instrument Wise Composition of Domestic Debt
(Rs. in billion)



7.5 The average maturity of domestic debt at the end of 2013-14 improved to 2.3 years compared with 1.8 years at the end of last fiscal year. Although there was a significant improvement in a year time, the government is required to further lengthen the maturity profile as around 52 percent of total domestic debt still had a maturity of less than a year as at end June, 2014.

The following sections highlight the developments in the various components of domestic debt during 2013-14:

I. Permanent Debt

7.6 The amount of permanent debt in the government's total domestic debt stood at Rs.4,005 billion as at end June 2014, registering an increase of Rs.1,826 billion during the year. The most important development during this period was the significant substitution of T-bills with PIBs. Inline with the government commitment to lengthen the maturity profile of domestic debt, the market responded positively from second quarter onwards which led to an unprecedented mobilization through PIBs i.e. government mopped up net of retirement Rs.1,902 billion through PIBs during 2013-14 compared with Rs.347 billion during last year.

II. Floating Debt

7.7 The volume of floating debt reduced to Rs.4,611 billion or 29 percent of total public debt in 2013-14 compared with Rs.5,196 billion or 36 percent in 2012-13. This reduction was mainly contributed by significant substitution of T-bills with PIBs i.e. by mid May 2014, commercial banks holdings of PIBs were higher than T-bills holding for the first time since launching of PIBs in December 2000. As at end June 2014, commercial banks holding of PIBs stood at Rs.2,171 billion compared with T-bills amounting to Rs.1,603 billion. Further, an analysis of T-bills yields revealed that these remained almost unchanged as the cut-off rates in the primary auction were very close to the policy rate. Further, the term premium between 3 months, 6 months and 12 months T-bills was almost negligible indicating the T-bills section of the yield curve was almost flat.

7.8 Keeping in view rising interest rate expectations in first few months of 2013-14, the commercial banks were not only reluctant to fully rollover their maturing T-bills amounts but also their investment in government securities remained confined primarily to 3 months T-bills. This was the period when banks remained liquid and SBP's intervention was primarily to absorb liquidity through Open Market Operation (OMO). This scenario changed after November 2013 when inflation started trending downward and an improvement was witnessed in external account. This was the time when commercial banks started to substitute their investment in T-bills with PIBs. Accordingly, cumulative amount offered in T-bills auctions fell short of quarterly targets for three quarters in 2013-14.

III. Unfunded Debt

7.9 Mobilization through unfunded debt stood at Rs.157 billion during 2013-14 compared with Rs.349 billion during last year. This reduction in mobilization through unfunded debt was expected as the exceptionally high mobilization in 2012-13 was primarily driven by institutional investors. Moreover, relatively higher return on PIBs (despite two upward revision in profit rates on NSS instruments) also dampened net inflows through unfunded debt. In terms of composition, most of the incremental mobilization went into Regular Income Certificates (Rs.63 billion) and Bahbood Savings Certificates (Rs.54 billion).

7.10 Over past few years, government took various measures to rationalize the NSS including linkage of profit rates on major NSS instruments with PIBs yield, levy of withholding tax on profits, service charges/penalty 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. Further, there is a need to weigh the cost of scheme in term of higher debt servicing and implication for the development of the financial sector especially the bond market. In this context, NSS instruments 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 problem for the government.

Table-5: Causative Factors in Change in Stock of Domestic Debt (Rs. in billion)

	Stock	Stock	Receipts	Repayments	Net Investment
	2012-13	2013-14	(in 2013-14)		
Permanent Debt	**2,179.2**	**4,005.3**	**2,272.6**	**446.5**	**1,826.1**
Market Loan	2.9	2.9	-	-	-
Government Bonds	0.7	0.7	-	-	-
Prize Bonds	389.6	446.6	161.6	104.6	57.1
Foreign Exchange Bearer Certificates	0.1	0.1	-	0.0	(0.0)
Bearer National Fund Bonds	0.0	0.0	-	-	-
Federal Investment Bonds	0.0	0.0	-	0.0	(0.0)
Special National Fund Bonds	0.0	0.0	-	-	-
Foreign Currency Bearer Certificates	0.0	0.0	-	-	-
U.S. Dollar Bearer Certificates	0.0	0.0	-	-	-
Special U.S. Dollar Bonds	4.2	4.4	0.1	0.0	0.1
Government Bonds Issued to SLIC	0.6	0.6	-	-	-
Pakistan Investment Bonds (PIBs)	1,321.8	3,223.5	2,061.4	159.6	1,901.7
Government Bonds issued to HBL	-	-	-	-	-
GOP Ijara Sukuk	459.2	326.4	49.5	182.4	(132.8)
Floating Debt	**5,196.2**	**4,610.9**	**13,394.3**	**13,979.6**	**(585.3)**
Treasury Bills through Auction	2,921.0	1,758.6	7,231.4	8,393.7	(1,162.4)
Rollover of Treasury Bills discounted SBP	0.5	0.5	-	-	-
Treasury Bills purchased by SBP (MRTBs)	2,274.7	2,851.8	6,162.9	5,585.8	577.1
Unfunded Debt	**2,146.5**	**2,303.8**	**941.8**	**784.5**	**157.3**
Defence Savings Certificates	271.7	284.6	45.8	32.8	13.0
Khas Deposit Certificates and Accounts	0.6	0.6	0.0	0.0	(0.0)
National Deposit Certificates	0.0	0.0	-	0.0	(0.0)
Savings Accounts	22.3	22.6	180.0	179.7	0.3
Mahana Amdani Account	2.0	1.9	0.6	0.6	(0.1)
Postal Life Insurance	67.1	67.1	-	-	-
Special Savings Certificates and Accounts	734.6	738.8	366.1	362.0	4.2
Regular Income Scheme	262.6	325.4	161.8	99.0	62.8
Pensioners' Benefit Account	179.9	198.4	41.2	22.7	18.5
Bahbood Savings Certificates	528.4	582.4	133.8	79.9	54.0
National Savings Bonds	0.2	0.2	-	-	-
G. P. Fund	73.1	80.5	7.8	0.4	7.4
Short Term Savings Certificates	4.0	1.3	4.8	7.4	(2.6)
Total Domestic Debt	**9,521.9**	**10,920.0**	**16,608.7**	**15,210.6**	**1,398.1**

Source: Budget Wing, Finance Division

7 (i) Domestic Debt during July - September, 2014

7.11 Domestic debt recorded an increase of Rs.186 billion during first three months of current fiscal year and stood at Rs.11,106 billion as at end September, 2014. The banks actively participated in PIBs auctions throughout the first quarter of 2014-15 in anticipation of decline in interest rates. This enabled the government to partly retire its debt to SBP and accordingly it met the limit of net zero quarterly borrowings from SBP in first quarter of 2014-15. In terms of ownership, considerable portion of PIBs was shifted to non-bank financial institutions through secondary market trading, however, around two-third of outstanding PIBs are still held by commercial banks.

7.12 During first quarter of 2014-15, public debt servicing was Rs.476 billion against the annual budgeted estimate of Rs.1,686 billion. Public debt servicing consumed nearly 57 percent of revenues. Domestic debt servicing stood at Rs.376 billion or 79 percent of total debt servicing.

7 (ii) Development of Domestic Debt Capital Market

7.13 A well developed debt market for long term investment is essential for the growth of economy as it provides additional avenues for raising funds besides providing investment opportunities to the investors. In accordance with the commitment of the government to develop debt capital market, secondary trading of Government Debt Securities (GDS) at the stock exchanges in Pakistan has been launched. Government has also approved the regulatory framework for trading of GDS.

Operational Framework:

7.14 Initially T-bills, PIBs and Government Ijara Sukuk are made available for trading at the stock exchange. The commercial banks designated as Primary Dealers (PDs) by SBP are allowed for direct proprietary trading and can also act as market maker in GDS. The stock brokers fulfilling specific eligibility criteria are allowed to trade in GDS on their own account and on behalf of their clients. The trading by brokers and their clients is subject to a pre-check by the stock exchange to ensure that only investors with sufficient cash and custody of GDS can execute trades on the stock exchange.

7.15 The settlement of trades executed at KSE is performed through the Real Time Gross Settlement (RTGS) system of SBP. PDs settle their trades directly whereas the brokers and their clients utilize the services of Central Depository Company (CDC) and those commercial banks which enter into a service level agreement with the stock exchange for this purpose.

Advantages of GDS Trading

7.16 The trading in GDS at the stock exchanges is considered to be an important breakthrough which can contribute significantly towards development of debt capital market. Trading of GDS on the stock exchanges will provide an efficient and liquid secondary market to the investors where they can sell GDS and realize their investments before maturity. The capital market will have a more market based yield curve and will provide a reliable benchmark for the pricing of these debt securities. This initiative is expected to increase depth in the debt market, paving the way to utilize stock exchanges as a medium for direct government borrowings from the general public.

Other Initiative for Development of Debt Capital Market:

7.17 Government has also taken the following steps for the development of debt capital market:

- **Commercial Papers Regulations, 2013:**
  Commercial Papers Regulations 2013 have been notified on December 04, 2013. Commercial Paper (CP) is an unsecured short term debt instrument issued by highly rated companies in the form of promissory note. In 2002, SECP had issued guidelines for issuance of CPs. In order to appropriately regulate CP issues and to facilitate the CP issuers, the guidelines have been reviewed and replaced with the Regulations.

- **Code of Conduct for Credit Rating Agencies (CRAs):**
  In order to review the role and responsibilities of CRAs, SECP constituted a

Committee having representation from SECP, SBP and both domestic CRAs. SECP in light of the recommendations of the Committee reviewed the Code of Conduct for CRAs dated February 17, 2005 and replaced it with a new Code. The new Code dated January 13, 2014 has been framed in line with the international best practices. It is expected that compliance with the new Code will further improve the performance and credibility level of CRAs.

– **The Regulations for Issuance of Sukuk:**

  Sukuk market is an important segment of capital market and is considered a viable and efficient alternative for fund raising. An efficient, broad based and well regulated Sukuk market may help in the development of capital market. For the development and proper regulated Sukuk Market, SECP is working on formulation of Regulations for issuance of Sukuk which will help in development of Islamic capital market.

Future Plans With Regard to Development of Debt Capital Market:

7.18 Following are some of the measures in pipeline for development of the domestic debt capital market:

- Integration of National Savings Scheme instruments into the mainstream capital market, in coordination with the federal government and the SBP;
- Formulation of the Regulations for listing of debt securities issued through public offer;
- Review of the Regulations for listing of debt securities issued to the Qualified Institutional Buyers (QIBs);
- Regulations for issuance of Convertible Securities;
- Review of the companies (Asset Backed Securitization) Rules, 1999;
- Utilization of the stock exchanges for primary market/auction of government debt securities to enable wider outreach and improve participation of retail segment.

8.0 External Debt and Liabilities

8.1 Pakistan's External Debt and Liabilities (EDL) include all foreign currency debt contracted by the public and private sector as well as foreign exchange liabilities of SBP. There is an inherent capital loss associated with the debt denominated in foreign currency, however, it is mitigated by the strong concessionality element (low cost and long tenors). The impact of any currency shock should not be looked in isolation, but rather be analyzed in the context of interest rate differential.

8.2 As at end June 2014, EDL was dominated by Public and Publically Guaranteed (PPG) debt having share of around 75 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 5 percent in EDL stock as compared with 7 percent at the end of 2012-13 owing to hefty repayments made during 2013-14.

8.3 The EDL recorded an increase of US$ 4.7 billion during 2013-14 and stood at US$ 65.6 billion at end June 2014 out of which external public debt was US$ 51.4 billion. External public debt recorded an increase of US$ 3.5 billion during 2013-14 which was primarily driven by:

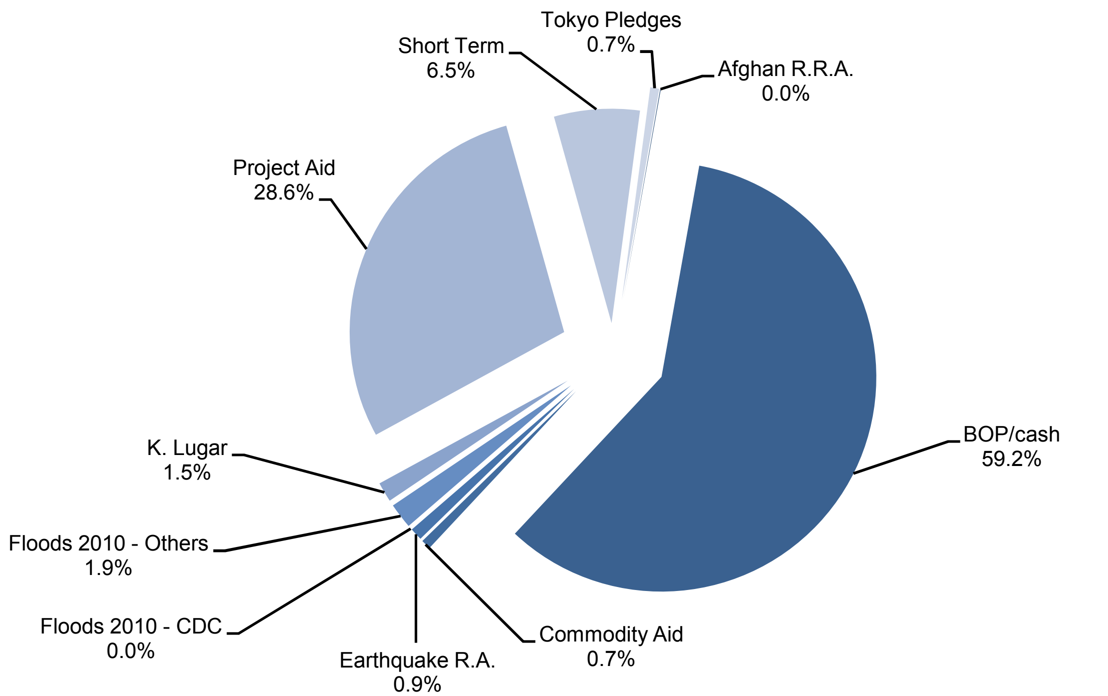
- Pakistan mobilized US$ 2 billion through issuance of Eurobonds;
- This was the first time in three years that net inflows from IFIs turned positive;
- Translation losses on account of depreciation of the US Dollar against major currencies also contributed to this increase by around US$ 571 million.

8.4 The IMF approved a three year Extended Fund Facility programme for Pakistan on September 04, 2013 for SDR 4.4 billion (US$ 6.6 billion) out of which US$ 1.675 billion were received during 2013-14. However, indebtedness to the IMF actually declined by US$ 1.4 billion during 2013-14 which shows that the Extended Fund Facility was not frontloaded i.e. government repaid around US$

3.1 billion against the IMF loans compared with the fresh disbursements of around US$ 1.675 billion during 2013-14.

8.5 Another positive development during 2013-14 was revival of external inflows as targeted in MTDS. During 2013-14, disbursements including loans and grants were recorded at US$ 6.8 billion compared with only US$ 2.9 billion during last fiscal year. Disbursements including the IMF stood around US$ 8.5 billion. The purpose and type wise disbursement of foreign economic assistance (excluding the IMF) is depicted through following graph:

Fig-7: Purpose Wise Disbursements
(in percent of total)



8.6 Disbursements from IFIs specifically World Bank and Asian Development Bank (ADB) significantly increased during 2013-14 as the government signed new contracts with these agencies to finance energy and structural reforms in the country. The pace of external inflows is likely to continue in future as the government has signed number of fresh financing agreements with international development partners. Specifically, during 2014-15, the government is expected to receive substantial inflows from international development partners including US$ 1.6 billion from International Development Association (IDA), US$ 1.5 billion from China, US$ 1.1 billion from ADB etc. Furthermore, Pakistan successfully returned to the international Islamic Bond market in November, 2014 with the issuance of 5-year Sukuk amounting to US$ 1 billion.

8.7 The EDL stock was recorded at US$ 64.4 billion as on September 30, 2014. Out of total EDL, public external debt amounted to US$ 50 billion. Public external debt witnessed a decline of US$ 1.4 billion during first quarter of 2014-15 despite net positive disbursements. This reduction in external debt was mainly contributed by translational gain on account of appreciation of US Dollar against other major currencies by US$ 1.8 billion.

8.8 During first quarter of 2014-15, disbursements including loans and grants stood at US$ 1,270 million compared with US$ 339 million during the same period last year. Pakistan also received US$ 556 million from the IMF in July 2015. Importantly, net inflows from the IMF stood at US$ 36 million in first quarter of 2014-15 compared with net outflow of US$ 308 million during the same period last year.

Table-6: Pakistan External Debt and Liabilities

	2009	2010	2011	2012	2013(P)	2014(P)	2015(P)*
	(US Dollar in billion)						
1. Public and Publically Guaranteed Debt	**42.6**	**43.1**	**46.5**	**46.4**	**44.4**	**49.0**	**47.6**
i) Public Debt	**42.4**	**42.9**	**46.4**	**46.2**	**43.5**	**48.5**	**47.1**
A. Medium and Long Term(>1 year)	**41.8**	**42.1**	**45.7**	**45.6**	**43.5**	**47.8**	**46.3**
Paris Club	14.0	14.0	15.5	15.0	13.5	13.6	12.8
Multilateral	23.0	23.7	25.8	25.3	24.2	25.8	24.8
Other Bilateral	1.4	1.8	1.9	2.5	2.9	3.5	3.8
Euro Bonds/Saindak Bonds	2.2	1.6	1.6	1.6	1.6	3.6	3.6
Military Debt	0.2	0.2	0.1	0.1	0.1	0.0	0.0
Commercial Loans/Credits	0.2	-	-	-	-	0.2	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	0.1	0.1
SAFE China Deposits	0.5	0.5	0.5	1.0	1.0	1.0	1.0
NBP/BOC Deposits	0.3	0.2	0.1	-	-	-	-
B. Short Term (<1 year)	**0.7**	**0.9**	**0.6**	**0.5**	**0.0**	**0.7**	**0.9**
Commercial Loans/Credits	**-**	**-**	**-**	**-**	-	0.2	0.2
IDB	0.7	0.8	0.6	0.5	-	0.4	0.6
Local Currency Securities	-	0.1	0.0	0.0	0.0	0.1	0.1
ii) Publicly Guaranteed Debt	**0.2**	**0.2**	**0.1**	**0.2**	**0.9**	**0.5**	**0.5**
A. Medium and Long Term(>1 year)	**0.2**	**0.2**	**0.1**	**0.2**	**0.9**	**0.5**	**0.5**
Paris Club	-	-	-	-	-	-	-
Multilateral	0.1	0.1	0.0	0.0	0.3	0.0	0.0
Other Bilateral	0.1	0.0	0.0	0.2	0.6	0.4	0.4

Table-6: Pakistan External Debt and Liabilities

	2009	2010	2011	2012	2013(P)	2014(P)	2015(P)*
Commercial Loans/Credits	-	0.1	-	-	-	-	-
Saindak Bonds	-	-	-	-	-	-	-
B. Short Term (<1 year)	-	-	-	-	-	-	-
IDB	-	-	-	-	-	-	-
2. Private Non-Guaranteed Debt (>1 year)	**2.4**	**3.8**	**4.4**	**3.6**	**3.1**	**3.0**	**3.1**
3. Public Sector Enterprises (PSEs Debt)	**0.9**	**1.4**	**1.3**	**1.3**	**1.2**	**1.7**	**1.6**
4. IMF	**5.1**	**8.1**	**8.9**	**7.3**	**4.4**	**3.0**	**2.9**
of which Central Government	-	1.1	2.0	1.9	1.7	0.9	0.7
Monetary Authorities	5.1	7.0	6.9	5.4	2.7	2.1	2.3
5. Banks	**-**	**0.7**	**1.1**	**1.8**	**1.6**	**2.0**	**2.2**
Borrowing	-	0.2	0.4	0.9	0.7	1.1	1.3
Nonresident Deposits (LCY & FCY)	-	0.6	0.7	1.0	0.8	0.9	0.9
6. Debt liabilities to direct investors - intercompany debt	**-**	**1.9**	**1.6**	**2.7**	**3.1**	**3.7**	**3.8**
Total External Debt (1 through 6)	**51.1**	**59.0**	**63.8**	**63.1**	**57.8**	**62.3**	**61.2**
7. Foreign Exchange Liabilities	**1.3**	**2.6**	**2.6**	**2.4**	**3.1**	**3.3**	**3.2**
Total External Debt & Liabilities (1 through 7)	**52.3**	**61.6**	**66.4**	**65.5**	**60.9**	**65.6**	**64.4**
(of which) Public Debt	**47.6**	**50.9**	**55.3**	**53.5**	**47.9**	**51.4**	**50.0**
Official Liquid Reserves	9.1	13.0	14.8	10.9	6.0	9.1	8.9
	(In percent of GDP)						
Total External Debt (1 through 6)	**30.4**	**33.2**	**29.8**	**28.1**	**24.7**	**25.2**	**21.2**
1. Public and Publically Guaranteed Debt	25.3	24.3	21.7	20.6	19.0	19.8	16.5
A. Medium and Long Term(>1 year)	24.8	23.7	21.4	20.3	18.6	19.4	16.0
B. Short Term (<1 year)	0.4	0.5	0.3	0.2	0.0	0.3	0.3
2. Private Sector Debt	1.4	2.1	2.0	1.6	1.3	1.2	1.1
3. Public Sector Enterprises (PSEs) Debt	0.5	0.8	0.6	0.6	0.5	0.7	0.6
4. IMF	3.1	4.6	4.2	3.3	1.9	1.2	1.0
5. Banks	0.0	0.4	0.5	0.8	0.7	0.8	0.8
6. Debt liabilities to direct investors - Intercompany debt	0.0	1.1	0.8	1.2	1.3	1.5	1.3
7. Foreign Exchange Liabilities	0.8	1.5	1.2	1.1	1.3	1.3	1.1
Total External Debt & Liabilities (1 through 7)	**31.1**	**34.7**	**31.0**	**29.2**	**26.1**	**26.6**	**22.3**
Official Liquid Reserves	5.4	7.3	6.9	4.8	2.6	3.7	3.1
Memo:							
GDP (Rs. in billion)	13,200	14,867	18,276	20,047	22,489	25,402	29,078
Exchange Rate (Rs./US$, Period Average)	78.5	83.8	85.5	89.2	96.2	102.9	100.7
Exchange Rate (Rs./US$, End of Period)	81.4	85.5	86.0	94.5	99.7	98.8	102.6
GDP (US$ in billion)	168	177	214	225	234	247	289

P: Provisional *end-September,2014

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

8 (i) - External Debt & Liabilities Servicing

8.9 Annual debt obligations have increased since 2008-09 and stood at US$ 7,697 million in 2013-14. An amount of US$ 1,528 million of multilateral debt, together with US$ 3,182 million of the IMF loans, accounted for most of these obligations. This was the first time Pakistan made such large repayments of debt in a single year. The debt servicing obligation is expected to be substantial in the medium term owing to the following:

- While the significant portion of the IMF loans has already been repaid, servicing of US$ 1.3 billion is still required in 2014-15;
- Maturity of 10 years Eurobonds issued in 2005-06 (US$ 500 million) and 2006-07 (US$ 750 million) is due in 2015-16 and 2016-17 respectively;
- Repayment of rescheduled Paris Club debt under Official Development Assistance (ODA) will start from 2016-17;
- The 5-year Eurobond issued in April 2014 (US$ 1 billion) will mature in 2018-19

8.10 Servicing of EDL fell by US$ 350 million in first quarter of 2014-15 compared to the same period last year and recorded at US$ 2,159 million. Out of this total, principal repayments were US$ 1,215 million and interest payments were US$ 244 million, whereas an amount of US$ 700 million was rolled over. Among the principal repayments, US$ 349 million of multilateral debt and US$ 520 million of IMF accounted for most of the share.

Table-7: Pakistan's Public External Debt Servicing

Years	Actual Amount Paid	Amount Rolled Over	Total
(US Dollar in million)			
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	6,996.5	700.0	7,696.5
2014-15*	1,459.3	700.0	2,159.3

*July-September, 2014

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

8 (ii) Performance of Pakistan Eurobonds

8.11 Pakistan successfully tapped international capital market after a gap of 7 years which highlights investors' confidence in structural reforms undertaken by the government which resulted in improvement of country's leading economic indicators and external finances. Against the initial expectations of raising US$ 500 million, the investor response was overwhelming and the order-books heavily oversubscribed consisting of over 400 orders from high quality investors. However, after a careful consideration, the government decided to raise financing of US$ 2 billion comprising US$ 1 billion each in 5 and 10 years tenor with coupon rate of 7.25 percent and 8.25 percent respectively. This represented the largest ever international bond transaction by Pakistan.

8.12 The issuance of Eurobonds has great significance for Pakistan as it not only introduced Pakistan back in the international capital markets but also allowed access to cheaper foreign resources for building country's reserves, which have paved the way for exchange rate appreciation and stability. Further, the proceeds were utilized to retire the domestic debt as reflected in the massive decline in borrowings from SBP that came down from Rs.1,446 billion in 2012-13 to Rs.303 billion in 2013-14, a mere 21 percent of the borrowing level of last year.

The region and investor wise break-up of these bonds is depicted through the following graphs:

Fig-8: Distribution of 5 Years Bonds Across Geographical Regions

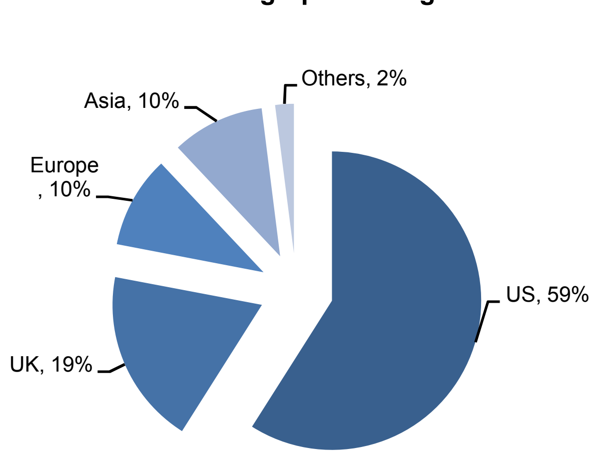


Fig-9: Distribution of 5 Years Bonds Across Investors

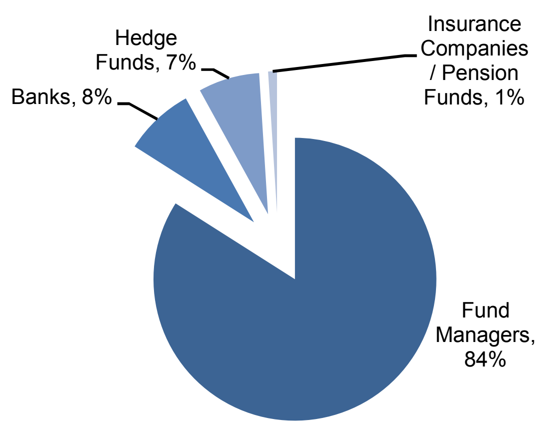


Fig:10 - Distribution of 10 Years Bonds Geographical Region

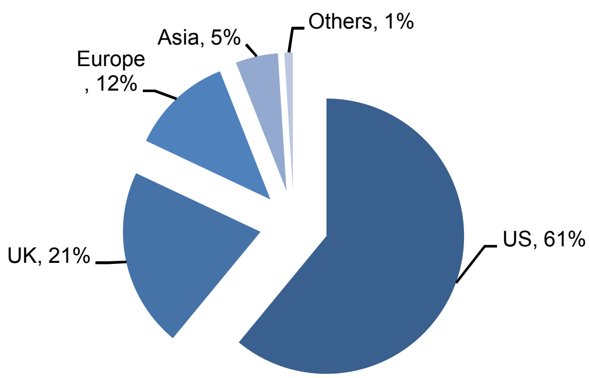
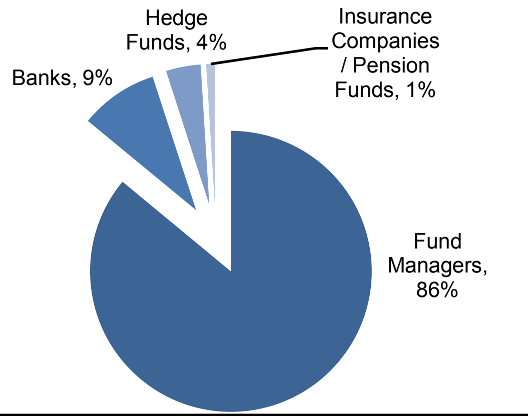


Fig-11: Distribution of 10 Years Bonds Across Investors



8.13 There has been a marked improvement in recent price performance of Pakistan's Eurobonds. The 2016s, 2017s, 2019s and 2024s Eurobonds broadly traded at a premium since May 2014. Credit Default Swap (CDS) levels, though volatile, have been on a downward trajectory.

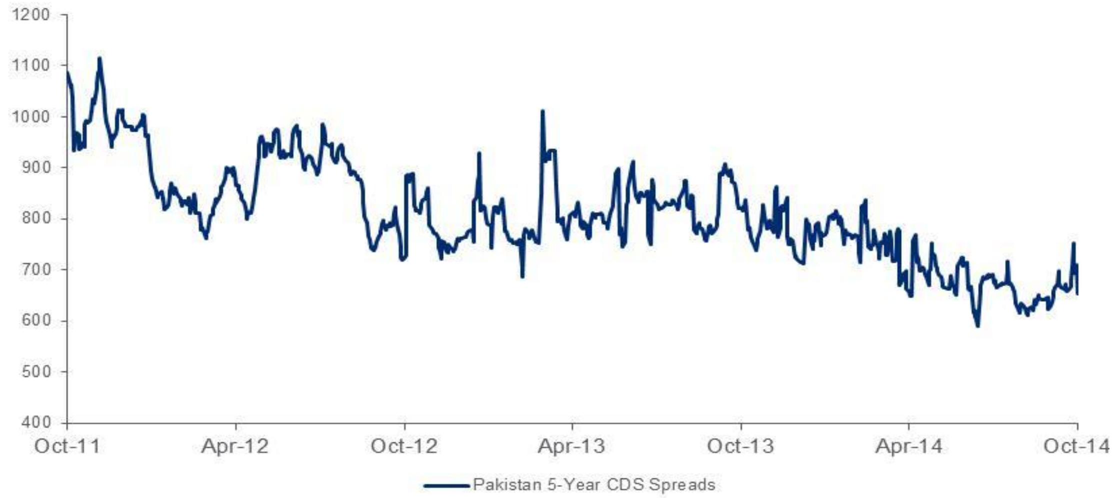
Table-8: Performance of Pakistan Eurobonds

Issuer	Ratings (Moody's/S&P)	Coupon (%)	Maturity	Yield (%)
Pakistan	Caa1/B-	7.125	March 2016	6.77
Pakistan	Caa1/B-	6.875	June 2017	6.66
Pakistan	Caa1/B-	7.250	April 2019	7.18
Pakistan	Caa1/B-	8.250	April 2024	8.17
Pakistan	Caa1/B-	7.875	March 2036	8.99

Source: Bloomberg, as at end October, 2014

Fig-12: Performance of Pakistan Eurobonds

Fig-13: Credit Default Swap (bps)



8.14 Pakistan also successfully returned to the international Islamic bond market in November 2014 with the issuance of Sukuk for US$ 1 billion. Similar to Eurobonds issued in April 2014, investors response was overwhelming as order-books oversubscribed by almost five times i.e. against the initial expectations of raising US$ 500 million, there were offers worth US$ 2.3 billion. The success of this Sukuk transaction highlights the growing confidence of the international investors towards the economic policies of the government being implemented to enhance the economic performance of the country. Encouragingly, the government was able to get even a lower rate compared to Eurobonds i.e. 6.75 percent for 5 year Sukuk compared with 7.25 percent on the same tenor Eurobonds issued in April 2014. This profit rate of 6.75 percent on the Sukuk also marks the lowest pricing achieved by Pakistan in the international conventional and Islamic bond market in last 7 years.

8 (iii) - <u>Currency Movements and Translational Impact</u>

8.15 External loans are contracted by Pakistan in various currencies and disbursements are effectively converted into Pak Rupee. As the Pak Rupee is not an internationally traded currency, other currencies are bought and sold by buying and selling US Dollars. Accordingly, external debt portfolio is exposed to currency exchange risk between the US Dollar and the foreign currencies of the various external loans, as well as between the US Dollar and the Pak Rupee.

8.16 The Pak Rupee depreciated against the US Dollar on average by 3.8 percent per annum between 2009-10 and 2013-14 which resulted in increase in Pakistan's external debt in local currency. Pakistan's loss on foreign currency debt is mitigated by the concessional terms (low cost and longer maturities) associated with its external loans i.e. the cost of adverse currency movements and existing external debt rates is still lower than the cost of domestic debt by approximately 5.3 percent over the last five years. Accordingly, policy of the government is to borrow more through these channels. The principal exchange rate risk for Pakistan is from loans denominated in US Dollars, Euro, Japanese Yen and Pound Sterling.

8.17 During 2013-14, depreciation of US Dollar against other major currencies caused the foreign currency component of public debt to increase by US$ 571 million. However, appreciation of Pak Rupee against US Dollar more or less offset this loss in domestic currency. On the contrary, first quarter of 2014-15 witnessed huge translational gain of US$ 1.8 billion on account of appreciation of US Dollar against other major currencies, however, depreciation of Pak Rupee against US Dollar by 4 percent reduced this gain in rupee term.

8 (iv) - External Debt Sustainability

8.18 Managing the levels of external debt and the risks associated with them pose a different set of challenges for policy makers. A key component of external debt sustainability analysis is to estimate the path of a country's external debt stock over time. The increase in interest rates, depreciation of exchange rate and higher external account deficit can increase stock of external debt. In crisis situations, countries can have recourse to debt restructuring or reduction, but such actions cannot be regular means of dealing with external financing problems, as these affect access to new financing. Thus, a good tracking system in the form of debt sustainability analysis based on key macroeconomic indicators can predict and prevent debt problems.

Table-9: External Debt Sustainability Indicators

(In percent)	2009	2010	2011	2012	2013	2014
Non-Interest Current Account / GDP	(4.4)	(1.4)	0.8	(1.3)	(0.5)	(0.7)
Growth in EDL	13.4	17.6	7.8	(1.3)	(7.0)	7.7
Growth in FEE	(5.1)	7.9	25.1	1.1	4.1	2.0
EDL/FEE (times)	1.5	1.6	1.4	1.4	1.2	1.3
EDL/FER (times)	4.2	3.7	3.6	4.3	5.5	4.6
EDL/GDP	31.1	34.7	31.0	29.2	26.1	26.6
EDL Servicing/FEE	18.0	16.6	11.4	12.5	14.3	15.0

FEE: Foreign Exchange Earnings; EDL: External Debt and Liabilities; FER: Foreign Exchange Reserves
Source: Debt Policy Coordination Office Staff Calculations, Finance Division

8.19 Analysis of the current account deficit provides important insight as to the future direction of the external debt path. Higher current account in the absence of offsetting increases to current transfers and non-debt creating capital flows can add to the stock of external debt. Due to improved trade balance (higher cotton prices) in 2010-11, non interest current account showed a surplus of 0.8 percent of GDP. Afterwards, non interest current account posted a deficit in last three years mainly owing to high value of oil imports. During 2013-14, non interest current account showed a deficit of 0.7 percent of GDP as compared with a deficit of 0.5 percent last year.

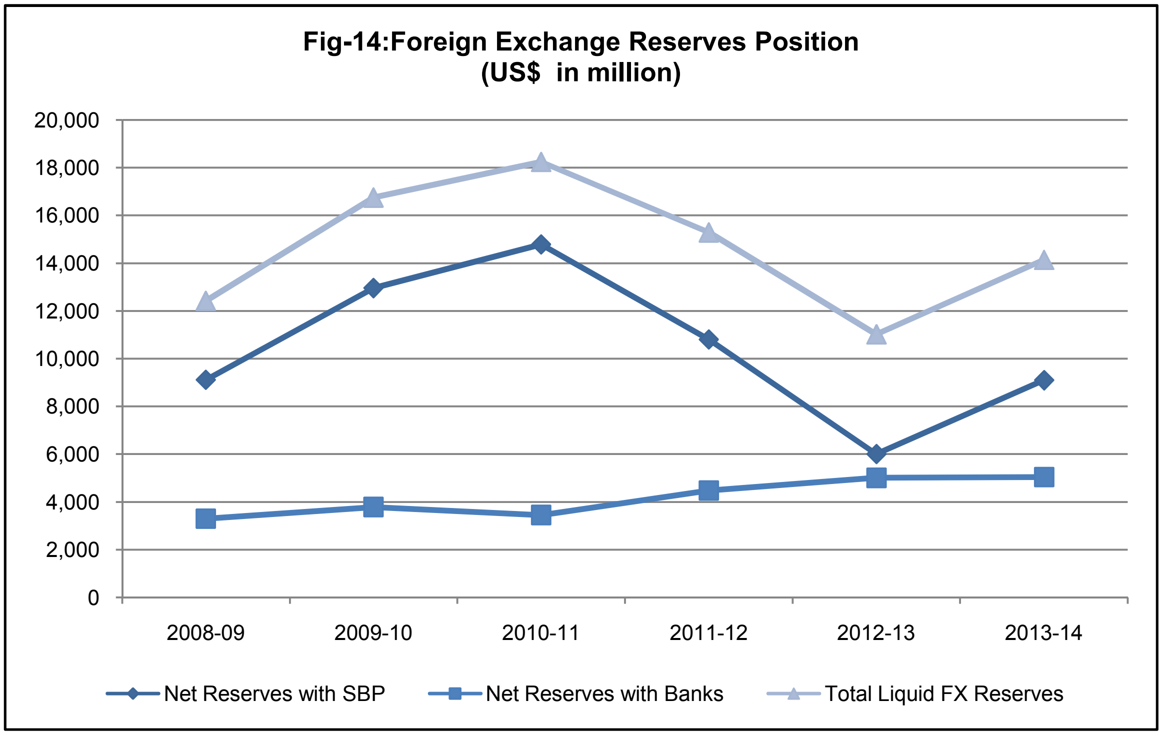
8.20 EDL as a percentage of FEE gives a measure of a country's debt repayment capacity. EDL at 2 times of FEE and EDL servicing below 20 percent of FEE are generally believed to be within the bounds of sustainability. Pakistan's EDL and its servicing in terms of FEE stood at 1.3 times and 15 percent respectively during 2013-14 compared with 1.2 times and 14.3 percent respectively last year. The erosion in EDL to FEE ratio suggests that stock of EDL witnessed more growth than foreign exchange earnings during 2013-14. Further, EDL Servicing to FEE ratio also weakened primarily due to hefty repayments to the IMF during 2013-14.

8.21 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 times in 2009-10 as EDL growth slowed and foreign exchange reserves shored up. The ratio improved slightly in 2010-11 mainly because of lower growth in EDL stock and improvement in reserves. However, it showed downward trend during 2011-12 and 2012-13 and recorded at 4.3 times and 5.5 times respectively, mainly because of drawdown on reserves owing to repayments of the IMF loans and other lower non-debt creating inflows. During 2013-14, this ratio improved and recorded at 4.6 times mainly due to increased external inflows (both debt and non-debt creating) and accordingly foreign exchange reserves shored up.

8.22 EDL as a percent of GDP stood at 26.1 percent at end of June 2013 compared with 29.2 percent in 2011-12. This improvement was mainly due to hefty repayments against the IMF loans and translational gain on account of US Dollar appreciation against other major currencies. By end June 2014, this ratio marginally increased and stood at 26.6 percent mainly due to successful launching of Eurobonds, fresh financing from World Bank, ADB and some bilateral inflows along with translational loss on account of US Dollar depreciation against other major currencies.

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

8.23 Pakistan's balance of payments position improved significantly in 2013-14. SBP foreign exchange reserves witnessed an increase of US$ 3.1 billion compared with cumulative decline of US$ 8.8 billion during last two fiscal years. Pressure on SBP reserves mainly eased as Pakistan received US$ 1.675 billion from the IMF, US$ 1.5 billion under the Pakistan Development Fund, US$ 2 billion through issuance of Eurobonds, fresh disbursement of US$ 1 billion from World Bank etc. In addition, proceeds from long awaited 3G/4G licenses auction and UBL divesture helped building the foreign exchange reserves. The increase in external inflows also enabled the government to meet its debt obligations as external debt servicing of around US$ 7 billion was made during 2013-14 which was larger than the size of SBP reserves (US$ 6 billion) at start of the year.



8.24 The current account deficit recorded at around US$ 3 billion in 2013-14 compared with US$ 2.5 billion during last fiscal year. This increase is mainly attributed to lower inflows under the Coalition Support Fund (CSF). The current account actually improved as compared with last fiscal year, if CSF is not taken into account. The improvement in current account (excluding CSF) is primarily contributed by increase in workers' remittances that reached at record high level of US$ 15.8 billion even surpassing the target of US$ 15.1 billion set for 2013-14. The increase in workers' remittances provided much needed foreign currency respite in past few years. In absolute terms, these remittances have financed 95 percent of the trade deficit, 38 percent of the total imports and contributed 6 percent in Gross National Income in 2013-14.

8.25 Overall trade deficit was recorded at US$ 16.6 billion in 2013-14 compared with US$ 15.4 billion in 2012-13. This increase in trade deficit came primarily from higher imports of machinery, iron, fertilizer and steel, whereas exports posted a nominal growth supported by award of GSP Plus status by the European Union

(EU). Services deficit also widened primarily due to lower inflows of CSF and recorded at US$ 2.5 billion compared with US$ 1.5 billion in the last fiscal year. Similarly, primary income account also posted a deficit of US$ 3.9 billion in 2013-14 compared with US$ 3.7 billion in last fiscal year. Together, the deficit in these accounts offset the remarkable improvement in worker remittances and accordingly current account deficit widened in 2013-14 compared with the last fiscal year.

8.26 Pakistan received a grant of US$ 1.5 billion from Saudi Arabia which augmented its capital account surplus. Financial account also improved significantly owing to proceeds from the issuance of Eurobonds, fresh loans from IFIs, sale of 3G/4G licenses auction and proceeds from the UBL divesture. The proceeds from telecommunication sector (auction of 3G/4G licenses) pushed foreign direct investment to surpass last year's level, whereas, growth in other sectors remained subdued. Similarly, increase in foreign portfolio investment was mainly driven by proceeds from the issuance of Eurobonds and UBL divesture.

8.27 The Pak Rupee appreciated by around 0.9 percent during 2013-14. Based on the fiscal year end exchange rate, this was the first year after 2002-03 when Pak rupee posted an appreciation against US Dollar. The effective exchange rate which indicates relative strength of the Pak Rupee compared to basket of other currencies showed a nominal depreciation of 0.3 percent during the year. However, this depreciation could not offset the sharp rise in relative prices (CPI in Pakistan compared to other countries in the trade basket) which lead to an appreciation of 5.5 percent in the Real Effective Exchange Rate (REER).

9.0 Progress on Medium Term Debt Management Strategy (2013/14 - 2014/18)

9.1 Government developed its first Medium Term Debt Management Strategy (2013/14 - 2017/18) which contains a policy advice on an appropriate mix of financing from different sources with the spirit to uphold the integrity of the Fiscal Responsibility & Debt Limitation (FRDL) Act, 2005. In accordance with the approved strategy, the government was required to lengthen the maturity profile of its domestic debt and mobilize sufficient external inflows.

Table-10: Public Debt Cost and Risk Indicators*

Risk Indicators		External Debt		Domestic Debt		Public Debt	
		2013	2014	2013	2014	2013	2014
Cost of Debt	Weighted Average IR (%)	1.7	2.1	10.7	11.3	7.7	8.4
Refinancing Risk	Average Time to Maturity (ATM) - Years	10.1	10.5	1.8	2.3	4.5	4.9
	Debt Maturing in 1 Year (% of total)	8.9	7.7	64.2	52.1	46.0	38.2
Interest Rate Risk	Average Time to Re-Fixing (ATR) - Years	9.2	9.7	1.8	2.3	4.2	4.6
	Debt Re-Fixing in 1 year (% of total)	22.2	20.3	67.2	53.4	52.4	43.1
	Fixed Rate Debt (% of total)	83.4	83.3	39.6	54.1	54.0	63.2
Foreign Currency Risk (FX)	Foreign Currency Debt (% of total debt)					32.9	31.3
	Short Term FX Debt (% of reserves)					68.5	42.8

* As per MTDS scope

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

9.2 As depicted in the table above, almost all public debt indicators improved in 2013-14 as compared with 2012-13 except for weighted average cost of debt. The weighted average cost of debt increased owing to implicit borrowing strategy of the government to reduce the refinancing / rollover risk by lengthening the maturity profile of domestic debt and increasing the external inflows.

9.3 Refinancing risk was probably the most significant in Pakistan's public debt portfolio, driven primarily by the concentration of domestic debt in short maturities at the end of 2012-13. The refinancing risk of the domestic debt reduced significantly at the end of 2013-14 as indicated by percentage of debt maturing in one year reduced to 52 percent compared with 64 percent at the end of 2012-13. Accordingly, Average Time to Maturity of domestic debt increased to 2.3 years at the end of 2013-14 as compared with 1.8 years at the end of last year. Similarly, Average Time to Maturity of external debt also increased to 10.5 years at the end of 2013-14 as compared with 10.1 years at the end of last year. Overall, Average Time to Maturity of public debt increased to 4.9 years at the end of 2013-14 as compared with 4.5 a year earlier.

9.4 Exposure to interest rate risk reduced as percentage of debt re-fixing in one year decreased to 43 percent at the end of 2013-14 as compared with 52 percent a year earlier. Accordingly, Average Time to Re-fixing increased to 4.6 years at the end of 2013-14 as compared with 4.2 years at the end of 2012-13. This number is a combination of Average Time to Re-fixing of 9.7 years on external debt and around 2.3 years on domestic debt. Further, fixed rate debt as a percentage of total debt increased to 63 percent at the end of 2013-14 as compared with 54 percent at the end of last fiscal year indicating reduced exposure to interest rate changes i.e. while external debt having fixed rate slightly reduced in proportion at the end of 2013-14 compared with last fiscal year, domestic debt carrying fixed rate increased to 54 percent at the end of 2013-14 as compared with 40 percent a year earlier as the government mobilized more through issuance of PIBs and retired some of its T-bills.

9.5 Around 31 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), around 96 percent of total external public debt is contracted in 4 currencies i.e. main exposure of exchange rate risk comes from USD denominated loans (41 percent of total external debt), followed by Euro (21 percent), Japanese Yen (19 percent) and Pound Sterling (15 percent). The amount of foreign loans maturing in 2014-15 is equal to 43 percent of official liquid reserves as compared with 69 percent a year earlier indicating reduction in exposure to exchange rate risk.

10.0 Guarantees

10.1 Contingent liabilities are conditional obligations that arise from past events that may require an outflow of resources embodying economic benefits based on the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the government.

10.2 Contingent liabilities can be distinguished from the liabilities as these are conditional in nature and do not represent the present obligations of the government. Accordingly, contingent liabilities are not recognized as liabilities regardless of the likelihood of the occurrence (or non-occurrence) of the uncertain future event. However, such off-balance sheet transactions cannot be overlooked in order to gain a holistic view of a country's fiscal position and unveil the hidden risks associated with the obligations made by the government outside the budget. Therefore, it is imperative to examine the contingent liabilities in the same manner as a proposal for a loan, taking into account, inter alia, the credit-worthiness of the borrower, the amount and risks sought to be covered by a sovereign guarantee, the terms of the borrowing, justification and public purpose to be served, probabilities that various commitments will become due and possible costs of such liabilities etc.

10.3 Contingent liabilities of Pakistan include, explicit and implicit guarantees issued to Public Sector Enterprises (PSEs) and unfunded losses of state owned entities. The sovereign guarantee is normally extended to improve financial viability of projects or activities undertaken by the 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.

10.4 During 2013-14, the government issued fresh/rollover guarantees aggregating to Rs.106 billion or 0.4 percent of GDP, whereas, outstanding stock of government guarantees as at end June 2014 amounted to Rs.555 billion. The domestic currency guarantees accounted for 77 percent of the total guarantees stock.

Table-11: Guarantees Outstanding as on June 30, 2014 (Rs. in billion)

Outstanding guarantees extended to PSEs	**555**
-Domestic Currency	426
-Foreign Currency	129
Memo:	
Foreign Currency (US$ in million)	1,310

During 2013-14, the government issued fresh/rollover guarantees aggregating to Rs.106 billion or 0.4 percent of GDP

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

Table-12: Entity Wise New Guarantees Issued (2013-14) - (Rs. in billion)	
Name of Organization	**Amount**
PIA	38.5
NPGCL	37.7
WAPDA (NJHP)	19.3
Pakistan Steel Mills	4.2
WAH Brass Private Limited	5.7
Pakistan Textile City	0.5
Total	**105.7**
In percent of GDP	**0.4**

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

10.5 Other than the publically guaranteed debt of PSEs, the government also issues 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 on June 30, 2014, the outstanding stock against commodity operations was Rs.604 billion against the end June 2013 position of Rs.571 billion.

10.6 At the end of first quarter of 2014-15, the government issued fresh/rollover guarantees amounting to Rs.31 billion or 0.1 percent of GDP. Total outstanding stock at the end of September 2014 amounted to Rs.581 billion. The outstanding stock issued against commodity operations was Rs.523 billion at the end of first quarter of 2014-15.

Table-13: Guarantees Outstanding as on Sep 30, 2014 (Rs. in billion)	
Outstanding guarantees extended to PSEs	**581**
-Domestic Currency	453
-Foreign Currency	128
Memo:	
Foreign Currency (US$ in million)	1,243

During first quarter of 2014-15, the government issued fresh/rollover guarantees aggregating to Rs.31 billion or 0.1 percent 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 June 13, 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 deficit was recorded at Rs.173 billion or 0.7 percent of GDP in 2013-14 compared with Rs.649 billion or 2.9 percent of GDP in last fiscal year. Although the government was able to reduce the revenue deficit significantly in 2013-14 as compared with previous fiscal year, there is still a need to achieve a revenue surplus so that borrowings are only utilized towards financing the development needs of the country.

Table-14: Revenue Balance (Percent of GDP)

	2009	2010	2011	2012	2013	2014
Revenue Balance*	(1.2)	(1.7)	(3.3) [a]	(4.5) [b]	(2.9) [c]	(0.7)

*Adjusted for grants
[a]includes arrears of electricity subsidies amounting to Rs.120 billion or 0.7 percent of GDP
[b]includes "one off" payment of Rs.391 billion on account of debt consolidation or 2 percent of GDP
[c] includes payment for the resolution of the circular debt amounting to 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 ratio was recorded at 63.6 percent in 2012-13. Government has brought it down to 63 percent in 2013-14 which was mainly driven by lower fiscal deficit and appreciation of Pak Rupee against US Dollar. Public debt also includes loans from the IMF amounting to US$ 3 billion or 1.2 percent of the GDP as on June 30, 2014. The borrowing from the IMF is only utilized towards balance of payment support and is reflected in foreign currency reserves of the country.

Table-15: Public Debt to GDP (Rs. in billion)

	2009	2010	2011	2012	2013	2014
Domestic Debt	3,860	4,654	6,017	7,638	9,522	10,920
External Debt	3,871	4,352	4,750	5,057	4,771	5,076
Total Public Debt	**7,731**	**9,006**	**10,767**	**12,695**	**14,293**	**15,996**
GDP	13,200	14,867	18,276	20,047	22,489	25,402
Total Public Debt (as percent of GDP)	**58.6**	**60.6**	**58.9**	**63.3**	**63.6**	**63.0**

(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 public debt to GDP ratio by 2.5 percent annually was envisaged in the FRDL Act, 2005 to achieve the core objective of reducing Public debt to GDP below 60 percent by end of 2012-13. As the government achieved this landmark in 2005-06, the sub-limit of annual reduction of 2.5 percent was no more applicable.

Social and poverty alleviation related budgetary expenditures remained at 7.6 percent of GDP in 2013-14. Additionally, expenditures on health and education stood at 0.8 percent and 2.1 percent of GDP respectively.

Table-16: Social Sector Expenditure

	2009	2010	2011	2012	2013	2014
Social sector and poverty related expenditure (as percent of GDP)	**7.4**	**7.5**	**6.8**	**9.4**	**8.5**	**7.6**
Expenditure on education (as percent of GDP)	1.8	1.7	1.8	2.2	2.1	2.1
Expenditure on health (as percent of GDP)	0.6	0.6	0.6	0.7	0.7	0.8

(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."

During 2013-14, the government issued new guarantees including rollovers amounted to Rs.106 billion or 0.4 percent of GDP.

Table-17: New Guarantees Issued

(Rs. in billion)	2009	2010	2011	2012	2013	2014
New guarantees issued	276	224	62	203	136	106
(as percent of GDP)	**2.1**	**1.5**	**0.3**	**1.0**	**0.6**	**0.4**

Government is committed to accomplish objectives outlined in Fiscal Responsibility and Debt Limitation Act, 2005. Accordingly, it has taken various corrective measures to effectively manage its public debt portfolio. Government is gradually moving towards achieving revenue surplus and reducing its public debt to GDP below 60 percent to ensure that both the level and rate of growth in public debt is fundamentally sustainable and can be serviced under a wide range of circumstances while meeting cost and risk objectives.

12.0 Conclusion

12.1 After several years of weak economic performance, 2013-14 was a better year from fiscal and debt management point of view. During the year, most of the macroeconomic indicators improved as fiscal deficit reduced, inflation rate declined, foreign exchange reserves increased, Pak Rupee appreciated against US Dollar, public debt to GDP ratio improved and the current account deficit relatively contained. There was also a marked shift in financing of fiscal deficit as pressure on domestic sources specially on the banking system reduced. This, in turn, created room for banks to finance private sector credit. Further, the government was able to improve the composition of its public debt owing to lengthening of maturity profile of domestic debt along with the availability of sufficient external funding.

12.2 Despite overall positive developments in 2013-14, the government is still confronting various challenges. More specifically (a) it is required to achieve and maintain revenue and primary surpluses for stabilizing the country's debt burden; (b) the government needs to bring its public debt to GDP ratio below 60 percent as stipulated in Fiscal Responsibility and Debt Limitation Act, 2005 to make its public debt more sustainable; (c) public debt as a percentage of government revenue needs improvement as it stood at 4.4 times and interest payment accounted for over one-fifth of total government expenditure; and (d) the government needs to fully meet the quarterly limit of net zero borrowing from SBP as prescribed in SBP Act, 1956.

12.3 Going forward, the prime objectives of public debt management include: (i) fulfilling the financing needs of the government keeping in view cost-risk tradeoffs; (ii) development of domestic debt capital market (iii) lengthening of maturities of domestic debt instruments at a reasonable cost; and (iv) stimulation of concessional external financing with reference to its impact on macroeconomic stability and debt sustainability. Further, it is important for the government to adopt an integrated approach for economic revival and debt reduction which will require trade-offs in the short-term, thus implementing structural reforms that boost potential growth which is a key to ensure public debt sustainability.

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