Debt Policy Statement 2015-16

Debt Policy Coordination Office
Ministry of Finance
Government of Pakistan

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Acknowledgements

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1.0 Introduction

1.1 Public debt management is the process of establishing and executing an effective policy for managing public debt portfolio to raise required amount of funding, achieve cost and risk objectives and to meet other goals such as developing and supporting an efficient debt capital market. In a broader macroeconomic context, governments should ensure that both the level and the rate of growth in their public debt are fundamentally sustainable over time and can be serviced under broad range of circumstances.

1.2 Developing countries like Pakistan hinge in a delicate balance; they need to borrow in order to facilitate their development process – on the other hand borrowing should be utilized efficiently in view of their repayment capacity. Debt may well act as a catalyst in the course of growth of an economy if it is undertaken to facilitate a very well thought out road map devised with due diligence. High and unsustainable level of debt plagues economic growth by lowering the development expenditure due to heavy debt servicing requirement. This intricate scenario calls for comprehensive and prudent debt management strategy which ensures the right choices among several options keeping in view cost and risk tradeoffs, addresses financial constraints and ensures intergenerational welfare impact.

1.3 Similar to last year, Pakistan's public debt dynamics continued to witness positive developments during 2014-15. Accumulation of public debt further slowed down and improvement was observed in most of the public debt sustainability indicators. Encouragingly, quarterly limits on government borrowing from SBP have mostly been observed in the recent period. In addition, composition of public debt further improved due to increased mobilization through medium to long term domestic debt instruments and disbursements from external sources.

1.4 Government of Pakistan has embarked upon a policy necessary for fiscal consolidation and debt management incorporated in Fiscal Responsibility and Debt Limitation Act, 2005. The following statement puts out the total public debt in detail and highlights the government efforts 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 conventional wisdom focuses on the management of debt, rather than debt itself. 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 linkage with macroeconomic policies including reserve management and exchange rate policy.

3.2 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.

3.3 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.

3.4 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 (incurred principally to finance fiscal deficit) and external debt (raised primarily to finance development expenditure).

4.2 During 2014-15, improvement in current account, relatively contained fiscal deficit and revaluation gain on account of appreciation of US dollar against major currencies, slowed down the pace of public debt accumulation. The maturity profile of domestic debt continued to improve in 2014-15 as the share of Pakistan Investment Bonds (PIBs) in total domestic debt increased to 34 percent by end June, 2015 from 30 percent in 2013-14 and only 14 percent in 2012-13. During the year, the policy rate was significantly reduced mainly owing to comfort on external account and sharp reduction in inflationary expectations. Specifically, during the four consecutive monetary policy decisions from mid-November 2014 to May 2015, SBP reduced the discount rate by a cumulative 300 basis points to a multi-decade low of 7 percent[1]. The conducive economic environment coupled with supportive monetary policy provided an ideal opportunity for the government to revise coupon rates on PIBs. Accordingly, the government was also able to rationalize the cost of domestic debt by aligning the rates on domestic debt instruments with the market yields. Moreover, ownership structure witnessed gradual shift from SBP to commercial banks, as the government retired portion of debt to SBP during 2014-15.

4.3 Government was able to mobilize external inflows from multilateral and bilateral development partners and continued its presence in international capital markets with successful launch of 5 year Islamic International Sukuk Bonds in November 2014. Pakistan entered the international capital market at the time, when interest rates were low and appetite for sovereign papers was high. This enabled the government not only to retire the expensive domestic debt but also helped to increase the foreign exchange reserves of the country. Encouragingly, the foreign exchange reserves crossed US$ 15 billion[2] mark by end December, 2014 which provided access to IBRD funding.

4.4 Public debt was Rs. 17,381 billion or 63.5 percent of GDP as at end-June 2015 compared with 63.8 percent during the same period last year. This reduction in public debt to GDP ratio is mainly attributed to improvement in fiscal and current account balances and revaluation gain on external public debt portfolio. Public debt recorded an increase of Rs. 1,389 billion during 2014-15 as compared with the increase of Rs. 1,673 billion witnessed during the preceding fiscal year. The primary source of increase in public debt was in domestic debt that positioned at Rs. 12,199 billion representing an increase of Rs. 1,279 billion, whereas, external debt at Rs. 5,182 billion represented an increase of Rs. 110 billion as compared to end June 2014.

4.5 In US Dollar terms, external public debt in fact recorded a decline of US$ 0.4 billion during 2014-15 as compared with last fiscal year despite net positive disbursements. This decrease in external public debt is attributed to revaluation gain on account of appreciation of US Dollar against other international currencies as well as repayment of external loans. However, net reduction in external public debt on this front was overshadowed by the depreciation of Pak Rupee by 3 percent against US Dollar which led to increase in external public debt in Pak Rupee terms.

Table-1: Public Debt

	2010	2011	2012	2013	2014(P)	2015(P)	2016(P)*
(Rs. in billion)							
Domestic Debt	4,654.3	6,016.7	7,638.1	9,521.9	10,920.0	12,198.9	12,718.7
External Debt	4,351.9	4,750.2	5,057.2	4,796.5	5,071.5	5,181.8	5,424.1

[1] The ceiling rate reduced further following a 50 basis point cut in SBP's target rate, effective from September 14, 2015.
[2] The foreign exchange reserves exceeded US$ 20 billion as at end September, 2015.

	2010	2011	2012	2013	2014(P)	2015(P)	2016(P)*
Total Public Debt	9,006.2	10,766.9	12,695.3	14,318.4	15,991.5	17,380.7	18,142.8
(In percent of GDP)							
Domestic Debt	31.3	32.9	38.1	42.5	43.6	44.5	41.5
External Debt	29.3	26.0	25.2	21.4	20.2	18.9	17.7
Total Public Debt	**60.6**	**58.9**	**63.3**	**64.0**	**63.8**	**63.5**	**59.2**
(In percent of revenues)							
Domestic Debt	224.0	267.1	297.6	319.3	300.2	310.3	---
External Debt	209.4	210.9	197.0	160.8	139.4	131.8	---
Total Public Debt	433.4	477.9	494.7	480.1	439.7	442.1	**---**
(In percent of total debt)							
Domestic Debt	51.7	55.9	60.2	66.5	68.3	70.2	70.1
External Debt	48.3	44.1	39.8	33.5	31.7	29.8	29.9
Memo:							
Foreign Currency Debt (US$ in billion)	50.9	55.3	53.5	48.1	51.3	50.9	51.9
Exchange Rate (Rs. /US$, End of Period)	85.5	86.0	94.5	99.7	98.8	101.8	104.5
GDP(b) (Rs. in billion)	14,867.0	18,276.4	20,046.5	22,379.0	25,068.1	27,383.7	30,672.0
Total Revenue (Rs. in billion)	2,078.2	2,252.9	2,566.5	2,982.4	3,637.3	3,931.0	**---**

P:Provisional *end-September, 2015

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

4.6 Government developed its first Medium Term Debt Management Strategy (2013/14 – 2017/18) with the aim to lengthen the maturity profile of its domestic debt and mobilize the external inflows. Accordingly, an improvement was observed in most of the public debt sustainability indicators during last two fiscal years. The refinancing risk of the domestic debt reduced at the end of 2014-15 as indicated by percentage of domestic debt maturing in one year reduced to 47 percent compared with 64 percent at the end of 2012-13. Exposure to interest rate risk reduced as percentage of debt re-fixing in one year decreased to 40 percent at the end of 2014-15 as compared with 52 percent at the end of 2012-13. Share of external loans maturing within one year was equal to around 28 percent of official liquid reserves at the end of 2014-15 as compared with around 69 percent at the end of 2012-13 indicating improvement in foreign exchange stability and repayment capacity (Refer section 9 for details). Government is also set to publish its updated Medium Term Debt Management Strategy (2015/16 - 2018/19) as the macroeconomic realities have changed since 2012-13. The purpose is to ensure that both the level and rate of growth in public debt is fundamentally sustainable while meeting cost and risks objectives.

4.7 One of the objectives of Medium Term Debt Management Strategy (MTDS) was to facilitate the development of debt capital market. 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, the government debt securities (T-bills, PIBs and Government Ijara Sukuk) are made available for trading at the stock exchanges. Further, the government is taking various steps to provide an efficient and liquid secondary debt market to the investors (Box-1).

Box-1 - Development of Debt Capital Market

Sukuk Regulations:

The Securities and Exchange Commission of Pakistan (SECP) has notified issue of Sukuk Regulations, 2015 under Section 506A of the Companies Ordinance, 1984 which requires appointment of Shariah Advisor and Investment Agent. An efficient, broad-based and well-regulated Sukuk market will greatly help in the development of capital market. The purpose of making the Sukuk regulations is to facilitate the issuers for fund raising from the capital market and to provide Shariah compliant investment avenue to the prospective investors.

Future Plans With Regard to Development of Debt Capital Market:

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

- Introduction of revised settlement model to promote trading in the government debt securities *i.e.* the current settlement system will be further refined through elimination of practical difficulties and regulatory changes which will facilitate retail investors in trading government securities at the stock exchanges;
- Integration of National Savings Scheme instruments into the mainstream capital market;
- 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;
- Possible utilization of the stock exchanges for primary market/auction of the government debt securities to enable wider outreach and improve participation of retail segment.

Source: Securities and Exchange Commission of Pakistan

4.8 Public debt was recorded at Rs. 18,143 billion as at end September 2015, registering an increase of Rs. 762 billion during first quarter of 2015-16. Out of this total increase, increase in domestic debt contributed Rs. 520 billion while government borrowing for fiscal deficit was Rs. 273 billion during first quarter of 2015-16. This differential is mainly attributed to increase in government deposits with SBP which was utilized by the government in October 2015. During first quarter of 2015-16, the government mobilized more through the net issuance of T-bills (Rs. 434 billion) followed by PIBs (Rs. 55 billion) and NSS (Rs. 54 billion) while the stock of MRTBs was retired by Rs. 58 billion.

4.9 External public debt increased by US$ 1 billion during first quarter of 2015-16 and recorded at US$ 51.9 billion. This increase was primarily driven by US$ 515 million commercial loans and US$ 500 million Eurobonds. In addition, 8th tranche under IMF Extended Fund Facility (EFF) added US$ 497 million in external public debt. An amount of US$ 910 million was repaid during the first quarter of 2015-16. In Pak Rupee terms, the depreciation of Pak Rupee against US Dollar by 2.7 percent during first quarter of 2015-16 contributed further increase in external public debt.

5.0 Dynamics of Public Debt Burden

5.1 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". Debt burden can be expressed in terms of the stock ratio *i.e.* debt to GDP, external debt to GDP or flow ratios *i.e.* debt to revenue, external debt to foreign exchange earnings etc. 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.

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

	2010	2011	2012	2013	2014	2015
Revenue Balance* / GDP	(1.7)	(3.3)[(a)]	(4.5)[(b)]	(2.9)[(c)]	(0.7)	(1.7)
Primary Balance* / GDP	(1.6)	(2.5)[(a)]	(4.2)[(b)]	(3.6)[(c)]	(0.2)	(0.5)
Fiscal Balance / GDP	(6.2)	(6.5)[(a)]	(8.8)[(b)]	(8.2)[(c)]	(5.5)	(5.3)
Public Debt / GDP	60.6	58.9	63.3	64.0	63.8	63.5
Public Debt / Revenue	433.4	477.9	494.7	480.1	439.7	442.1
Debt Service / Revenue	40.4	38.0	39.9	40.5	40.1	40.4
Debt Service / GDP	5.6	4.7	5.1	5.4	5.8	5.8

*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, Ministry of Finance

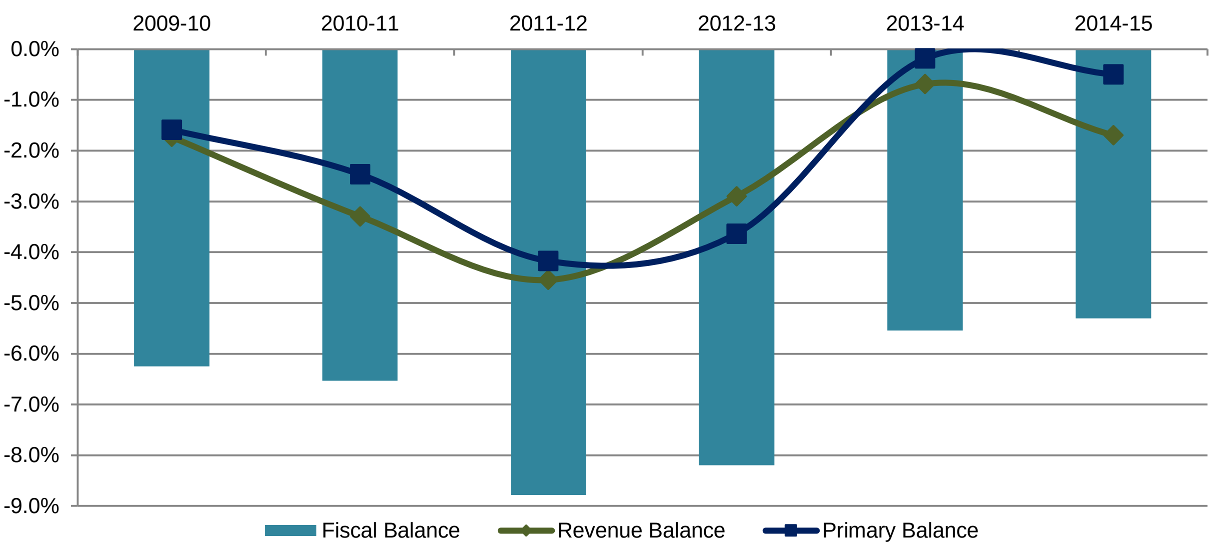
5.2 Revenue balance is the total revenues minus current expenditure. The persistence of revenue deficit indicates that the government is not only borrowing to finance its development expenditure, but partially to finance its current expenditure. Revenue deficit increased to 1.7 percent of GDP in 2014-15 as compared with 0.7 percent of GDP in 2013-14 due to higher growth in current expenditure (on account of one off expense of TDPs, security situation and floods) as compared with the growth in total revenues. 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. Primary deficit improved significantly in 2013-14 and recorded at 0.2 percent of GDP compared with 3.6 percent in 2012-13. However, it increased slightly in 2014-15 and recorded at 0.5 percent of GDP owing to reasons elaborated in the paragraph earlier. Achieving a primary surplus is normally viewed as important, being usually necessary for reduction in public debt to GDP ratio.

5.4 Pakistan's fiscal balance improved significantly in 2013-14 as compared with 2012-13. 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 6.6 percent. During 2014-15, fiscal deficit further reduced and recorded at 5.3 percent of GDP. This improvement in fiscal deficit slowed down the pace of public debt accumulation. However, the government relied mainly on domestic market during 2014-15 to finance its fiscal deficit as compared with 2013-14 *i.e.* the government financed around 88 percent of its fiscal deficit from domestic sources during 2014-15 as compared with 63 percent during last fiscal year.

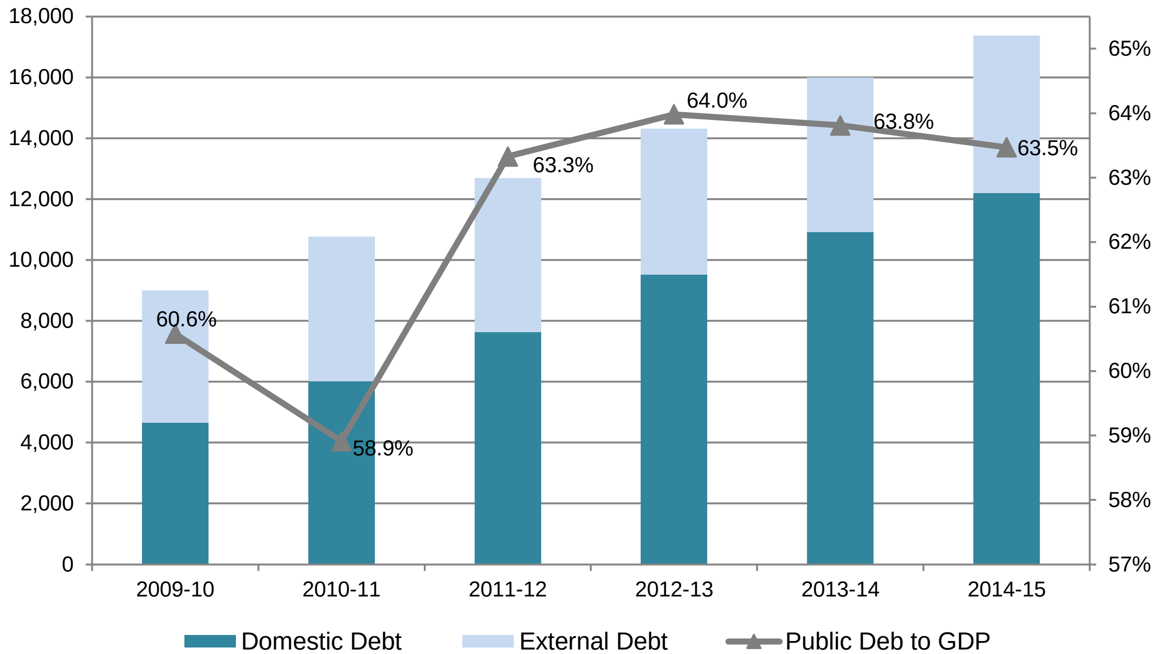
Fig-1: Trends in Fiscal, Revenue and Primary Balance (In Percent of GDP)



5.5 Public debt to GDP ratio recorded a decline of 30 basis points and stood at 63.5 percent at the end of 2014-15 compared with 63.8 percent at the end of last fiscal year. This improvement in public debt to GDP ratio was mainly contributed by reduced twin deficit (fiscal and current account) and appreciation of US Dollar against other international currencies. The government has not only been able to reduce its public debt to GDP ratio 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. The trends in public debt are shown through the graph below:

Fig-2: Profile of Public Debt
(LHS: in billion of PKR, RHS: percent of GDP)



5.6 It is a common practice to measure the public debt burden as a percentage of GDP. Another approach is to scale public debt levels against actual government revenues as this ratio measures debt repayment capacity of the country. There was 40 percentage point reduction in public debt to government revenues in 2013-14, indicating some easing in government indebtedness. However, this ratio increased slightly by around 2.5 percentage points in 2014-15 and stood at 442 percent. Government is committed to reduce this ratio to a generally acceptable threshold of 350 percent by increasing its revenues and rationalizing current expenditures which will reduce the 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. In order to meet high debt servicing obligations, an extra burden is placed on limited government resources and may costs in the shape of foregone public investment or expenditure in other sectors of the economy. 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 over time.

6.2 During 2014-15, public debt servicing was recorded at Rs. 1,589 billion against the annual budgeted estimate of Rs. 1,686 billion. Public debt servicing consumed nearly 40 percent of total revenues during 2014-15. Ideally, this ratio should be below 30 percent to allow government to allocate more resources towards development and social sectors.

Table-3: Public Debt Servicing - (2014-15)

	Budgeted	Actual (P)	Percent of Revenue	Percent of Current Expenditure
(Rs. in billion)				
Servicing of External Debt	100.6	95.7	2.4	2.2
Repayment of External Debt	360.7	285.2	7.3	6.4
Servicing of Domestic Debt	1,224.6	1,208.1	30.7	27.3
Servicing of Public Debt	1,685.9	1,589.0	40.4	35.9

P: Provisional

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

6.3 Domestic interest payments constituted around 76 percent of total debt servicing which is due to increasing volume of domestic debt in overall public debt portfolio. Domestic interest payments grew by 13 percent during 2014-15 compared to 17 percent recorded in 2013-14. Further analysis of domestic debt servicing revealed that large portion was paid against PIBs (Rs. 389 billion), followed by Market Related Treasury Bills (Rs. 270 billion), T-Bills (Rs. 170 billion), Special Savings Certificates and Accounts (Rs. 99 billion) and Bahbood Saving Certificates (Rs. 89 billion).

7.0 Domestic Debt

7.1 The pace of domestic debt slowed down during 2014-15 on the back of improvement in fiscal balance. The domestic debt increased by Rs. 1,279 billion during 2014-15 and recorded at Rs. 12,199 billion as at end June, 2015. The composition of domestic debt witnessed some changes as share of SBP Market Related Treasury Bills (MRTBs) in total domestic debt decreased to 19 percent at the end of 2014-15 as compared with 26 percent at the end of last fiscal year. Similar to last year, financing structure remained tilted towards medium to long term debt instruments. Consequently, the share of permanent debt in total domestic debt further increased to 34 percent at the end of 2014-15 as compared with 30 percent at the end of 2013-14. The evolution of domestic debt is shown through following graphs:

Fig-3: Instrument Wise Evolution of Domestic Debt
(Rs. in billion)

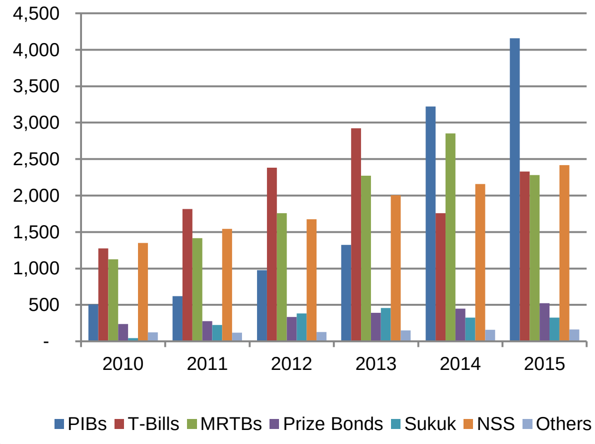


Fig-4 : Source Wise Evolution of Domestic Debt
(LHS: in billion of PKR, RHS: percent of GDP)

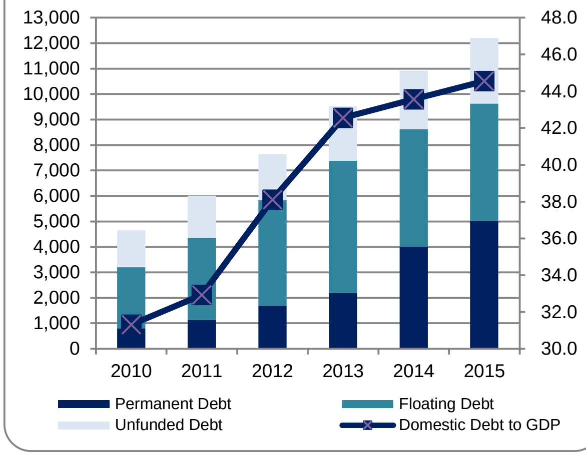


Table-4: Outstanding Domestic Debt - (Rs. in billion)

	2010	2011	2012	2013	2014(P)	2015(P)	2016(P) *
Permanent Debt	**797.7**	**1,125.6**	**1,696.9**	**2,179.2**	**4,005.3**	**5,016.0**	**5,106.3**
Market Loans	2.9	2.9	2.9	2.9	2.9	2.8	2.8
Government Bonds	7.2	0.7	0.7	0.7	0.7	0.7	0.7
Prize Bonds	236.0	277.1	333.4	389.6	446.6	522.5	557.7
Foreign Exchange Bearer Certificates	0.1	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	0.0	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	0.1	0.1
Special U.S. Dollar Bonds	2.7	1.0	0.9	4.2	4.4	4.4	4.5
Government Bonds Issued to SLIC	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Pakistan Investment Bonds (PIBs)	505.9	618.5	974.7	1,321.8	3,223.5	4,158.3	4,213.3
Government Bonds issued to HBL	-	-	-	-	-	-	-
GOP Ijara Sukuk	42.2	224.6	383.5	459.2	326.4	326.4	326.4
Floating Debt	**2,399.1**	**3,235.4**	**4,143.1**	**5,196.2**	**4,610.9**	**4,612.6**	**4,988.4**
Treasury Bills through Auction	1,274.1	1,817.6	2,383.4	2,921.0	1,758.6	2,331.3	2,765.3
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)	1,124.4	1,417.3	1,759.2	2,274.7	2,851.8	2,280.9	2,222.7
Unfunded Debt	**1,457.5**	**1,655.8**	**1,798.0**	**2,146.5**	**2,303.8**	**2,570.3**	**2,624.0**
Defence Savings Certificates	224.7	234.5	241.8	271.7	284.6	300.8	301.4
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	17.8	17.2	21.2	22.3	22.6	26.4	26.0

	2010	2011	2012	2013	2014(P)	2015(P)	2016(P) *
Mahana Amdani Account	2.2	2.1	2.0	2.0	1.9	1.8	1.8
Postal Life Insurance	67.1	67.1	67.1	67.1	67.1	67.1	67.1
Special Savings Certificates and Accounts	470.9	529.1	537.4	734.6	738.8	867.5	894.5
Regular Income Scheme	135.6	182.6	226.6	262.6	325.4	376.0	373.2
Pensioners' Benefit Account	128.0	146.0	162.3	179.9	198.4	214.1	220.2
Bahbood Savings Certificates	366.8	428.5	480.8	528.4	582.4	628.3	650.9
National Savings Bonds	3.6	3.6	3.6	0.2	0.2	0.1	0.1
G.P. Fund	39.9	44.3	54.6	73.1	80.5	85.8	86.4
Short Term Savings Certificates				4.0	1.3	1.7	1.7
Total Domestic Debt	**4,654.3**	**6,016.7**	**7,638.1**	**9,521.9**	**10,920.0**	**12,198.9**	**12,718.7**

P: Provisional *end-September,2015

Source: Budget Wing, Finance Division

7(i) Auction Profile of Government Securities

7.2 Auction profile of government securities showed different pattern of investment by the commercial banks during 2014-15, depending largely on their assessment of changes in the interest rates, inflation and liquidity conditions. In this context, following points are worth noting:

– In-line with the objective of improving the maturity profile of domestic debt, the government announced a higher pre-auction target of Rs. 300 billion against PIBs during first quarter of 2014-15. However, commercial banks' offered amounts in PIBs in July and August 2014 fell short of the target and government also could not make up for the shortfall from T-Bills auction. Although commercial banks' appetite for PIBs started to revive from September 2014, however, cumulative borrowing during first quarter of 2014-15 was lower than the required amount. Resultantly, the government had to rely on SBP financing during this period.

– In second quarter of 2014-15, commercial banks started offering large amounts in PIBs owing to declining interest rate expectations on the back of decrease in inflation, ease in external account and stability in exchange rate. The offered amount against PIBs auction were five times higher than target while offered amount in T-bills remained below the target during second quarter of 2014-15. The significant shift from T-bills to PIBs during second quarter of 2014-15 facilitated improvement in the maturity profile of domestic debt.

– Following a second cut in the policy rate in January 2015 and fall in term premium between 3 years PIBs and 6-month T-bills, commercial bank followed a balanced approach *i.e.* the banks started investing both in T-bills and PIBs during third quarter of 2014-15. The term premium between 3 years PIBs and 6-month T-bills started to decline after October 2014 onwards as cut-off yields remained closer to the policy rate in third and fourth quarter of 2014-15. Accordingly, for the first time since August 2008, PIBs coupon rates were cut by 2 percent to 2.25 percent in February 2015 to have an alignment in coupon rates and market yields. The conducive economic environment coupled with supportive monetary policy provided an ideal opportunity for the government to revise coupon rates on PIBs.

The yields (6 months T-bills, 3, 5 and 10 years PIBs) and auction wise details from July 2014 to June 2015 are depicted through following graph:

Fig-5: T-Bills PIBs Yields (6 Months, 3, 5 & 10 Years) - In Percent

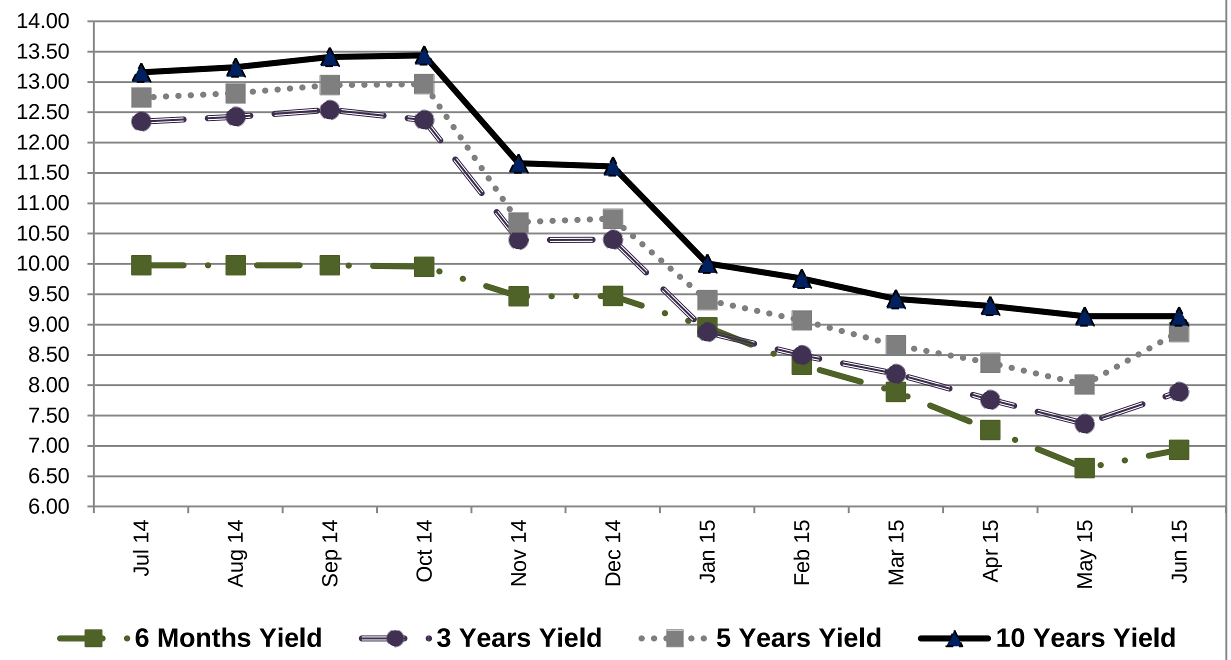
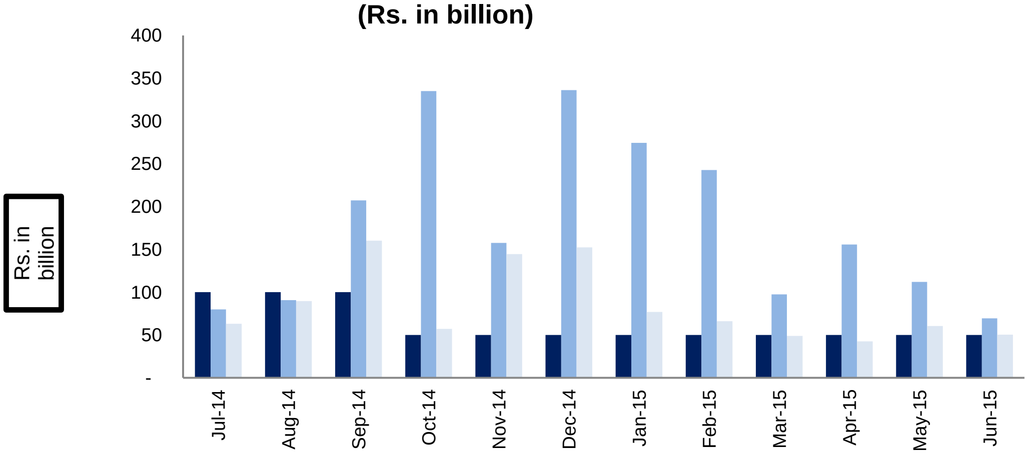
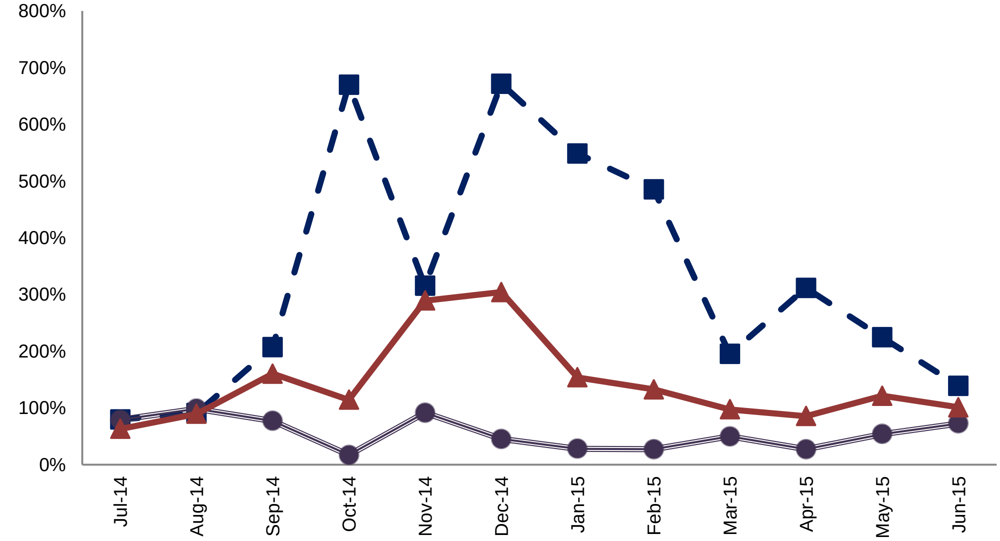


Fig-6: PIBs Auction Profile - 2014-15
(Rs. in billion)



	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15
Auction Target (Rs. in billion)	100	100	100	50	50	50	50	50	50	50	50	50
Auction Participation (Rs. in billion)	80	91	207	335	158	336	274	243	98	156	112	70
Amount Accepted (Rs. in billion)	63	90	160	57	145	152	77	66	49	43	61	51

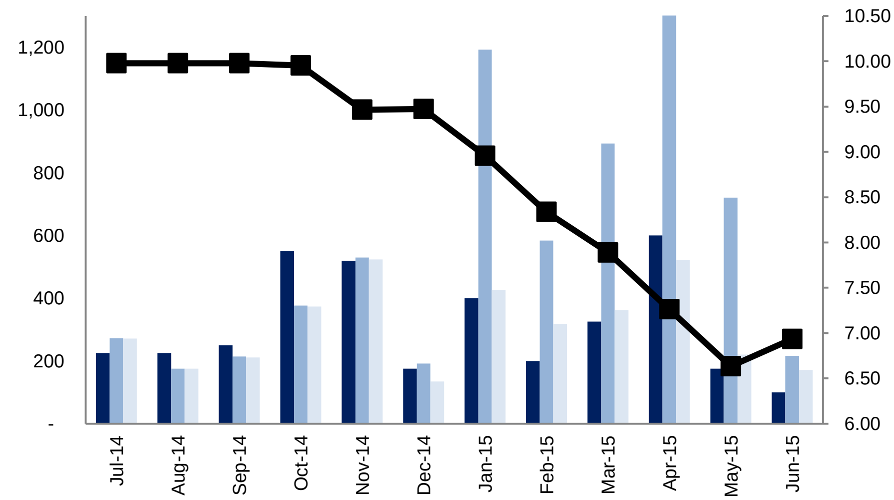
Fig-7: PIBs Auction Ratios - 2014-15



	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15
Bid Coverage	80%	91%	207%	670%	316%	672%	549%	486%	195%	312%	225%	139%
Acceptance Ratio	79%	99%	77%	17%	92%	45%	28%	27%	50%	27%	54%	73%
Acceptance/ Target	63%	90%	160%	115%	289%	305%	154%	133%	98%	86%	122%	101%

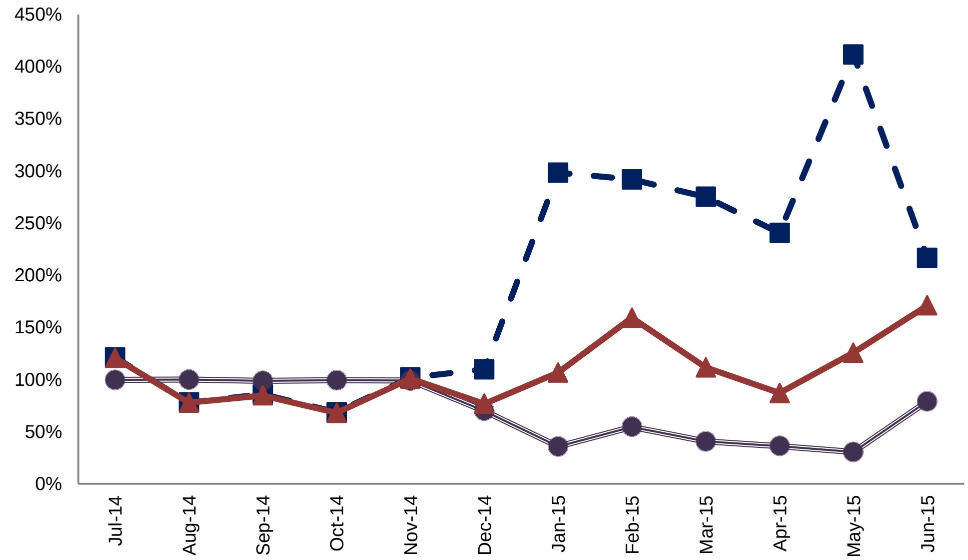
Bid Coverage = Auction Participation / Auction Target
Acceptance Ratio = Amount Accepted / Auction Participation
Acceptance / Target = Amount Accepted / Auction Target

Fig-8: T-Bills Auction Profile - 2014-15
(LHS:PKR in billion, RHS: Percentage)



	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15
Auction Target (Rs. in billion)	225	225	250	550	520	175	400	200	325	600	175	100
Auction Participation (Rs. in billion)	272	175	214	377	529	192	1,193	584	894	1,443	720	216
Amount Accepted (Rs. in billion)	271	175	212	374	524	134	426	318	362	522	220	171
6 month T-Bill Yield (%)	9.98	9.98	9.98	9.95	9.47	9.47	8.96	8.34	7.89	7.26	6.64	6.94

Fig-9: T-Bills Auction Ratios - 2014-15



	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15
Bid Coverage	121%	78%	86%	69%	102%	110%	298%	292%	275%	240%	412%	216%
Acceptance Ratio	100%	100%	99%	99%	99%	70%	36%	55%	41%	36%	31%	79%
Acceptance/ Target	121%	78%	85%	68%	101%	77%	107%	159%	112%	87%	126%	171%

Bid Coverage = Auction Participation / Auction Target
Acceptance Ratio = Amount Accepted / Auction Participation
Acceptance / Target = Amount Accepted / Auction Target

7.3 As at end June 2015, domestic debt continued being dominated by commercial banks that held 44 percent of domestic debt. Overall debt from banking system (including SBP debt) stood at 63 percent of total domestic debt as at end June 2015 as compared with 62 percent a year earlier. The bank investment in government securities stood on average at 43 percent of the total assets of the banks as of June 30, 2015.

7(ii) Secondary Market Activities of Government Securities

7.4 During 2014-15, government securities amounting Rs. 10,682 billion (*i.e.* Rs. 43.3 billion per day average) were traded in the secondary market showing a marginal increase compared to Rs. 10,604 billion in 2013-14. The trading turnover (represented by ratio of trading volume to outstanding stock of government securities) has decreased (refer Table-5). Main reason for this declining turnover is investors' preference to buy and hold government securities particularly PIBs, in the wake of declining interest rate scenario.

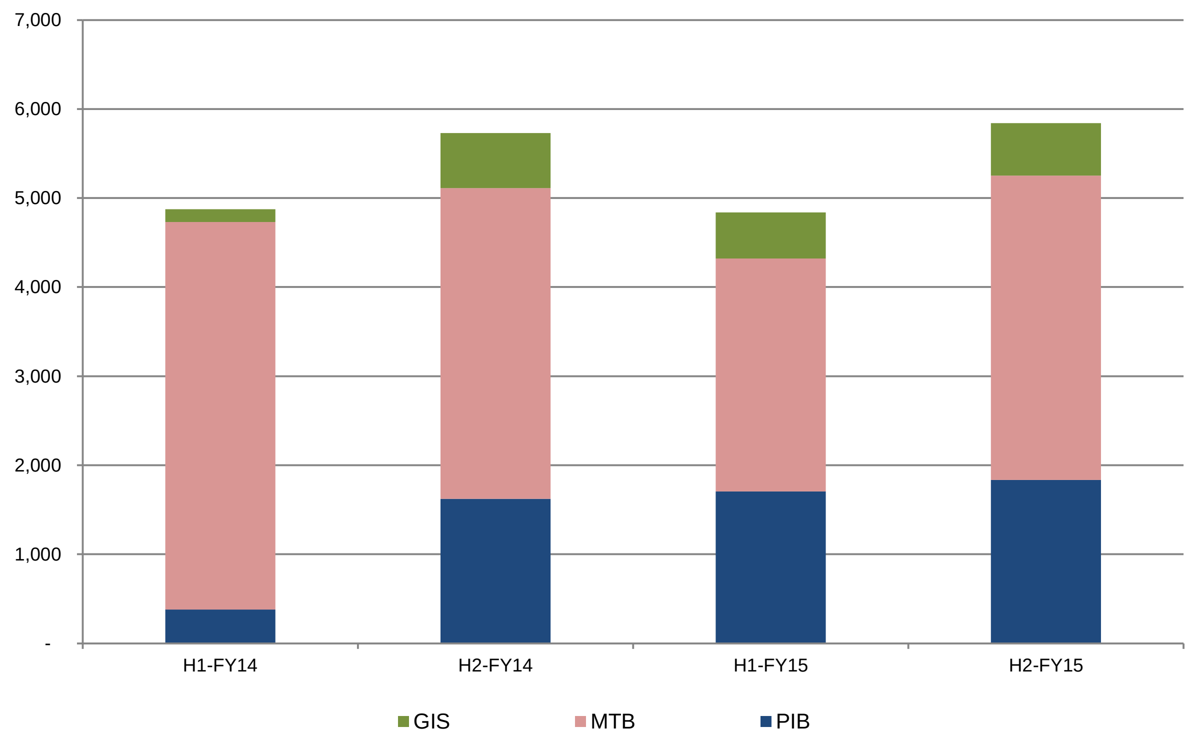
Table-5: Secondary Market Outright Trading Volume

(Rs. in billion)			
Security	**2013**	**2014**	**2015**
MTB-3M	1,907	5,057	1,550
MTB-6M	3,159	1,128	2,156
MTB-12M	4,166	1,657	2,325
PIB-3Y	328	1,030	1,751
PIB-5Y	367	430	742
PIB-10Y	320	506	1,014
PIB-20Y	11	35	34
Sukuk-3Y	386	761	1,110
Total	**10,644**	**10,604**	**10,682**
End Period Stock	**4,932**	**5,429**	**6,955**
Turnover	**2.16**	**1.95**	**1.54**

Source: State Bank of Pakistan

7.5 Trading activity in the secondary market usually follows the issuance pattern in primary auctions of government securities. There was marked shift in share of PIBs in overall trading volume from second half of 2013-14. The market started to invest in medium to long term securities due to expectation of decrease in interest rate. The outlook about interest rates prompted banks and institutional investors to substitute their investment in MTBs with PIBs. This shift in investment behavior also contributed in enhancing the share of PIBs in overall secondary market trading volume in second half 2013-14 and continued in 2014-15 (Refer Fig-10). However, increase in share of PIBs in overall trading volume was much less than the increase in share of PIBs in total outstanding stock due to buy and hold preference of the investors and limited base of non-bank investors.

Fig-10: Share of Government Securities in Overall Trading Volume (Rs in billion)



7.6 The major participants in the secondary market of tradable government securities are banks, corporate and mutual funds. Around 70 percent of the trading volumes in the secondary market are contributed by banks acting as primary dealers (PDs) and most of the trading takes place among the banks. Currently, there are twelve PDs (11 banks and 1 DFI) which act as market makers in the secondary market and play important role in distribution of government securities. Trading in the secondary market is mainly “Over the Counter” through brokers, Bloomberg Electronic Bond Trading Platform and electronic messaging platform like Reuters.

Repo Market:

7.7 The repo market in Pakistan continued to have a major share in security based transactions in the secondary market, covering 57 percent trading (by volume) during the 2014-15 (refer Table-6). In Repo market, more than 74 percent of the volumes were traded in the overnight tenor and most of these transactions were based on short term instruments.

Table-6: Government Security based Transactions

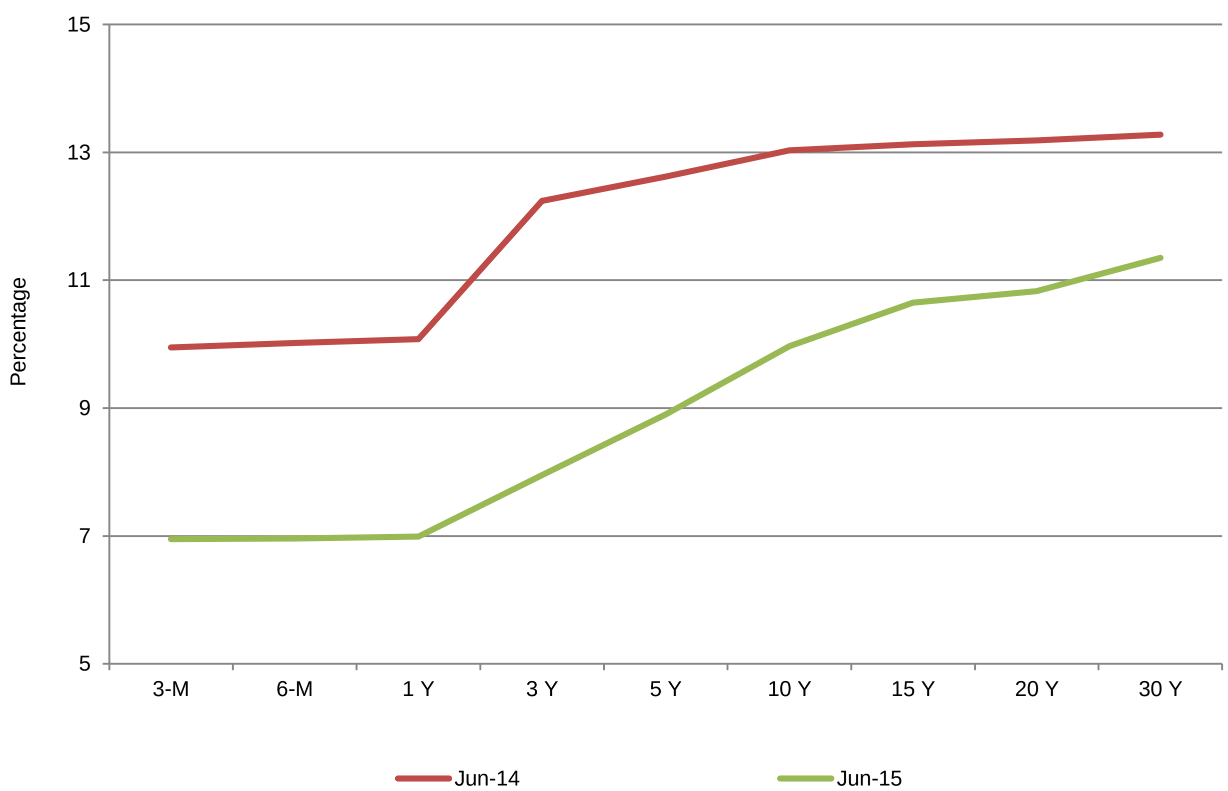
Type	Volume (Rs. in billion)			Percentage Share		
	2013	2014	2015	2013	2014	2015
Repo	12,980	14,374	14,138	55	58	57
Outright	10,644	10,604	10,682	45	42	43
Total	**23,624**	**24,978**	**24,820**	**100**	**100**	**100**

Source: State Bank of Pakistan

Yield Curve Trend:

7.8 Looking at the secondary market yield curve, it is evident that the secondary market rates responded to the cut in policy rate by SBP, a cumulative cut of 300 bps in 2014-15. Moreover, the term premium between 3-M and 12-M MTBs remained negligible, which kept short end of the yield curve flat (see Fig-11). The significant change as compared to previous year was rationalization of term premium between 12-M MTBs and 3-year PIBs.

Fig-11: Secondary Market Yield Curve



7(iii) Development in Domestic Debt During 2014-15

The following sections highlight the developments in the various components of domestic debt during 2014-15:

I. Permanent Debt

7.9 The amount of permanent debt in the total domestic debt stood at Rs. 5,016 billion as at end June 2015, representing an increase of Rs. 1,011 billion or 25 percent higher than the stock at the end of last fiscal year. Out of total mobilization through permanent debt, the government mopped up (net of retirement) Rs. 935 billion through successful auctions of PIBs. Accordingly, the share of permanent debt (mostly PIBs) increased to 41 percent in 2014-15 from 37 percent in 2013-14 which was only 17 percent five years back. Around 79 percent of the total increase in domestic debt stock was contributed by permanent debt during 2014-15.

II. Floating Debt

7.10 Floating debt was recorded at Rs. 4,613 billion at end June 2015. The share of floating debt has decreased considerably during last two fiscal year as it stood at 27 percent and 38 percent in overall public debt and domestic debt at end June 2015, respectively, while it was 36 percent and 55 percent at the end of 2012-13 respectively. During 2014-15, net mobilization through T-bills stood at Rs. 573 billion, whereas, the stock of MRTBs was retired by Rs. 571 billion. This retirement enabled the government to meet quarterly target of borrowing from SBP agreed with the IMF during second and third quarter of 2014-15. However, in first and last quarters of 2014-15, these targets were missed marginally.

III. Unfunded Debt

7.11 Pakistan's unfunded debt, primarily comprised of the National Savings Schemes (NSS), saw an expansion of Rs. 267 billion in 2014-15, which was around 69 percent increase over the amount mobilized in last fiscal year. Most of the incremental mobilization went into Special Savings Certificates and Accounts (Rs. 129 billion), followed by Regular Income Certificates (Rs. 51 billion) and Bahbood Savings Certificates (Rs. 46 billion). The total share of unfunded debt in the government's domestic debt stood at Rs. 2,570 billion or 21 percent at end June, 2015.

7.12 Over past few years, government took various measures to rationalize the NSS including linkage of profit rates on major NSS instruments with comparable wholesales market instrument yields, 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, NSS instruments need to be integrated into mainstream capital markets by making them tradable and by catering to the implicit put option which is a potential source of liquidity and reprising risk for the government.

Table-7: Causative Factors in Change in Stock of Domestic Debt (Rs. in billion)

	Stock	Stock	Receipts	Repayments	Net Investment
	2013-14	2014-15	(in 2014-15)		
Permanent Debt	**4,005.3**	**5,016.0**	**1,315.9**	**305.2**	**1,010.7**
Market Loan	2.9	2.8	-	-	-
Government Bonds	0.7	0.7	-	-	-
Prize Bonds	446.6	522.5	162.1	86.2	75.9
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	-	-	-
U.S. Dollar Bearer Certificates	0.0	0.1	-	-	-
Special U.S. Dollar Bonds	4.4	4.4	0.1	-	0.1
Government Bonds Issued to SLIC	0.6	0.6	-	-	-
Pakistan Investment Bonds (PIBs)	3,223.5	4,158.3	1,153.7	219.0	934.7
Government Bonds issued to HBL	-	-	-	-	-
GOP Ijara Sukuk	326.4	326.4	-	-	-
Floating Debt	**4,610.9**	**4,612.6**	**9,250.6**	**9,248.8**	**1.7**
Treasury Bills through Auction	1,758.6	2,331.3	4,040.0	3,467.3	572.7
Rollover of Treasury Bills discounted SBP	0.5	0.5	-	-	-
Treasury Bills purchased by SBP (MRTBs)	2,851.8	2,280.9	5,210.6	5,781.5	(570.9)
Unfunded Debt	**2,303.8**	**2,570.3**	**1,009.9**	**743.4**	**266.5**
Defence Savings Certificates	284.6	300.8	43.3	27.1	16.2
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	22.6	26.4	184.1	180.2	3.9
Mahana Amdani Account	1.9	1.8	0.1	0.1	(0.1)
Postal Life Insurance	67.1	67.1	-	-	-
Special Savings Certificates and Accounts	738.8	867.5	467.3	338.6	128.7
Regular Income Scheme	325.4	376.0	133.4	82.9	50.6
Pensioners' Benefit Account	198.4	214.1	38.4	22.7	15.7
Bahbood Savings Certificates	582.4	628.3	130.2	84.2	45.9
National Savings Bonds	0.2	0.1	-	0.1	(0.1)
G. P. Fund	80.5	85.8	8.3	3.0	5.3
Short Term Savings Certificates	1.3	1.7	4.8	4.5	0.4
Total Domestic Debt	**10,920.0**	**12,198.9**	**11,576.4**	**10,297.5**	**1,278.9**

Source: Budget Wing, Finance Division

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 exchange rate risk associated with the debt denominated in foreign currency, however, it is mitigated by concessional element (low cost and long tenors). The impact of any currency risk should not be looked in isolation, but rather be analyzed in the context of savings generated through interest rate differential.

8.2 External Debt and Liabilities (EDL) stock was recorded at US$ 65.1 billion as at end June 2015 out of which external public debt worth US$ 50.9 billion. Despite significant amount of disbursements by IFIs and mobilization of US$ 1 billion through issuance of Pakistan International Sukuk, public external debt witnessed a decline of US$ 425 million during 2014-15 primarily due to repayments and revaluation gain on account of appreciation of US Dollar against other major currencies.

Table-8: Pakistan External Debt and Liabilities

	2010	2011	2012	2013	2014(P)	2015(P)	2016(P)*
			(US Dollar in billion)				
			PUBLIC EXTERNAL DEBT				
1. Public Debt (i+ii+iii)**	**50.9**	**55.3**	**53.5**	**48.1**	**51.3**	**50.9**	**51.9**
i). Medium and Long Term(>1 year)	**42.1**	**45.7**	**45.6**	**43.5**	**47.7**	**45.8**	**46.0**
Paris Club	14.0	15.5	15.0	13.5	13.6	11.7	11.7
Multilateral	23.7	25.8	25.3	24.2	25.8	24.3	24.1
Other Bilateral	1.8	1.9	2.5	2.9	3.4	3.9	3.9
Euro Bonds/Saindak Bonds	1.6	1.6	1.6	1.6	3.6	4.6	5.1
Military Debt	0.2	0.1	0.1	0.1	0.0	-	-
Commercial Loans/Credits	-	-	-	-	0.2	0.3	0.1
Local Currency Bonds**	0.0	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	0.1
SAFE China Deposits	0.5	0.5	1.0	1.0	1.0	1.0	1.0
NBP/BOC Deposits	0.2	0.1	-	-	-	-	-
ii). Short Term (<1 year)	**0.9**	**0.6**	**0.5**	**0.3**	**0.7**	**1.0**	**1.3**
Commercial Loans/Credits	-	-	-	-	0.2	-	0.5
Multilateral	0.8	0.6	0.5	0.3	0.4	1.0	0.8
Local Currency Securities**	0.1	0.0	0.0	0.0	0.1	0.0	0.0
iii). IMF	**8.1**	**8.9**	**7.3**	**4.4**	**3.0**	**4.1**	**4.5**
of which Central Government	1.1	2.0	1.9	1.5	0.9	0.1	-
Monetary Authorities	7.0	6.9	5.4	2.9	2.1	4.1	4.5
			PUBLICLY GUARANTEED DEBT				
2) Publicly Guaranteed Debt	**0.2**	**0.1**	**0.2**	**0.6**	**0.5**	**1.0**	**1.1**
i). Medium and Long Term(>1 year)	**0.2**	**0.1**	**0.2**	**0.6**	**0.5**	**1.0**	**1.1**
Paris Club	-	-	-	-	-	-	-
Multilateral	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other Bilateral	0.0	0.0	0.2	0.6	0.5	1.0	1.1
Commercial Loans/Credits	0.1	-	-	-	-	-	-
Saindak Bonds	-	-	-	-	-	-	-
ii). Short Term (<1 year)	-	-	-	-	-	-	-
			NON PUBLIC DEBT				
3. Private Sector Debt	**3.8**	**4.4**	**3.6**	**3.1**	**3.0**	**3.0**	**3.0**
4. Public Sector Enterprises (PSEs Debt)	**1.4**	**1.3**	**1.3**	**1.2**	**1.7**	**1.4**	**1.5**
5. Banks	**0.7**	**1.1**	**1.8**	**1.6**	**2.0**	**2.3**	**2.5**
Borrowing	0.2	0.4	0.9	0.7	1.1	1.3	1.6
Nonresident Deposits (LCY & FCY)	0.6	0.7	1.0	0.8	0.9	1.0	0.9

	2010	2011	2012	2013	2014(P)	2015(P)	2016(P)*
6. Debt liabilities to direct investors - intercompany debt	**1.9**	**1.6**	**2.7**	**3.1**	**3.4**	**2.7**	**2.7**
Total External Debt (1 through 6)	**59.0**	**63.8**	**63.1**	**57.8**	**62.1**	**61.4**	**62.8**
FOREIGN EXCHANGE LIABILITIES							
7. Foreign Exchange Liabilities	**2.6**	**2.6**	**2.4**	**3.1**	**3.3**	**3.7**	**3.7**
Total External Debt & Liabilities (1 through 7)	**61.6**	**66.4**	**65.5**	**60.9**	**65.4**	**65.1**	**66.5**
Memo:							
GDP (Rs. in billion)	14,867.0	18,276.4	20,046.5	22,379.0	25,068.1	27,383.7	30,672.0
Exchange Rate (Rs. /US$, Period Average)	83.8	85.5	89.2	96.7	102.9	101.5	103.0
Exchange Rate (Rs. /US$, End of Period)	85.5	86.0	94.5	99.7	98.8	101.8	104.5
GDP (US$ in billion)	177.4	213.8	224.6	231.4	243.7	269.9	297.7

P: Provisional *end-September,2015 **excluding local currency bonds/securities since they are already included in domestic debt

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

8.3 During 2014-15, the government mobilized $ 7.7 billion from external sources. The inflows from bilateral sources recorded an increase during 2014-15 while inflows from multilateral sources recorded a slight decline. The increase from bilateral creditors largely owes to the provision of support for energy related projects by China during 2014-15. Inflows from multilateral sources mainly included: (i) financing from ADB for infrastructure and social sector development; (ii) financing from IDA was primarily for budgetary support; and (iii) borrowing from IDB was mostly done on short term basis under Murabaha arrangement. Government also mobilized US$ 1 billion through issuance of Pakistan International Sukuk in November 2014.

8 (i) Public External Debt Servicing

8.4 After hefty repayments in 2013-14, public external debt servicing witnessed a decline of 25 percent during 2014-15 and recorded at US$ 4,475 million as compared with US$ 5,995 million in the last fiscal year. The decline in external debt servicing during 2014-15 was mainly due to lower repayments to the IMF that peaked out in 2013-14.

8.5 Servicing of public external debt fell by US$ 66 million in first quarter of 2015-16 compared to the same period last year and recorded at US$ 1,087 million. This was mainly on account of decline in repayment to the IMF.

Table-9: Public External Debt Servicing

Years	Actual Amount Paid	Interest	Amount Rolled Over	Total
(US Dollar in million)				
2009-10	2,643.1	850.3	623.0	4,116.4
2010-11	2,084.7	930.0	488.0	3,502.7
2011-12	2,700.0	880.9	543.0	4,123.9

Years	Actual Amount Paid	Interest	Amount Rolled Over	Total
(US Dollar in million)				
2012-13	4,794.6	800.4	500.0	6,095.1
2013-14	5,220.0	774.6	1,000.0	6,994.5
2014-15	3,500.3	974.5	1,000.0	5,474.8
2015-16*	910.3	176.7	-	1,087.0

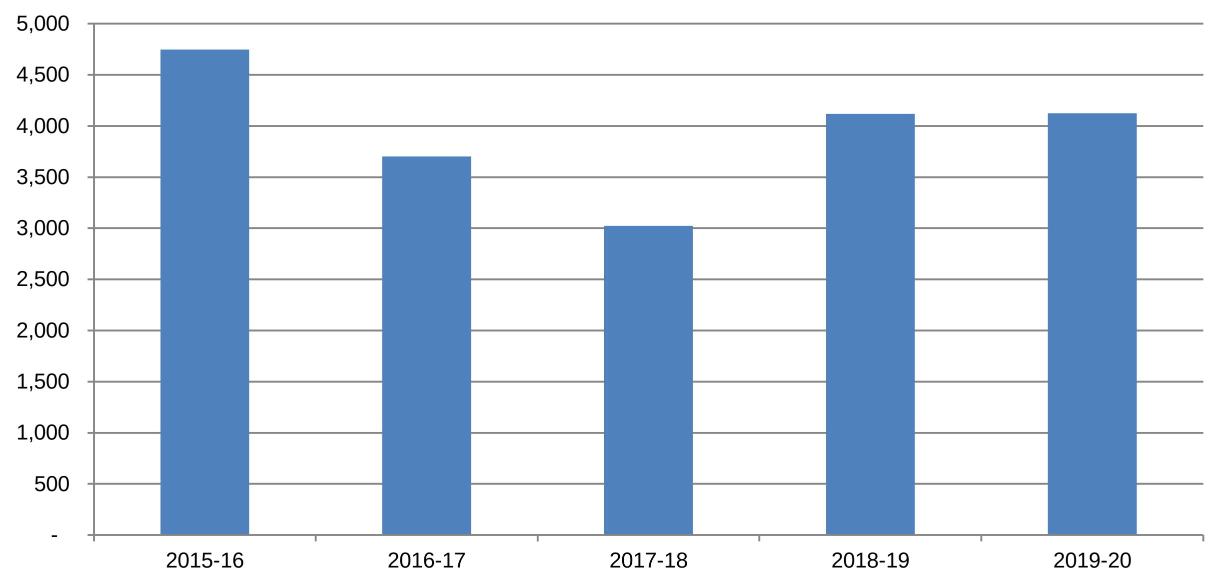
*July-September, 2015

Source: Source: State Bank of Pakistan and Debt Policy Coordination Office , Ministry of Finance

8.6 While the significant portion of the IMF loans has already been repaid, this decline will be somewhat offset by an increase in debt servicing costs over the medium-term, arising from:

- The 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;
- The repayment of rescheduled Paris Club debt under Official Development Assistance (ODA) will start from 2016-17;
- The Repayment of on-going EFF with IMF will begin in 2017-18;
- The 5-year Eurobond issued in April 2014 (US$ 1 billion) will mature in 2018-19;
- The 5-years Pakistan International Sukuk issued in November 2014 (US$ 1 billion) will mature in 2019-20.

Fig-12: Public External Debt Payments ($ in million)
(Based on Outstanding as on June 30, 2015)



8 (ii) Performance of Pakistan Eurobonds

8.7 The issuance of Eurobonds has great significance for Pakistan as it not only introduced Pakistan back in the international capital market but also allowed access to foreign resources for building country's reserves, which have paved the way for exchange rate stability. Further, the proceeds were utilized to retire the expensive domestic debt.

8.8 Pakistan successfully returned to the international Islamic bond market in November 2014 with the issuance of Sukuk worth 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.

8.9 Pakistan's international Eurobonds have traded well since issuance and levels have remained relatively stable since the start of 2015, other than intermittent impact for broad based market wide volatility. Pakistan's 2016s, 2017s, 2019s, 2024s bonds have broadly traded at a premium since May 2014 and CDS levels, though volatile, have been on a downward trajectory. As illustrated by these levels and Pakistan's issuance of international bonds and Sukuk since 2014 after a gap of 7 years, markets are accessible with investor appetite in the frontier market credit like Pakistan.

Global and Emerging Market ("EM") Credit

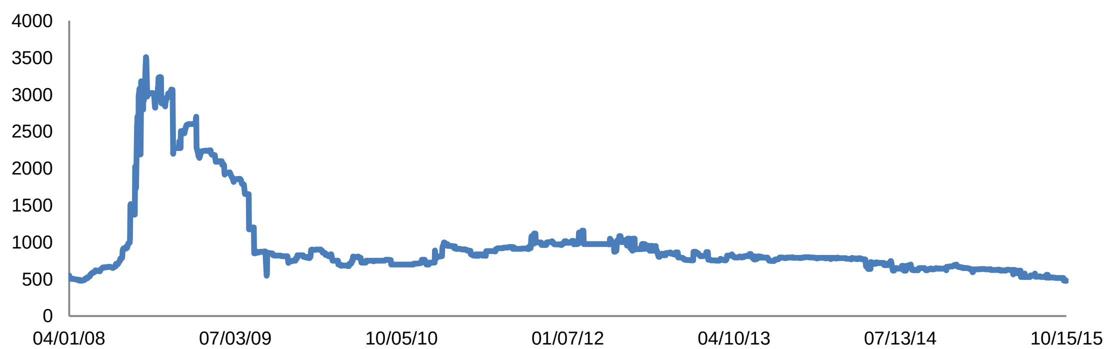
8.10 Capital markets have been impacted lately by events of a global nature. Despite such risks around a fragile geopolitical backdrop, falling oil prices and slower Chinese growth, there is expected to be considerable scope for new debt issuance opportunities. Given recent improvement in employment numbers in the US, there is more expectation of a Fed rate hike which could impact global capital markets.

Table-10: Secondary Trading Levels:

Bond	Ratings			Maturity	Size	Coupon (%)	Price	Yield (%)
	M	S&P	F		($ in million)			
EM Sovereign Bonds								
Pakistan	B3	B-	--	Mar-16	500	7.13	101.7	3.10
Pakistan	B3	B-	--	Jun-17	750	6.88	104.0	4.28
Pakistan	B3	B-	--	Apr-19	1,000	7.25	104.7	5.73
Pakistan (Sukuk)	B3	B-	--	Dec-19	1,000	6.75	104.7	5.44
Pakistan	B3	B-	--	Apr-24	1,000	8.25	107.5	7.06
Pakistan	B3	B-	B	Sep-24	1,000	8.25	106.5	7.32
Pakistan	B3	B-	--	Mar-36	300	7.88	96.2	8.26

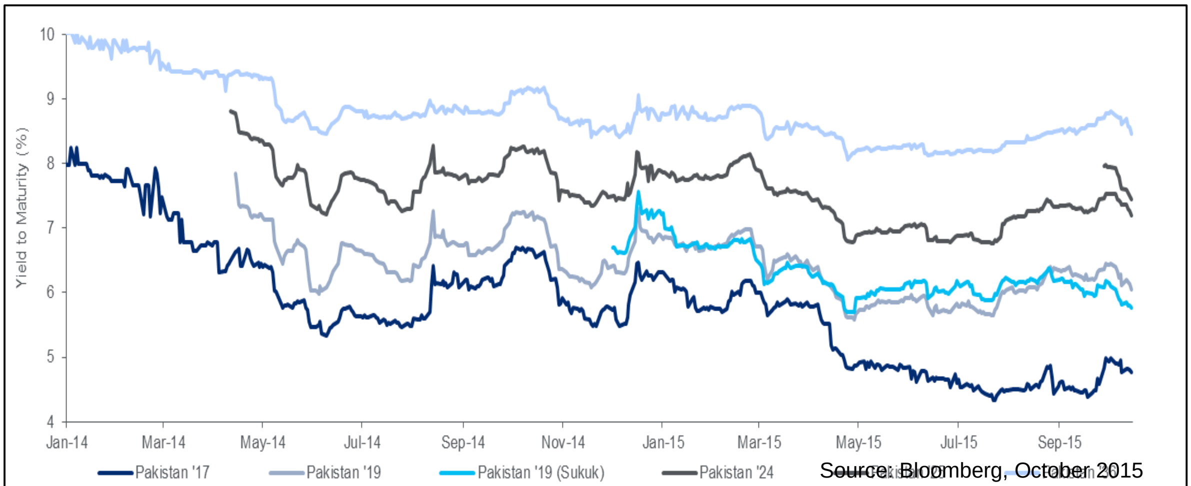
Source: Bloomberg, October 2015

Fig-13: CDS Level for Pakistan - 5 Years



Source: Bloomberg, October 2015

Fig-14: Bond Trading Levels



Source: Bloomberg, October 2015

8 (iii) - Currency Movements and Revaluation Impact

8.11 External loans are contracted by Pakistan in different currencies and disbursements are effectively converted into Pak Rupee. As the Pak Rupee is not a widely traded international 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. The main exchange rate risk for Pakistan is from loans denominated in US Dollars, Euro, Japanese Yen and Pound Sterling. During 2014-15, appreciation of US Dollar against other major currencies resulted in decrease in foreign currency component of public debt. However, depreciation of Pak Rupee against US Dollar by 3 percent reduced this gain in domestic currency. During the first quarter of 2015-16, slight depreciation of US Dollar against other international currencies coupled with depreciation of Pak Rupee against US Dollar increased the external public debt.

8.12 The Pak Rupee depreciated against the US Dollar on average by 3.6 percent per annum during last five years which resulted in increase in Pakistan's external debt in local currency. This cost on foreign currency debt is compensated by the concessional terms (low cost and longer maturities) associated with its external loans. Accordingly, policy of the government is to borrow more through these channels.

8 (iv) - External Debt Sustainability

8.13 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 position 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 sound monitoring system in the form of debt sustainability analysis based on key macroeconomic indicators can predict and avoid debt problems.

8.14 Generally, country's ability to make repayments can be assessed with two types of indicators; (i) solvency indicators and (ii) liquidity indicators. Solvency indicator such as external debt-to-GDP ratio shows debt bearing capacity of the country. Liquidity indicators such as external debt servicing to foreign exchange earnings ratio shows debt servicing capacity of the country.

Table-11: External Debt Sustainability Indicators

(In percent)	2010	2011	2012	2013	2014	2015
ED/FEE (times)	1.3	1.2	1.1	1.0	1.0	1.0
ED/FER (times)	3.0	3.0	3.5	4.4	3.6	2.7
ED/GDP	28.7	25.9	23.8	20.8	21.1	18.9
ED Servicing/FEE	10.8	7.3	8.5	12.1	13.7	10.3

FEE: Foreign Exchange Earnings; ED: External Debt; FER: Foreign Exchange Reserves
Source: Debt Policy Coordination Office, Ministry of Finance

8.15 The impact of the decrease in external debt and its servicing is evident in almost all the external debt sustainability indicators during 2014-15. Pakistan's external debt was slightly lower than the foreign exchange earnings in 2014-15. Further, decline in external debt repayments coupled with strong growth in the remittance, improved the debt servicing capacity of the country. Specifically, the external debt servicing to foreign exchange earnings ratio dropped to 10 percent in 2014-15, from 14 percent last year.

8.16 External debt to GDP ratio witnessed a significant decline in 2014-15 and recorded at 18.9 percent as compared with 21.1 percent at the end of last fiscal year. The improvement in this indicator was due to a drop in external debt caused by significant revaluation gains during 2014-15 on account of appreciation of US Dollar against other major international currencies.

8.17 A decrease in external debt 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. This ratio started improving since 2013-14 and recorded at 2.7 times in 2014-15 as compared with 4.4 times at the end of 2012-13. The reduction in external debt coupled with accumulation of foreign exchange reserves led to remarkable improvement in this ratio.

9.0 Progress on Medium Term Debt Management Strategy (2013/14 - 2017/18)

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-12: Public Debt Cost and Risk Indicators*

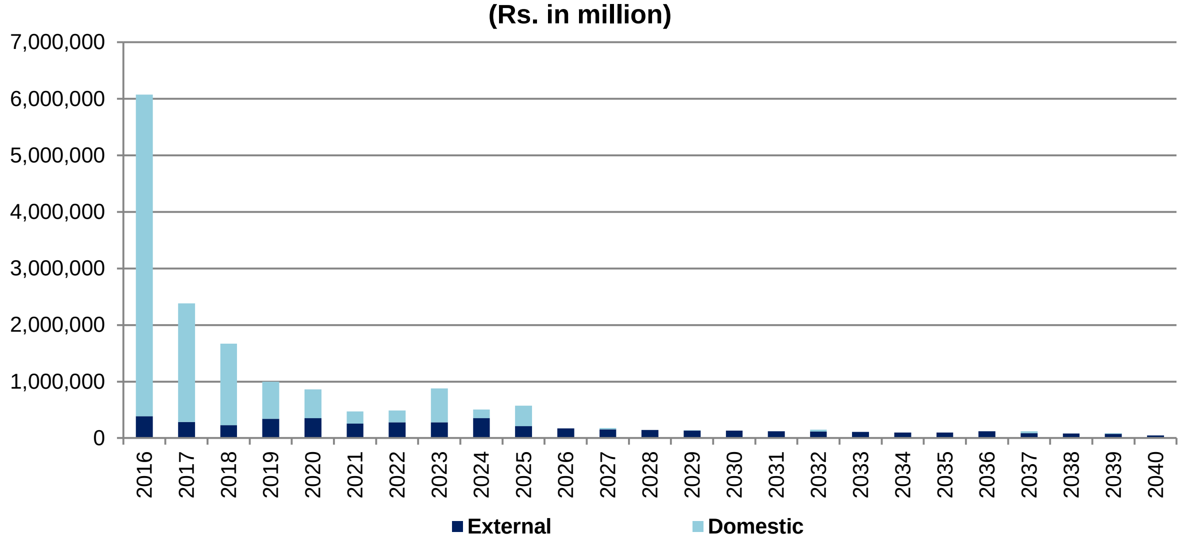
Risk Indicators		External Debt		Domestic Debt		Public Debt	
		2013	2015	2013	2015	2013	2015
Refinancing Risk	Average Time to Maturity (ATM) - Years	10.1	9.4	1.8	2.3	4.5	4.3
	Debt Maturing in 1 Year (% of total)	8.9	8.1	64.2	47.3	46.0	36.2
Interest Rate Risk	Average Time to Re-Fixing (ATR) - Years	9.2	8.6	1.8	2.3	4.2	4.1
	Debt Re-Fixing in 1 year (% of total)	22.2	20.6	67.2	47.7	52.4	40.0
	Fixed Rate Debt (% of total)	83.4	83.3	39.6	58.9	54.0	65.8
Foreign Currency Risk (FX)	Foreign Currency Debt (% of total debt)					32.9	28.3
	Short Term FX Debt (% of reserves)					68.5	27.9

* As per modalities of MTDS (2013/14 – 2017/18)

Source: Debt Policy Coordination Office, Ministry of Finance

9.2 Refinancing risk was of prime concern in Pakistan's public debt portfolio, driven by the concentration of domestic debt in short maturities at the end of 2012-13. The refinancing risk of the domestic debt reduced at the end of 2014-15 as indicated by percentage of domestic debt maturing in one year reduced to 47 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 2014-15 as compared with 1.8 years at the end of 2012-13. However, average time to maturity of external debt decreased to 9.4 years as compared with 10.1 years at the end of 2012-13. This reduction in average time to maturity of external debt may be attributed to relatively higher proportion of external debt repayments in next 10 years and running off the existing long term external debt portfolio. The redemption profile of domestic and external debt as at end June 2015 is shown in the graph below:

Fig-15: Redemption Profile of Public Debt at end June 2015
(Rs. in million)



9.3 The structure of principal repayments and refinancing of government securities presented in the graph above shows some accumulation of principal repayments in next three years. Although government has able to reduce refinancing risk of its domestic debt as compared with end June 2013, still concentration of repayments over the short term are evident in the redemption profile. Government is gradually reducing refinancing risk of its domestic debt portfolio through more mobilization from medium to long term securities.

9.4 Exposure to interest rate risk reduced as percentage of debt re-fixing in one year decreased to 40 percent at the end of 2014-15 as compared with 52 percent at the end of 2012-13. Average time to re-fixing slightly decreased to 4.1 years at the end of 2014-15 as compared with 4.2 years at the end of 2012-13. This number is a combination of average time to re-fixing of 8.6 years on external debt and around 2.3 years on domestic debt. Further, fixed rate debt as a percentage of total debt increased to 66 percent at the end of 2014-15 as compared with 54 percent at the end of 2012-13 indicating reduced exposure to interest rate changes while external debt having fixed rate slightly reduced in proportion at the end of 2014-15 compared with 2012-13. Domestic debt carrying fixed rate increased to 59 percent at the end of 2014-15 as compared with 40 percent at the end of 2012-13 as the government mobilized more through issuance of PIBs during last two years.

9.5 Around 28 percent of total public debt stock was denominated in foreign currency which is a source of exchange rate risk. Currency wise composition of public debt stock is depicted through table below:

Table-13: Currency Wise Public Debt[(a)] (in US$)

Currencies	Percentage
Pak Rupee	71.7
US Dollar	10.6
Special Drawing Right	8.7
Japanese Yen	5.1
Euro	2.4
Others	1.5
Total	**100.0**

[(a)]As per modalities of MTDS

9.6 Within external debt and adjusted for Special Drawing Rights (SDR)[3], around 91 percent of total external public debt is contracted in 3 major currencies *i.e.* main exposure of exchange rate risk comes from USD denominated loans

[3]Loans in SDR are decomposed in relevant currencies available in basket according to their assigned weights.

(52 percent of total external debt), followed by Japanese Yen (20 percent) and Euro (19 percent). The share of external loans maturing within one year was equal to around 28 percent of official liquid reserves at the end of 2014-15 as compared with around 69 percent at the end of 2012-13 indicating improvement in foreign exchange stability and repayment capacity.

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. Contingent liabilities are not added to the overall debt of the country, till they are called, if at all.

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 are guarantees issued to Public Sector Enterprises (PSEs). 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 2014-15, the government issued fresh/rollover guarantees aggregating to Rs. 156 billion or 0.6 percent of GDP, whereas, outstanding stock of government guarantees as at end June 2015 amounted to Rs. 644 billion. The domestic currency guarantees accounted for 83 percent of the total guarantees stock.

Table-14: Guarantees Outstanding as on June 30, 2015 (Rs. in billion)

Outstanding guarantees extended to PSEs	**644**
-Domestic Currency	533
-Foreign Currency	111
Memo:	
Foreign Currency (US$ in million)	1,088

During 2014-15, the government issued fresh/rollover guarantees aggregating to Rs.156 billion or 0.6 percent of GDP

Source: Debt Policy Coordination Office, Ministry of Finance

Table-15: Entity Wise New Guarantees Issued (2014-15) - (Rs. in billion)

Name of Organization	Amount
PHPL	96.0
PIA	58.8
Pakistan Textile City	1.2
Total	**155.9**
In percent of GDP	**0.6**

Source: Debt Policy Coordination Office, Ministry of Finance

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 at end June 2015, the outstanding stock against commodity operations was Rs. 675 billion.

10.6 At the end of first quarter of 2015-16, the government issued fresh/rollover guarantees amounting to Rs. 18.5 billion or 0.1 percent of GDP. Total outstanding stock at the end of September 2015 amounted to Rs. 670 billion. The outstanding stock issued against commodity operations was Rs. 477 billion at the end of first quarter of 2015-16.

Table-16: Guarantees Outstanding as on September 30, 2015 (Rs. in billion)

Outstanding guarantees extended to PSEs	**670**
-Domestic Currency	550
-Foreign Currency	120
Memo:	
Foreign Currency (US$ in million)	1,144

During first quarter of 2015-16, the government issued fresh/rollover guarantees aggregating to Rs.18.5 billion or 0.1 percent of GDP

Source: Debt Policy Coordination Office, Ministry of Finance

11.0 Report on Compliance with FRDL Act 2005

The Fiscal Responsibility and Debt Limitation (FRDL) Act, 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. 471 billion or 1.7 percent of GDP in 2014-15. The government is striving to achieve a revenue surplus so that borrowings are only utilized towards financing the development needs of the country.

Table-17: Revenue Balance (Percent of GDP)

	2010	2011	2012	2013	2014	2015
Revenue Balance*	(1.7)	(3.3)[a]	(4.5)[b]	(2.9)[c]	(0.7)	(1.7)

*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 is on declining trajectory since 2012-13. The fiscal consolidation achieved during last two years has paved the way for a reduction in public debt, which fell from 64 percent in 2012-13 to 63.5 percent at the end of 2014-15. Public debt also includes loans from the IMF amounting to US$ 4.1 billion or 1.5 percent of the GDP as on June 30, 2015. The borrowing from the IMF is only utilized towards balance of payment support and is reflected in foreign currency reserves of the country.

In the medium term, public Debt to GDP ratio is expected to be less than 60 percent in accordance with the provisions of the Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005 through effective fiscal and debt management.

Table-18: Public Debt to GDP (Rs. in billion)

	2010	2011	2012	2013	2014	2015
Domestic Debt	4,654.3	6,016.7	7,638.1	9,521.9	10,920.0	12,198.9
External Debt	4,351.9	4,750.2	5,057.2	4,796.5	5,071.5	5,181.8
Total Public Debt	**9,006.2**	**10,766.9**	**12,695.3**	**14,318.4**	**15,991.5**	**17,380.7**
GDP	14,867.0	18,276.4	20,046.5	22,379.0	25,068.1	27,383.7
Total Public Debt (as percent of GDP)	**60.6**	**58.9**	**63.3**	**64.0**	**63.8**	**63.5**

(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 increased to 7.9 percent of GDP in 2014-15. Additionally, expenditures on health and education stood at 0.8 percent and 2.2 percent of GDP respectively.

Table-19: Social Sector Expenditure

	2010	2011	2012	2013	2014	2015
Social sector and poverty related expenditure (as percent of GDP)	7.5	8.3	9.7	8.5	7.7	7.9
Expenditure on education (as percent of GDP)	1.7	1.8	2.0	2.1	2.1	2.2
Expenditure on health (as percent of GDP)	0.6	0.6	0.7	0.7	0.8	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 2014-15, the government issued new guarantees including rollovers amounted to Rs. 156 billion or 0.6 percent of GDP.

Table-20: New Guarantees Issued

(Rs. in billion)	2010	2011	2012	2013	2014	2015
New guarantees issued	224	62	203	136	106	156
(as percent of GDP)	**2.1**	**1.5**	**0.3**	**1.0**	**0.4**	**0.6**

Given the fiscal constraints mainly on account of high interest payments, large subsidies, growing security spending needs and structural bottlenecks, the government is gradually moving towards achieving the thresholds as stipulated in Fiscal Responsibility and Debt Limitation Act, 2005. 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 Conclusion

12.1 Government inherited chronic challenges like large fiscal deficit, rising debt to GDP burden, unfavourable balance of payment position, low foreign exchange reserves, limited revenue base, rising current expenditures, circular debt, energy crises, flight of capital, weakening exchange rate and perilously declining investor confidence. On the external front, all major development partners had parted ways due to weakening economic fundamentals and predictable inability of the country to service its external obligations.

12.2 Such challenges could not have been faced without a credible commitment to undertake painful decisions and follow a well-designed structural adjustment program that would first stabilize the economy and then spur growth. A key requirement for stability was to stem falling reserves and establish a stable exchange rate. This could not have been possible without having access to external financing, which was virtually dried. Consequently, the composition of public debt tilted toward domestic debt and that too into shorter maturities making debt management vulnerable and entailing high rollover and refinancing risk for the government. In such a scenario, maintaining exchange rate stability was the prime need as depreciation of Pak Rupee would not only affect stock of the government debt (through loss of capital on foreign debt) but increasing debt servicing as well, besides eroding investors' confidence and fuelling inflation. The need for re-profiling the debt to check its growth, lengthen maturity, reduce cost and strike a balance between foreign and domestic debt thus became inevitable, both for interest rate stability and regaining growth momentum.

12.3 Keeping in view the importance and indispensable nature of debt sustainability, the government has taken corrective measures and accordingly public debt sustainability indicators have improved during last two fiscal years. Public debt to GDP ratio has fallen from 64 percent in 2012-13 to 63.5 percent at the end of 2014-15. In the next three years, this ratio is projected to fall to less than 60 percent in accordance with the provisions of the Fiscal Responsibility and Debt Limitation Act, 2005 as a result of continued fiscal adjustment and prudent debt management. Furthermore, as envisaged in Medium Term Debt Management Strategy (2013/14 – 2017/18), most of the public debt sustainability indicators improved as government was able to further lengthen the maturity profile of its domestic debt and accordingly refinancing and interest rate risks were reduced. External debt sustainability improved owing to increase in debt repayment capacity of the country. Yields on retail domestic debt were synchronized with wholesale secondary market yields to practically eliminate distortions in their yield curves. Government is also set to publish its updated Medium Term Debt Management Strategy (2015/16 - 2018/19) as the macroeconomic realities have changed since 2012-13. The purpose is to ensure that both the level and rate of growth in public debt is fundamentally sustainable while meeting cost and risks objectives.

12.4 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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