Debt Policy Statement

2018-19

Debt Policy Coordination Office
Ministry of Finance

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Government of Pakistan

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Acknowledgements

This policy statement has been prepared to fulfil the requirement laid out under Section 7 of the Fiscal Responsibility and Debt Limitation Act 2005. I would like to acknowledge the strategic input and policy guidance provided by Finance Secretary, Mr. Arif Ahmed Khan. I would like to acknowledge the input of various Ministries, Departments, Divisions and Agencies especially Budget Wing, External Finance Wing and Economic Affairs Division. I would like to recognize the efforts put in by Mr. Muhammad Umar Zahid, Market and Financial Risk Specialist, Mr. Arsalan Ahmed, Market and Financial Risk Specialist, Mr. Shujaat Malik Awan, Credit Risk Specialist, Syed Haroon Qidwai, Credit Risk Specialist, Mr. Muhammad Abdullah, Research Associate, Ms. Punel Zafar, Research Associate and Mr. Zaheer Abbasi, Section Officer in the realization of this comprehensive document.

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1.0 Introduction

1.1 Government borrowing at an intrinsic level is a requirement originating from deficit of resources available to finance the government budget as well as to provide coverage towards foreign exchange obligations emitting out of external sector. At times, borrowed funds are also required towards resource-intensive infrastructure projects which are geared towards facilitating economic growth and accelerate the social development goals. Therefore, both domestic and external debt provide a way for economies to balance their financing needs and these debt creating flows remain a vital part of financing mechanism for developing countries.

1.2 Borrowing can be productive for economic growth of developing countries as long as the economic returns are higher than the cost of borrowed funds. However, borrowed funds are required to be properly utilized and should conform to the country's repayment capacity. While debt is useful for growth of the economy, dependence on debt must be closely monitored and proper strategy should be adopted for managing and improving the repayment capacity of the country. High and unsustainable level of debt not only plagues economic growth but due to heavy debt servicing also lowers the development expenditure in future years.

1.3 Pakistan's public debt dynamics witnessed various developments during 2017-18, some of them are highlighted below:

- The higher twin deficits (fiscal and current account) along with depreciation of exchange rate contributed towards increase in debt burden of the country. Total public debt as percentage of GDP increased by 5.6 percentage points to stand at 72.5 percent at end June 2018, remaining significantly higher than the 60 percent threshold envisaged in the Fiscal Responsibility & Debt Limitation Act, 2005;
- The composition of public debt in terms of maturity profile continued to witness unfavorable changes during 2017-18 as government relied mainly on short-term domestic borrowing while most of the external loans were contracted through commercial sources. These factors contributed towards breach in few indicative ranges for public debt risk indicators as defined in

Medium Term Debt Management Strategy (2015/16 - 2018/19);

- Government could only adhere to its net zero quarterly limit set under the amended SBP Act 1956 during 2nd and 4th quarters of 2017-18;
- Government introduced floating rate bonds with tenor of 10 years to reduce the refinancing risk of it domestic debt portfolio;
- Interest payments consumed 29 percent of government revenue;
- Government raised US$ 2.5 billion through a 5-year Sukuk and 10-year conventional bond with the latter issued at 6.875 percent, the lowest rate for a Pakistan 10-year international bond.

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) analysis of the foreign currency exposure of Pakistan's external debt;

(d) consistent and authenticated information on public and external debt and guarantees issued by the Federal Government;

(e) information of all loan agreements contracted, disbursements made thereof and repayments made thereon, if any, by the Government during the fiscal year; and

(f) 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 Prudent utilization of debt leads to higher economic growth and helping the government to accomplish its social and developmental goals. Comprehensive debt management is required on part of the government to not only keep current levels of debt under control but to also fulfill its future repayment obligations. This does not subvert the importance of vigilant fiscal and monetary policies. The management of public debt requires effective coordination with macroeconomic policies, including reserve management and exchange rate policy.

3.2 Domestic and external debt needs to be treated separately owing to their different dynamics. 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 to 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 reduce. 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 it pose a different set of challenges. In this case, if growth in Foreign Exchange Earnings

(FEE) exceeds the growth in external public debt, the ratio of external public debt 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 can also be assessed by analyzing the non-interest current account balance. A nil current account deficit before interest payment and higher growth in FEE compared to the interest rate paid on external public debt will ensure reduction in external public debt to FEE over time. By focusing on limiting the non-interest current account deficit and ensuring that 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 Fiscal Responsibility and Debt Limitation Act 2005 defines "Total Public Debt" as debt owed by government (including Federal Government and Provincial Governments) serviced out of consolidated fund and debts owed to the International Monetary Fund. Whereas, "Total Debt and Liabilities" of the country include "Total Public Debt" (Government Debt) as well as debt of other sectors as presented in the table below:

Table-1: Pakistan's Debt and Liabilities

(Rs in billion)	2008	2013	2014	2015	2016	2017 (P)	2018 (P)	SEP 18 (P)
I. Government Domestic Debt	3,274.2	9,520.4	10,906.5	12,192.5	13,625.9	14,849.2	16,416.3	16,919.8
II. Government External Debt	2,761.6	4,336.4	4,786.3	4,770.0	5,417.6	5,918.7	7,795.8	8,122.9
III. Debt from IMF	91.3	434.8	298.4	417.6	633.1	640.8	740.8	740.7
IV. External Liabilities[1]	88.5	307.9	324.2	377.6	377.1	373.8	622.3	620.7
V. Private Sector External Debt	128.4	465.5	500.4	539.2	709.1	1,183.2	1,639.3	1,701.1
VI. PSEs External Debt	82.1	183.2	203.8	252.7	294.0	285.2	324.6	353.6
VII. PSEs Domestic Debt	137.2	312.2	366.2	458.7	568.1	822.8	1,068.2	1,128.9
VIII. Commodity Operations[2]	127.2	469.7	492.4	564.5	636.6	686.5	819.7	808.9
IX. Intercompany External Debt from Direct Investor abroad	-	308.2	335.9	276.6	315.6	353.9	465.0	479.1
A. Total Debt and Liabilities (sum I to IX)	**6,690.5**	**16,338.2**	**18,214.3**	**19,849.4**	**22,577.1**	**25,114.2**	**29,892.0**	**30,875.8**
B. Total Debt and Liabilities (excluding private sector external debt)	**6,562.1**	**15,872.7**	**17,713.9**	**19,310.2**	**21,868.1**	**23,930.9**	**28,252.7**	**29,174.6**
C. Total Public Debt (sum I to III)	**6,127.1**	**14,291.7**	**15,991.3**	**17,380.2**	**19,676.6**	**21,408.7**	**24,952.9**	**25,783.4**
D. Total Debt of the Government[3]	**5,650.8**	**13,457.3**	**14,623.9**	**15,986.0**	**17,823.2**	**19,635.4**	**23,051.5**	**23,717.7**

Table-1: Pakistan's Debt and Liabilities

(Rs in billion)	2008	2013	2014	2015	2016	2017 (P)	2018 (P)	SEP 18 (P)
(As percent of GDP)								
Total Debt and Liabilities	62.9	73.0	72.4	72.3	77.6	78.6	86.9	80.4
Total Debt and Liabilities (excluding private sector external debt)	61.7	70.9	70.4	70.4	75.2	74.9	82.1	76.0
Total Public Debt	57.6	63.8	63.5	63.3	67.7	67.0	72.5	67.2
Total Debt of the Government	53.1	60.1	58.1	58.3	61.3	61.4	67.0	61.8
Memorandum Items								
GDP (current market price)	10,637.8	22,385.7	25,168.8	27,443.0	29,075.6	31,962.6	34,396.5	38,388.0
Government Deposits with the banking system[4]	476.3	834.4	1,367.3	1,394.1	1,853.5	1,773.3	1,901.3	2,065.8
US Dollar, last day average exchange rates	68.3	99.1	98.8	101.8	104.8	104.9	121.5	124.2

P: Provisional

1 External liabilities include Central bank deposits, SWAPS, Allocation of Special Drawing Rights (SDR) and Non-resident LCY deposits with central bank.

2 Includes borrowings from banks by provincial governments and PSEs for commodity operations.

3 As per Fiscal Responsibility and Debt Limitation Act, 2005 amended in June 2017, "Total Debt of the Government" means the debt of the government (including the Federal Government and the Provincial Governments) serviced out of the consolidated fund and debts owed to the International Monetary Fund (IMF) less accumulated deposits of the Federal and Provincial Governments with the banking system.

4 Accumulated deposits of the Federal and Provincial Governments with the banking system.

Source: State Bank of Pakistan

4.2 The increasing twin deficits (fiscal and current account) continued to accelerate the pace of debt accumulation during 2017-18. Total public debt was recorded at Rs 24,953 billion by end June 2018, showing an increase of Rs 3,544 billion during the year. Main drivers of this increase were:

- Budget deficit reached its highest level during last five years registering at Rs 2,260 billion or 6.6 percent of GDP. This higher fiscal deficit increased government reliance on borrowing from domestic and external sources, especially from the domestic banking sector. Government borrowed Rs 1,120 billion from banking sources, Rs 353 billion from non-bank sources while external borrowing for the financing of budget deficit stood at Rs 785 billion;
- Revaluation losses due to appreciation of international currencies against US Dollar and depreciation of Pak Rupee against US Dollar increased the total public debt by around Rs 1.2 trillion; and
- Rest of the increase in total public debt was on account of increase in credit balances of the government with the banking system.

4.3 Resultantly, total public debt increased by 5.6 percentage points to 72.5 percent of GDP by end June 2018. In addition to total public debt, considerable increase in PSEs debt, loans for commodity operations and external liabilities pushed Pakistan's total debt and liabilities to 82.1[1] percent of GDP at end Jun 2018 from 74.9 percent at end June 2017.

4.4 Similar to last year, composition of public debt in terms of maturity profile continued to witness unfavorable changes during 2017-18. Government relied mainly on short-term domestic borrowing while demand for medium to long term government securities remained subdued in anticipation of change in the interest rates, inflation and liquidity conditions. On external public debt front, most of the loans were contracted through commercial sources mainly on floating rates. These factors contributed towards breach in few indicative ranges for public debt risk indicators as defined in Medium Term Debt Management Strategy (MTDS).

- The upper range for the risk indicator "Domestic Debt Maturing Within a Year" was 65 percent while this indicator reached at 66.3 percent at end June 2018;
- Similarly, upper range for "Domestic Debt Re-Fixing in 1 Year" and "Public Debt Re-Fixing in 1 Year" was envisaged at 65 percent and 55 percent respectively while these indicators stood at 66.6 percent and 55.5 percent respectively at end June 2018.

4.5 One of the objectives of MTDS is to facilitate the development of debt capital markets. A well-developed debt market is essential to reduce financial risks of the overall economy, provide the government with a non-inflationary source of finance, create a well-balanced financial environment and promote economic growth. Government is taking various steps to provide an efficient and liquid secondary debt markets to the investors (Box-1).

[1] excluding private sector debt

BOX-1 - STEPS TAKEN FOR THE DEVELOPMENT OF DEBT CAPITAL MARKET

I. Formulation of Bond Pricing Agency Rules, 2017;
II. Formulation of Sukuk (Privately Placed) Regulations, 2017;
III. Formulation of Shariah Advisors Regulations, 2017;
IV. Formulation of Futures Exchanges (Licensing and Operations) Regulations, 2017;
V. Notified the following persons to whom privately placed debt securities being instrument of redeemable capital can be issued under Section 66 of the Companies Act, 2017:
   (i) a Mutual Fund, Voluntary Pension Scheme and Private Fund being managed by NBFCs;
   (ii) an Insurer;
   (iii) a Securities Broker;
   (iv) a Fund and Trust as defined in the Employees Contributory Funds (Investment in Listed Securities) Regulations, 2018; and
   (v) a Company and a Body Corporate as defined in the Companies Act, 2017;

VI. Formulation of the Regulations for Listing of the Privately Placed Debt Securities at the Pakistan Stock Exchange Limited;
VII. Shariah Governance Regulations, 2018. The Regulations entail comprehensive governance framework for Shariah compliant companies and securities including debt securities;
VIII. Training program on "Fixed Income Investment & Trading Certification" jointly organized by USAID Financial Market Development Activity and IFMP (Institute of Financial Markets of Pakistan); and
IX. Tax credit for resident persons, other than companies, for cost of acquiring through public offer Sukuk, listed on the stock exchange, offered by a public company if investor is the original allottee of the Sukuk. (Section 62 of the Income Tax Ordinance, 2001.

Future Plans with Regard to Development of Debt Capital Market:

I. Establishment of Bond Pricing Agency under the Bond Pricing Agency Rules, 2017;
II. Review of the Companies (Asset Backed Securitization) Rules, 1999;
III. Rationalization of rate of stamp duty applicable on the issuance of debt instruments;
IV. Study on Exchange Traded Funds (ETF) on fixed income securities; and
V. Implementation of standards of Islamic Financial Services Board (IFSB) Malaysia, through Shariah Governance Framework.

Source: Securities and Exchange Commission of Pakistan

4.6 During first quarter of 2018-19, total public debt reached Rs 25,783 billion at end September 2018 registering an increase of Rs 831 billion. The bifurcation of this increase is explained below:

- Domestic debt registered an increase of Rs 504 billion while government borrowing for financing of fiscal deficit from domestic sources was Rs 331 billion, indicating an increase in government credit balances with the banking system during the period under review; and
- Increase in external public debt contributed Rs 327 billion to total public debt while government borrowing for financing of fiscal deficit from external sources was around Rs 211 billion. This differential was primarily due to revaluation losses on account of depreciation of Pak Rupee against US Dollar.

5.0 Dynamics of Public Debt

5.1 Debt burden of a country can be assessed through multiple parameters as one dimensional approach may not be suitable to delineate the "bad" from the "good". Therefore, various solvency and liquidity indicators are employed to assess the debt burden of the country.

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

	2013	2014	2015	2016	2017	2018
Revenue Balance* / GDP	(2.9)**	(0.7)	(1.7)	(0.8)	(0.7)	(1.7)
Primary Balance* / GDP	(3.6)**	(0.2)	(0.5)	(0.2)	(1.5)	(2.1)
Fiscal Balance / GDP	(8.2)**	(5.5)	(5.3)	(4.6)	(5.8)	(6.6)
Total Public Debt / GDP	63.8	63.5	63.3	67.7	67.0	72.5
Total Government Debt / GDP	60.1	58.1	58.3	61.3	61.4	67.0
Gross Public Debt / Revenue	479.2	439.6	442.1	442.5	433.7	477.3
Total Government Debt / Revenue	451.2	402.1	406.7	400.8	397.7	440.9
Debt Service / Revenue	40.5	40.1	40.4	35.9	38.3	37.3
Interest Service / Revenue	33.2	31.6	33.2	28.4	27.3	28.7
Debt Service / GDP	5.4	5.8	5.8	5.5	5.9	5.7

* Adjusted for grants ** 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 Fiscal deficit continued to rise for second consecutive year while reaching its highest level in last five years. During 2017-18, fiscal deficit was recorded at 6.6 percent of GDP, surpassing both its budget target of 4.1 percent as well as 5.8 percent recorded in the last fiscal year. Although, pace of increase in both revenue and expenditure slowed down during 2017-18, however, growth in expenditure outstripped revenue. The fiscal performance can also be assessed through analysis of revenue and primary balances as follow:

- The revenue deficit[2], which excludes development expenditure, recorded at 1.7 percent of GDP in 2017-18 compared with 0.7 percent during the preceding fiscal year. This increase was on account of higher growth in current expenditures (13 percent) which outpaced the growth in revenue (6 percent) during 2017-18. The higher growth in current expenditures were mainly due to higher provincial current spending while growth in federal

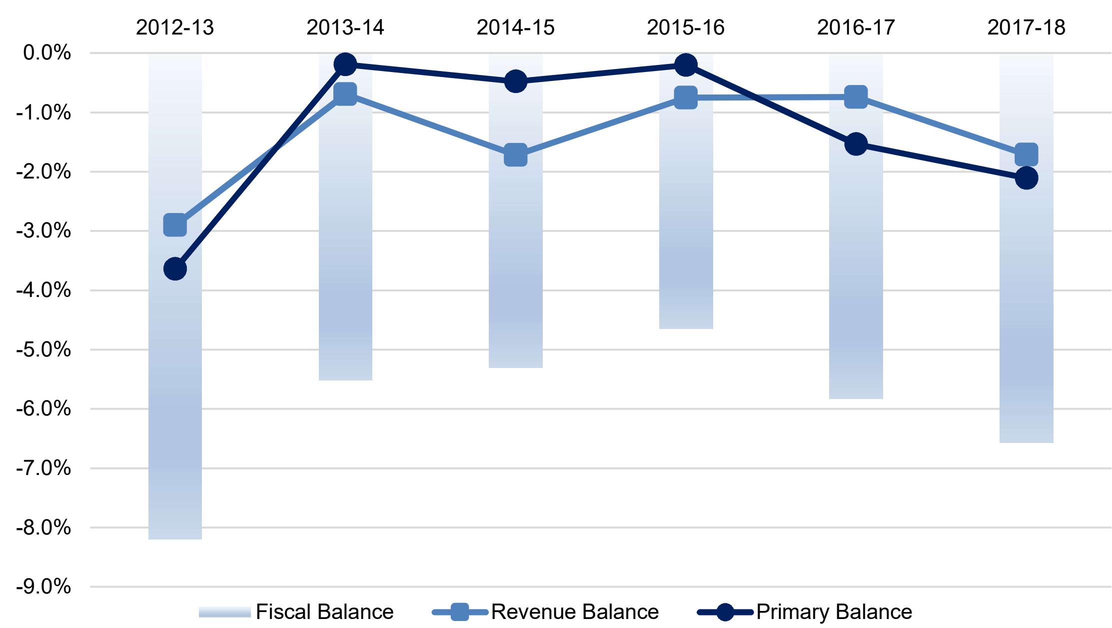
[2] Revenue balance is the total revenues minus current expenditure. The persistence of revenue deficit indicates that the government is not only borrowing to finance its development expenditure, but partially also financing its current expenditure.

current spending decreased despite increase in interest payments and defense expenditure. Development expenditures declined by around 4 percent during 2017-18 compared with last fiscal year indicating that fiscal deficit was mainly driven by increase in current expenditure;

- Similarly, the primary deficit[3], which excludes interest payments, increased to 2.1 percent of GDP during 2017-18 from 1.5 percent during 2016-17, indicating a much faster increase in non-interest expenditure compared to revenue.

The trends in fiscal, revenue and primary balance are depicted in the graph below:

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



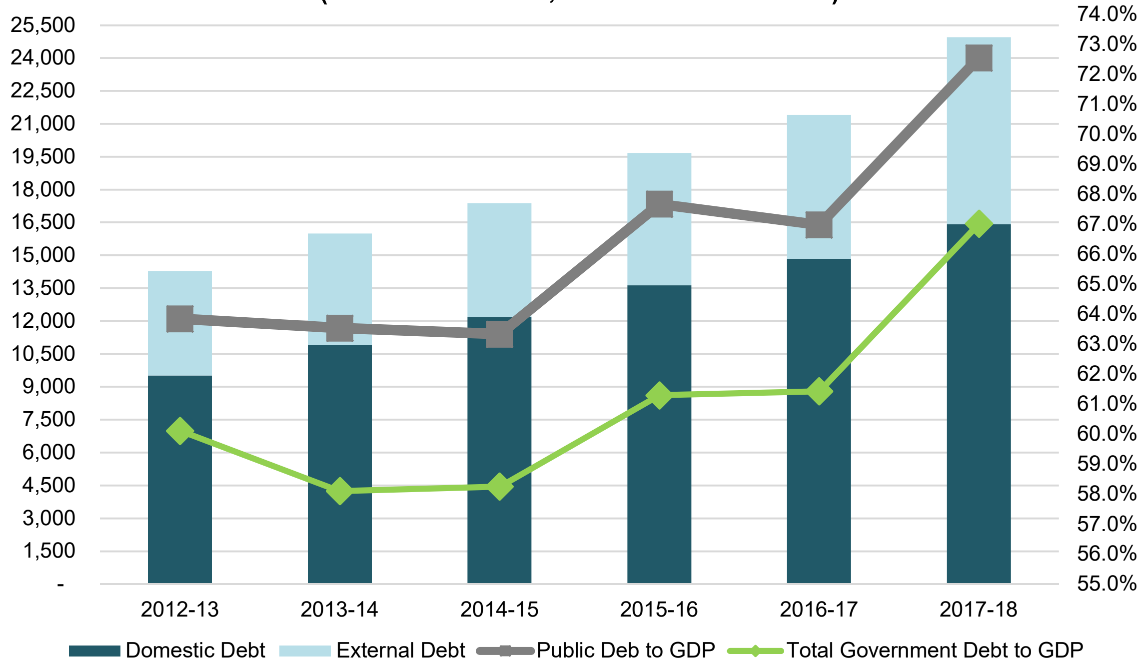
5.3 Total public debt as percentage of GDP stood at 72.5 percent while total debt of the government[4] recorded at 67 percent at end June 2018. Thus, these indictors remained significantly higher than the 60 percent threshold as envisaged under FRDL Act, 2005. Importantly, total public debt to GDP ratio witnessed 5.6 percentage points increase during 2017-18 driven primarily by higher than budgeted fiscal deficit as well as revaluation losses on account of appreciation of

[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.

[4] Total Debt of the Government is public debt less accumulated deposits of the Federal and Provincial Governments with the banking system.

other international currencies against US Dollar and depreciation of Pak Rupee against US Dollar also contributed significantly towards this increase. Total public debt position since fiscal year 2013 (both in absolute and GDP terms) are depicted in the following graph:

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



5.4 Public debt levels against actual government revenues reveal important information about debt bearing capacity of the country. Total public debt as percentage of revenue stood at 477 percent in 2017-18 compared with 434 percent in 2016-17, indicating increase in government indebtedness and weakening debt affordability. Growth in revenue was much lower than the growth in total public debt during 2017-18 which led to sharp increase in this ratio.

5.5 Interest payments were 29 percent of revenue during 2017-18 compared with 27 percent during 2016-17 while it was around 33 percent in 2012-13. Given the present rising interest rate environment[5] coupled with higher share of short term domestic debt[6], interest payments are expected to increase further in the coming

[5] Policy rate increased by around 4.25 percent during calendar year 2018 while global interest rates have also started to pick up during last few years.
[6] Domestic debt maturing within one year was around 66 percent at end June 2018

years as refinancing of these maturities are expected to transmit higher interest cost to government finances in addition to procurement of fresh debt at higher cost.

6.0 Servicing of Public Debt

6.1 During 2017-18, public debt servicing was recorded at Rs 1,950 billion against the annual budgeted estimate of Rs 1,689 billion. Total debt servicing increased by around 3 percent during 2017-18 compared with last fiscal year[7] which was driven by higher interest servicing while external debt repayments remained lower than last fiscal year. The interest servicing grew by around 11 percent mainly due to increased borrowing on account of higher than budgeted fiscal deficit, increase in domestic and global interest rates as well as depreciation of Pak Rupee against main international currencies also contributed towards this rise.

Table-3: Public Debt Servicing **(Rs in billion)**

	2017-18			
	Budgeted	**Actual**	**Percent of Revenue**	**Percent of Current Expenditure**
Repayment of External Debt	326.4	450.2	8.6	7.7
Total External Principal Repayment (A)	**326.4**	**450.2**	**8.6**	**7.7**
Servicing of External Debt	132.0	177.3	3.4	3.0
Servicing of Domestic Debt	1,231.0	1,322.6	25.3	22.6
Total Interest Servicing (B)	**1,363.0**	**1,499.9**	**28.7**	**25.6**
Total Servicing of Public Debt (A+B)	**1,689.4**	**1,950.1**	**37.3**	**33.3**

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

7.0 Domestic Debt

7.1 Domestic debt is primarily obtained to finance fiscal deficit while also lending support to Public Sector Development Programme (PSDP). Domestic debt mainly includes borrowing from commercial banks, SBP and through various National Savings Schemes (NSS). Government usually conducts three auctions in the

[7] Total debt servicing was recorded at Rs 1,893 billion while the interest servicing was Rs 1,348 billion during 2016-17

domestic market per month, one for Pakistan Investment Bonds (PIBs) of various maturities (3 years or more) and two auctions for Treasury Bills (T-bills) of maturities of 3, 6, and 12 months. Borrowing from SBP is channeled through Market Related Treasury Bills (MRTBs) while debt from NSS are ongoing process through different schemes to attract funds from retail savers.

7.2 Despite increased net external inflows recorded during 2017-18, the government continued to rely on domestic sources to finance higher than the budgeted fiscal deficit i.e. fiscal deficit financing from domestic sources were 65 percent during 2017-18. Domestic debt witnessed an increase of Rs 1,567 billion or 11 percent during 2017-18 pushing the domestic debt stock to Rs 16,416 billion at end June, 2018. Similar to last year, almost entire increase in domestic debt came from short-term floating debt as the government continued to retire its long-term permanent debt while net mobilization from NSS remained limited. Over last two fiscal years, the government net retirement against PIBs stood at Rs 1.5 trillion. Resultantly, share of medium to long term permanent debt in domestic debt reduced to 28 percent at end June 2018 compared with 37 percent at end June 2017 (44 percent at end June 2016). Similarly, the share of short-term floating debt in domestic debt increased to 54 percent at end June 2018 compared with 44 percent at end June 2017 (37 percent at end June 2016).

7.3 The interest scenario of Pakistan exhibited some reversal after bottoming out of the policy rates which led the banks to reduce the duration on their fixed income portfolio to contain the effects of repricing risk. Banks also kept intact their preference to invest at higher rate given the interest rate expectations, therefore, opted to tilt their portfolio towards short term government securities. In comparison, demand for medium to long term securities was lower and the government was cautious about the cost risk trade-off as market participants were seeking higher than usual rates on these securities.

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

	2008	2013	2014	2015	2016	2017 (P)	2018 (P)	SEP 18 (P)
Permanent Debt	**616.9**	**2,179.0**	**4,003.6**	**5,012.8**	**5,940.6**	**5,533.1**	**4,659.2**	**4,369.2**
Market Loans	3.0	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Government Bonds*	9.9	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Prize Bonds**	182.8	389.6	446.6	522.5	646.4	747.1	851.0	893.2
Foreign Exchange Bearer Certificates	0.2	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	0.0
Federal Investment Bonds	1.0	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	0.1
U.S. Dollar Bearer Certificates	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Special U.S. Dollar Bonds	8.3	4.3	4.2	4.4	4.5	4.5	5.1	5.2
Pakistan Investment Bonds (PIB)***	411.6	1,321.6	3,222.0	4,155.2	4,921.4	4,391.8	3,413.3	3,081.0
GOP Ijara Sukuk	-	459.2	326.4	326.4	363.9	385.4	385.4	385.4
Floating Debt	**1,636.9**	**5,194.9**	**4,599.1**	**4,609.4**	**5,001.7**	**6,550.9**	**8,889.0**	**9,667.8**
Market Treasury Bills***	536.5	2,919.7	1,746.8	2,148.9	2,771.4	4,082.0	5,294.8	4,324.1
MTBs for Replenishment****	1,100.4	2,275.2	2,852.3	2,460.5	2,017.6	2,468.9	3,594.2	5,343.7
Bai Muajjal*****	0.0	0.0	0.0	0.0	212.6	0.0	0.0	0.0
Unfunded Debt	**1,020.4**	**2,146.5**	**2,303.8**	**2,570.3**	**2,683.7**	**2,765.3**	**2,868.1**	**2,882.9**
Defense Saving Certificates	284.6	271.7	284.6	300.8	308.9	325.5	336.2	336.1
National Deposit Certificates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Khass Deposit Certificates	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2
Special Savings Certificates (Registered)	160.3	388.2	445.8	474.3	472.4	433.1	381.9	385.4
Special Savings Certificates (Bearer)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Regular Income Certificates	51.0	262.6	325.4	376.0	359.8	338.8	347.5	361.1
Premium Saving Certificates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Behbood Savings Certificates	229.0	528.4	582.4	628.3	692.1	749.5	794.9	815.5
Short Term Savings Certificates	-	4.0	1.3	1.7	1.9	3.7	4.3	5.0
Khass Deposit Accounts	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Savings Accounts	27.7	22.3	22.6	26.4	30.2	34.9	38.3	38.8
Special Savings Accounts	67.0	346.2	292.7	392.9	423.8	489.0	549.0	514.0
Mahana Amdani Accounts	2.5	2.0	1.9	1.8	1.8	1.7	1.7	1.6
Pensioners' Benefit Account	87.7	179.9	198.4	214.1	234.7	253.4	274.9	281.6
Shuhadas Family Welfare Account	-	-	-	-	-	-	-	0.0
National Savings Bonds	-	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Postel Life Insurance Schemes	67.1	67.1	67.1	67.1	67.1	45.8	46.7	46.4
GP Fund	42.5	73.1	80.5	85.8	90.0	88.8	91.7	96.3
Total Domestic Debt	**3,274.2**	**9,520.4**	**10,906.5**	**12,192.5**	**13,625.9**	**14,849.2**	**16,416.3**	**16,919.8**

P: Provisional
*Special Government Bond for SLIC have been added into Government Bonds.
**Includes Premium Prize Bonds (Registred)
***Govt. Securities held by non-residents deducted from PIB's and T Bills
****Includes outright sale of MRTBs to Commercial Banks and SBP(BSC) holding of MTB's i.e. Rs 0.509 billion
*****Includes Rs 0.013 billion of Treasury Bills on Tap

Source: State Bank of Pakistan

7.4 These challenging market dynamics made it difficult for the government to even refinance its existing medium to long term maturities during 2017-18, let alone raise additional financing from these instruments. Therefore, apart from T-bills, the government had to rely on Central Bank borrowings as net mobilization from NSS also remained limited. Given the situation, the government used SBP borrowing (MRTBs) to generate Rs 2,149 billion of funds in 3rd quarter of 2017-18, a part of which (Rs 1,106 billion) were retired during 4th quarter of 2017-18. Hence, net addition to the central bank's borrowing remained at Rs 1,125 billion during 2017-18 with share of MRTBs increasing to around 22 percent of domestic debt at end June 2018 compared to around 17 percent at end June 2017. Due to these developments, the government could only adhere to its net zero quarterly limit set under the amended SBP Act 1956 during 2nd and 4th quarters of 2017-18.

7.5 Government also recently introduced a Floating Rate Bond with tenor of 10 years. Prudent use of this instrument is likely to mitigate refinancing risk of the government in the present interest rate environment. In addition, issuance of instruments based on asset-lite structure, Bai-Muajjal transactions etc. are also expected to facilitate the utilization of excess liquidity of Islamic Financial Institutions (IFIs). These new products are not only expected to facilitate the IFIs but would also help the government to improve the maturity profile of its domestic debt portfolio. Government also plans to issue negotiable instruments of approximately Rs 100 billion to settle its liabilities related to Drawback of Local Taxes and Levies (DLTL) and pending tax refunds.

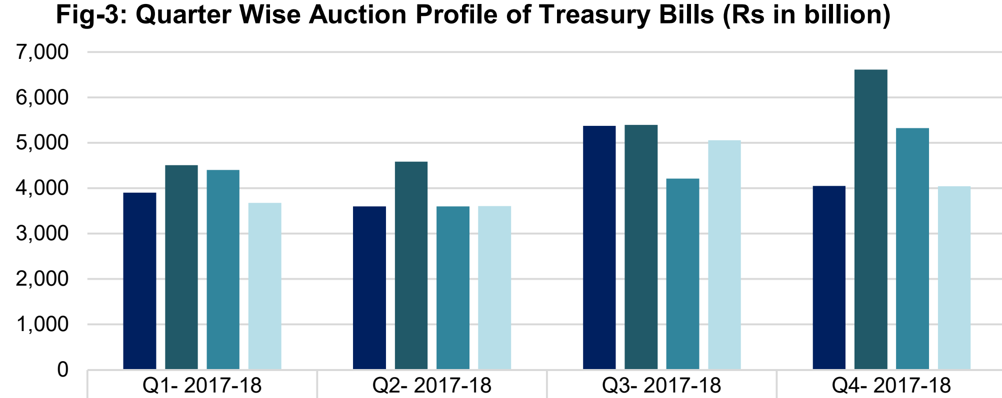
7(i) Quarterly Domestic Borrowing Pattern

7.6 During first quarter of 2017-18, the government met its financing requirements mostly through short-term floating debt instruments, which helped to retire maturing PIBs as both offered and accepted amount in PIBs auctions fell short of the maturity and target set for the said quarter. Limited participation was observed in PIBs auctions owing to rising interest rate expectations whereas T- bills auctions attracted significant participation during first quarter 2017-18.

7.7 Government managed to meet most of its financing requirements from the external sources, and the rest mainly from 3-months T-bills during second quarter of 2017-18. With ongoing expectations of monetary tightening, banks' interest in PIBs auctions remained almost non-existent while substantial amounts were offered in T-bills auctions i.e. offered amount in PIBs auction was only Rs 54 billion while T-bills attracted significant participation of Rs 4,586 billion. Whereas, during first half of 2017-18, the offered amount in PIBs auctions were recorded at Rs 158 billion against the target of Rs 500 billion while Rs 9,098 billion were offered in T-bills auctions against the target of Rs 7,500 billion.

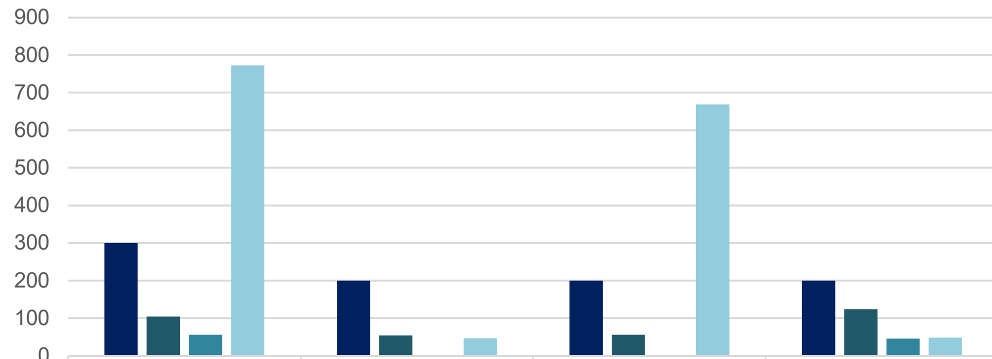
7.8 Continuing the trend observed during the second quarter, banks remained reluctant to invest in medium to long term government securities in anticipation of increase in interest rates. The banks demanded higher rates with meager participation and accordingly all the bids against PIBs auctions were rejected during third quarter of 2017-18. On the other hand, offered amounts in T-bills auctions were mostly in 3-months tenor and that too at relatively higher rates. These factors made it difficult for the government to raise the targeted amount and accordingly government relied on SBP borrowings during third quarter of 2017-18. However, part of this SBP borrowing was retired through funds mobilization from scheduled banks in the last quarter of 2017-18. The following graphs illustrate the auction profile of PIBs and T-bills:

Fig-3: Quarter Wise Auction Profile of Treasury Bills (Rs in billion)



	Q1- 2017-18	Q2- 2017-18	Q3- 2017-18	Q4- 2017-18
Target	3,900	3,600	5,375	4,050
Participation	4,511	4,586	5,396	6,611
Acceptance	4,406	3,601	4,215	5,328
Maturity	3,681	3,605	5,059	4,042

Fig-4: Quarter Wise Auction Profile of PIBs (Rs in billion)

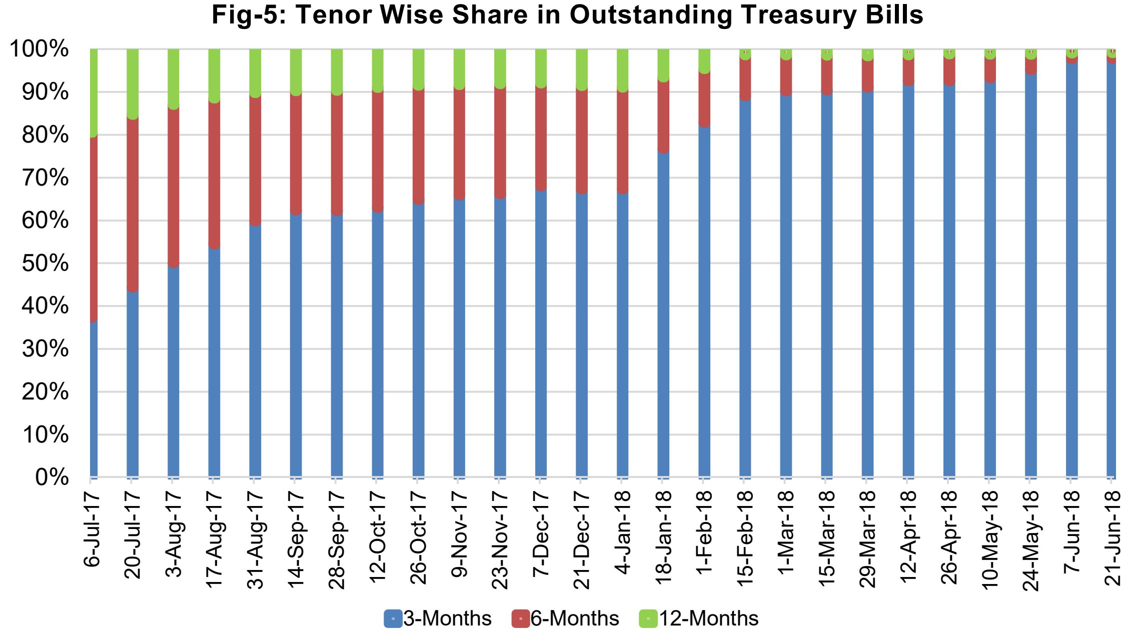


	Q1- 2017-18	Q2- 2017-18	Q3- 2017-18	Q4- 2017-18
Target	300	200	200	200
Participation	104	54	56	124
Acceptance	56	-	-	46
Maturity	773	46	669	48

Target Participation Acceptance Maturity

7.9 Overall, the bidding pattern of market participants congregated towards short-term instruments on back of rising interest rate expectations. Resultantly, the government was mostly able to generate funds via 3-months T-bills as participation for 6-months and 12-months T-bills also remained limited. Accordingly, share of 3-months T-bills in total T-bills portfolio reached around 98 percent at end June 2018 compared with 40 percent at end June 2017 as depicted in the graph below:

Fig-5: Tenor Wise Share in Outstanding Treasury Bills



7(ii) Secondary Market Activities of Government Securities (2017-18)

7.10 Pakistan has a mature and vibrant secondary market in the government debt securities. During 2017-18, the secondary market trading volumes witnessed significant increase. Overall, trading volumes of the government securities almost doubled and reached to Rs 27,557 billion during 2017-18, against Rs 14,779 billion during 2016-17. Accordingly, average daily trading volume and turnover ratio showed significant rise. Daily average volumes increased to Rs 112 billion as against Rs 60 billion in 2016-17 and the turnover ratio surged to 3 times that of outstanding stock from 1.64 times in 2016-17.

Table-5: Secondary Market Outright Trading Volume

(Rs in billion)

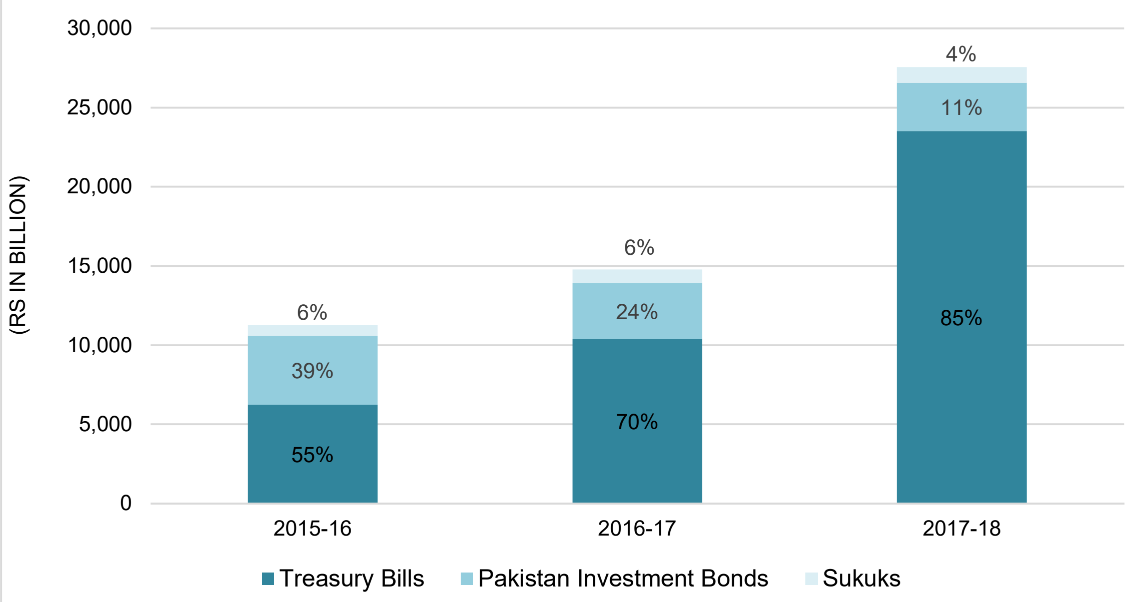
Security	2015-16	2016-17	2017-18
Treasury Bill - 3 Months	1,369	4,954	20,118
Treasury Bill - 6 Months	2,142	3,069	3,147
Treasury Bill - 12 Months	2,720	2,361	258
Sub Total	**6,230**	**10,384**	**23,523**
Pakistan Investment Bonds - 3 Years	2,387	1,480	1,062
Pakistan Investment Bonds - 5 Years	959	1,193	1,031
Pakistan Investment Bonds - 10 Years	1,018	853	928
Pakistan Investment Bonds - 15 Years	3	4	10
Pakistan Investment Bonds - 20 Years	10	19	11
Sub Total	**4,378**	**3,549**	**3,042**
GOP Ijara Sukuk	653	846	992
Grand Total	**11,261**	**14,779**	**27,557**
Daily Average volume	**44.9**	**60.3**	**111.6**
End Period Stock	8,199	8,991	9,175
Turnover Ratio (times)	1.37	1.64	3.00

Source: State Bank of Pakistan

7.11 This significant increase in secondary market trading volumes is mainly attributable to the higher issuances and tradability of short-term T-bills, specifically, the 3-months tenor. Instrument wise, T-bills, which contributed around 85 percent (Rs 23,523 billion) to the overall secondary market trading during 2017-18, have been gaining share as PIBs witnessed significant decline (Figure 6). In terms of volume, 2017-18 witnessed Rs 3,042 billion worth of PIBs changing hands compared to Rs

3,549 billion in 2016-17. The declining trading volume in PIBs is mainly attributable to the lack of fresh issuances and the maturity of some outstanding issuances during the year.

Fig-6: Instrument-Wise Secondary Market Trading Volume and Share



7.12 As for the Ijara Sukuk, though the trading volumes witnessed marginal increase, its share in overall trading volumes of the government securities has declined, which can mainly be attributed to the lack of fresh issuances and scarcity of Shariah compliant instruments.

Repo Market:

7.13 The rising trend of repo transaction volumes continued in 2017-18, as yearly volumes increased to Rs 26,235 billion from Rs 19,609 billion during 2016-17 (Table 6). Much of the repo market volumes are used for day-to-day liquidity management with 77 percent of the market volume concentrated in overnight tenor. The high volumes and increased liquidity in the repo market means that financial institutions can efficiently meet their temporary liquidity needs from the money market.

7.14 Both repo and outright volumes increased significantly in 2017-18. Encouragingly, the share of outright volumes surpassed that of repo, increasing by 8 percent during the year to reach at 51 percent of the market share in 2017-18. The high issuance volume as well as concentrated market liquidity in 3-month T-bills were the main drivers of higher outright trading volumes.

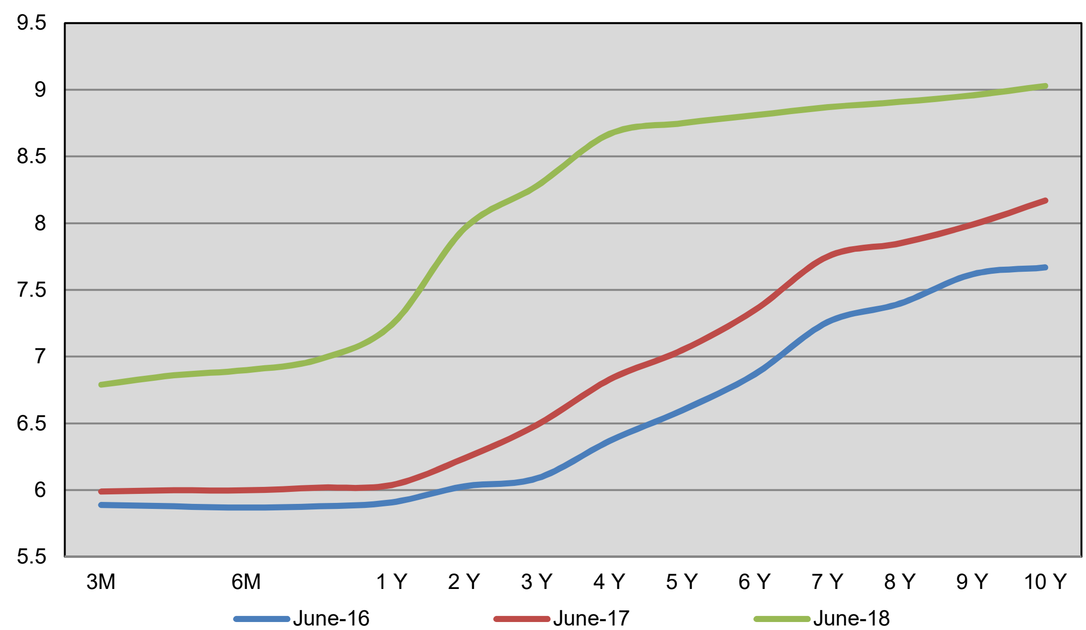
Table-6: Government Security based Transactions

Type	Volume (Rs in billion)			Market Share (%)		
	2015-16	2016-17	2017-18	2015-16	2016-17	2017-18
Repo	13,469	19,609	26,235	54	57	49
Outright	11,261	14,779	27,557	46	43	51
Total	**24,730**	**34,388**	**53,792**	**100**	**100**	**100**

Secondary Market Yield Curve:

7.15 In-line with the market expectations of moderate increase in interest rates during 2017-18, owing mainly to fundamentals, SBP increased its policy rate by 25 and 50 basis points in January and May, 2018, respectively, which resulted in upward shift in the yield curve. Moreover, 1 to 4 years bracket of the yield curve also witnessed some steepening, indicating market expectations of further interest rate hikes for these tenors. The lack of any dampening effect on the transmission of policy rate increases to the long-term interest rates (tenors of 7-year and above) is likely an indicator of the market expecting higher interest rates in future.

Fig-7: Secondary Market Yield Curve (%)



7(iii) Development in Domestic Debt During 2017-18

Permanent Debt:

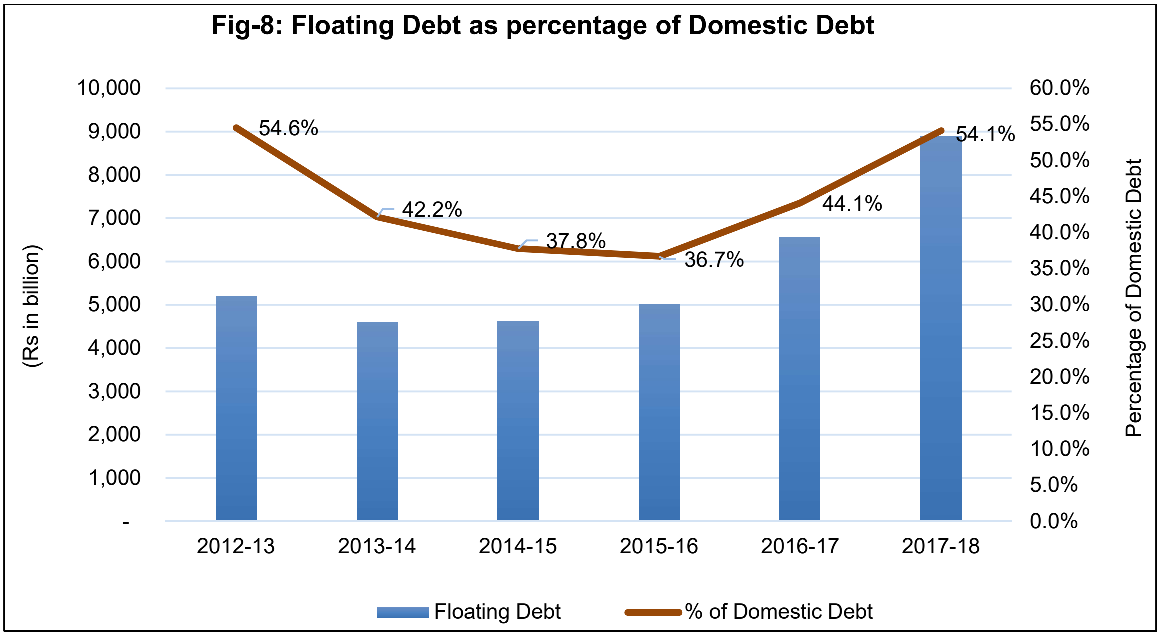
7.16 Permanent debt is mainly characterized into medium to long term debt instruments (Pakistan Investment Bonds, Government Ijara Sukuk and Prize bonds etc.). PIBs have fixed and semi-annual coupon payment with tenors of 3, 5, 10, 20 years. On the other hand, Government Ijara Sukuk are medium term Shariah complaint bonds currently issued in 3 years' tenor to raise money from Islamic financial institutions.

7.17 The permanent debt reached its peak at Rs 5,941 billion in 2015-16. Since then, the share of permanent debt in domestic debt has plummeted i.e. permanent debt stock reduced to Rs 5,533 billion in 2016-17 with further reduction witnessed during 2017-18 to stands at Rs 4,659 billion. Although stock of prize bonds increased by Rs 104 billion during 2017-18, however, net retirement of PIBs amounting to Rs 978 billion contributed towards reduction in permanent debt stock.

Floating Debt:

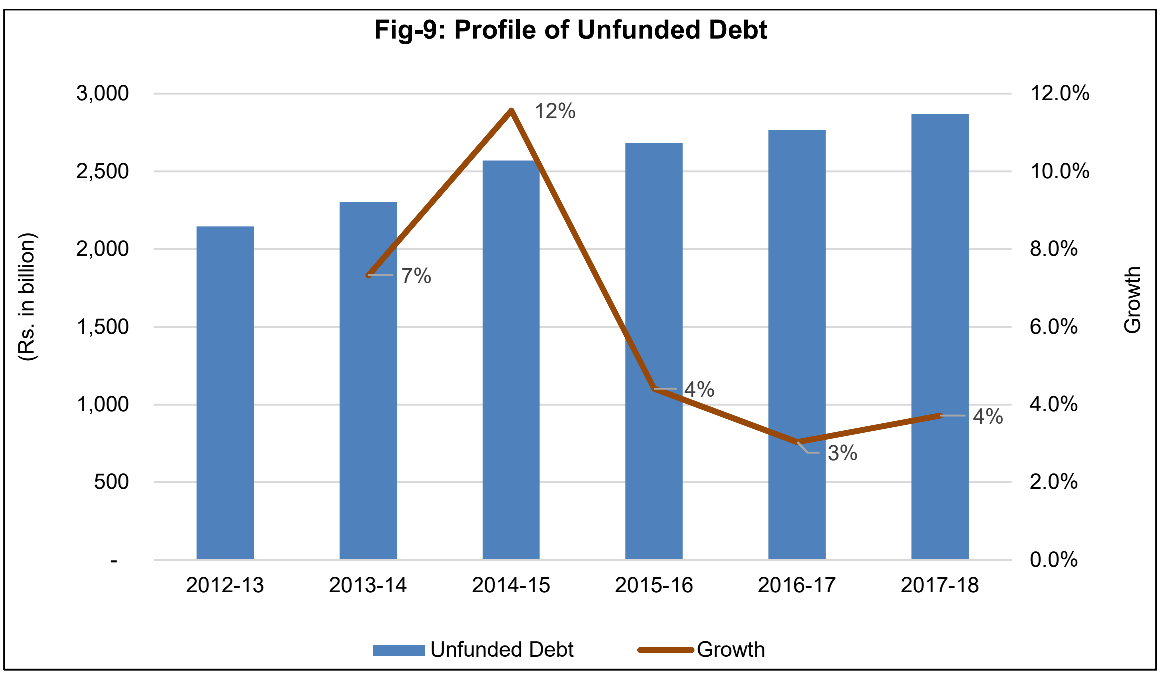
7.18 Floating debt consists of short-term domestic borrowing instruments i.e. Market Treasury Bills and State Bank borrowing through purchase of Market Related Treasury Bills. Market Treasury Bills are discounted or zero-coupon instruments issued in 3-months, 6-months and 12-months. In order to meet the short-term financing needs, the government borrows from domestic banks via auction of Market Treasury Bills, arranged by SBP twice a month.

7.19 Floating debt formed the largest part of domestic debt portfolio at end June 2018 and constituted around 54 percent of total domestic debt (Table 4). It registered a cumulative average annual growth of around 33 percent during last two years as retirement in permanent debt was mainly financed through floating debt. The trend in floating debt stock is depicted through following graph:



Unfunded Debt:

7.20 The stock of unfunded debt (primarily made up of various instruments available under National Savings Schemes) stood at Rs 2,868 billion at end June 2018, constituted around 17 percent of domestic debt portfolio (Table 4). Over the course of last five years, unfunded debt has witnessed moderate increase with declining growth trajectory as depicted in the graph below:

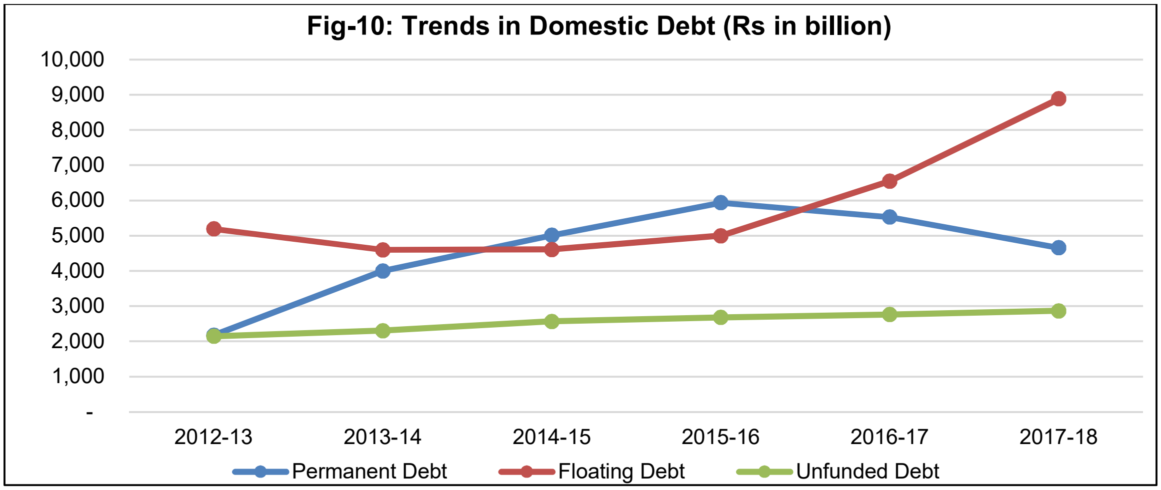


7.21 It is clearly elaborated from the above graph that the growth in unfunded debt reached its peak in fiscal year 2015 after which it has expanded at lower rate. This declining trend may be attributable to lower profit rates and higher withholding tax on non-filers. Net inflows in NSS was recorded at Rs 99 billion in 2017-18, which remains slightly lower than the Rs 104 billion during 2016-17. Within NSS, most of the incremental mobilization came from Behbood Saving Certificates (Rs 45 billion) and Pensioners Benefit Account (Rs 22 billion).

7.22 Over period of time, the government has taken various measures to transform CDNS from merely a retail debt raising arm of the government to an effective vehicle for financial inclusion and provider of social safety net to the vulnerable sections of the society. In this regard, following measures are worth mentioning:

- CDNS is planning to introduce innovative products in order to increase financial inclusion of small savers and contribute towards social safety net of deserving segments of the society. In this respect, Shuhadas' Family Welfare Accounts ("SFWAs") – an extension of Bahbood Savings Certificates ("BSCs") – for family members of martyrs has already been launched while introduction of an exclusive scheme for non-resident Pakistanis is under consideration.
- CDNS also became the only non-banking member of National Institutional Facilitation Technologies (Pvt.) Limited ("NIFT") – the Banking Clearinghouse. With this initiative, profits can be credited directly into investors' bank accounts, thereby offering safety and security along with access to other banking services.

The year wise share of permanent debt, floating debt and unfunded debt in domestic debt portfolio is depicted in the following graph wherein choice of market participants towards short term instruments is evident during last two years:



8.0 External Debt and Liabilities

8.1 Pakistan's External Debt and Liabilities (EDL) represent debt and liabilities of public as well as the private sector. The part of EDL which falls under government domain is debt which is serviced out of consolidated fund and owed to International Monetary Fund. Whereas, remaining includes liabilities of central bank, debt of public sector entities, private sector and banks.

8.2 External public debt is primarily obtained to supplement the domestic resources required to accelerate the pace of economic development and make positive contribution towards developing the country's infrastructure base. The receipts are also used for balance of payment support, reducing domestic borrowing and covering repayment obligations. Overall, external inflows help in building foreign exchange reserves, providing stability to exchange rate vis-à-vis other currencies and help in achieving accelerated economic growth.

8.3 During 2017-18, EDL recorded an increase of US$ 11.9 billion registering at US$ 95.3 billion by end June 2018. Out of this total increase in EDL, external public debt contributed US$ 7.7 billion and stood at US$ 70.2 billion at end June 2018. The increase in external debt and liabilities was mainly on account of burgeoning current account deficit which led to a considerable increase in external financing requirements during 2017-18. In addition, revaluation losses on account of US Dollar depreciation against international currencies also contributed towards the increase in external public debt during 2017-18.

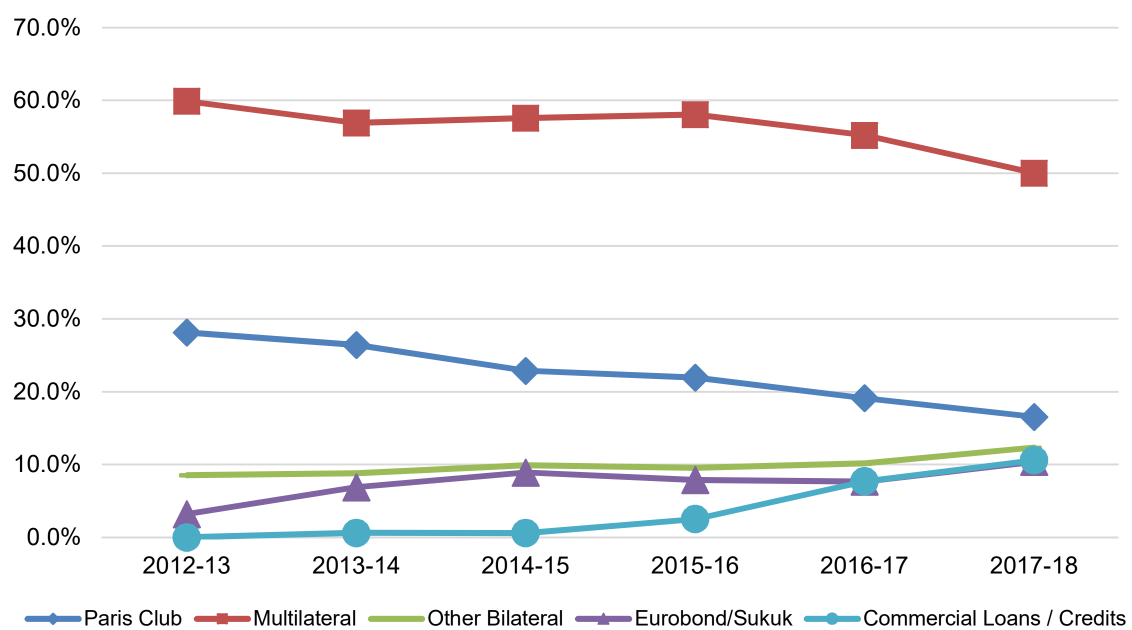
Table-7: Pakistan's External Debt and Liabilities

(US$ in million)	2008	2013	2014	2015	2016	2017 (P)	2018 (P)	SEP 18 (P)
A. Public External Debt (1+2)	**41,782**	**48,139**	**51,460**	**50,964**	**57,757**	**62,539**	**70,237**	**71,344**
1. Government External Debt	**40,445**	**43,752**	**48,440**	**46,861**	**51,714**	**56,430**	**64,142**	**65,382**
i) Long term(>1 year)	**39,722**	**43,488**	**47,709**	**45,849**	**50,026**	**55,547**	**62,525**	**64,061**
Paris Club	13,928	13,548	13,607	11,664	12,678	11,973	11,643	11,498
Multilateral	21,449	24,198	25,826	24,262	26,376	27,605	28,102	27,606
Other Bilateral	1,129	3,939	4,385	4,941	5,445	6,323	8,674	10,831
Euro/Sukuk Global Bonds	2,650	1,550	3,550	4,550	4,550	4,800	7,300	7,300
Military Debt	41	71	36	-	-	-	-	-
Commercial Loans/Credits	120	-	150	300	882	4,826	6,806	6,826
Local Currency Securities (PIBs)	5	2	16	32	35	-	-	-
Saudi Fund for Development (SFD)	-	180	140	100	60	20	-	-
NBP/BOC Deposits	400	-	-	-	-	-	-	-
ii) Short term (<1 year)	**723**	**264**	**731**	**1,012**	**1,688**	**882**	**1,617**	**1,321**
Multilateral	713	256	443	983	1,112	832	961	901
Local Currency Securities (T-bills)	10	8	116	29	1	51	-	-
Commercial Loans/Credits	-	-	173	-	575	-	655	420
2. From IMF	**1,337**	**4,387**	**3,020**	**4,103**	**6,043**	**6,109**	**6,095**	**5,962**
i) Federal Government	-	1,519	655	52	-	-	-	-
ii) Central Bank	1,337	2,868	2,366	4,051	6,043	6,109	6,095	5,962
B. Foreign Exchange Liabilities	**1,296**	**3,106**	**3,281**	**3,709**	**3,600**	**3,564**	**5,121**	**4,996**
i) Central Bank Deposits	1,200	800	700	700	700	700	700	700
ii) Foreign Currency Bonds (NHA / NC)	66	-	-	-	-	-	-	-
iii) Other Liabilities (SWAP)	30	814	1,045	1,612	1,507	1,482	3,022	2,908
iv) Allocation of SDR	-	1,487	1,528	1,390	1,383	1,375	1,390	1,379
v) Nonresident LCY Deposits with Central Bank	-	6	8	7	10	8	9	9
C. Public Sector Enterprises (PSEs)	**1,203**	**1,848**	**2,063**	**2,482**	**2,807**	**2,719**	**2,671**	**2,846**
a. Guaranteed Debt	**196**	**598**	**537**	**970**	**1,265**	**1,214**	**1,384**	**1,337**
Paris Club	-	-	-	-	-	-	-	-
Multilateral	132	30	25	19	11	6	5	5
Other Bilateral	60	568	512	951	1,254	1,208	1,179	1,132
Commercial Loans	4	-	-	-	-	-	200	200
Sandak Metal Bonds	-	-	-	-	-	-	-	-
b. Non-Guaranteed debt	**1,007**	**1,250**	**1,525**	**1,512**	**1,541**	**1,505**	**1,287**	**1,509**
i) Long Term(>1 year)	1,007	638	726	534	466	403	334	511
ii) Short Term (<1 year)	-	612	799	978	1,075	1,102	953	998
D. Banks	**-**	**1,554**	**1,989**	**2,286**	**2,695**	**4,522**	**4,416**	**4,452**
a. Borrowing	-	710	1,080	1,334	1,618	3,303	2,966	3,010
b. Nonresident Deposits (LCY & FCY)	-	843	909	952	1,078	1,220	1,450	1,443
E. Private Sector	**1,880**	**3,143**	**3,076**	**3,011**	**4,073**	**6,759**	**9,071**	**9,240**
F. Debt Liabilities to Direct Investors - Intercompany Debt	**-**	**3,110**	**3,400**	**2,717**	**3,013**	**3,375**	**3,826**	**3,857**
Total External Debt and Liabilities (A+B+C+D+E+F)	**46,161**	**60,899**	**65,268**	**65,170**	**73,945**	**83,477**	**95,342**	**96,735**

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

8.4 Borrowing from commercial sources (foreign commercial banks and Eurobonds/Sukuks) have relatively increased during the last few years, however, external public debt still largely comprises multilateral and bilateral sources which cumulatively constitute 79 percent of external public debt portfolio at end June 2018. These multilateral and bilateral loans are contracted at concessional terms (low cost and longer tenor) and are primarily utilized to remove structural growth anomalies and promote reform in the areas of energy, taxation, business, trade and education. The trend in external public debt profile is depicted through following graph:

Fig-11: Source Wise Profile of External Public Debt



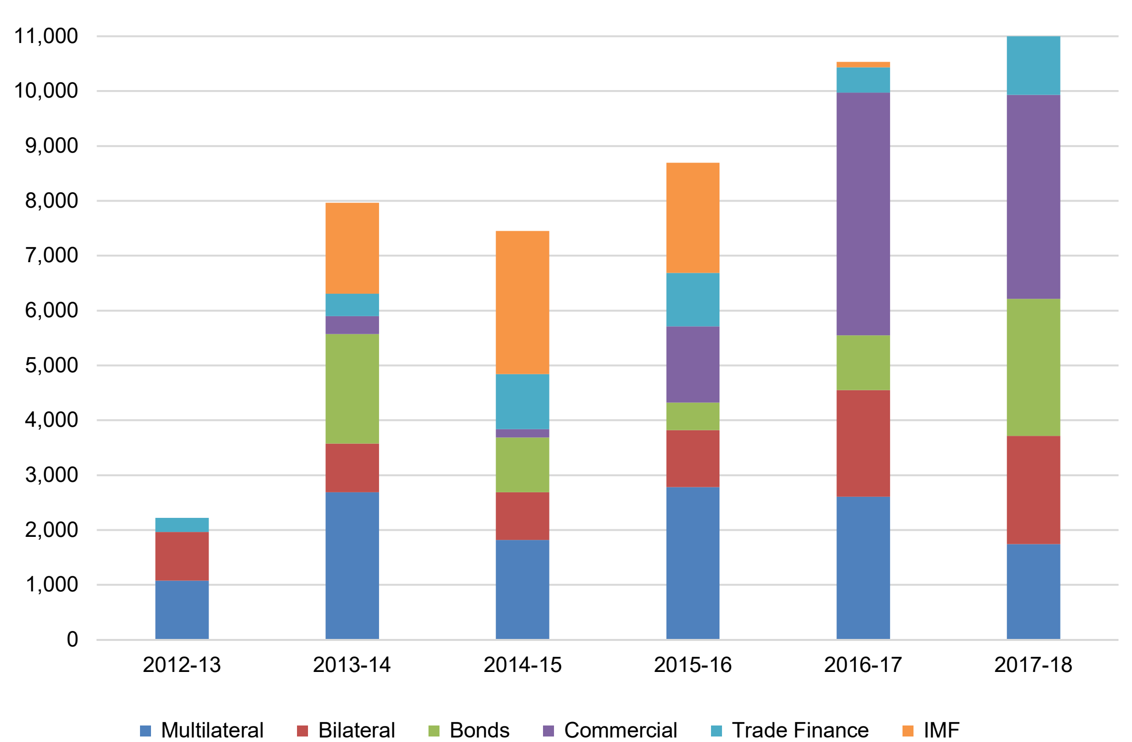
8.5 As depicted in the above graph, Pakistan's reliance on commercial sources to finance external financing needs has relatively increased during past few years and correspondingly the floating portion of external public debt has inched up to 28 percent in 2018 compared with 17 percent in 2015 (Table 11). The increase in floating portion of external public debt portfolio may pose some challenges going forward as international interest rates have started to exhibit upward trend. This rising interest rate scenario coupled with country's increased reliance on commercial sources may not only result in higher re-fixing risk but also increase the debt servicing in coming years.

8 (i) - Analysis of External Public Debt Inflows and Outflows

8.6 Gross external disbursements were US$ 11,000 million while commitments were US$ 10,654 million during 2017-18. The details of gross external inflows from main sources are as follows:

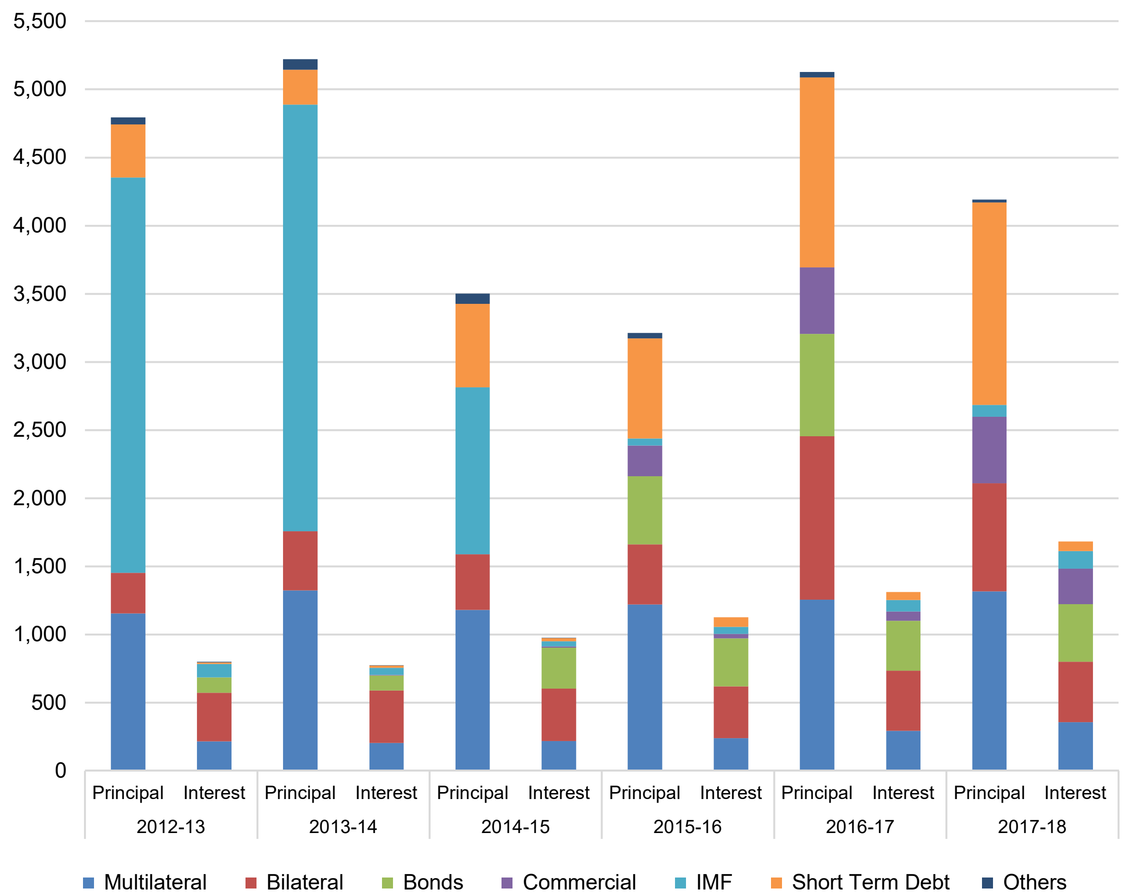
- Foreign commercial loans remained the main contributor in gross external disbursements with a share of 34 percent or US$ 3,716 million. Government also raised US$ 2,500 million through a 5-year Sukuk and 10-year conventional Eurobonds. Increased borrowing from commercial sources primarily reflects requirements arising from financing of increasing current account deficit;
- Disbursements from bilateral sources stood at US$ 1,971 million out of which China contributed US$ 1,810 million; and
- Government mobilized US$ 1,744 million from multilateral sources largely for energy and infrastructure projects while disbursement against trade finance facility stood at US$ 1,069 million.

Fig-12: Source Wise Gross External Inflows (US$ in million)



8.7 External public debt servicing declined to US$ 5,874 million during 2017-18 compared with US$ 6,440 million in the preceding fiscal year. Although interest payments increased during 2017-18, however, it was more than compensated by lower principal repayments primarily due to absence of Eurobonds repayment in 2017-18 as Pakistan repaid Eurobonds amounting to US$ 750 million in 2016-17. Whereas, higher interest payments were mainly driven by sovereign bonds, bilateral, multilateral and commercial borrowings. Importantly, the interest payment on external public debt has increased significantly during last few years which may be attributed to higher external borrowings from commercial sources and rise in the global benchmarks rates.

Fig-13: Source Wise Debt Servicing (US$ in million)



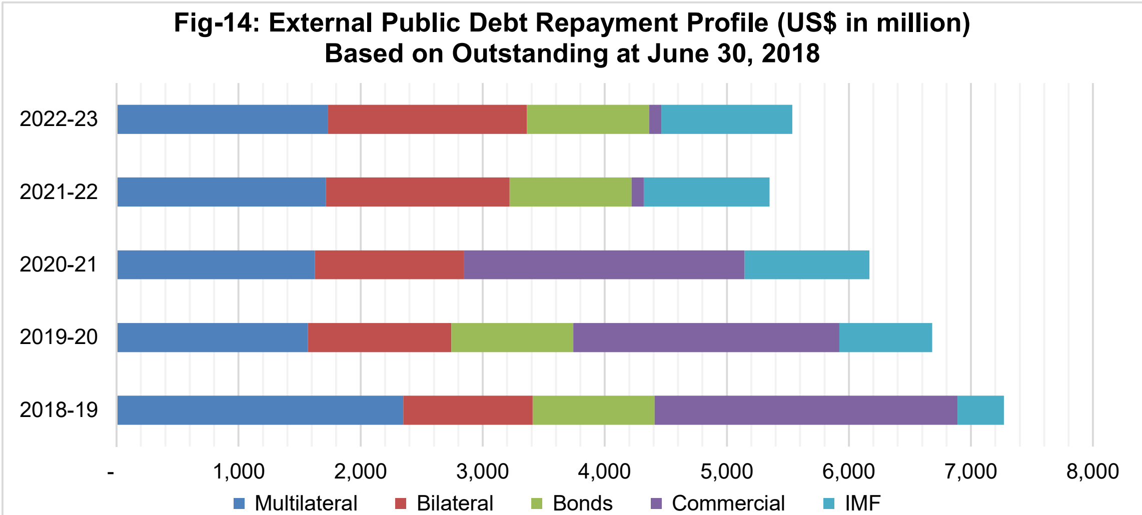
The source wise details of external public debt inflows and outflows over last few years are depicted in the table below:

Table-8: Source Wise External Inflows and Outflows

(US$ in million)	2013	2014	2015	2016	2017	2018
DISBURSEMENTS						
Multilateral	1,076	2,687	1,819	2,782	2,608	1,744
Bilateral	889	887	867	1,040	1,941	1,971
Bonds	-	2,000	1,000	500	1,000	2,500
Commercial	-	323	150	1,387	4,426	3,716
Trade Finance	256	409	1,005	975	456	1,069
IMF	-	1,656	2,611	2,009	102	-
Total Inflows (A)	**2,221**	**7,962**	**7,452**	**8,693**	**10,533**	**11,000**
REPAYMENTS						
Multilateral	1,155	1,324	1,181	1,221	1,255	1,317
Bilateral	299	435	407	440	1,200	793
Bonds	-	-	-	500	750	-
Commercial	-	-	-	225	489	489
IMF	2,899	3,130	1,226	53	-	86
Short Term Debt	390	256	612	735	1,393	1,486
Others	52	76	76	40	40	20
Total Repayments (B)	**4,795**	**5,220**	**3,500**	**3,213**	**5,127**	**4,190**
Net Inflows (A-B)	**(2,574)**	**2,742**	**3,952**	**5,480**	**5,406**	**6,809**
INTEREST PAYMENTS						
Multilateral	217	204	219	239	295	357
Bilateral	357	386	385	380	441	444
Bonds	111	111	300	354	366	423
Commercial	0	4	9	33	66	260
IMF	100	52	39	51	86	128
Short Term Government Debt	11	16	22	69	58	72
Others	4	3	1	0	0	0
Total Interest Payments (C)	**800**	**775**	**975**	**1,127**	**1,313**	**1,684**
Total Debt Servicing (B+C)	**5,595**	**5,995**	**4,475**	**4,340**	**6,440**	**5,874**

Source: Economic Affairs Division and State Bank of Pakistan

The projected external public debt repayments based on outstanding at June 30, 2018 is presented through the graph below:



8 (ii) - Currency Movements and Revaluation Impact

8.8 In Pakistan, external loans are contracted in various currencies, however, disbursements are effectively converted into Pak Rupee. Since Pak Rupee is not an internationally traded currency, other international currencies are bought and sold via selling and buying of US Dollar. Hence, the currency exposure of foreign debt originates from two sources: US Dollar/other foreign currencies and Pak Rupee/US Dollar. Thus, any movement in international currencies (in which debt is contracted) and PKR vis US Dollar can change the dollar and Pak Rupee value of external debt respectively.

8.9 In addition to net external inflows, revaluation losses on account of depreciation of US Dollar against international currencies as well as appreciation of US Dollar against Pak Rupee contributed towards increase in external debt stock during 2017-18 as per the following details:

- Revaluation losses owing to depreciation of US Dollar against other international currencies added around US$ 0.5 billion to external public debt. It is important to note that revaluation losses reduced from around US$ 2.0 billion (July 2017-March 2018) to around US$ 0.5 billion due to strengthening of US dollar against major currencies in last quarter of 2017-

18. Specifically, the Japanese Yen and Special Drawing Rights (SDR) – comprised around 44 percent of external public debt portfolio at end June 2018 – depreciated by 4.1 and 3.4 percent during fourth quarter of 2017-18, against appreciation of 5.2 and 4.3 percent during July 2017 - March 2018 respectively; and

- In Pak Rupee terms, around Rs 1.2 trillion was added due to depreciation of Pak Rupee against US Dollar. Thereby, out of total increase of Rs 2 trillion witnessed in external public debt stock during 2017-18, around 59 percent was on account of revaluation losses.

8 (iii) - Performance of Emerging Markets and Pakistan:

8.10 In the course of 2018, most Emerging Market assets remained under pressure. The continued trade tensions, appreciation of the Dollar and reduced economic growth forecasts caused significant capital outflows from emerging markets which has been exacerbated by a generalized investors' risk-avoidance. The interest rates environment remained volatile, particularly in earlier period of 4th quarter of 2018 with 10-year US Treasury yields increased above 3.2 percent for the first time in seven years. Nevertheless, the US curve remains flat with the historically lowest differential between short end (2 years) and long end (7/10 years).

8.11 In-line with the sovereign peer group, Pakistan's secondary trading spreads have widened compared to January 2018 with the yield curve moving up by 1.5-1.7 percent on average. At the same time, despite an overall widening, Pakistani bonds have outperformed the Emerging Market Bond Index (EMBI).

Table-9: Pakistan Sovereign Bonds - Secondary Trading Levels

Bond	Ratings			Maturity	Size	Coupon	Yield
	M	S&P	F		(US$ in million)	(%)	(%)
Eurobond	B3	B	B	April-19	1,000	7.250	6.955
Sukuk	B3	B	B	December-19	1,000	6.750	6.766
Sukuk	B3	--	B	October-21	1,000	5.500	6.701
Sukuk	B3	B	--	December-22	1,000	5.625	6.882
Eurobond	B3	B	B	April-24	1,000	8.250	7.830
Eurobond	B3	--	B	September-25	500	8.250	7.919
Eurobond	B3	B	--	December-27	1,500	6.875	8.258
Eurobond	B3	B	B	March-36	300	7.875	8.980

Source: Bloomberg, November 19th 2018

8 (iv) - External Debt Sustainability

8.12 A country can achieve external debt sustainability if it can meet its current and future external debt service obligations, without debt rescheduling, accumulation of arrears and without compromising growth. Strong external position of a country carries favorable market perception and creditworthiness which invariably encourages foreign investment.

8.13 There are two principal indicators or ratios which assess the external debt sustainability; (i) solvency indicators and (ii) liquidity indicators. Solvency indicator such as external debt-to-GDP ratio shows debt bearing capacity while liquidity indicators such as external debt servicing to foreign exchange earnings ratio shows debt servicing capacity of the country.

Table-10: External Debt Sustainability Indicators

(In percent)	2013	2014	2015	2016	2017	2018
ED/FEE (times)	1.0	1.0	1.0	1.1	1.2	1.3
ED/FER (times)	4.4	3.6	2.7	2.5	2.9	4.3
ED/GDP (Percentage)	21.3	20.2	18.9	20.8	20.5	24.8
ED Servicing/FEE (Percentage)	11.1	11.7	8.5	8.5	12.4	10.8
EDL/GDP (Percentage)	27.0	25.6	24.2	26.6	27.4	33.7
FER/EDL (Percentage)	18.1	21.7	28.7	31.2	25.6	17.2

FEE: Foreign Exchange Earnings; ED: External Public Debt; FER: Foreign Exchange Reserves, EDL: External Debt and Liabilities
Source: State Bank of Pakistan and Debt Policy Coordination Office, Ministry of Finance
Note: Above ratios are calculated based on US Dollar amounts.

8.14 External public debt to GDP ratio grew to 24.8 percent at end June 2018 compared with 20.5 percent at end June 2017, depicting increased external debt burden. This increase in external public debt may be attributed to net external public debt inflows as well as revaluation losses owing to depreciation of US Dollar against other international currencies. Similarly, EDL to GDP ratio increased from 27.4 percent at end June 2017 to 33.7 percent at end June 2018 which also accounts for increase in net private sector inflows, foreign exchange liabilities in addition to external public debt.

8.15 Some relief was realized from liquidity standpoint, where external debt servicing to foreign exchange earnings ratio decreased to 10.8 percent in 2017-18 from 12.4 percent in 2016-17 owing to lower principal payments while moderate growth witnesses in FEE during the year. However, relatively higher growth in external public debt stock pushed the ED/FEE ratio to 1.3 times during 2017-18 compared with 1.2 times during preceding fiscal year.

8.16 Assessment of external public debt in terms of country's foreign exchange reserves depicts a deteriorating external debt coverage as widening of current account deficit continues to deplete foreign exchange reserves. During 2017-18, ED/FER recorded at 4.3 times, registering a significant increase from 2.9 times during 2016-17.

8.17 Stagnation of exports over last few years primarily due to bottlenecks in the energy and infrastructure continue to exert pressure on the country's liquidity situation. Exports are predominant source of foreign exchange earnings which on one hand provide coverage towards interest servicing while also lending support towards building-up of foreign exchange reserves. Over last few years, negative trend has been observed in exports while imports have exhibited significant growth. Although other income including worker's remittances witnessed moderate growth, however, it could not keep pace with imports resulting in widening of the current account deficit and erosion of foreign exchange reserves. These factors contributed towards deterioration in debt bearing capacity of the country as FER to EDL ratio reduced to 17.2 percent during 2017-18 from 31.2 percent in 2015-16.

9.0 Progress on Medium Term Debt Management Strategy (2015/16 - 2018/19)

9.1 Government updated its Medium Term Debt Management Strategy for the period of four (4) years (2015/16-2018/19). In accordance with approved strategy, the government was required to lengthen the maturity profile of its domestic debt and mobilize sufficient external inflows in the medium term keeping in view cost risks tradeoff while remaining within the indicative ranges as specified under the MTDS.

Table-11: Public Debt Cost and Risk Indicators*

Risk Indicators		Indicative Ranges (MTDS 2015/16 - 2018/19)	External Debt		Domestic Debt		Public Debt	
			2013	2018	2013	2018	2013	2018
Refinancing Risk	Average Time to Maturity (ATM) - Years	1.5 (minimum) and 2.5 - DD 3.0 (minimum) and 4.5 - PD	10.1	7.6	1.8	1.6	4.5	3.6
	Debt Maturing in 1 Year (% of total)	50% and 65% (maximum) - DD 35% and 50% (maximum) - PD	8.9	12.4	64.2	66.3	46.0	48.9
Interest Rate Risk	Average Time to Re-Fixing (ATR) - Years	1.5 (minimum) and 2.5 - DD 3.0 (minimum) and 4.5 - PD	9.2	6.6	1.8	1.6	4.2	3.2
	Debt Re-Fixing in 1 year (% of total)	50% and 65% (maximum) - DD 40% and 55% (maximum) - PD	22.2	32.2	67.2	66.6	52.4	55.5
	Fixed Rate Debt (% of total)	**	83.4	72.5	39.6	44.3	54.0	53.4
Foreign Currency Risk (FX)	Foreign Currency Debt (% of total debt)	20% (minimum) and 35%					32.9	32.2
	Short Term FX Debt (% of reserves)	**					68.5	80.6

* As per modalities of MTDS (2015/16 - 2018/19)
**Not Applicable
PD: Public Debt, DD: Domestic Debt
Source: Debt Policy Coordination Office, Ministry of Finance

9.2 Government remained within the said thresholds till end December 2017, however, at end June 2018, three (3) of the nine (9) thresholds were marginally breached ranging from 0.5 percent to 1.6 percent as per the following details:

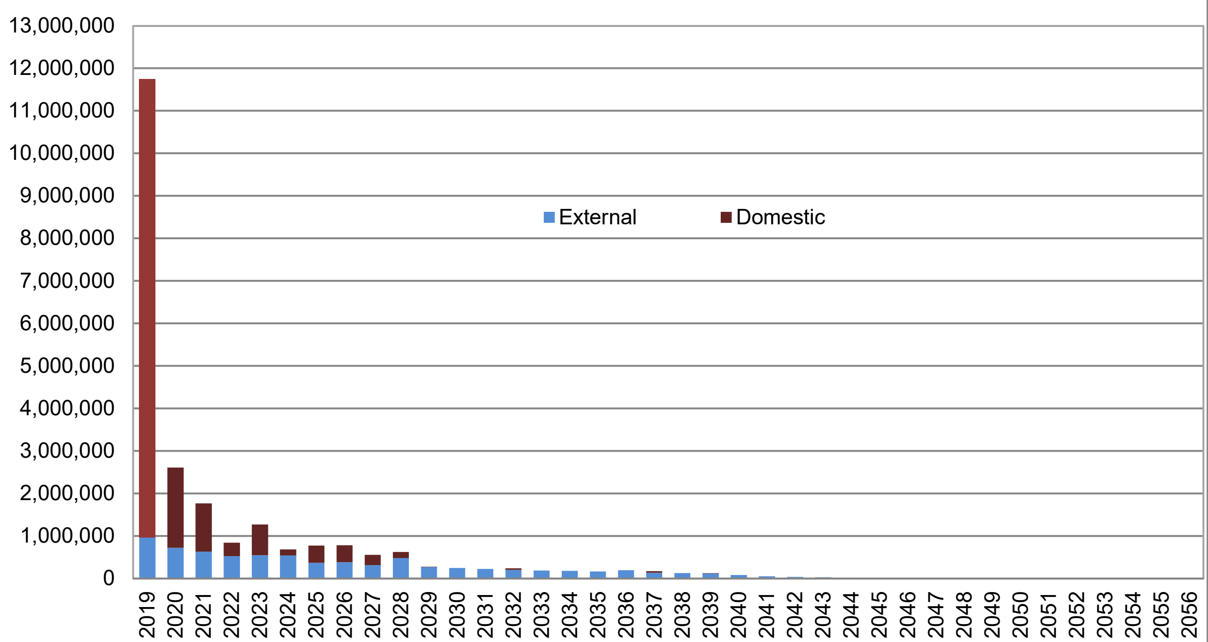
I. The upper range for the risk indicator “Domestic Debt Maturing Within a Year” was 65 percent while this indicator at end June 2018 reached at 66.3 percent. It was due to subdued demand of banks towards medium to long term government securities in anticipation of change in the interest rates, inflation and liquidity conditions;

II. Similarly, upper range for “Domestic Debt Re-Fixing in 1 Year” and “Public Debt Re-Fixing in 1 Year” was envisaged at 65 percent and 55 percent respectively while these indicators stood at 66.6 percent and 55.5 percent at end June 2018. Borrowings through short term T-bills/MRTBs (which requires interest rate re-fixing in short term) as well as borrowing contracted from foreign commercial banks on floating rates (mainly to fund foreign debt maturities and to finance the rising current account deficit) led these indicators to surpass the defined thresholds;

III. Although no threshold was defined for “ST FX debt maturity (percentage of official liquid reserves), however, this indicator witnessed deterioration from 34.5 percent at end December 2017 to 80.6 percent at end June 2018. This sharp increase is mainly attributed to decline of official liquid reserves by around US$ 4.3 billion during January 2018 to June 2018 and ensuing maturities of long term debt falling within a year such as Eurobond (US$ 1 billion), short term commercial Loans (US$ 2.5 billion) along with other scheduled external debt obligations.

9.3 Overall, public debt indicators witnessed some unfavorable changes as borrowing requirements were mainly met through T-bills/MRTBs and commercial borrowings during 2017-18 which not only have shorter maturities but also carry re-fixing risk as these loans were mostly contracted on floating rates. The maturity profile of public debt at end June 2018 is depicted through following graph:

Fig:15 - Redemption Profile of Public Debt
(Rs in million) - As at end June 2018



9.4 Around 32 percent[8] of total public debt stock was denominated in foreign currency exposing public debt portfolio to exchange rate risk. Currency wise composition of public debt portfolio is depicted through table below:

Table-12: Currency Wise Public Debt

Currencies	Percentage
Pak Rupee	67.8
US Dollar	17.3
Special Drawing Right	8.8
Japanese Yen	4.0
Euro	2.1
Total	**100.0**

Source: Debt Policy Coordination Office, Ministry of Finance

10.0 Guarantees

10.1 In Pakistan, guarantees are generally 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 fulfil the requirement where sovereign guarantee is a precondition for concessional loans from bilateral/multilateral agencies to sub sovereign borrowers.

10.2 The volume of new government guarantees issued during a financial year is limited under Fiscal Responsibility and Debt Limitation Act which stipulates that the government shall not give guarantees aggregating to an amount exceeding 2 percent of the GDP in any financial year including those for rupee lending, rate of return, outright purchase agreements and other claims and commitments provided the renewal of existing guarantees shall be considered as issuing a new guarantee. The limit of 2 percent of the GDP is applicable on guarantees issued both in local and foreign currencies.

[8] As per modalities of MTDS

10.3 During 2017-18, the government issued fresh/rollover guarantees aggregating to Rs 324 billion or 0.94 percent of GDP compared with Rs 599 billion issued during 2016-17. Whereas, the outstanding stock of government guarantees increased to Rs 1,236 billion at end June 2018 compared with Rs 937 billion at the end of preceding fiscal year. The outstanding stock of government guarantees along with guarantees issued during 2017-18 is shown in the tables below:

Table-13: Guarantees Outstanding as on June 30, 2018 (Rs in billion)

Outstanding guarantees extended to PSEs	**1,236**
-Domestic Currency	1161
-Foreign Currency	76
Memo:	
Foreign Currency (US$ in million)	622

Source: Debt Policy Coordination Office, Ministry of Finance

Table-14: Entity Wise New Guarantees Issued (2017-18) - (Rs in billion)

Name of Organization	Amount
PHPL	202
WAPDA	80
PIACL	36
Wah Brass Mills	6
Total	**324**
In percent of GDP	**0.94**

Source: Debt Policy Coordination Office, Ministry of Finance

10.4 Guarantees issued against commodity operations are secured against the underlying commodity which are essentially self-liquidating on short term basis and thus should not create a long term liability for the government. These guarantees are issued against the commodity financing operations undertaken by TCP, PASSCO and provincial governments. The outstanding stock of guarantees issued against commodity operations were Rs 875 billion at end June 2018.

10.5 During first quarter of 2018-19, the government issued fresh/rollover guarantees aggregating to Rs 70 billion while outstanding stock of government guarantees at end September, 2018 was Rs 1,254 billion.

Table-15: Guarantees Outstanding as on September 30, 2018 (Rs in billion)

Outstanding guarantees extended to PSEs	**1,254**
-Domestic Currency	1,195
-Foreign Currency	59
Memo:	
Foreign Currency (US$ in million)	475

Source: Debt Policy Coordination Office, Ministry of Finance

11.0 Report on Compliance with FRDL Act 2005

11.1 The FRDL Act, 2005 requires that the federal government take measures to reduce federal fiscal deficit and total public debt to maintain it within prudent limits thereof. The following sections identifies the various limits prescribed by the FRDL Act, and reports on progress thereof.

(1) limiting of Federal fiscal deficit excluding foreign grants to four percent of gross domestic product during the three years, beginning from the financial year 2017-18 and maintaining it at a maximum of three and a half percent of the gross domestic product thereafter;

The federal fiscal deficit (excluding grants) was recorded at Rs 2,243 billion or 6.5 percent of GDP during 2017-18, thus, remained higher than the threshold of 4 percent.

(2) ensuring that within a period of two financial years, beginning from the financial year 2016-17, the total public debt shall be reduced to sixty percent of the estimated gross domestic product;

Total public debt and total debt of the government as percentage of GDP stood at 72.5 percent and 67 percent respectively at end June 2018, thus, remained higher than the 60 percent threshold.

(3) ensuring that within a period of five financial years, beginning from the financial year 2018-19 total public debt shall be reduced by 0.5 percent every year and from 2023-24 and going upto financial year 2032-33 a reduction of 0.75 percent every year to reduce the total public debt to fifty percent of the estimated gross domestic product and thereafter maintaining it to fifty percent or less of the estimated gross domestic product; and";

The debt reduction path in terms of GDP has been envisaged after 2017-18 to reduce the public debt to GDP ratio to 50 percent by 2032-33 and thereafter maintaining it at or below that level.

(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 2017-18, the government issued new guarantees including rollovers amounted to Rs 324 billion or 0.94 percent of GDP.

12.0 Conclusion

12.1 Lower growth in revenue compared to government expenditure and increased dependence on imports to meet growing domestic demand led to widening of twin deficits during 2017-18. The increase in imports pushed the current account deficit to a historic high which exerted pressure on foreign exchange reserves and exchange rate. Similarly, fiscal deficit reached its highest level during last five years. These developments contributed towards higher debt burden of the country. Accordingly, the government could not fully comply with the provisions of FRDL Act 2005 in 2017-18.

12.2 Government is committed to achieve the targets outlined in FRDL Act, 2005 for public debt management. From debt management standpoint, prime objectives remain: (i) strengthening of debt management functions; (ii) fulfill financing needs of the government at the lowest possible cost; (iii) broadening of the investor base through active involvement of other channels (Islamic banks, mutual funds, institutions and foreign investors) to reduce reliance on domestic bank borrowing; (iv) have a well-functioning domestic debt capital market; (v) lengthening of maturity profile of domestic debt through enhanced mobilization from medium to long term securities to reduce re-financing and interest rate risks; and (vi) mobilization of maximum available concessional external financing.

12.3 Given, the prevalent economic situation, it is important for the government to embark upon a policy for fiscal consolidation for debt reduction while concurrently implementing structural reforms to boost potential growth leading to economic revival. Accordingly, a multipronged strategy is being pursued with a focus to substantially increase tax revenues and country's foreign exchange earnings. At the same time, reducing unnecessary expenditures with curtailment of losses of public sector enterprises is also being pursued to bring down the deficit, which contributes to higher borrowing and resultant indebtedness. Government has set up a task force to expedite institutional reform and promote austerity to reduce the non-development and non-productive spending. All these measures are expected to reduce the debt burden of the country in the medium term.

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