

# DEBT POLICY STATEMENT

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**2019-20**



Debt Policy Coordination Office  
Ministry of Finance



# **Debt Policy Statement 2019-20**

**Debt Policy Coordination Office  
Ministry of Finance  
Government of Pakistan**

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### 1.0 Introduction

- 1.1 Government borrowing remains vital part of financing mechanism for developing countries like Pakistan. Most economies world-wide rely on debt inflows to fulfill the shortfall in available resources to fund the government budget. Borrowed funds are at times also required for resource-intensive infrastructure projects which are geared towards facilitating economic growth and achieving social development goals. Therefore, both domestic and external debt provide a way for the economies to balance their financing needs.
- 1.2 Government inherited extremely challenging macroeconomic situation marked by high fiscal deficits and debt levels. The situation further exacerbated due to decrease in foreign exchange reserves which contributed to a sharp devaluation of Pakistani Rupee and inflationary pressure which in-turn led to a tight monetary policy stance significantly increasing the domestic debt servicing cost.
- 1.3 Public debt witnessed various developments during FY 2018-19 and first half of FY 2019-20, some of them are highlighted below:
- Public debt as percentage of GDP was recorded at 84.8 percent at end June 2019 compared with 72.1 percent at end June 2018. This increase was primarily due to the build-up of liquidity buffers and higher exchange rate depreciation;
  - Government reached an agreement with the International Monetary Fund (IMF) in July 2019 for a US\$ 6 billion Extended Fund Facility (EFF). The disbursements under EFF would be available for the government as budgetary resource;
  - Government re-profiled the existing stock of State Bank of Pakistan (SBP) borrowing from short term (6 months) to medium to long term (1 to 10 years) with the target to retire it completely over a period of 10 years;
  - Government introduced Pakistan Banao Certificates (PBC) which is a US Dollar denominated retail instrument, for Pakistanis having an overseas bank account. PBC is the first sovereign retail instrument being offered by Government of Pakistan that allow overseas Pakistanis to contribute

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towards their country's development while providing an attractive investment opportunity to earn reasonable returns;

- The Rs 40,000 denomination prize bonds were withdrawn from circulation in order to improve the documentation of the economy;
- As part of the government's efforts to adopt fiscal discipline, government is not borrowing from SBP since July 2019;
- Yields on government bonds are declining since August 2019 in the range of 1 to 2.5 percent per annum despite increase in policy rate by 1 percent during July 2019. This indicates the confidence of market participants in government policies and the expectations of lower inflation and interest rates going forward;
- During first half of FY 2019-20, over 90 percent of incremental domestic borrowing was through long term bonds and saving schemes. On external public debt front, the net external borrowing primarily comprised concessional loans from multilateral / bilateral sources while there was net retirement of commercial bank loans / Eurobonds;
- Foreign investors took keen interest in government securities during first half of FY 2019-20, as they made investments worth US\$ 1.5 billion. This is a positive development as foreign portfolio investment in government securities has been very low historically. Government strategy is to encourage foreign portfolio investments. This will enhance the liquidity and competition in domestic capital markets which in turn is expected to lower borrowing cost of the government, decrease government's reliance on domestic resources and reduce the crowding out effect.

- 1.4 Over the medium term, the government's objective is to bring and maintain its Public Debt-to-GDP and Debt Service-to-Revenue ratios to sustainable levels through a combination of greater revenue mobilization, rationalization of current expenditure and efficient/productive utilization of debt.



### 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 helps the government to accomplish its social and developmental goals. However, 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

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- 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 has a charge on budget and must be serviced through government revenues and/or additional borrowings whereas external debt, in addition to charge on revenues, also carry a charge on balance of payments and must be serviced from foreign exchange earnings, reserve drawdown and / or 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.
- 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.

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### 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 Summary**

(Rs in billion)	FY13	FY14	FY15	FY16	FY17	FY18	FY19	SEP 19 (P)
I. Government Domestic Debt	9,520	10,907	12,193	13,626	14,849	16,416	20,732	22,650
II. Government External Debt	4,336	4,786	4,770	5,418	5,919	7,796	11,055	10,598
III. Debt from IMF	435	298	418	633	641	741	921	993
IV. External Liabilities <sup>1</sup>	308	324	378	377	374	622	1,710	1,619
V. Private Sector External Debt	466	500	539	709	1,183	1,654	2,465	2,378
VI. PSEs External Debt	183	204	253	294	285	325	654	601
VII. PSEs Domestic Debt	312	366	459	568	823	1,068	1,394	1,392
VIII. Commodity Operations <sup>2</sup>	470	492	564	637	687	820	756	741
IX. Intercompany External Debt from Direct Investor abroad	308	336	277	316	354	437	535	518
<b>A. Total Debt and Liabilities (sum I to IX)</b>	<b>16,338</b>	<b>18,214</b>	<b>19,849</b>	<b>22,577</b>	<b>25,114</b>	<b>29,879</b>	<b>40,223</b>	<b>41,489</b>
<b>C. Total Public Debt (sum I to III)</b>	<b>14,292</b>	<b>15,991</b>	<b>17,380</b>	<b>19,677</b>	<b>21,409</b>	<b>24,953</b>	<b>32,708</b>	<b>34,241</b>
<b>D. Total Debt of the Government<sup>3</sup></b>	<b>13,457</b>	<b>14,624</b>	<b>15,986</b>	<b>17,823</b>	<b>19,635</b>	<b>23,024</b>	<b>29,521</b>	<b>29,300</b>
<b>(As percent of GDP)</b>								
Total Debt and Liabilities	73.0	72.4	72.3	77.6	78.7	86.3	104.3	94.3
Total Public Debt	63.8	63.5	63.3	67.7	67.1	72.1	84.8	77.8
Total Debt of the Government	60.1	58.1	58.3	61.3	61.5	66.5	76.6	66.6
<b>Memorandum Items</b>								
GDP (current market price)	22,386	25,169	27,443	29,076	31,922	34,619	38,559	44,003
Government Deposits with the banking system <sup>4</sup>	834	1,367	1,394	1,853	1,773	1,929	3,187	4,941
US Dollar, last day average exchange rates	99.1	98.8	101.8	104.8	104.9	121.5	163.1	156.3

P: Provisional

- External liabilities include Central Bank Deposits, SWAPS, Allocation of Special Drawing Rights (SDR) and Non-Resident LCY Deposits with Central Bank.
- Includes borrowings from banks by provincial governments and PSEs for commodity operations.
- 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 IMF less accumulated deposits of the Federal and Provincial Governments with the banking system.
- Accumulated deposits of the Federal and Provincial Governments with the banking system.

Source: State Bank of Pakistan

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- 4.2 Total public debt was recorded at Rs 32,708 billion at end June 2019. Total public debt increased by Rs 7,755 billion during FY 2018-19, out of which:
- Rs 3,635 billion (47 percent) was borrowed for meeting the federal budget deficit;
  - Rs 3,061 billion (39 percent) was due to currency depreciation;
  - Rs 927 billion (12 percent) was offset by higher cash balances necessary for effective cash management as the government is committed to zero borrowing from SBP in future; and
  - Rs 132 billion (2 percent) is difference between the face value (which is used for recording of debt) and the realized value (which is recorded as budgetary receipt) of Pakistan Investment Bonds issued during the year.
- 4.3 One of the notable developments from debt management perspective in FY 2018-19 was the re-profiling of domestic debt, where government re-profiled the existing stock of SBP borrowing from short term (6 months) to medium to long term (1 to 10 years). The re-profiling took into effect in the month of June 2019, which increased the share of long-term debt (permanent and unfunded) in total domestic debt from 46 percent at end June 2018 to 73 percent at end June 2019. This structural shift has reduced the refinancing risk for the government as average time to maturity of domestic debt portfolio increased from 1.6 years at end June 2018 to 4.2 years at end June 2019 which is very close to the long-term target set by the government for its domestic debt portfolio.
- 4.4 Development of debt capital market is essential to reduce financial risks of the overall economy, provide the government with a non-inflationary source of financing, 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-I).

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

- I. **Listing of Privately Placed Debt Securities:** To encourage and facilitate listing of Privately Placed Debt Securities (PPDS), PSX has been empowered to grant relaxation to companies for their listing.
- II. **Cost of Doing Business:** To facilitate growth in debt market and reduce associated costs, Central Depository Company (CDC) tariff structure for debt market securities has been significantly reduced.
- III. **Issuance of Notification under Section 66 of the Companies Act, 2017:** In order to enhance the investors base, facilitate debt issues and to provide additional investment avenues to corporates, mutual funds and employees' funds, SECP has notified the following persons as other persons to whom privately placed debt securities being instrument of redeemable capital can be issued:
  - Mutual Funds, Voluntary Pension Schemes and Private Funds being managed by NBFC;
  - Insurer registered under the Insurance Ordinance, 2000 (XXXIX of 2000);
  - a Securities Broker;
  - a Fund and Trust as defined in the Employees Contributory Funds (Investment in Listed Securities) Regulations, 2018; and
  - A Company and Body Corporate as defined in the Companies Act, 2017.
- IV. **Allowing sponsors of the issuer to invest in Privately Placed Debt Securities:** In order to develop the debt market and broaden the investor base, PSX permits sponsors of the issuer to invest in Privately Placed Debt Securities by making necessary amendments in Private Placement of Debt Securities Listing Regulations.

#### Future Plans with Regard to Development of Debt Capital Market:

- I. Introduce measures for inclusion of investors in primary market debt auction;
- II. In continuation of creating ease of doing business, revisiting debt listing requirements and simplifying regulatory framework/requirements for Government Debt Listing;
- III. Review of Market Makers existing regime to enhance effectiveness;
- IV. Study to look into factors attributable to inefficient use of debt market platform placed at PSX and suggesting reforms to make Bonds Automated trading System (BATS) a vibrant trading platform;
- V. Efforts to be made for launching Derivative products based on Government debt instruments (such as futures) at PSX.

Source: Securities and Exchange Commission of Pakistan

4.5 Total public debt reached Rs 34,241 billion at end September 2019 registering an increase of Rs 1,533 billion during first quarter of current fiscal year. The bifurcation of this increase is explained below:

- Domestic debt registered an increase of Rs 1,918 billion during first quarter of FY 2019-20 while government borrowing for financing of federal fiscal

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deficit from domestic sources was only Rs 308 billion during the said period.

Rest of the increase in domestic debt was on account of increase in cash balances of the government by around Rs 1,610 billion. In the wake of government commitment to zero borrowing from SBP, a cash buffer is being maintained to meet short term liquidity needs of the government. The size of the cash buffer keeps changing in-line with the liquidity requirements. This is the normal cash management practice which is followed throughout the world whereby cash buffers are built in anticipation of the upcoming maturities/contingencies. The size of cash buffer has reduced significantly by end December 2019;

- Government borrowing for financing of federal fiscal deficit from external sources was Rs 166 billion during first quarter of FY 2019-20 while external public debt stock decreased by Rs 385 billion. The impact of exchange rate was favorable during first quarter of current fiscal year which decreased the rupee value of external public debt stock at end September 2019; and
- Overall, Total Debt of the Government<sup>1</sup> (Net Debt) decreased by Rs 221 billion during first quarter of FY 2019-20 which indicates that exchange rate gains on account of appreciation of Pak Rupee against US Dollar more than offset the increase caused by financing of fiscal deficit.

### 5.0 Dynamics of Public Debt

5.1 Borrowing can be productive for economic growth as long as the economic returns are higher than the cost of borrowed funds. Therefore, 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 the resulting heavy debt servicing also lowers the development expenditure in future years.

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<sup>1</sup> Fiscal Responsibility and Debt Limitation Act, 2005 (amended in June 2017) defines Total Debt of the Government as "public debt less accumulated deposits of the Federal and Provincial Governments with the banking system".

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

	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Revenue Balance* / GDP	(2.9)**	(0.7)	(1.7)	(0.8)	(0.7)	(1.7)	(5.6)
Primary Balance* / GDP	(3.6)**	(0.2)	(0.5)	(0.2)	(1.5)	(2.1)	(3.4)
Fiscal Balance / GDP	(8.2)**	(5.5)	(5.3)	(4.6)	(5.8)	(6.5)	(8.9)
Total Public Debt / GDP	63.8	63.5	63.3	67.7	67.1	72.1	84.8
Total Government Debt / GDP	60.1	58.1	58.3	61.3	61.5	66.5	76.6
Total Public Debt / Revenue	479.2	439.6	442.1	442.5	433.7	477.3	667.4
Total Government Debt / Revenue	451.2	402.1	406.7	400.8	397.7	440.4	602.3
Debt Service / Revenue	40.5	40.1	40.4	35.9	38.3	37.3	62.5
Interest Service / Revenue	33.2	31.6	33.2	28.4	27.3	28.7	42.7
Debt Service / GDP	5.4	5.8	5.8	5.5	5.9	5.6	7.9

\* 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 Lower revenue collection and sharp rise in current expenditures caused a deterioration in fiscal indicators during FY 2018-19 i.e. the government registered a primary deficit<sup>2</sup> of 3.4 percent of GDP and an overall deficit of 8.9 percent of GDP. Similarly, revenue deficit<sup>3</sup> also witnessed significant increase and recorded at 5.6 percent of GDP. The fiscal performance during FY 2018-19 can be mainly assessed through analysis of developments in revenue and current expenditures as highlighted below:

- Revenue collection at the Federal level remained lower than 2 percent of GDP than expected during FY 2018-19, out of which around  $\frac{3}{4}$  of the revenue shortfall was due to one-off factors which are not expected to carry over into FY 2019-20 i.e. delay in renewing telecom licenses, delay in sale of envisaged state assets and weaker than anticipated tax amnesty proceeds contributed around 1 percent of GDP while a shortfall in the transfer of SBP profits contributed an additional 0.5 percent of GDP. Profit of SBP witnessed a steep plunge during FY 2018-19 as SBP incurred heavy exchange rate losses on its external liabilities;

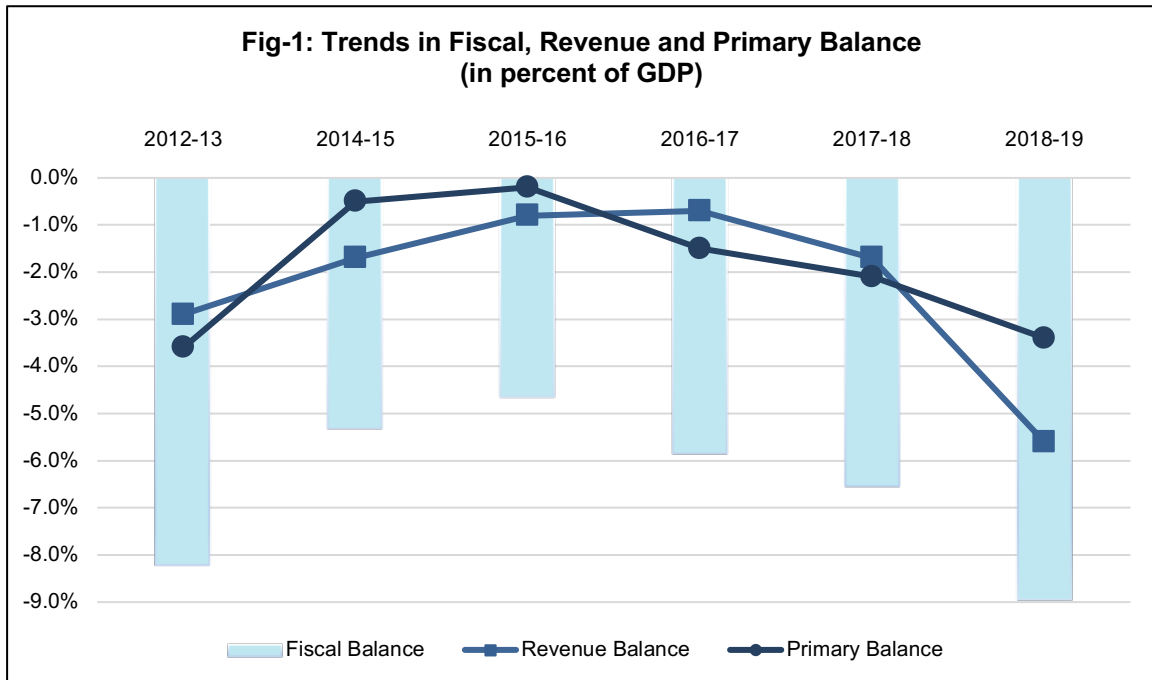
2. Primary balance is the total revenues minus non-interest expenditure or fiscal deficit before interest payments. Primary balance is an indicator of current fiscal efforts since interest payments are predetermined by the size of previous deficits.

3. 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.

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- The current expenditure grew by around 21 percent during FY 2018-19 mainly due to higher interest payments (up by 39 percent) on account of rise in domestic interest rates. Government initially budgeted the interest servicing target that was only 6 percent over FY 2017-18, however, overall interest payments were 29 percent higher compared to expense targeted in the Budget 2018-19. Apart from rise in domestic interest rates, one-off transaction amounting to Rs 296 billion on account of interest payment against re-profiling of SBP borrowing contributed towards increase in interest payments i.e. re-profiling of SBP borrowing from short-term to medium-to-long term on June 30, 2019 required the government to pay accrued interest amounting to Rs 296 billion to SBP. Since re-profiling of SBP borrowing involved creation of new instruments, accrued interest was required to be paid on existing debt instruments till June 30, 2019 as per accounting policies followed by SBP.

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

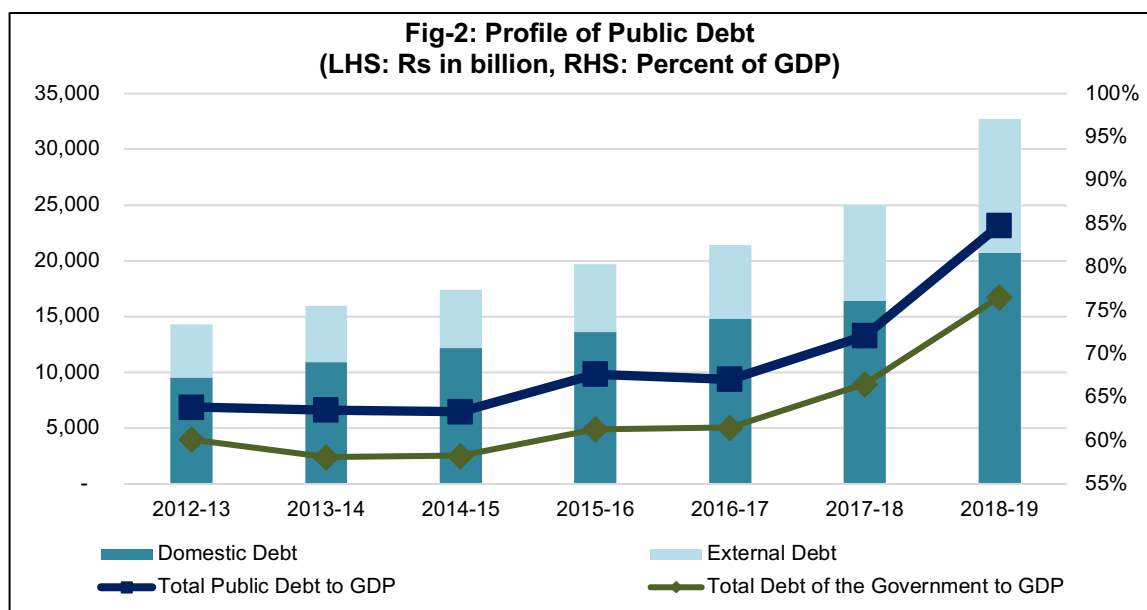


5.3 Total public debt as percentage of GDP stood at 84.8 percent while total debt of the government recorded at 76.6 percent of GDP at end June 2019. Total public



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debt to GDP ratio was 72.1 percent at end June 2018, well above the threshold of 60 percent as specified in Fiscal Responsibility and Debt Limitation Act. Public debt as percentage of GDP further increased during FY 2018-19 primarily due to build-up of liquidity buffers and higher exchange rate depreciation. Total public debt position since fiscal year 2013 (both in absolute and GDP terms) are depicted in the following graph:



5.4 Steep rise in domestic interest rate and depreciation of Pak Rupee along with already constrained revenue growth increased the debt-servicing requirements during FY 2018-19 i.e. interest payments consumed almost 43 percent of total government revenue.

### 6.0 Servicing of Public Debt

6.1 During FY 2018-19, public debt servicing was recorded at Rs 3,065 billion against the annual budgeted estimate of Rs 2,396 billion. Total debt servicing increased by around 57 percent during FY 2018-19 compared with last fiscal year<sup>4</sup> which was driven by higher domestic interest payments (on account of rise in domestic interest rates) while external debt repayments increased significantly and recorded at Rs 974 billion during FY 2018-19 compared with Rs 450 billion during last fiscal

4. Total debt servicing was recorded at Rs 1,950 billion while the interest servicing was Rs 1,500 billion during FY 2017-18.

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year. The interest servicing grew by around 39 percent during FY 2018-19 compared with last fiscal year mainly due to increased borrowing on account of higher than budgeted fiscal deficit, increase in domestic 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)

	FY19			
	Budgeted	Actual	Percent of Revenue	Percent of Current Expenditure
Repayment of External Debt	775.9	974.0	19.9	13.7
<b>Total External Principal Repayment (A)</b>	<b>775.9</b>	<b>974.0</b>	<b>19.9</b>	<b>13.7</b>
Servicing of External Debt	229.2	270.3	5.5	3.8
Servicing of Domestic Debt	1,391.0	1,820.8	37.2	25.6
<b>Total Interest Servicing (B)</b>	<b>1,620.2</b>	<b>2,091.1</b>	<b>42.7</b>	<b>29.4</b>
<b>Total Servicing of Public Debt (A+B)</b>	<b>2,396.1</b>	<b>3,065.1</b>	<b>62.5</b>	<b>43.1</b>

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

### 7.0 Domestic Debt

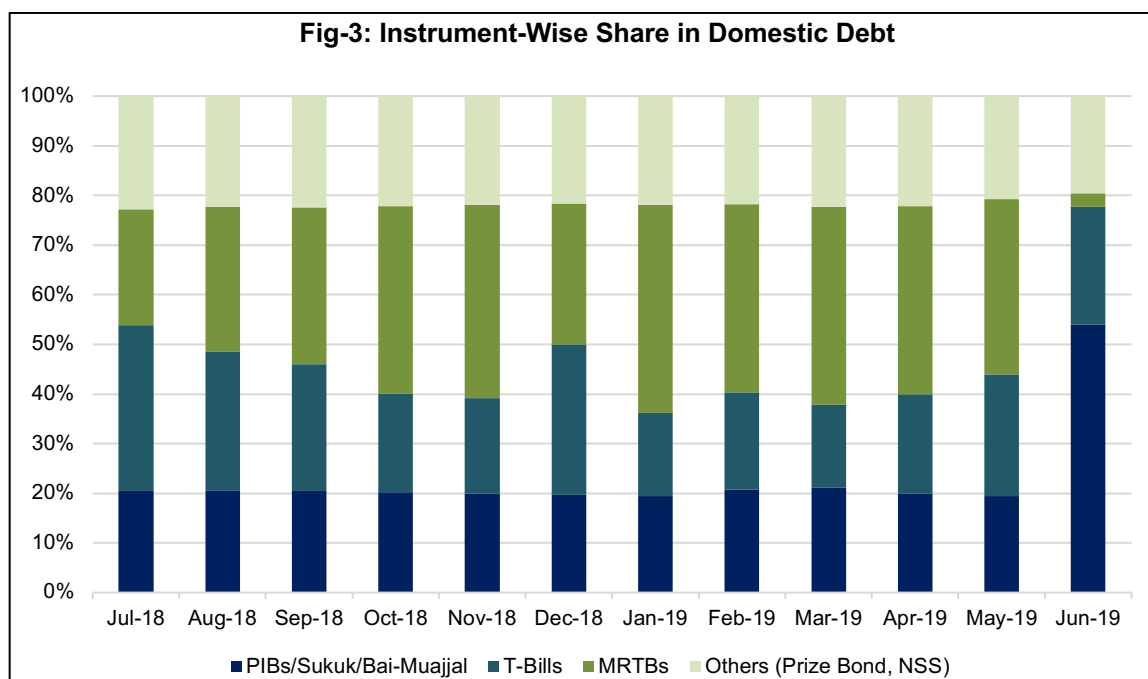
7.1 Domestic debt is primarily obtained to finance fiscal deficit while lending support to Public Sector Development Programme (PSDP). Domestic debt comprises permanent debt (medium and long-term), floating debt (short-term) and unfunded debt (primarily made up of various instruments available under National Savings Schemes).

7.2 Government issues two broad types of marketable government securities in order to raise domestic debt i.e. Treasury Bills (T-bills) and Pakistan Investment Bonds (PIBs). T-bills are considered short-term securities and have maturities of 12 months or less at the time of issuance. PIBs are considered longer-term securities and have maturities of more than 12 months at the time of issuance. Government currently issues fixed-rate PIBs with 3-year, 5-year, 10-year and 20-year maturities and floating-rate PIBs with 10-year maturity. All of these PIBs pay profit on semi-annual basis. Shariah-compliant securities program has also been in place since FY 2008-09, however, it still constitutes a small proportion of the government

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domestic securities portfolio. In addition, number of different schemes are offered under National Savings Schemes (NSS) in the investment horizon of 3 months to 10 years.

- 7.3 Domestic debt stock was recorded at Rs 20,732 billion at end June 2019, registering an increase of Rs 4,315 billion during FY 2018-19. Apart from reliance on domestic sources for financing of fiscal deficit, build-up of cash buffers and difference between cash and realized value of PIBs contributed towards this increase. Within domestic debt, the government relied mainly on short-term borrowing from SBP through Market Related Treasury Bills (MRTBs) until May 2019 which helped the government to retire its maturing debt to the market. Nonetheless, the government re-profiled its existing stock of SBP borrowing from short term (6 months) to medium to long term (1 to 10 years) in June 2019. As a result of this re-profiling, the refinancing risk of the government greatly reduced as domestic debt maturing within year reduced to 37 percent at end June 2019 compared with 66 percent at end June 2018. The month-wise and instrument-wise composition of domestic debt during FY 2018-19 is depicted through following graph:



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

	FY13	FY14	FY15	FY16	FY17	FY18	FY19	SEP 19 (P)
<b>Permanent Debt</b>	<b>2,179.0</b>	<b>4,003.6</b>	<b>5,012.8</b>	<b>5,940.6</b>	<b>5,533.1</b>	<b>4,659.2</b>	<b>12,087.0</b>	<b>12,840.9</b>
Market Loans	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Government Bonds*	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Prize Bonds**	389.6	446.6	522.5	646.4	747.1	851.0	893.9	741.6
Foreign Exchange Bearer Certificates	0.1	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	0.0	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	0.1	0.1
U.S. Dollar Bearer Certificates	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Special U.S. Dollar Bonds	4.3	4.2	4.4	4.5	4.5	5.1	6.7	6.5
Pakistan Investment Bonds (PIB)***	1,321.6	3,222.0	4,155.2	4,921.4	4,391.8	3,413.3	10,933.2	11,839.6
GOP Ijara Sukuk	459.2	326.4	326.4	363.9	385.4	385.4	71.0	71.0
Bai-Muajjal of Sukuk		-					177.8	177.8
<b>Floating Debt</b>	<b>5,194.9</b>	<b>4,599.1</b>	<b>4,609.4</b>	<b>5,001.7</b>	<b>6,550.9</b>	<b>8,889.0</b>	<b>5,500.6</b>	<b>6,528.8</b>
Market Treasury Bills***	2,919.7	1,746.8	2,148.9	2,771.4	4,082.0	5,294.8	4,929.6	5,957.8
MTBs for Replenishment	2,275.2	2,852.3	2,460.5	2,017.6	2,468.9	3,594.2	571.0	571.0
Bai Muajjal	0.0	0.0	0.0	212.6	0.0	0.0	0.0	0.0
<b>Unfunded Debt</b>	<b>2,146.5</b>	<b>2,303.8</b>	<b>2,570.3</b>	<b>2,683.7</b>	<b>2,765.3</b>	<b>2,868.1</b>	<b>3,144.1</b>	<b>3,280.2</b>
Defense Saving Certificates	271.7	284.6	300.8	308.9	325.5	336.2	393.6	446.9
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	0.2	0.2	0.2	0.2
Special Savings Certificates (Registered)	388.2	445.8	474.3	472.4	433.1	381.9	413.7	395.4
Special Savings Certificates (Bearer)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Regular Income Certificates	262.6	325.4	376.0	359.8	338.8	347.5	489.6	515.4
Premium Saving Certificates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Behbood Savings Certificates	528.4	582.4	628.3	692.1	749.5	794.9	914.5	953.9
Short Term Savings Certificates	4.0	1.3	1.7	1.9	3.7	4.3	5.1	5.6
Khass Deposit Accounts	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Savings Accounts	22.3	22.6	26.4	30.2	34.9	38.3	38.2	37.7
Special Savings Accounts	346.2	292.7	392.9	423.8	489.0	549.0	416.6	439.8
Mahana Amdani Accounts	2.0	1.9	1.8	1.8	1.7	1.7	1.6	1.6
Pensioners' Benefit Account	179.9	198.4	214.1	234.7	253.4	274.9	318.3	328.1
Shuhadas Family Welfare Account	-	-	-	-	-	-	0.0	4.3
National Savings Bonds	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Postal Life Insurance Schemes	67.1	67.1	67.1	67.1	45.8	46.7	47.9	47.7
GP Fund	73.1	80.5	85.8	90.0	88.8	91.7	104.3	102.8
<b>Total Domestic Debt</b>	<b>9,520.4</b>	<b>10,906.5</b>	<b>12,192.5</b>	<b>13,625.9</b>	<b>14,849.2</b>	<b>16,416.3</b>	<b>20,731.8</b>	<b>22,649.9</b>

P: Provisional

\*Special Government Bond for SLIC have been added into Government Bonds.

\*\*Includes Premium Prize Bonds (Registered)

\*\*\*Govt. Securities held by non-residents deducted from PIB's and T Bills

Source: State Bank of Pakistan

### 7(i) Auction Profile of Government Securities

- 7.4 Banks were expecting an upward interest rate trajectory almost throughout the year. The SBP's Monetary Policy Committee (MPC) increased the policy rate in all six decisions during FY 2018-19, by a cumulative 575 bps. Therefore, within T-bills, the banks preferred to bid only in 3 months paper while their combined offered volume in 6 months and 12 months paper remained less than 1 percent of the total offers. Another common trend witnessed in the T-bills auction was that banks participated heavily in auctions immediately following the Policy Rate decision even with maturity amounts and Government's borrowing targets were much lower. Conversely, banks' participation remained quite low in the auctions preceding the next Policy Rate decision even if the maturity amounts and Government's borrowing targets were much higher. Banks increasingly used Open Market Operations (OMOs) of SBP as an alternative avenue to temporarily park their funds until the announcement of the next monetary policy. This strategy was convenient from the banks' perspective, since the SBP had been regularly conducting these OMOs to keep the overnight rates close to the target rates.
- 7.5 During first quarter of FY 2018-19, the banks remained mainly interested in the 3-month treasury bills. In case of fixed rate PIBs, limited participation was observed as the offered amount was only 14 percent of the maturities during the quarter. In contrast, participation in 10-years floating rate PIBs was relatively better i.e. against the target of Rs 150 billion set for first quarter of FY 2018-19, offered amount was around Rs 157 billion and government accepted Rs 108 billion keeping in consideration cost risks trade-off. Overall, the government had to borrow from SBP to retire its ensuing maturities against treasury bills and fixed rate PIBs as both offered and accepted amount in these securities auctions fell short of their maturities and targets set for the said quarter.
- 7.6 During second quarter of FY 2018-19, the government borrowed more from the market and retired some of its borrowing from SBP. Continuing the trend observed during the first quarter, market remained more interested in 3-month treasury bills during second quarter of FY 2018-19 and consequently the proportion of longer tenure treasury bills almost diminished in the outstanding domestic debt. The

## Debt Policy Statement 2019-20

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participation in fixed rate PIBs remained subdued during second quarter of FY 2018-19 while all the bids in floating rate PIBs auction were rejected. Government also mobilized Rs 73 billion from the auction of outright purchase of Government Ijara Sukuk (GIS) on deferred payment (Bai Muajjal) basis. Overall, 3-months treasury bills remained the main source for domestic financing of fiscal deficit and refinancing of existing maturities.

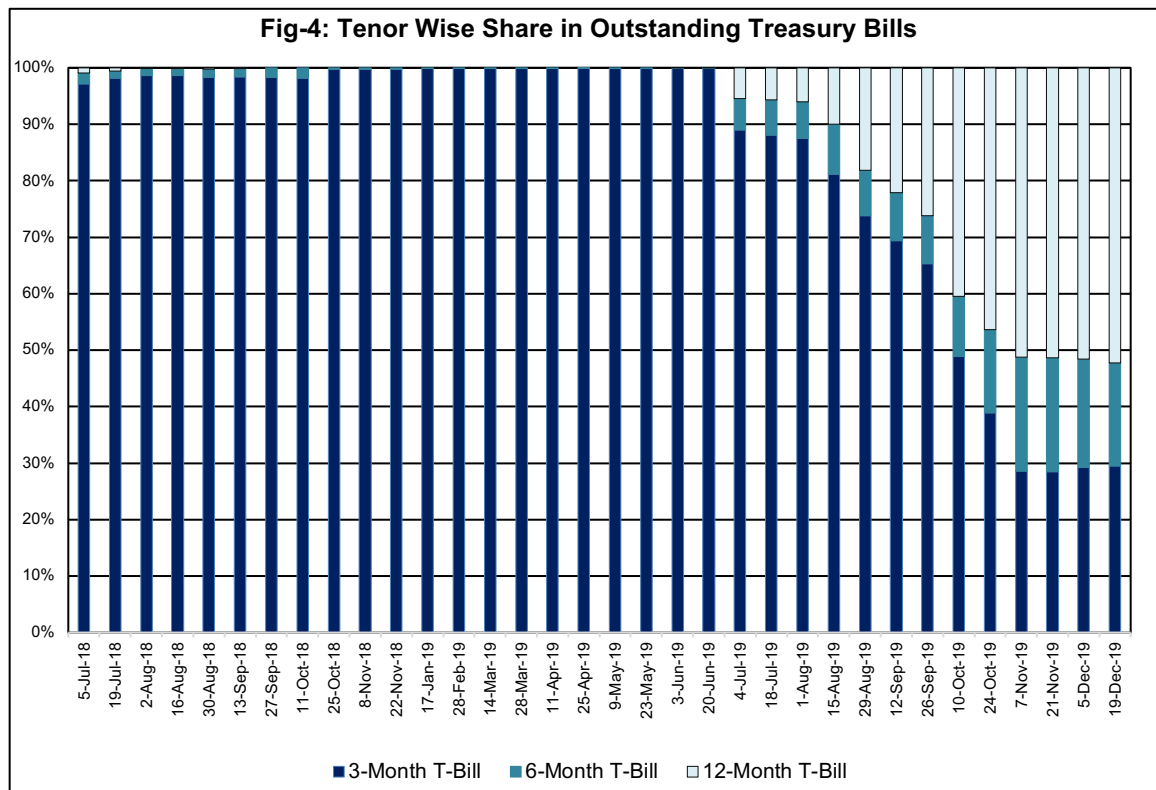
- 7.7 Market appetite for medium to long term securities started to revive from January 2019 and healthy participation amounting to Rs 1,190 billion was observed during third quarter of FY 2018-19 out of which the government accepted Rs 496 billion keeping in view cost risks trade-off. On the other hand, participation and acceptance in treasury bills auctions fell well short of both the maturities and auction targets set for the said quarter and consequently the government had to again resort to SBP borrowing to meet its additional financing requirements and to cover existing short-term maturities. Government also mobilized additional Rs 105 billion from the auction of outright purchase of GIS on deferred payment (Bai Muajjal) basis during the said quarter.
- 7.8 During fourth quarter of FY 2018-19, the government received massive participation of Rs 8,827 billion against the target of Rs 3,400 billion and maturity of Rs 3,029 billion. Almost entire offers were in 3-months T-bills and the government accepted Rs 4,930 billion. Continuing the trend observed during the third quarter, healthy participation amounting to Rs 1,508 billion was observed in the auctions of fixed and floating rate PIBs during fourth quarter of FY 2018-19 out of which the government accepted Rs 536 billion. In case of Floating Rate PIBs, an important development that came towards the close of the fiscal year was the amendment in the determination of coupon. Previously, it was linked only to the weighted average yield of the latest successful 6-month T-bill auction. As per the new instructions, in case the latest held auction of 6-month MTBs is either rejected or there is no participation from the market, the average of 6-month PKRV (i.e. 121-180 days) of last five working days before the start of the coupon period will be used as an alternate benchmark. Government borrowings from SBP also increased during fourth quarter of FY 2018-19 mainly for building-up of liquidity

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buffers in the wake of government commitment to zero borrowing from SBP in future.

7.9 Due to above mentioned developments, the government had to rely on SBP borrowing for meeting its budgetary requirements and building-up of liquidity buffers. Accordingly, the government could only adhere to its net zero quarterly limit set under the amended SBP Act 1956 during 2nd quarters of FY 2018-19<sup>5</sup>.

7.10 During first half of FY 2019-20, healthy participation was observed in 12 months Treasury Bills and 3 to 10 years Government Bonds. Resultantly, share of 3-months T-bills in total T-bills portfolio reduced to around 29 percent at end December 2019 compared with around 100 percent at end June 2019 as depicted in the graph below:

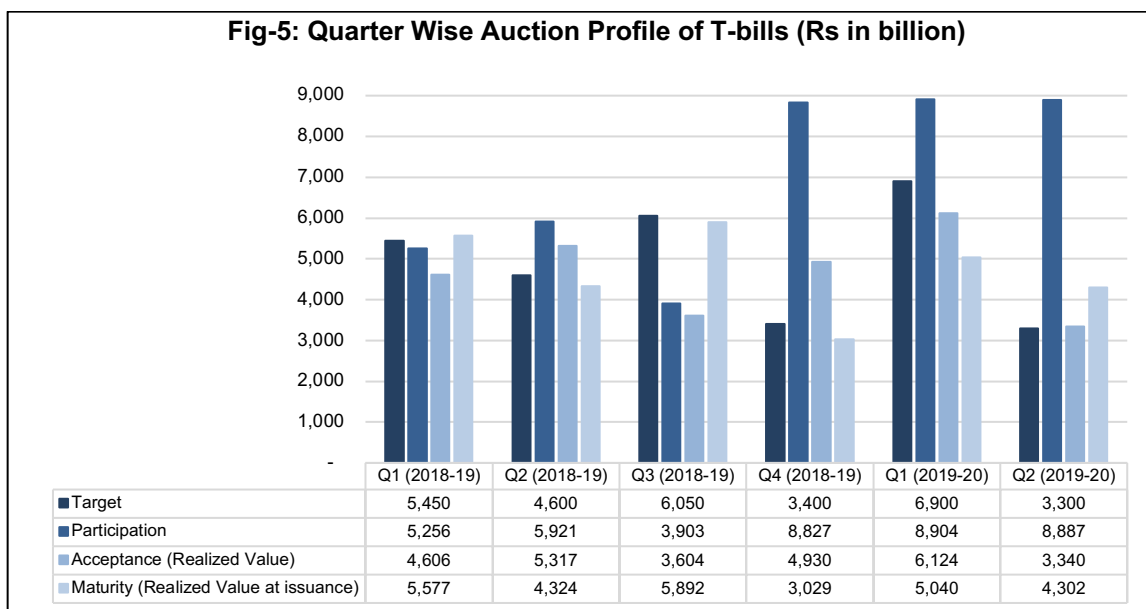


The following graphs illustrate the auction profile of PIBs and T-bills from July 2018 to December 2019:

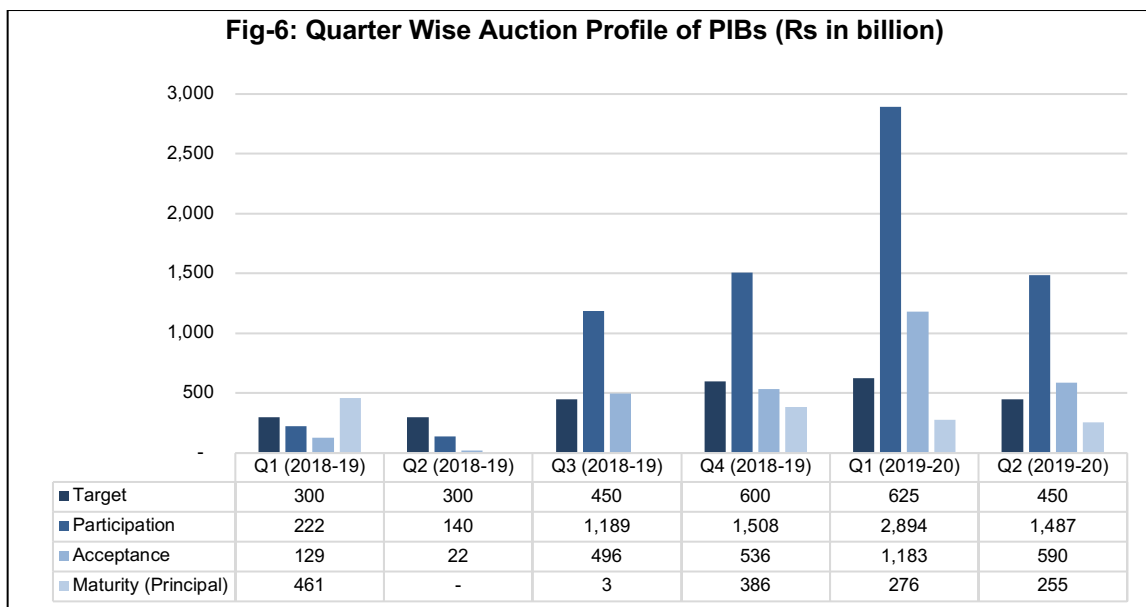
5. The Clause 9(C)(1) requires Federal Government borrowing from the Bank shall be such that at the end of each quarter they shall be brought to zero barring the ways and means limit that shall be determined by the Central Board from time to time. However, no ways and means limit has so far been determined.

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**Fig-5: Quarter Wise Auction Profile of T-bills (Rs in billion)**



**Fig-6: Quarter Wise Auction Profile of PIBs (Rs in billion)**



### 7(ii) Secondary Market Activities of Government Securities (2018-19)

7.11 During FY 2018-19, the secondary market trading volumes witnessed a moderate increase. Overall, outright trading volume in the government securities during the FY 2018-19 reached Rs 29,109 billion, against Rs 27,557 billion recorded during last year. Average daily trading volume and turnover ratio also grew accordingly. Daily average volumes increased to Rs 118 billion per day from Rs 112 billion per day in FY 2017-18, and the turnover ratio increased to 3.33 times that of the outstanding stock from 3.00 times in FY 2017-18 (Table-5).



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**Table-5: Secondary Market Outright Trading Volume**

(Rs in billion)				
Security	FY18	FY19	Q1-FY19	Q1-FY20
Treasury Bill - 3 Months	20,118	23,330	5,173	4,239
Treasury Bill - 6 Months	3,147	41	3	116
Treasury Bill - 12 Months	258	33	7	969
<b>Sub Total</b>	<b>23,523</b>	<b>23,404</b>	<b>5,183</b>	<b>5,324</b>
Pakistan Investment Bonds - 3 Years	1,062	1,596	145	577
Pakistan Investment Bonds - 5 Years	1,031	889	278	237
Pakistan Investment Bonds - 10 Years	928	1,017	214	174
Pakistan Investment Bonds - 15 Years	10	0.6	0.1	0.1
Pakistan Investment Bonds - 20 Years	11	0.9	0.9	1.4
<b>Sub Total</b>	<b>3,042</b>	<b>3,503</b>	<b>638</b>	<b>989</b>
Government Ijara Sukuk	992	2,202	231	875
<b>Grand Total</b>	<b>27,557</b>	<b>29,109</b>	<b>6,052</b>	<b>7,188</b>
<b>Daily Average volume</b>	<b>111.6</b>	<b>117.8</b>	<b>106.2</b>	<b>110.6</b>
End Period Stock	9,175	8,749	7,864	10,166
Turnover Ratio (times)	3.00	3.33	3.08	2.83

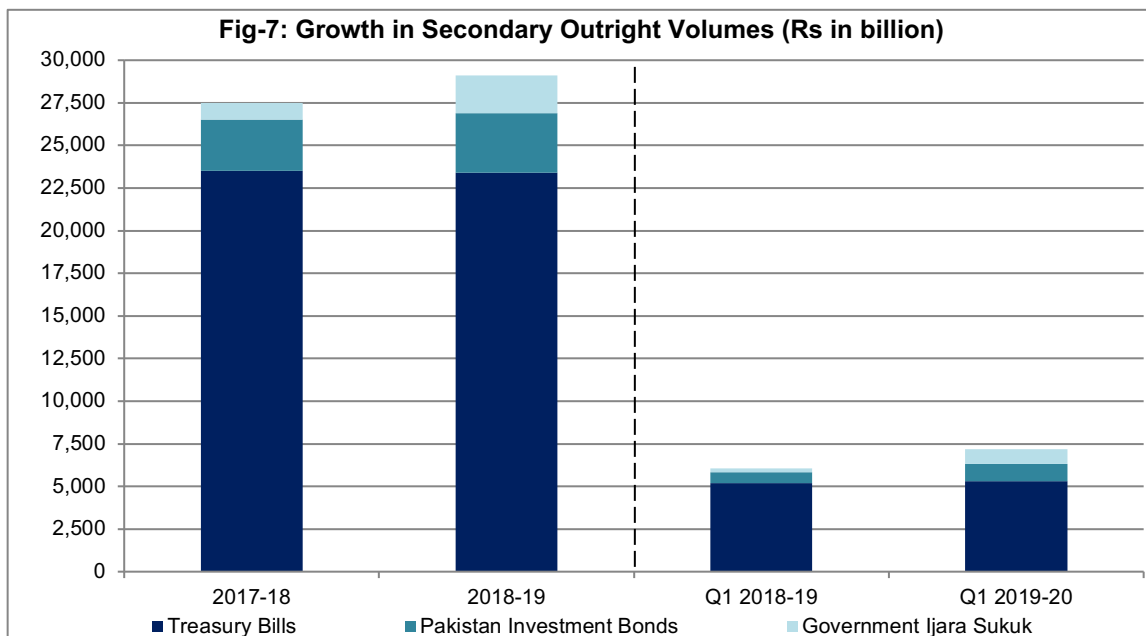
Source: State Bank of Pakistan

7.12 The increased secondary market trading volumes are attributed to high turnover associated with issuance of short-term T-bills during the year. However, Banks participation in longer-tenure T-bills remained non-existent as banks tried to minimize their interest-rate risk. As a consequence, secondary market trading volumes in 6 months and 12 months dried up (Table-5).

7.13 A security-wise break up of volumes indicate that the treasury bills trading constitutes around 80 percent (Rs 23,404 billion) of the overall secondary market trading, with almost all of the Treasury Bills trading concentrated in 3-month T-bills. Supported by successful PIBs auctions since December 2018, PIBs trading volumes registered strong growth. Secondary market trading in PIBs increased to Rs 3,503 billion in FY 2018-19 compared to Rs 3,042 billion in FY 2017-18, registering a 15 percent growth over the previous fiscal year. Data indicate that the banks were net sellers of PIBs to the non-banks, which accounted for 46 percent of the PIBs trading volume. Demand and issuance of floating-rate PIBs remained

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robust, however, their trading on the market was limited as banks preferred to buy and hold these securities. Trading volumes in GIS more than doubled during the fiscal year. Despite limited outstanding stock of Rs 268 billion at the year start and Rs 197 billion worth of issues maturing during the year, GIS trading volume increased owing to Bai-Muajjal transactions. During the year, GIS outright trading volumes increased to Rs 2,202 billion from Rs 992 billion recorded previously.



7.14 During first quarter of FY 2019-20, Rs 7,188 billion worth of the debt securities were traded. Trading volumes in 6 and 12-months T-bills recovered owing to resumption in their issuance in the primary market. However, 3-months T-bills trading continued to make significant contribution towards the total T-bills volumes, contributing Rs 4,239 billion (58 percent) to the total trading. Similarly, PIBs trading volumes increased owing to higher PIBs issuances. In particular, 3-years PIBs trading quadrupled to Rs 577 billion in first quarter of FY 2019-20 when compared with the same period last year. Further, GIS trading volumes continued to remain high i.e. trading volumes increased more than three times during first quarter of FY 2019-20. This is owing to Islamic institution's reliance on a single issue of GIS for their Bai-Muajjal transactions.

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### Repo Market:

- 7.15 The repo transaction volumes continued to depict robust growth in FY 2018-19 as well, as yearly volumes increased by 37 percent to Rs 35,879 billion from Rs 26,235 billion during FY 2017-18 (Table-6). Much of the repo market volumes are used for day-to-day liquidity management with 74 percent of the market volume concentrated in overnight tenor. The high volumes and increased liquidity in the repo market mean that financial institutions can efficiently meet their temporary liquidity needs from money market.
- 7.16 During first quarter of FY 2019-20, repo volumes declined to Rs 8,619 billion, a decline of 6 percent compared to the same period last year. On the other hand, the outright trading volumes clocked in at Rs 7,188 billion during the quarter, registering an increase of 19 percent compared to same period last year. Accordingly, the market-share of repo decreased by 5 percent to 55 percent.

**Table-6: Government Security Based Transactions**

Type	Volume (Rs in billion)				Market Share (Percentage)			
	FY18	FY19	Q1-FY19	Q1-FY20	FY18	FY19	Q1-FY19	Q1-FY20
Repo	26,235	35,879	9,123	8,619	49	55	60	55
Outright	27,557	29,109	6,052	7,188	51	45	40	45
<b>Total</b>	<b>53,792</b>	<b>64,988</b>	<b>15,175</b>	<b>15,807</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

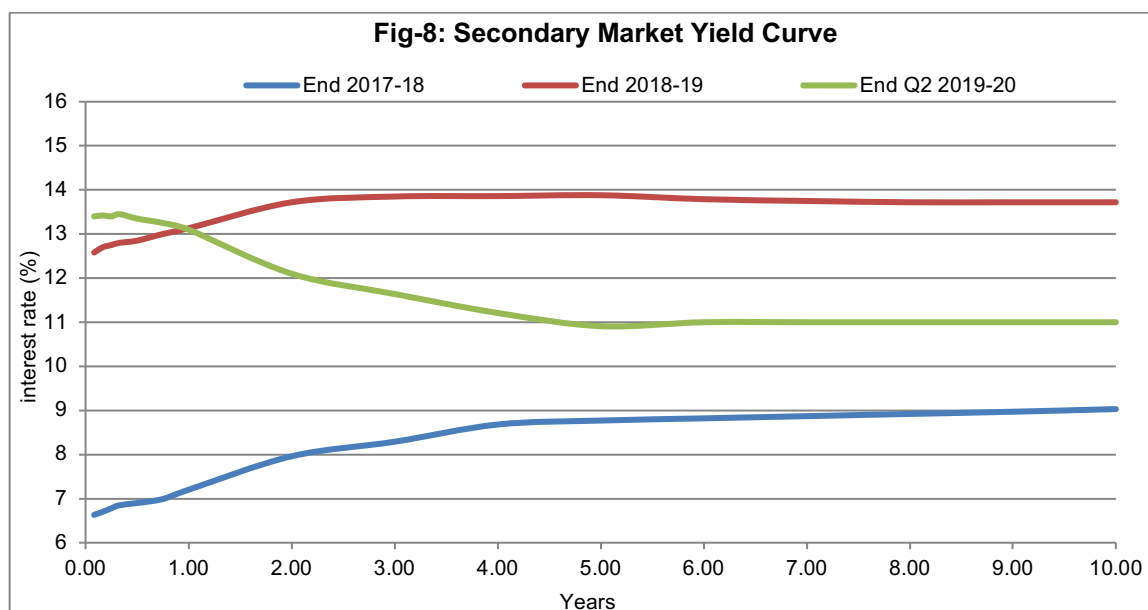
Source: State Bank of Pakistan

### Secondary Market Yield Curve:

- 7.17 At the start of the FY 2018-19, the yield curve indicated expectations of a moderate increase in the interest rates during the year. However, SBP hiked the policy rate by a cumulative 575 basis points during the period. In response, both short and longer-term tenor securities' yields increased by same magnitude. The steepness of the yield curve has increased for securities having tenors of up to 1 year with longer-term yields having flattened in the range of 13.5 percent - 14.0 percent.
- 7.18 During first quarter of FY 2019-20, short term interest rates edged up as SBP increased the policy rate from 12.25 percent to 13.25 percent in its July monetary

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policy. Despite this increase, yields on government bonds have declined by 1 percent to 2.5 percent per annum at the end of first half of FY 2019-20 compared to that of end FY 2018-19, which indicates the confidence of market participants in government policies and the expectations of lower inflation and interest rates going forward. As a consequent, the yield curve stood inverted at end December, 2019.



### 7(iii) Development in Domestic Debt during FY 2018-19

#### Permanent Debt:

- 7.19 Permanent debt mainly comprises medium to long term instruments (PIBs, GIS, Prize Bond etc.). PIBs have fixed and semi-annual coupon payment with tenors of 3, 5, 10 and 20 years. Whereas, GIS are medium term Shariah compliant bonds currently issued in 3 years' tenor. Government of Pakistan has also introduced a conventional long-term (10-year maturity) floating-rate PIBs. It has been a very good addition to domestic securities portfolio enabling the government to borrow for a longer period without locking itself into high fixed borrowing cost. This instrument is also useful for investors which prefer to avoid fluctuations in the market value of their investments.
- 7.20 Permanent debt was recorded at Rs 12,087 billion at end June 2019. The declining share of permanent debt in domestic debt portfolio witnessed a reversal during FY 2018-19 mainly supported by re-profiling SBP debt. Accordingly, its share in

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domestic debt portfolio increased to 58 percent during FY 2018-19 from 28 percent during last fiscal year. Government also mobilized Rs 178 billion from the auction of outright purchase of GIS on deferred payment (Bai Muajjal) basis.

- 7.21 Prize bonds recorded an increase of Rs 43 billion in FY 2018-19 compared with the increase of Rs 104 billion during last year. All denominations of prize bonds recorded net inflows, barring the denomination of Rs 40,000 prize bonds as government notified withdrawal of these prize bonds from circulation on 24 June 2019. The holders of these prize bonds were given three options: i) conversion to premium prize bonds; ii) replacement with special savings certificate/defense savings certificates; or iii) encashment at face value (transfer of proceeds to the bond-holders bank account. Many bond-holders preferred to encash these bonds resulting in net outflows.

### **Floating Debt:**

- 7.22 Floating debt consists of short-term domestic borrowing instruments i.e. Treasury Bills. 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 via auction of Treasury Bills, arranged by SBP twice a month.
- 7.23 Floating debt was recorded at Rs 5,501 billion at end June 2019, constituting around 27 percent of domestic debt portfolio compared with 54 percent at end of last fiscal year. This reduction is attributed to re-profiling of SBP debt from short-term to medium and long term.

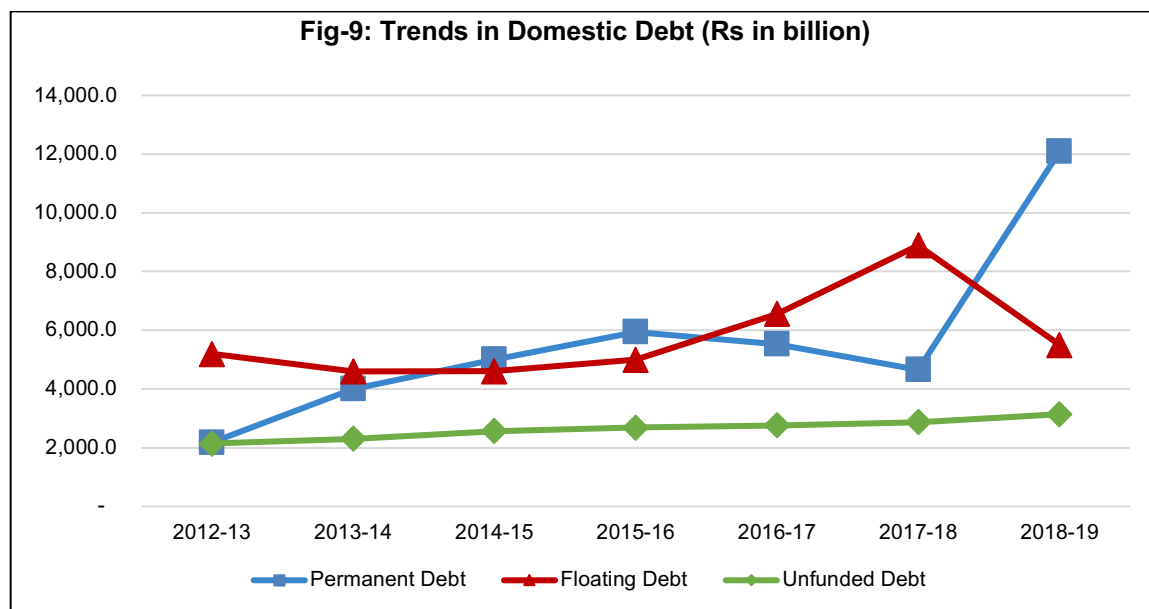
### **Unfunded Debt:**

- 7.24 The stock of unfunded debt (primarily made up of various instruments available under National Savings Schemes) stood at Rs 3,144 billion at end June 2019, constituted around 15 percent of domestic debt portfolio. Higher profit rates in FY 2018-19 kept the savings schemes attractive as net inflows in various NSS increased by Rs 262 billion compared with Rs 99 billion last year. A disaggregated analysis reveals that most of the incremental mobilization came from Regular Income Certificates (Rs 142 billion) and Behbood Savings Certificates (Rs 120

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billion), while net retirement of Rs 132 billion was recorded in Special Savings Accounts.

Year wise share of permanent debt, floating debt and unfunded debt in domestic debt portfolio is depicted in the following graph:



### 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 EDL was recorded at US\$ 106.3 billion by end June 2019, registering an increase of US\$ 11.1 billion compared to an increase of US\$ 11.8 billion recorded a year earlier. The bifurcation of this increase is as follow:

- One half of the increase in EDL was due to rise in SBP liabilities in the form of deposits placed by bilateral partners (Saudi Arabia, UAE, Qatar). It is important to note that these deposits only provide balance of payments support, add to foreign currency reserves and do not come as an extra resource in the budget;

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- External public debt increased by US\$ 3.2 billion during FY 2018-19 compared with the increase of US\$ 7.7 billion during FY 2017-18. Sizeable repayment (US\$ 7.4 billion) reduced the pace of external public debt accumulation during FY 2018-19;
- PSEs external debt increased by US\$ 1.3 billion mainly driven by development loans obtained by concerned PSEs; and
- Private sector loans recorded an increase of US\$ 1.2 billion.

**Table-7: Pakistan's External Debt and Liabilities**

(US\$ in million)	FY13	FY14	FY15	FY16	FY17	FY18	FY19	SEP 19 (P)
<b>A. Public External Debt (1+2)</b>	<b>48,139</b>	<b>51,460</b>	<b>50,964</b>	<b>57,757</b>	<b>62,539</b>	<b>70,237</b>	<b>73,449</b>	<b>74,159</b>
<b>1. Government External Debt</b>	<b>43,752</b>	<b>48,440</b>	<b>46,861</b>	<b>51,714</b>	<b>56,430</b>	<b>64,142</b>	<b>67,800</b>	<b>67,807</b>
<b>i) Long term (&gt;1 year)</b>	<b>43,488</b>	<b>47,709</b>	<b>45,849</b>	<b>50,026</b>	<b>55,547</b>	<b>62,525</b>	<b>66,536</b>	<b>66,236</b>
Paris Club	13,548	13,607	11,664	12,678	11,973	11,643	11,235	11,077
Multilateral	24,198	25,826	24,262	26,376	27,605	28,102	27,788	28,056
Other Bilateral	3,939	4,385	4,941	5,445	6,323	8,674	12,717	12,787
Euro/Sukuk Global Bonds	1,550	3,550	4,550	4,550	4,800	7,300	6,300	6,300
Military Debt	71	36	0	0	0	0	0	0
Commercial Loans/Credits	0	150	300	882	4,826	6,806	8,470	7,977
Local Currency Securities (PIBs)	2	16	32	35	0	0	0	4
Saudi Fund for Development (SFD)	180	140	100	60	20	0	0	0
NBP/BOC deposits/PBC*	0	0	0	0	0	0	26	35
<b>ii) Short term (&lt;1 year)</b>	<b>264</b>	<b>731</b>	<b>1,012</b>	<b>1,688</b>	<b>882</b>	<b>1,617</b>	<b>1,264</b>	<b>1,571</b>
Multilateral	256	443	983	1,112	832	961	778	922
Local Currency Securities (T-bills)	8	116	29	1	51	0	0	360
Commercial Loans/Credits	0	173	0	575	0	655	486	289
<b>2. From IMF</b>	<b>4,387</b>	<b>3,020</b>	<b>4,103</b>	<b>6,043</b>	<b>6,109</b>	<b>6,095</b>	<b>5,648</b>	<b>6,352</b>
i) Federal Government	1,519	655	52	0	0	0	0	976
ii) Central Bank	2,868	2,366	4,051	6,043	6,109	6,095	5,648	5,376
<b>B. Foreign Exchange Liabilities</b>	<b>3,106</b>	<b>3,281</b>	<b>3,709</b>	<b>3,600</b>	<b>3,564</b>	<b>5,121</b>	<b>10,488</b>	<b>10,359</b>
i) Central Bank Deposits	800	700	700	700	700	700	6,200	6,200
ii) Foreign Currency Bonds (NHA / NC)	0	0	0	0	0	0	0	0
iii) Other Liabilities (SWAP)	814	1,045	1,612	1,507	1,482	3,022	2,912	2,808
iv) Allocation of SDR	1,487	1,528	1,390	1,383	1,375	1,390	1,374	1,348
v) Nonresident LCY Deposits with Central Bank	6	8	7	10	8	9	1	3
<b>C. Public Sector Enterprises (PSEs)</b>	<b>1,848</b>	<b>2,063</b>	<b>2,482</b>	<b>2,807</b>	<b>2,719</b>	<b>2,671</b>	<b>4,013</b>	<b>3,844</b>
<b>a. Guaranteed Debt</b>	<b>598</b>	<b>537</b>	<b>970</b>	<b>1,265</b>	<b>1,214</b>	<b>1,384</b>	<b>2,800</b>	<b>2,731</b>
Paris Club	0	0	0	0	0	0	0	0
Multilateral	30	25	19	11	6	5	0	0
Other Bilateral	568	512	951	1,254	1,208	1,179	2,600	2,531
Commercial Loans	0	0	0	0	0	200	200	200
Sandak Metal Bonds	0	0	0	0	0	0	0	0
<b>b. Non-Guaranteed debt</b>	<b>1,250</b>	<b>1,525</b>	<b>1,512</b>	<b>1,541</b>	<b>1,505</b>	<b>1,287</b>	<b>1,213</b>	<b>1,113</b>
i) Long Term(>1 year)	638	726	534	466	403	334	410	388

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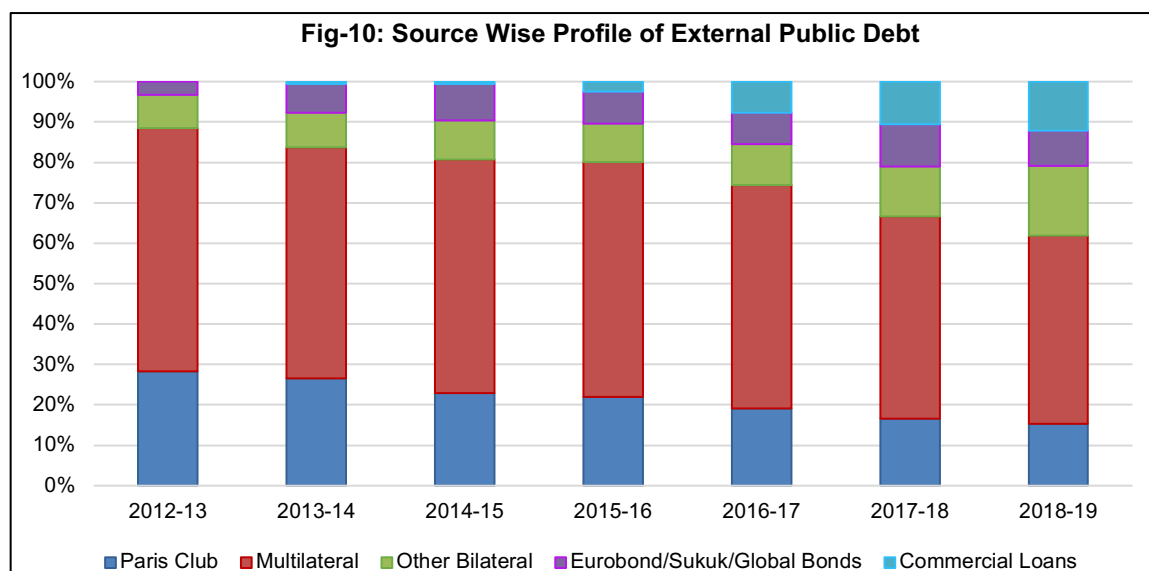
(US\$ in million)	FY13	FY14	FY15	FY16	FY17	FY18	FY19	SEP 19 (P)
ii) Short Term (<1 year)	612	799	978	1,075	1,102	953	803	725
<b>D. Banks</b>	<b>1,554</b>	<b>1,989</b>	<b>2,286</b>	<b>2,695</b>	<b>4,522</b>	<b>4,417</b>	<b>4,706</b>	<b>4,464</b>
a. Borrowing	710	1,080	1,334	1,618	3,303	2,967	3,157	2,822
b. Nonresident Deposits (LCY & FCY)	843	909	952	1,078	1,220	1,450	1,550	1,642
<b>E. Private Sector</b>	<b>3,143</b>	<b>3,076</b>	<b>3,011</b>	<b>4,073</b>	<b>6,759</b>	<b>9,195</b>	<b>10,380</b>	<b>10,750</b>
<b>F. Debt Liabilities to Direct Investors - Intercompany Debt</b>	<b>3,110</b>	<b>3,400</b>	<b>2,717</b>	<b>3,013</b>	<b>3,375</b>	<b>3,597</b>	<b>3,276</b>	<b>3,314</b>
<b>Total External Debt and Liabilities (A+B+C+D+E+F)</b>	<b>60,899</b>	<b>65,268</b>	<b>65,170</b>	<b>73,945</b>	<b>83,477</b>	<b>95,237</b>	<b>106,312</b>	<b>106,891</b>

P: Provisional

\*: Pakistan Banao Certificates (PBC) issued by Government of Pakistan for overseas Pakistanis, effective from 4 February 2019.

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

8.3 Pakistan's external debt is derived from four key sources, with 46 percent coming from multilateral loans, 33 percent from bilateral loans, 9 percent from Eurobonds/Sukuk and 12 percent from commercial loans. Although borrowing from commercial sources (foreign commercial banks and Eurobonds/Sukuku) have relatively increased during the last few years, however, multilateral and bilateral sources still cumulatively constitute 79 percent of external public debt portfolio at end June 2019. 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 following graph summarizes the component wise break-up of external public debt as at the end (30 June) of the periods stated:





## Debt Policy Statement 2019-20

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

8.4 Gross external disbursements were US\$ 10,496 million while commitments were US\$ 8,247 million during FY 2018-19. The details of gross external inflows from main sources are as follows:

- Bilateral sources remained the main contributor in external public debt disbursements with a share of 42 percent or US\$ 4,377 million. Out of this total, disbursements from China was US\$ 4,201 million or 96 percent of total disbursement from bilateral sources;
- Commercial loans contributed US\$ 4,098 million in external public debt disbursements. Out of this total, Chinese Banks provided US\$ 2,534 million or 62 percent of total disbursement from commercial banks. These commercial loans were primarily obtained for balance of payments support;
- Overall, China had highest share in external public debt disbursements in FY 2018-19 as the country received both commercial and bilateral loans amounting to total US\$ 6,735 million or 64 percent of total external public disbursements;
- Government mobilized US\$ 2,021 million from multilateral sources largely for energy and infrastructure projects.

8.5 External public debt repayments increased to US\$ 7,355 million during FY 2018-19 compared with US\$ 4,190 million in the preceding fiscal year. This increase was mainly on the back of repayment of Eurobonds of US\$ 1,000 million and commercial repayments of US\$ 2,097 million. Around 30 percent of external debt is contracted on floating rates, hence the rise in the benchmark rate (i.e. LIBOR) mainly led to an increase in interest payments during FY 2018-19 compared with last fiscal year i.e. interest payments were recorded at US\$ 2,103 million during FY 2018-19 compared with 1,684 million during last fiscal year.

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

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**Table-8: Source Wise External Inflows and Outflows**

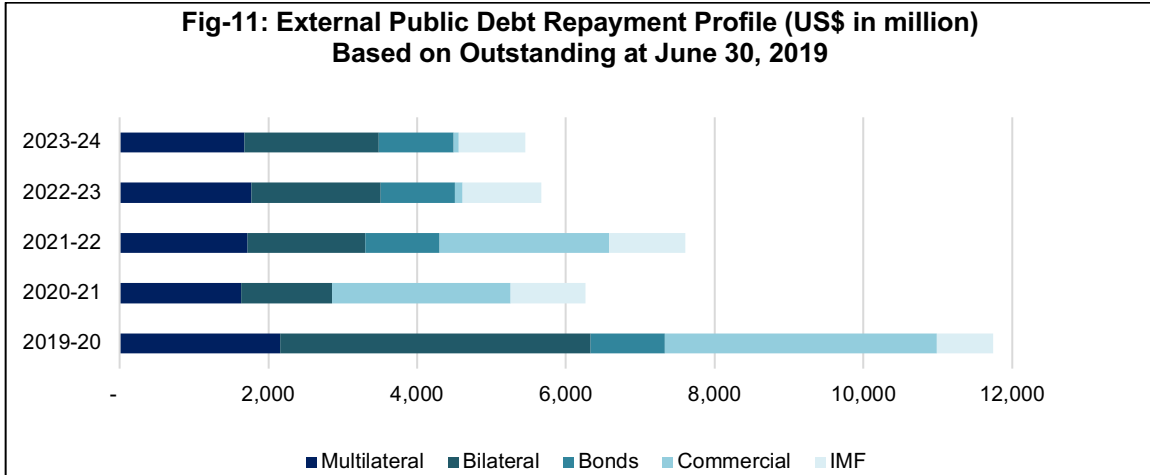
(US\$ in million)	FY13	FY14	FY15	FY16	FY17	FY18	FY19
<b>DISBURSEMENTS</b>							
Multilateral	1,332	3,096	2,824	3,757	3,064	2,813	2,021
Bilateral	889	887	867	1,040	1,941	1,971	4,377
Bonds	-	2,000	1,000	500	1,000	2,500	-
Commercial	-	323	150	1,387	4,426	3,716	4,098
IMF	-	1,656	2,611	2,009	102	-	-
<b>Total Inflows (A)</b>	<b>2,221</b>	<b>7,962</b>	<b>7,452</b>	<b>8,693</b>	<b>10,533</b>	<b>11,000</b>	<b>10,496</b>
<b>REPAYMENTS</b>							
Multilateral	1,155	1,324	1,181	1,221	1,255	1,317	1,375
Bilateral	299	435	407	440	1,200	793	970
Bonds	-	-	-	500	750	-	1,000
Commercial	-	-	-	225	489	489	2,097
IMF	2,899	3,130	1,226	53	-	86	375
Short Term Debt	390	256	612	735	1,393	1,486	1,537
Others	52	76	76	40	40	20	-
<b>Total Repayments (B)</b>	<b>4,795</b>	<b>5,220</b>	<b>3,500</b>	<b>3,213</b>	<b>5,127</b>	<b>4,190</b>	<b>7,355</b>
<b>Net Inflows (A-B)</b>	<b>(2,574)</b>	<b>2,742</b>	<b>3,952</b>	<b>5,480</b>	<b>5,406</b>	<b>6,809</b>	<b>3,140</b>
<b>INTEREST PAYMENTS</b>							
Multilateral	217	204	219	239	295	357	440
Bilateral	357	386	385	380	441	444	541
Bonds	111	111	300	354	366	423	503
Commercial	0	4	9	33	66	260	412
IMF	100	52	39	51	86	128	144
Short Term Government Debt	11	16	22	69	58	72	63
Others	4	3	1	0	0	0	0
<b>Total Interest Payments (C)</b>	<b>800</b>	<b>775</b>	<b>975</b>	<b>1,127</b>	<b>1,313</b>	<b>1,684</b>	<b>2,103</b>
<b>Total Debt Servicing (B+C)</b>	<b>5,595</b>	<b>5,995</b>	<b>4,475</b>	<b>4,340</b>	<b>6,440</b>	<b>5,874</b>	<b>9,458</b>

Note: Apart from above disbursements, the government also launched Pakistan Banao Certificates during FY 2018-19 and managed to raise US\$ 26 million during FY 2018-19;

Source: Economic Affairs Division and State Bank of Pakistan

The projected external public debt repayments based on outstanding at June 30, 2019 is presented through the graph below:

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### 8 (ii) - Currency Movements and Revaluation Impact

8.6 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 vs US Dollar can change the dollar and Pak Rupee value of external debt respectively.

8.7 In addition to net external inflows, following factors influenced the movement in external public debt stock during FY 2018-19:

- In US Dollar terms, revaluation gain owing to appreciation of US Dollar against other international currencies reduced the external public debt by around US\$ 56 million;
- It is important to note that external public debt recorded an increase of 5 percent in US Dollar terms. However, Pak Rupee depreciated by 32 percent against US Dollar during the year which led to 40 percent increase in external public debt when reported in Pak Rupee terms i.e. out of Rs 7,755 billion increase recorded in total public debt during FY 2018-19, significant amount of Rs 3,061 billion (39 percent) was due to the currency depreciation.

### **8 (iii) - Recent Development in External Public Debt (July - September 2019):**

- 8.8 External public debt was recorded at US\$ 74.2 billion, registering an increase of US\$ 711 million during July - September 2019 compared with the increase of US\$ 1,107 million during the same period last year. Whereas, total external public debt disbursements were US\$ 3,288 million during first quarter of FY 2019-20 compared with US\$ 3,057 million during the same period last year. Despite higher disbursements, higher external debt repayment (US\$ 2,089 million in first quarter of FY 2019-20 compared with US\$ 1,458 million during the same period last year) and revaluation gains due to appreciation of US Dollar against major currencies (US\$ 489 million) were the main factors leading to slowdown in accumulation of the external public debt during first quarter of FY 2019-20 compared with the same period last year.
- 8.9 Government also received first IMF tranche of US\$ 991 million during the quarter. In addition, the government was able to attract foreign interest in domestic government securities as the Pak Rupee stabilized, yields became attractive, and confidence began to return on economic policies. Foreign investment in government securities was US\$ 364 million at end September 2019.

### **8 (iv) - Performance of Emerging Markets and Pakistan:**

- 8.10 In the second half of 2018, most Emerging Market (“EM”) assets came under pressure. The continued trade tensions, appreciation of the Dollar and reduced economic growth forecasts caused significant capital outflows from EM, as investors took on a strategy of risk-avoidance. Due to these market conditions, Pakistan did not issue new bonds in the course of 2018. In-line with the sovereign peer group, Pakistan’s secondary trading spreads followed a widening trend from mid-July 2018 until almost the very end of the calendar year 2018. Despite this widening, Pakistan’s 19s, 21s, 22s, 24s, 25s bonds continued to trade close to par or at a premium, indicating that the investor perception of the credit remained generally favorable.
- 8.11 The beginning of 2019 brought a material shift in investor sentiment. After a net outflow position for EM fund flows in 2018, the first half of 2019 brought fresh

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liquidity into EM markets on the back of investors' eagerness for higher-yielding new issue supply and dovish signals from the Fed, with a record US\$ 29 billion in net inflows into emerging market funds. Against this backdrop, Pakistan's bonds rallied significantly since the beginning of the year with the full curve trading above par. Compared to levels at the beginning of July 2018, yield-to-maturity across Pakistan's curve tightened by 270 bps on average. Against overall EM Sovereign BB/B credits, Pakistan's yield differential pivoted from trading at a premium to trading materially inside the comparable index, standing at -52 bps at the end of first half of 2019 versus +90bps at the beginning of July 2018.

**Table-9: Pakistan Sovereign Bonds - Secondary Trading Levels:**

Bond	Ratings			Maturity	Size (\$ in million)	Coupon (%)	Price	Yield (%)	Z-Spread (bps)
	M	S&P	F						
Pakistan (Sukuk)	B3	B-	B-	Dec-19	1,000	6.750	100.2	4.919	305
Pakistan (Sukuk)	B3	B-	B-	Oct-21	1,000	5.500	100.3	5.348	367
Pakistan (Sukuk)	B3	B-	B-	Dec-22	1,000	5.625	100.1	5.578	394
Eurobond	B3	B-	B-	Apr-24	1,000	8.250	108.5	6.044	442
Eurobond	B3	B-	B-	Sep-25	500	8.250	108.9	6.421	478
Eurobond	B3	B-	B-	Dec-27	1,500	6.875	99.6	6.935	525
Eurobond	B3	B-	B-	Mar-36	300	7.875	100.4	7.833	601

Source: Bloomberg as of 30th October 2019

### 8 (v) - External Debt Sustainability

8.12 A country can achieve debt sustainability if it can meet its current and future debt service obligations in a timely manner and has the capacity to withstand macroeconomic shocks. 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.

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**Table-10: External Debt Sustainability Indicators**

(In percent)	FY13	FY14	FY15	FY16	FY17	FY18	FY19
ED/FEE (times)	1.0	1.0	1.0	1.1	1.2	1.3	1.3
ED/FER (times)	4.4	3.6	2.7	2.5	2.9	4.3	5.1
ED/GDP (Percentage)	20.8	21.1	18.8	20.7	20.5	22.3	25.9
ED Servicing/FEE (Percentage)	11.1	11.7	8.5	8.5	12.4	10.8	17.2
EDL/GDP (Percentage)	26.3	26.7	24.1	26.5	27.4	30.3	37.5
FER/EDL (Percentage)	18.1	21.7	28.7	31.2	25.6	17.2	13.6

FEE: Foreign Exchange Earnings; ED: External Public Debt; FER: Foreign Exchange Reserves, EDL: External Debt and Liabilities

Note: Above ratios are calculated based on US Dollar amounts.

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

- 8.13 External public debt to GDP ratio increased to 25.9 percent at end June 2019 compared with 22.3 percent at end June 2018, depicting increased external debt burden. Apart from increase in external public debt stock, reduction in GDP size in US Dollar terms contributed towards increase in this ratio. Similarly, external public debt to foreign exchange reserves ratio increased and recorded at 5.1 times during FY 2018-19 compared with 4.3 times during FY 2017-18. Moderate growth in external public debt and depletion of foreign exchange reserves owing to challenging balance of payment situation led to increase in this ratio during FY 2018-19.
- 8.14 Growth in external public debt servicing mainly driven by repayments of Eurobonds and commercial loans outpaced the growth in FEE and accordingly external public debt servicing to foreign exchange earnings ratio increased to 17.2 percent in FY 2018-19 compared with 10.8 percent in FY 2017-18.
- 8.15 The external imbalances that accumulated over past two years started to show improvement as current account deficit reduced significantly during FY 2018-19, after reaching its historic high in FY 2017-18. The current account deficit is anticipated to decrease further in FY 2019-20. With improved balance of payment situation, external debt sustainability is expected to improve going forward.

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

9.1 Government updated its Medium-Term Debt Management Strategy (MTDS) for period of 4 years (2015/16-2018/19). In accordance with the approved strategy, the government was mainly required to lengthen the maturity profile of its domestic debt portfolio while certain indicative ranges were defined to monitor the risks of public debt portfolio and ensure its sustainability.

**Table-11: Public Debt Cost and Risk Indicators\***

Risk Indicators		Indicative Ranges (MTDS 2015/16 - 2018/19)	Domestic Debt		External Debt		Public Debt	
			FY18	FY19	FY18	FY19	FY18	FY19
Refinancing Risk	Average Time to Maturity (ATM) - Years	1.5 (minimum) and 2.5 - DD 3.0 (minimum) and 4.5 - PD	1.6	4.2	7.6	7.0	3.6	5.2
	Debt Maturing in 1 Year (% of total)	50% and 65% (maximum) - DD 35% and 50% (maximum) - PD	66.3	36.8	12.4	17.2	48.9	29.9
Interest Rate Risk	Average Time to Re-Fixing (ATR) - Years	1.5 (minimum) and 2.5 - DD 3.0 (minimum) and 4.5 - PD	1.6	1.7	6.6	6.1	3.2	3.2
	Debt Re-Fixing in 1 year (% of total)	50% and 65% (maximum) - DD 40% and 55% (maximum) - PD	66.6	64.9	32.2	36.1	55.5	54.9
	Fixed Rate Debt (% of total)	**	44.3	71.9	72.5	68.3	53.4	70.6
Foreign Currency Risk (FX)	Foreign Currency Debt (% of total debt)	20% (minimum) and 35%					32.2	34.8
	Short Term FX Debt (% of reserves)	**					80.6	158.7

\* As per modalities of MTDS (2015/16 - 2018/19)

\*\*Not Applicable

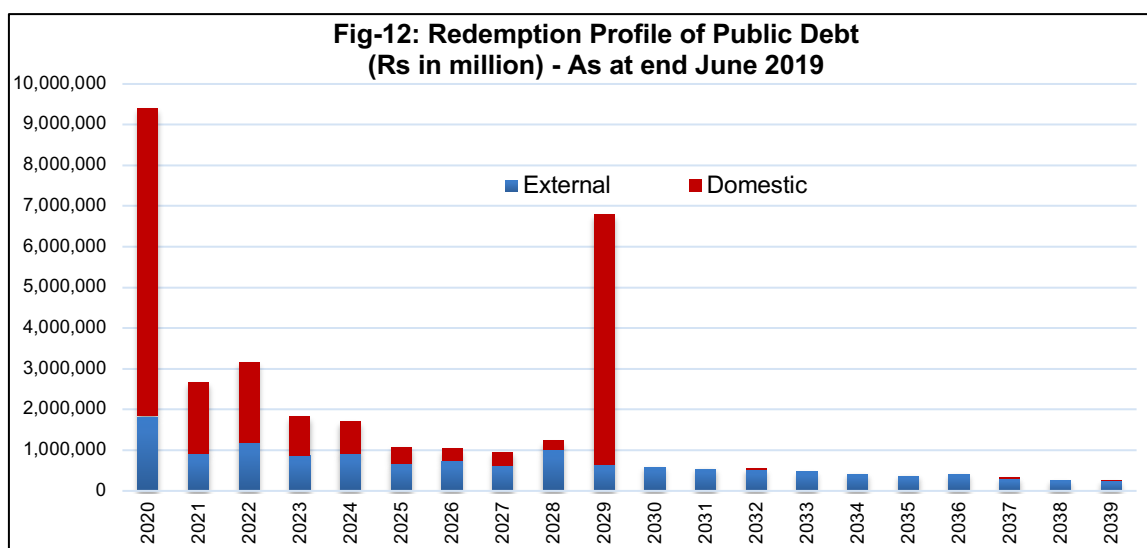
PD: Public Debt, DD: Domestic Debt

Source: Debt Policy Coordination Office, Ministry of Finance

9.2 At end June 2018, the government was in breach of three (3) of the nine (9) risk indicators thresholds as prescribed under MTDS (2015/16 - 2018/19). However, public debt risks reduced at end June 2019 primarily supported by re-profiling of SBP debt. Accordingly, government was not in breach of any risk indicator thresholds at end June 2019.

### Refinancing Risk

9.3 As stated above, the government re-profiled its borrowing from SBP from short term (6 months) to medium to long term (1 to 10 years). This re-profiling helped the government in reducing the refinancing risk of its domestic debt portfolio at end June 2019 as domestic debt maturing in one year reduced to 36 percent compared with 66 percent at end of last fiscal year. Accordingly, average time to maturity of domestic debt portfolio increased to 4.2 years at end June 2019 compared with 1.6 years at end June 2018, which is very close to long-term target set by the government for its domestic debt portfolio. External debt's average time to maturity is already 7 years and government intends to maintain it over medium to long term. The redemption profile of domestic and external debt at end June 2019 is shown in the graph below:



### Interest Rate Risk

9.4 It is important to note that 70 percent of the re-profiling of SBP borrowing was carried out through floating rate PIBs. Therefore, the government remained very close to maximum limit set for debt re-fixing / interest rate. Exposure to interest rate risk reduced as percentage of debt re-fixing in one year decreased to around 55 percent at end June 2019 compared with 56 percent at end June 2018. Going forward, government preference is to borrow more through fixed rate instruments to reduce interest rate risk of its public debt portfolio.



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### Foreign Currency Risk

9.5 Short-term external public debt maturities as percentage of official liquid reserves stood at 159 percent at end June 2019 compared with 81 percent at end June 2018. The higher proportion of external public maturities falling within a year compared with the level of official liquid reserves resulted in an increase in this ratio. Around 35 percent of total public debt stock was denominated in foreign currencies exposing public debt portfolio to exchange rate risk. Currency wise composition of public debt portfolio at end June 2019 is depicted through table below:

**Table-12: Currency Wise Public Debt**

Currencies	Percentage
Pak Rupee	65.2
US Dollar	20.0
Special Drawing Right	8.9
Japanese Yen	3.9
Euro	1.9
<b>Total</b>	<b>100.0</b>

Source: Debt Policy Coordination Office, Ministry of Finance

Government is in a process of updating its Medium-Term Debt Management Strategy on the basis of two broad principles to ensure sustainability (i) keeping public debt stock within manageable levels; and (ii) maintaining a diversified debt portfolio comprising variety of instruments and tenors while providing flexibility and enhanced borrowing options.

### 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.

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- 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.
- 10.3 During FY 2018-19, the government issued fresh/rollover guarantees aggregating to Rs 489 billion or 1.3 percent of GDP compared with Rs 324 billion issued during FY 2017-18. Whereas, the outstanding stock of government guarantees stood at Rs 1,554 billion at end June 2019. During first half of FY 2019-20, the government issued fresh / rollover guarantees aggregating to Rs 67 billion while outstanding stock of government guarantees was Rs 1,544 billion and total issued guarantees<sup>6</sup> stood at Rs 1,632 billion at end December, 2019.
- 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 756 billion at end June 2019.

### **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 maintain total public debt 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**

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<sup>6</sup> Outstanding guarantees plus guarantees committed (un-disbursements).

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**2018-19 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 3,635 billion or 9.4 percent of GDP during FY 2018-19, thus, remaining higher than the threshold of 4 percent. It is important to highlight that one-off factors contributed around 2.25 percent of GDP towards Federal fiscal deficit which are not expected to carry over into FY 2019-20 as per the following details:

- Delay in renewing telecom licenses, delay in sale of envisaged state assets and weaker than anticipated tax amnesty proceeds contributed around 1 percent of GDP;
- A shortfall in the transfer of SBP profits contributed an additional 0.5 percent of GDP. Profit of SBP witnessed a steep decline during FY 2018-19 as SBP incurred heavy exchange rate losses on its external liabilities;
- Payments of accrued interest on account of re-profiling of SBP borrowing at end June 2019 contributed 0.75 percent of GDP in Federal fiscal deficit;

In addition to above, some other factors were beyond the control of the fiscal authorities which contributed towards higher than budgeted federal fiscal deficit during FY 2018-19 such as (i) sharp rise in domestic interest rates and exchange rate depreciation (that escalated the debt servicing burden); (ii) legal constraints on the revenue side (court orders to substantially reduce the sales tax rate on major petroleum products and suspend the deduction of withholding tax on mobile phone top-ups); and an overall slowdown in the economy resulted in lower than budgeted revenue collections.

**(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;**

Government was required to reduce its Debt-to-GDP ratio to 60 percent by end June 2018 as per Fiscal Responsibility and Debt Limitation Act. However, Total Public Debt to GDP ratio reached 72.1 percent while total debt of the government to GDP was 66.5 percent. Total public debt and total debt of the government as percentage of GDP stood at 84.8

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percent and 76.6 percent respectively at end June 2019, thus, increasing further during FY 2018-19. Apart from fiscal deficit, unprecedented revaluation loss on account of currency depreciation and build-up of liquidity buffer contributed significantly toward the increase Debt-to-GDP ratio during FY 2018-19.

**(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 FY 2018-19, the government issued new guarantees including rollovers amounting to Rs 489 billion or 1.3 percent of GDP.

### 12.0 Conclusion

12.1 Government is committed to achieve the targets outlined in Fiscal Responsibility and Debt Limitation Act, 2005. Going forward, following are the main priorities with respect to public debt management over the medium term:

- Government objective is to bring and maintain its Public Debt-to-GDP and Debt Service-to-Revenue ratios to sustainable levels through a combination of greater revenue mobilization, rationalization of current expenditure and efficient/productive utilization of debt;

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- For domestic debt market development, the government is planning to introduce various new instruments with the objective to meet government financing requirements at the lowest possible cost while providing additional avenue to investor in-line with their investment horizon and risk appetite / preference;
- Government intends to broaden the universe of Shariah compliant securities (domestic as well as international);
- Lengthening of maturity profile of domestic debt through enhanced mobilization from medium to long term government securities will remain priority to reduce the re-financing and interest rate risks of domestic debt portfolio;
- Government will continue to seek long term concessional loans for development purposes.

12.2 Government is also taking necessary steps for ensuring fiscal discipline and consolidation, stabilizing the economy and accelerating growth. Accordingly, the government has started revamping the economy through structural reforms and stabilization measures such as broadening the tax base, reforming the Public Sector Enterprises (PSEs) and reducing the fiscal deficit, while ensuring that social safety net and development spending are not only protected but enhanced considerably. All these measures are expected to bring stability leading to gradual reduction in the fiscal deficit over next few years and subsequently would reduce the country's reliance on additional debt.

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