MEDIUM TERM DEBT MANAGEMENT STRATEGY (FY23-FY26)

Debt Management Office

1.0 INTRODUCTION

1.1 The Medium-Term Debt Management Strategy (MTDS) reflects the optimum combination of borrowing from various sources keeping in view tradeoff between cost and risk. Within the Medium-Term National Macro Fiscal Framework (MTNMFF), that aims at ensuring debt sustainability, the focus of the debt management strategy is to provide guidelines on the debt management decisions and borrowing operations of government keeping in view the composition and risk exposure of the public debt.

1.2 The medium term debt strategy shall be in line with the medium term budgetary framework as per section 13 (a) in sub section (2) of Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005.

1.3 Information on strategy implementation shall be provided through annual public debt review report.

2.0 OBJECTIVES & STRATEGIC GUIDELINES

To ensure that the government's financing needs, and its payment obligations are met at the lowest possible cost over the medium to long term, consistent with a prudent level of risk. A secondary objective is to enhance debt market development

Cost of Debt:	The cost of debt should be competitive and reasonable.
Availability of Financing:	Government should be able to borrow in a timely manner to cover its financing needs and payment obligations.
Domestic Debt Capital Market:	Development of domestic debt market remains a priority for the government.

2.1 STRATEGIC GUIDELINES

- **Lengthening of Maturity Profile:** Lengthening of maturity profile of domestic debt by mobilizing financing from medium and longer tenor instruments will remain priority over the medium-term.

- **Smooth Redemption Profile:** Government aims to have a smooth redemption profile of its debt portfolio to reduce the risk of refinancing.
- **Transparency in Borrowing Operations:** Transparency in domestic securities issuance process will be enhanced by providing clear information on borrowing program to investors and having continuous investor interaction including appropriate consultation.
- **Diversification of instruments and Investor Base:** Government priority is to borrow through multiple instruments to lower borrowing cost and provide more options to investors to choose investments which are closer to their investment horizons, income preferences and risk appetite.
- **More Issuance of Shariah Compliant Instruments:** In order to promote Islamic banking industry in the country and support budgetary position, government will continue to issue shariah compliant instruments in the domestic capital market regularly along with introduction of multiple tenor instruments with various options of profit frequency. Further, the untapped potential of the Islamic financial market may be utilized by offering asset light structures (besides asset backed instruments), which will help in optimal utilization of the scarce government resources. Exploring asset light structures for domestic debt borrowing may free-up the government assets for International Sukuk issuances as well.
- **Concessional External Financing:** Government will continue to avail maximum available concessional external financing from bilateral and multilateral development partners to benefit from favorable terms and conditions. This will help in lengthening of maturity profile of external debt.
- **Presence in International Capital Markets:** Government will continue to ensure its presence in the International Capital Markets (ICM) through issuance of Eurobonds and International Sukuks. Government also intends to tap other avenues within ICM like Environmental, Social, and Governance (ESG) bonds, Green Bonds, Sustainability Linked Bonds, Gender Bonds, etc.
- **Facilitate investment by non-residents in Government Securities:** Government will facilitate non-residents investment in Government Securities. This will enhance liquidity and competition in domestic capital

markets which in turn is expected to lower borrowing cost of the government and decrease government's reliance on domestic resources.

- **Provision of Liquidity buffer:** Government is committed making provision of a revolving cash buffer for liquidity and liability management.

2.2 SCOPE

The scope for coverage of public debt portfolio includes the debt contracted by the federal government. It also includes debt extended to provinces and SOEs under on-lending arrangement by the federal government. The analysis also includes the portion of IMF debt which was utilized towards budgetary support. However, the balance of payment portion of IMF debt is not included in the analysis since it is not a financing source for the government budget.

Time horizon of MTDS is 2022/23 - 2025/26. The starting point for the analysis is the debt portfolio at end-June, 2022.

2.3 LIMITATIONS OF DEBT MANAGEMENT STRATEGY

- Level of public debt is primarily determined by the size of fiscal deficits;
- Level of public debt is prone to economic factors i.e., exchange rate shocks, interest rate shocks;
- Debt repayment capacity of the government is determined mainly by the size of the economy which in turn is driven by underlying GDP growth rate;
- MTDS focuses mainly on mix of borrowings that make up the debt portfolio.

3.0 PROGRESS ON MTDS (2019/20-2022/23)

3.1 In accordance with the MTDS (2019/20-2022/23), the government was required to lengthen the maturity profile of its domestic debt portfolio while certain indicative ranges were defined to monitor the risks of total public debt portfolio and ensure its sustainability.

Table-1: Public Debt Risk Indicators (2019/2020 – 2021/2022)*

Risk Exposure	Indicators	Indicative Benchmarks	(2019-20)		(2020-21)		(2021-22)	
			Target	Actual	Target	Actual	Target	Actual
Currency Risk	Share of External Debt in Total Public Debt	40% (Maximum)	-	36	-	34	-	37
Refinancing Risk	ATM of Domestic Debt (Years)	3.5 (Minimum)	4.0	4.1	4.0	3.6	4.0	3.6
	ATM of External Debt (Years)	6.5 (Minimum)	7.0	7.0	7.0	6.8	7.0	6.2
	GFN (% of GDP)	35% (Maximum)	32	31	30	28	27	26
	Share of Shariah Compliant Debt in Govt Securities (%)	-	2.0	2.0	5.0	3.9	7.5	8.6
Interest Rate Risk	Share of Fixed Rate Debt in Govt Securities (%)	25% (Minimum)	30	34	30	30	30	26

ATM: Average Time to Maturity; GFN: Gross Financing Needs; External Debt refers to External Public Debt

* As per modalities of MTDS (2019/20 - 2022/23) Source: Debt Management Office, Ministry of Finance

3.2 As evident from the table above, the government has been able to meet most of the strategic benchmarks and targets during last three years as envisaged in Medium Term Debt Management Strategy (2019/20 – 2022/23). However, few targets set for 2021-22 with respect to debt risk indicators have not been met. Recent years have been challenging for the government due to economic and fiscal impact of the catastrophic floods, COVID-19 pandemic, volatility in international commodity prices, and global inflationary pressure. These macroeconomic shocks resulted in increased borrowing requirements for the government. The performance of various indicators along with underlying reasons and future strategy to meet the benchmarks are discussed below.

3.2.1 Share of external debt in total public debt increased slightly from 36 percent in 2019-20 to 37 percent in 2021-22 but remained below the benchmark (maximum limit) of 40 percent. The increase was attributable mainly to exchange rate depreciation rather than excessive external borrowings.

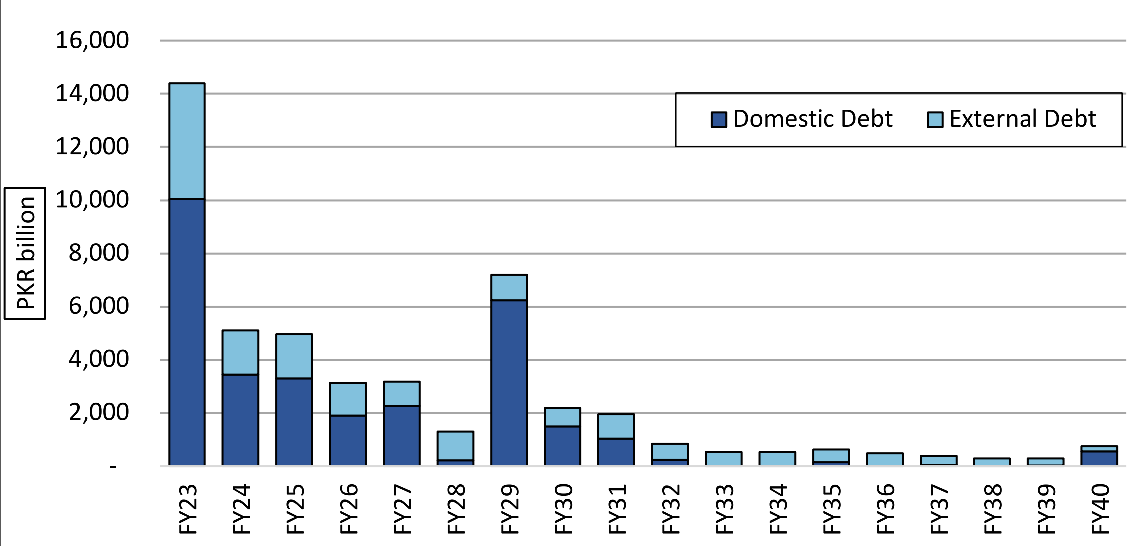
Table-2: Currency Composition of Total Public Debt (In Percent of Total Public Debt)

Currencies	Jun-20	Jun-21	Jun-22
Pak Rupee	64	66	63
US Dollar	19	18	21
Special Drawing Right (SDR)	13	11	11
Japanese Yen	3	2	2
Others	1	3	3
Total	**100**	**100**	**100**

3.2.2 Average Time to Maturity (ATM) of Domestic Debt fell from 4.1 years in 2019-20 to 3.6 years in 2021-22, mainly due to increased borrowing requirement and rising interest rates with larger appetite for short term instruments. Average Time to Maturity (ATM) of external debt declined from 7.0 years in 2019-20 to 6.2 years in 2021-22 and stood below the target of 7 years and also below the benchmark of 6.5 years mainly owing to running off of long-term portfolio. Furthermore, in recent years, the government has borrowed significant amounts by raising debt from commercial sources including medium to long-term Eurobonds, and short-term bank loans. Eurobonds mostly consist of 5- and 10-year tenors whereas bank loans typically have maturities of 1-year. Most of the bilateral loans obtained in recent years also had relatively shorter maturities. A combination of the above factors has resulted in lower ATM of the external debt. GFN/GDP ratio lowered during 2021-22 and stood at 26 percent for the year.

This ratio in 2021-22 is attributable partly to an upward revision in GDP as a result of rebasing of GDP figures and partly to the consistent and successful efforts made by MoF to contain the borrowing through short-term T-bills which are the single largest contributor to the GFN/GDP ratio.

Fig-1: Maturity Profile of Total Public Debt as at end June 2022



3.2.3 Shariah-Compliant domestic Sukuks issuance remained robust and the government was able to exceed the target set for 2021-22. The strategy worked well as the government not only exceeded the target for increasing the share of shariah-compliant securities, but was also able to consistently borrow at lower rates through these securities.

3.2.4 Government, in recent years, has consistently raised significant amounts through long-term fixed-rate securities. However, due to high borrowing needs under rising domestic interest rate environment, market participants were skewed towards investing in floating rate bonds. Therefore, larger amounts were raised by issuing floating-rate debt rather than fixed-rate debt. As a result, share of fixed rate debt in government Securities fell below the target set for 2021-22.

4.0 INDICATIVE THRESHOLDS/BENCHMARKS AND RATIONALE (FY 2022/23 - FY 2025/26)

4.1 Clear and quantitative targets for debt management demonstrate the sustainability of public debt portfolio. Based on the strategic guidelines and analysis of alternative strategies, following are the indicative ranges for key risk indicators that reflect the desired composition of public debt portfolio:

Table-3: Indicative Benchmarks and Targets for Key Risk Indicators (FY 2022/23 - FY 2025/26)

Risk Exposure	Indicators	Indicative Benchmarks (FY22-FY26)	Targets			
			FY23	FY24	FY25	FY26
Currency Risk	Share of External Debt in Total Public Debt	40% (Maximum)				
Refinancing Risk	ATM of Domestic Debt (Years)	3.0 (Minimum)	3.0	3.1	3.2	3.3
	ATM of External Debt (Years)	6.0 (Minimum)	6.0	6.1	6.2	6.3
	Share of Shariah Compliant Instruments in Government Securities (%)	-	8	10	12	15
Interest Rate Risk	Share of Fixed Rate Debt in Government Securities (%)	20% (Minimum)	20	22	24	25

ATM: Average Time to Maturity; GFN: Gross Financing Needs; GDP: Gross Domestic Product

4.2 Rationale for setting the MTDS targets:

4.2.1 Currency Risk

In relation to the currency risk, the maximum benchmark of external debt in total public debt is set to be 40 percent. In recent years, the increase in this ratio was attributable mainly to exchange rate depreciation rather than excessive external borrowings. Over the medium term, government will aim to reduce the share of external debt in total public debt.

4.2.2 Refinancing Risk

On the targets related to the refinancing risk, reason behind setting lower benchmark and target for ATM of domestic debt is that for external market for long-term loans exists – various multilateral financial institutions provide loans ranging from 20 to 40 years to developing countries at concessional rates, whereas, a domestic market for similar loans does not exist. Until the domestic market grows and deepens to a level where loans for very long tenors are available, it is only reasonable and realistic to set relatively lower targets for ATM of domestic debt. 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 and helped the government in reducing the rollover/refinancing risk of its domestic debt portfolio. However, as the SBP debt portfolio is running off and getting close its major maturity in 2029, its weightage impact on the overall domestic ATM is increasing. Henceforth, the minimum benchmark for domestic debt ATM is 3.0 years and for external debt ATM is 6.0 years. Government aims to improve these indicators over the medium term in-line with the targets set under the MTDS. Furthermore, higher financing requirements primarily due to higher fiscal deficits at times require higher short-term borrowings. However, government is committed to ensure fiscal discipline and has set a GFN to GDP maximum benchmark of 35 percent. Over the medium-term, the Government objective is to reduce its GFN as well as GFN to GDP ratio through various measures mainly including (i) better cash flow management; (ii) higher issuance of long-term debt; (iii) development of regular Islamic based lending programs; and (iv) availing maximum concessional financing from bilateral and multilateral development partners.

4.2.3 Concentration Risk

Diversification of lenders and borrowing instruments is important to reduce concentration risk. Diversification protects the borrower from over-reliance on any one category of lenders or borrowing instruments. Such over-reliance may exacerbate liquidity problems and worsen the borrowing costs in difficult times. Increasing the share of shariah-compliant government securities is an important part of the diversification strategy. Due to the high growth and rising market share of shariah-compliant financial institutions in the country, the rationale for this strategy is even stronger. In light of this, government aims to increase the share of shariah-compliant instruments in government securities to 15 percent till June 2026, while ensuring adherence to the yearly targets.

4.2.4 Interest Rate Risk

It is important to manage and maintain a high share of fixed-rate debt within domestic as well as external debt. Fixed-rate debt protects the borrower from unexpected increases in borrowing rates in wake of adverse economic developments. Under this MTDS, government has set a benchmark (minimum limit) of 20 percent for the share of fixed-rate debt within the domestic government securities. No such benchmark or target has been set for external debt because the share of fixed-rate debt with external debt is already quite high. The reason behind setting conservative benchmark and target for fixed-rate debt within domestic government securities is that the demand for fixed-rate debt among the domestic investors has been limited owing to high interest rate environment. Domestic financial markets are dominated by commercial banks which have preference for floating-rate debt because their liabilities are mostly based on floating-rates. Also, the lack of price stability in the past has led to a lowering of investor demand for long-term fixed-rate government securities in general. Until the market share of investors (such as insurance companies and pension funds etc.) with a clear preference for long-term fixed-rate instruments increases significantly, and the government's performance in the area of price stability improves substantially, it is appropriate to set realistic targets for this indicator.

4.3 OVERVIEW OF PUBLIC DEBT PORTFOLIO & GUARANTEES

4.3.1 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 4: Total Public Debt (Rs in billion)

	Jun-13	Jun-18	Jun-19	Jun-20	Jun-21	Jun-22	Mar-23
Domestic Debt	9,520	16,416	20,732	23,283	26,265	31,085	35,076
External Debt	4,771	8,537	11,976	13,116	13,601	18,157	24,171
Total Public Debt	**14,292**	**24,953**	**32,708**	**36,399**	**39,866**	**49,242**	**59,247**
Total Debt of the Government[1]	**13,457**	**23,024**	**29,521**	**33,235**	**35,669**	**44,361**	**54,392**
(In percent of GDP)							
Domestic Debt	38.0	41.9	47.3	49.0	47.0	46.7	-
External Debt	19.1	21.8	27.3	27.6	24.4	27.3	-
Total Public Debt	**57.1**	**63.7**	**74.7**	**76.6**	**71.4**	**73.9**	-
Total Debt of the Government[1]	**53.7**	**58.7**	**67.4**	**69.9**	**63.9**	**66.6**	-
(Memorandum Items)							
GDP (current market price)	25,042	39,190	43,798	47,540	55,836	66,624	84,658
US Dollar, (end of period Av.)	99.1	121.5	163.1	168.2	157.3	204.4	283.8

1 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.
Note: PBS has changed the National Accounts base year from 2005/06 to 2015/16. The new GDP numbers are available from 1999-2000 (updated in May 2023)

4.3.2. The expected average yield for FY2023 on domestic and external debt is around 15 percent and 4 percent, respectively, which makes the overall weightage average yield on public debt of around 12 percent. The interest expense to revenue is around 62 percent. In the medium term, the overall average yields on total public debt (domestic and external) is expected fall to single digit inline with the downward projections for inflation. Accordingly, interest expense to revenue will also decrease based on macroeconomic framework.

4.3.3 The Fiscal Responsibility and Debt Limitation (Amendment) Act, 2005 imposes following two ceilings on Government guarantees:

i. Flow ceiling: 2 percent of GDP on the issuance of Government guarantees, with renewal of existing guarantees being considered as issuing new guarantees.

ii. Stock ceiling: 10 percent of GDP on the total stock of outstanding Government guarantees.

4.3.4 During 2021-22, the government issued fresh/rollover guarantees aggregating to 0.7 percent of GDP and during Jul-Mar FY23, the Government issued fresh/rollover guarantees aggregating to 0.2 percent of GDP. The outstanding stock of guarantees was Rs 3,460 billion at end-March 2023.

Table-5: Government Guarantees Stock **(PKR in billion)**

	June-20	June-21	June-22	March-23
Outstanding Guarantees (Extended to PSEs)	**2,344**	**2,407**	**2,983**	**3,460**
-Domestic Currency	1,631	1,564	1,533	1,579
-Foreign Currency	713	843	1,451	1,881
Outstanding Guarantees (% of GDP)	**4.9**	**4.3**	**4.5**	**-**
Memo: Foreign Currency (US$ in billion)	4.2	5.4	7.1	6.6

Source: Debt Management Office, Ministry of Finance

4.3.5 Complete analyses of debt management operations, guarantees, and assessment of the progress against the medium-term debt management strategy in-line with the long-term priorities of the Federal Government are published bi-annually on Finance Division Website.

4.4 MEDIUM-TERM NATIONAL MACRO FISCAL FRAMEWORK (MTNMFF)

4.4(i) Macroeconomic Assumptions

4.4.1 The underlying assumptions of MTDS are in-line with the MTNFF. It is important to note that effective implementation of MTNFF is necessary for successful implementation of the MTDS. Specifically, adherence to key macro-fiscal targets such as GDP growth, inflation and fiscal deficits need to be complied to achieve the desired results with respect to public debt management over the medium-term.

4.4.2 Pakistan started FY 2022-23 with challenges both on domestic and external fronts. Accordingly, MTNMFF 2022-23 to 2025-26 mainly focuses recovering from the economic and fiscal impact of the catastrophic floods, post COVID-19 pandemic scenario, Russia-Ukraine conflict, and global inflationary pressure through a sustainable fiscal policy over the medium-term. Key features of medium-term projections are as follows:

- Government intends to reduce budget deficit from 7.9 percent of GDP in FY22 to 3.1 percent of GDP by FY26.
- Inflation is projected to converge to around 6.5 percent per annum by FY26 on the back of improved commodity-producing sectors (agriculture and industry), effective monetary policy, and stronger fiscal discipline
- With increased investor confidence, stable inflation, fairly valued exchange rate, improved current account balance and better fiscal and monetary management, economic growth is projected to reach 5.5 percent per annum by FY26;
- Over the medium term, reduction in inflation rates is expected to result in lower borrowing costs for the government. Accordingly, the interest expenditures as percentage of GDP are expected to reduce over the medium-term which will create fiscal space.

Table-6: Macroeconomic Indicators

(As percentage of GDP, unless otherwise indicated)				
	FY23	FY24	FY25	FY26
Inflation (Annual Percentage Change)	29.0	21.0	7.5	6.5
Real GDP Growth (Annual Percentage Change)	0.3	3.5	5.0	5.5
Overall Primary Balance	(0.5)	0.4	0.3	0.4
Federal Primary Balance	(1.1)	(0.3)	(0.2)	(0.1)
Overall Fiscal Balance	(7.0)	(6.5)	(5.1)	(3.1)
Federal Fiscal Balance	(7.6)	(7.2)	(5.7)	(3.6)

Source: Medium Term Budget Strategy Paper FY 2023/24 – FY 2025/26

4.4(ii) Risks Associated with Macroeconomic Indicators

4.4.3 The estimates of key economic indicators are prone to certain risks and vulnerabilities that could cause deviations from the projections. These risks can undermine the achievement of the targets set under the MTDS. Following are the key risks:

4.4.4 Lower tax revenues lead to greater fiscal deficits that may need to be financed through higher borrowings, and also reduce fiscal space for expenditure pertaining to development and social sectors. Government is targeting higher growth in Federal Board of Revenue (FBR) revenues over the next 4 years. Any shortfall in achievement of targets in tax revenue collection will have adverse consequences for the projected fiscal position of the government.

4.4.5 A combination of factors including achieving primary surplus, lowering overall fiscal deficit, attaining higher GDP growth, and ensuring stability in exchange rate are fundamental to achieve the goal of debt sustainability. Impact arising from climate change events may also adversely affect macroeconomic framework.

4.4.6 Government has projected sufficient external financing over the medium-term for financing of its budget deficit. Any shortfall in external financing may pose a risk to fiscal health as well as overall macroeconomic stability of the country by putting additional borrowing pressure on domestic markets.

4.4.7 Apart from the crowding out effect, large domestic borrowing needs make the domestic markets susceptible to macroeconomic shocks. Expectations of continuing inflation and high interest rates can disrupt the domestic markets with adverse implications for government’s liquidity management and cost of borrowing.

4.4.8 Government is maintaining a cash buffer to meet unexpected liquidity requirements on account of cashflow mismatches and/or other contingencies. Proactive cash management is necessary so that government can provide support in managing risks to fiscal stability in case of adverse shock scenarios such as natural calamities.

4.5 POTENTIAL FUNDING SOURCES

4.5.1 Government meets its financing requirements from both domestic and external sources. Domestic sources mainly include issuance of government securities (Treasury Bill having less than 1-year maturity, Pakistan Investment Bonds having maturity over 1 year and Government Ijarah Sukuks having maturity 1 to 5 years) and receipt of deposits through National Savings Schemes (3 months to 10 years). External sources mainly include loans from multilateral and bilateral development partners, issuance of bonds in the international capital markets and short to medium term foreign currency loans from commercial banks.

4.5(i) Expectations for 2022/23 - 2025/26 from Domestic Sources

4.5.2 The domestic market will remain as a main source of funding to finance the fiscal deficit and for refinancing of existing domestic debt. Government intends to continue building liquid benchmarks across the yield curve with a transparent issuance policy that will define the number of benchmark securities, range of issue sizes, as well as information in advance of the market in terms of volume and frequency of issues.

4.5.3 Government is planning to introduce multiple instruments in order to broaden the investor base and offer diversified investment avenues to investors which are closer to their investment horizons, income preferences and risk appetite.

- Government earlier introduced a conventional long-term (10-year maturity) floating-rate PIBs alongwith floating-rate PIBs with 3-year and 5-year maturities and quarterly coupon payments. These provided useful additions to the portfolio of government securities.
- In the medium-term, Government also issued 2 years Floating Rate Notes (FRNs) to attract more diversified investor base.
- Government may also introduce inflation linked bonds[1]. Insurance companies, pension funds and mutual funds prefer to buy these instruments for their liability management.

[1] Inflation-Indexed bonds are securities with the principal linked to the Consumer Price Index. The principal changes with inflation, guaranteeing the investor that the real purchasing power of the investment will keep pace with the rate of inflation.

- Further, Government may also consider listing and trading of Government Securities through stock exchange to support investor outreach.
- Liquidity available with Islamic banks is being tapped through issuance of Shariah compliant instruments against assets which have become available after maturity of earlier issued GoP Ijara Sukuks. Government also identified new assets for continuing Sukuks program with the following modalities[2]:
    - Similar to conventional bond, Sukuks are being re-opened in multiple auctions (with identical profit coupon and maturity dates). The objective is to attract investors, increase liquidity of the Sukuks issue and lower costs for the government;
    - The tenor of the Sukuks was initially fixed at 5 years consistent with the objective of the government to lengthen the maturity profile of domestic debt portfolio.
- Government has also initiated issuing Sukuks of 1 and 3 year tenor in response to market appetite for development of domestic debt market. This is mainly due to the prevailing high interest environment which will be reversed once the interest rates are stable in order to pursue the lengthening of maturity profile objective.
- Government will also consider option of asset light structures based on Musharaka, Ijara, Murabaha or any other Shariah compliant mode to raise funds, as assets available with government are limited.
- Government may also consider undertaking bond exchanges and buyback operations to manage roll-over and refinancing risk by consolidating the large number of outstanding securities into fewer and more liquid instruments. In this regard, Government has already notified a policy to buy back government securities.
- Sarwa Islamic Savings Account (SISA) is expected to be a good addition to the existing product basket of NSS. The Product is set to receive healthy response from the general public and a sizeable increase in inflows is expected over the medium term.

2 Subject to approval of Shariah Advisory Board of State Bank of Pakistan and Islamic Banks.

- Government is actively pursuing its commitment of offering digital financial services to its existing as well as prospective customers through NSS. The NSS Certificates will be available for purchase in digital form through Central Depository Company (CDC).

4.5.4 Within non-banking sector, most of the incremental proceeds are expected to be mobilized through NSS. Government is taking various steps to increase mobilization from non-banking sector. Efforts are geared towards increasing the retail investor participation in government securities in both primary and secondary markets. The ultimate aim is to utilize the stock exchanges for primary market / auction of the government debt securities to enable wider outreach and improve participation of retail segment.

4.5.5 Financing of the budget deficit would be carried out through domestic and external sources. Domestic source constitutes the major portion for budget financing, for which government aims to meet most of its net domestic financing requirements through the issuance of medium to long term government securities and NSS while remaining shortfall, if any, would be met through issuance of T-bills.

4.5(ii) Expectations for 2022/23 - 2022/23 from External Sources

4.5.6 Government intends to secure external financing mainly from multilateral and bilateral development partners and international capital markets over the medium term keeping in view cost risk tradeoffs.

4.5.7 Government intends to continue its partnership with international development partners to take advantage of concessional / semi-concessional funding. Disbursement of project loans is dependent on the implementation capacity and efficiency of the implementing entities. It is expected that as a result of renewed efforts to speed-up the pace of project implementation, disbursements will increase over the medium-term. Policy based funding is linked with the macroeconomic stability. The structural reforms initiated by the government are producing results and are expected to increase macroeconomic stability. With improved macroeconomic indicators coupled with faster project implementation, disbursement from multilateral and bilateral creditors is expected to increase in the medium-term.

4.5.8 Owing to the global economic conditions, issuance in international capital market during FY 2023 is extremely difficult. However, Government plans to maintain its presence in international capital market over the medium-term. Flexibility in terms of timing, size, interest rate type, maturity and repayment structure will be maintained keeping in view cost and risk considerations. Existing external commercial loans from foreign banks will mostly be rolled-over/refinanced over the medium-term while incremental external inflows from commercial sources would not be significant. Government is committed to increase the average maturity of its commercial loan portfolio to reduce its refinancing risk of external public debt portfolio.

4.6 ALTERNATIVE DEBT STRATEGIES

4.6.1 Macroeconomic projections indicate a declining trajectory of public debt to GDP ratio over the medium-term. Average Time to Maturity (ATM) of domestic debt portfolio remained mostly below 2 years in the past, however, it increased significantly to over 4 years at end June 2019, primarily supported by one-off re-profiling of SBP borrowing. The SBP portfolio is also running off, therefore, government intends to maintain ATM minimum at 3 years in the medium-term keeping in view cost risk trade-offs.

4.6.2 ATM of external debt has decreased over the past few years from 10 years in FY 2012-13 to 7 years in FY 2018-19, further down to 6.2 years at end June 2022. This is primarily attributable to running-off of existing portfolio and due to the fact that the government had to partially meet its growing external financing requirements from commercial avenues. Commercial borrowing is contracted at market terms i.e. at relatively higher cost and lower tenor compared with concessional terms offered by multilateral and bilateral development partners. Since Pakistan is not considered as low-income country anymore, increase in loans from banks or through Eurobonds is necessity for which the geopolitical as well as global economic environment has not been supportive. Government intends to increase the ATM of its external debt portfolio over the medium-term through a combination of following measures:

- To avail maximum concessional external financing from bilateral and multilateral development partners. These loans provide maximum flexibility to the borrower in the choice of grace period, final maturity, and amortization structure. In such cases, the government will prefer to choose relatively higher ATM while ensuring smooth redemption profile of its external public debt portfolio;

- Preference is to borrow more in 10 years and 15 years tenors in international capital market while keeping in consideration cost risks tradeoffs; and
- Government intends to contract fresh commercial loans in relatively higher tenors (3 years or more). In addition, efforts will be geared towards reprofiling of existing stock of commercial loans from short-term to medium-to-long-term.

4.6.3 Based on these considerations, the government evaluated financing alternatives with the objective to reduce exposure to refinancing and interest rate risks. Following options were analyzed to check the possibility of reducing these risks:

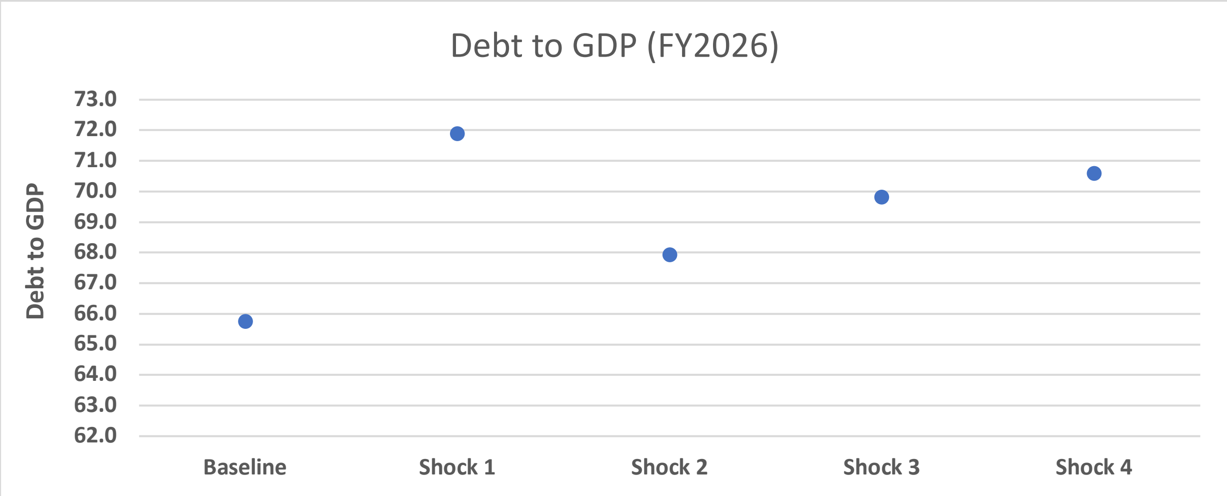
- **Domestic Debt:** Mobilization more through medium to longer tenor domestic debt instruments along with the residual funding financed through short term domestic debt instrument **or** mobilization in medium to longer term tenor domestic debt instruments with higher quantum reducing reliance on short term debt instruments.
- **External Debt:** Mobilization more through concessional loans along with the residual funding financed through commercial loans and Eurobonds **or** meeting all needs from concessional sources minimizing the need for commercial borrowings.

Other borrowing strategies with more reliance on short term domestic debt instrument along with mobilization of less than projected external funding were also simulated to evaluate their impact on debt portfolio, which may return low cost or less currency exposure, but become undesirable due to associated significant risk and practical implications. Aggressive mobilization from medium to long term domestic debt and concessional external sources yields best results in terms of risk reduction of debt portfolio but also comes with its limitations.

Recommendation: A balance between the aggressive and business as usual approach appears to be more practical and expected to reduce the risks of debt portfolio over the medium-term, which is preferred in line with the debt management objectives.

4.7 SENSITIVITY ANALYSES

Using alternative strategies and in light of interest rate shock (moderate and extreme), exchange rate shock and combined shocks, the effect on Debt to GDP ratio was analyzed. Considering the results obtained from the analyses, public debt to GDP ratio is expected to reduce over next 4 years from its level of 73.9 percent at end June 2022.



Shock 1 – Exchange Rate Depreciation (30%) **Shock 2** – Moderate Interest Rate **Shock 3** – Extreme Interest Rate **Shock 4** – Combined Shock (15% depreciation & Shock 2)

5.0 CONCLUSION

- The MTDS will be implemented through annual borrowing plans that meets the funding requirements of the government for each fiscal year. The borrowing plan takes into account the desired composition assumed in the MTDS analysis. The information of the government's domestic borrowing plan is disseminated to the market on monthly basis through the publication of auction calendar i.e. Government announces auction calendar of government securities every month for the next three months on rolling basis. The auction calendar contains tenor wise target amounts which the government intends to borrow from domestic securities for financing of its budget deficit during any particular quarter.
- Government will continue to actively engage investors and market participants through periodic meetings, conference calls and investor presentations with Primary Dealers (PDs) and key market players. The meetings will focus on market development, financing plans, financing operations and investor views, as well as performance of the PD system. Regular meetings will also be held with mutual fund managers and insurance companies, as well as regulators

including State Bank of Pakistan and Securities and Exchange Commission of Pakistan.

- Government will continue working with development partners to deepen the domestic debt market, enhance capacity building of debt management staff and improve efficiency in debt management operations.
- Government will ensure transparency on debt management in accordance with international best practices through provision of accurate and timely information on public debt through various publications.

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