Chapter 9

Public Debt

9.1 Introduction

Developing countries have distinct debt dynamics from that of developed ones. During the economic growth catching-up process, developing countries often find themselves in a position where debt levels are positively correlated with their growth levels. A simple law governing such a relationship is brisker growth in the developing world which allows them to ride on a declining debt trajectory provided debt accumulation is backed by a diligently thought out road map. However, public debt becomes much unsustainable when debt burden starts mounting as debt growth outstrips revenue growth, and debt servicing starts exceeding recommended threshold levels. To avoid such a quagmire, certain aspects are of pivotal importance. First, successful debt reduction requires fiscal consolidation and a policy mix that supports growth. Second, fiscal consolidation aiming to reform structural weaknesses preferred over myopic measures. Third, realizing the fact that debt reduction is bound to be time consuming.

Pakistan debt dynamics has witnessed substantial changes over past few years. Fiscal imbalance and difficult balance of payments position have contributed towards public debt accumulation. The composition of public debt has witnessed major changes with increasing reliance on domestic debt due to non-availability of sufficient funds from external sources. The composition of major components shaping the domestic debt portfolio has itself undergone a transformation from a high dominance of unfunded debt to an increasing dependence on short term floating debt that led to shortening of maturity profile of public debt. Maintaining exchange rate stability is also a pre-requisite for external debt sustainability and to reduce the impact of growing external indebtedness. The Government of Pakistan has embarked upon a rule based policy necessary for fiscal consolidation and debt management incorporated in Fiscal Responsibility and Debt Limitation Act (FRDLA), 2005.

9.2 Public Debt

The portion of total debt which has a direct charge on government revenues is taken as public debt. Public debt is a measure of government indebtedness. It includes debt denominated in rupee as well as foreign currency. Public debt comprises of domestic and external debt. 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 needs to be balanced in order to ensure ample and timely access to cost efficient funding.

Domestic debt is a charge on budget and must be serviced through government revenues and/or additional borrowings whereas external debt (both public and private), in addition to charge on revenues, is also a charge on balance of payment and must be serviced from foreign exchange earnings, reserve drawdown, and additional borrowings. Therefore, the two should be managed separately to ensure fiscal and external account solvency.

As at end-March 2013, public debt reached at Rs.13,626 billion, an increase of Rs.959 billion or 8 percent higher than the debt stock at the end of last fiscal year. Public debt as a percent of GDP reached at 59.5 percent of GDP by end-March 2013 compared to 59.8 percent during the same period last year. The primary source of increase in public debt during July-March, 2012-13 was increase in domestic debt that positioned at Rs.8,796 billion represented an increase of Rs.1,159 billion, whereas, external debt posed at Rs.4,831 billion represented a decrease of Rs.200 billion as compared to end-June 2012. The decline in external debt during July-March, 2012-2013 is mainly attributed to repayments against IMF loans, translational gain on account of US Dollar appreciation against other major currencies and marginal fresh disbursements.

Table-9.1: Public Debt (1990-2013*)

	1990	1995	2000	2005	2008	2009	2010	2011(P)	2012(P)	2013 (P)*
	(Rs. in billion)									
Domestic Debt	374	790	1,576	2,178	3,266	3,852	4,651	6,016	7,637	8,796

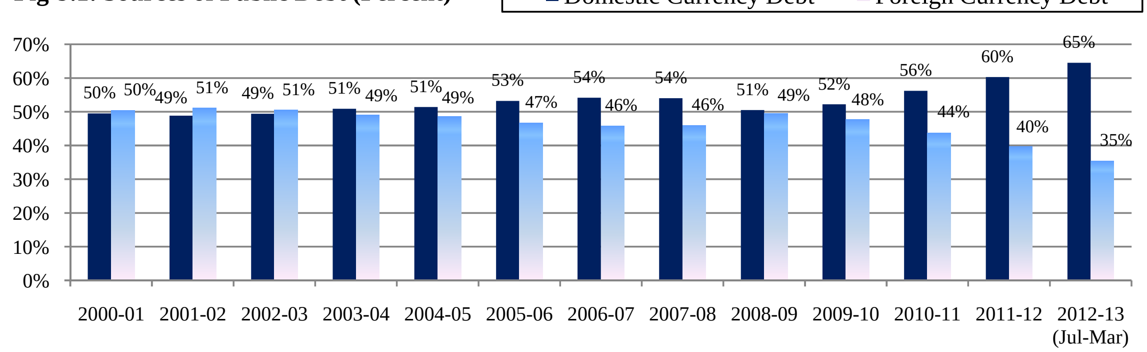
Table-9.1: Public Debt (1990-2013*)

	1990	1995	2000	2005	2008	2009	2010	2011(P)	2012(P)	2013 (P)*
	(Rs. in billion)									
External Debt	428	873	1,442	1,913	2,778	3,776	4,260	4,685	5,030	4,831
Total Public Debt	801	1,662	3,018	4,091	6,044	7,629	8,911	10,700	12,667	13,626
	(In percent of GDP)									
Domestic Debt	42.8	42.3	41.2	33.5	30.7	29.2	31.3	32.9	38.0	38.4
External Debt	48.9	46.8	37.7	29.4	26.1	28.6	28.7	25.6	25.0	21.1
Total Public Debt	91.7	89.1	78.9	62.9	56.8	57.8	59.9	58.5	63.0	59.5
	(In percent of Revenue)									
Domestic Debt	235	245	308	242	218	208	224	267	298	-
External Debt	269	270	281	213	185	204	205	208	196	-
Total Public Debt	505	515	589	455	403	412	429	475	494	-
	(In percent of Total Debt)									
Domestic Debt	46.6	47.5	52.2	53.2	54.0	50.5	52.2	56.2	60.3	64.5
External Debt	53.4	52.5	47.8	46.8	46.0	49.5	47.8	43.8	39.7	35.5
Memo:										
Foreign Currency Debt (US$ in billion)	19.5	28.1	27.5	32.1	40.7	46.4	49.8	54.5	53.2	49.1
Exchange Rate (Rs./US$, End of Period)	21.9	31.1	52.5	59.7	68.3	81.4	85.5	86.0	94.5	98.4
GDP (Rs. in billion)	874	1,866	3,826	6,500	10,638	13,200	14,867	18,285	20,091	22,909
Total Revenue (Rs. in billion)	159	323	513	900	1,499	1,851	2,078	2,253	2,567	3,378

Source: Budget Wing, Economic Affairs Division, State Bank of Pakistan & Debt Policy Coordination Office Staff Calculations
P: Provisional. *: End-March 2013

Historically, public debt stock accounted for almost the same burden from domestic and external sources. However, government has increasingly focused on the domestic part over the last few years owing to non-availability of sufficient external financing i.e. domestic borrowings inched up in share from 50.5 percent of total public debt in 2008-09 to 64.5 percent at end-March 2013.

Fig-9.1: Sources of Public Debt (Percent)



The public debt may be understated without reporting contingent liabilities. Contingent liabilities are possible obligations that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the government. Contingent liabilities are not added to the overall debt of the country, however, such off-balance sheet transactions cannot be overlooked in order to gain a holistic view of a country's fiscal position and unveil the hidden risks associated with the obligations made by the government outside the budget. It is imperative to examine the contingent liabilities in the same manner as a proposal for a loan, taking into account, inter alia, the credit-worthiness of the borrower, the amount and risks sought to be covered by a sovereign guarantee, the terms of the borrowing, justification and public purpose to be served, probabilities that various commitments will become due and possible costs of such liabilities etc.

In the case of Pakistan, these include, for instance, explicit and implicit guarantees issued to Public Sector Enterprises (PSEs). During July-March, 2012-13, the Government of Pakistan issued fresh/rollover guarantees aggregating to Rs.111 billion or 0.5 percent of GDP. The outstanding stock of government guarantees as at end-March, 2013 is positioned at Rs.609 billion.

Table-9.2: Guarantees Outstanding as on March 31, 2013 (Rs. in billion)

Outstanding Guarantees extended to Public Sector Enterprises (PSEs)	**609**
- Domestic Currency	328
- Foreign Currency	281
Memo:	
Foreign Currency (US$ in million)	**2,855**

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

9.2.1 Dynamics of Public Debt Burden

Public debt is an important measure of bridging the financing gaps of the government. Prudent utilization of public debt leads to higher economic growth and adds to capacity to service and repay external and domestic debt. It also helps the government to accomplish its social and developmental goals. Debt problems arise if debt-servicing capacity does not keep pace with growth of debt. This may also be expressed as debt exceeding sustainable levels. Unsustainable levels of debt have repercussions for an economy in the form of a re-allocation of resources towards debt servicing.

The debt burden can be expressed in terms of the stock ratio i.e. debt to GDP, external debt to GDP or flow ratios i.e. debt to revenue, external debt to foreign exchange earnings. It is a common practice to measure the public debt burden in terms of stock ratios; however, it is more appropriate to measure the burden of public debt in terms of flow ratios as the level of debt depends on the debt servicing capacity of the economy. The more important rule about limiting public debt growth must be expressed in relation to revenue growth. If the primary deficit is zero, the ratio of public debt to revenues will not grow as long as the rate of growth of debt does not exceeds the rate of growth of revenues. Similarly, if the growth in Foreign Exchange Earnings (FEE) exceeds the growth in External Debt and Liabilities (EDL), the ratio of EDL-to-FEE will continue to decline.

Table-9.3: Selected Debt Indicators

	2008	2009	2010	2011	2012	2013[i]
Revenue Balance / GDP*	(3.1)	(1.2)	(1.7)	(3.3)**	(2.6)***	(2.2)
Primary Balance / GDP*	(2.4)	(0.1)	(1.6)	(2.5)**	(2.2)***	(1.1)
Fiscal Balance / GDP	(7.3)	(5.2)	(6.2)	(5.9)**	(6.8)***	(4.6)
Public Debt / GDP	56.8	57.8	59.9	58.5	63.0	59.5
Public Debt / Revenue	403.1	412.2	428.8	475.0	493.6	-
Debt Service / Revenue	37.2	46.6	40.4	38.0	39.9	44.1
Debt Service / GDP	5.2	6.5	5.6	4.7	5.1	4.1

Source: Debt Policy Coordination Office Staff Calculations, Finance Division
[i]July – March
*: Adjusted for grants
**: excludes arrears of electricity subsidies amounting Rs.120 billion
***: excludes, "one off" payment of Rs.391 billion on account of debt consolidation

The revenue shortfall over current expenditure is a reflection of non-availability of fiscal space for undertaking development spending for which the government needs to generate a revenue surplus or at least maintain revenue balance. It also implies that the borrowed money is mostly spent on current outlays that otherwise should be available solely for development purposes. The revenue deficit reached at Rs.497 billion or 2.2 percent of GDP during July - March, 2012-13.

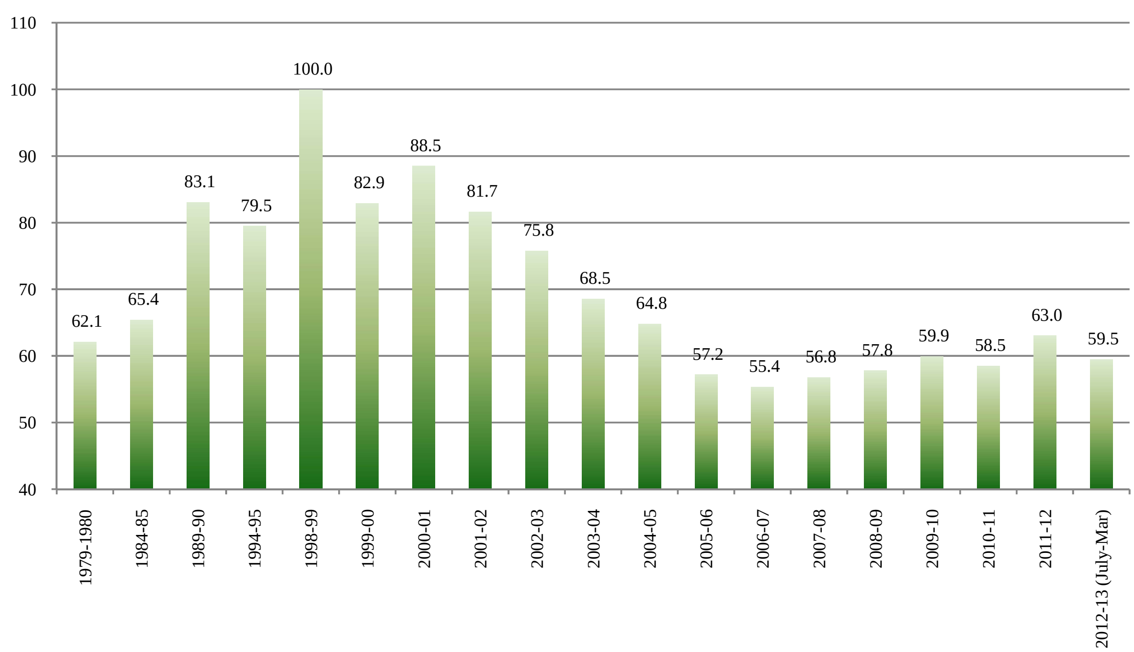
Primary balance is the total revenue adjusted for non-interest expenditure. A negative primary balance essentially means that the government is borrowing money to pay interest payment on the debt stock which resulted in debt trap. In 2008-09, government was able to bring the deficit down to 0.1 percent of GDP from 2.4 percent in 2007-08 as a result of fiscal consolidation and rationalization of expenditure. However since 2009-10, owing to increased security expenditure, unsustainable food and energy subsidies and great floods of 2010, fiscal adjustment path was reversed and the primary deficit reached 2.2 percent of GDP at the end of June 2012. During July-March, 2012-13, primary deficit reached Rs.254 billion or 1.1 percent of GDP.

Pakistan's fiscal deficit over the last few years saw significant variation from its original targets. The fiscal deficit already reached Rs.1,046 billion or 4.6 percent of GDP during first nine months of current fiscal year as compared with the annual target of 4.7 percent. The higher fiscal deficit is adding to public debt and pre-empting a major chunk of revenues to service it i.e. During July-March, 2012-13, nearly 44 percent of total revenues have been consumed in debt servicing.

The real growth of debt (12.4 percent) has been greater than the real growth of revenues (8.2 percent); and, this complemented by the primary deficit resulted in increase of the debt burden during 2011-12. The public debt stood at 4.9 times of government revenues at the end of fiscal year 2011-12, ideally this ratio should be 3.5 times or lower.

Public debt as a percent of GDP stood at 59.5 percent of GDP by end-March 2013 compared to 59.8 percent during the same period last year.

Fig-9.2: Public Debt as Percentage of GDP



9.2.2 Servicing of Public Debt

Increase in the outstanding stock of total public debt have implications for the economy as it forced the government to adjust its expenditure and direct additional resources towards the repayment of debt and associated interest payments. Total public debt servicing below 30 percent of government revenue are generally believed to be within the bounds of sustainability. The government is required to make concentrated efforts to increase the revenues and rationalize current expenditure to reduce the debt burden and improve the debt carrying capacity of the country to finance the growth and development needs.

During July - March, 2012-13, public debt servicing reached at Rs.936 billion against the annual budgeted estimate of Rs.1,142 billion. Public debt servicing consumed nearly 44 percent of total revenues during July-March, 2012-13 against a ratio of 41 percent during the same period last year. Out of total, domestic debt servicing reached at Rs.725

billion against Rs.579 billion paid during the same period last year.

Table-9.4: Public Debt Servicing (Rs. in billion)

	2012-2013*			
	Budgeted	Actual	Percent of Revenue	Percent of Current Expenditure
Servicing of External Debt	80.2	47.5	2.2	1.8
Repayment of External Debt	216.0	164.1	7.7	6.2
Servicing of Domestic Debt	845.6	724.7	34.1	27.4
Servicing of Public Debt	1,141.8	936.3	44.1	35.4

Source: Budget Wing and Debt Policy Coordination Office Staff Calculations, Finance Division
*: July-March

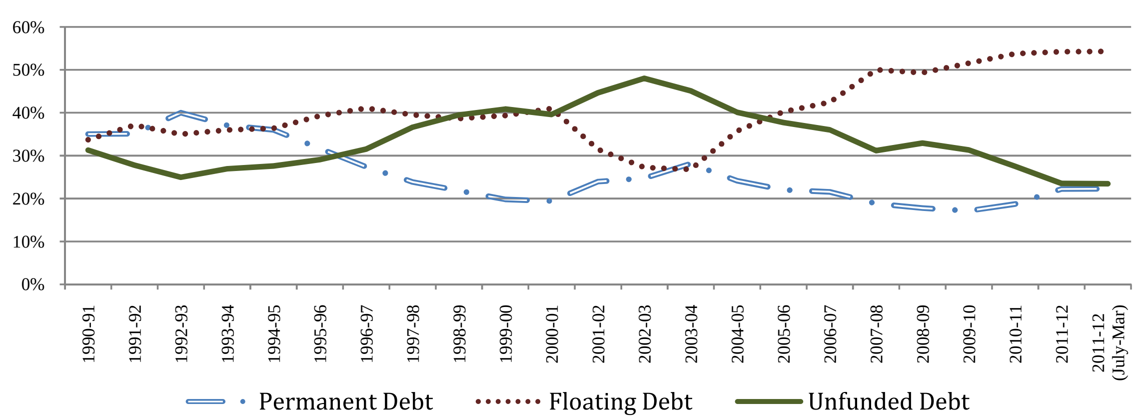
9.3 Domestic Debt

Domestic debt has always been fundamental part of a government's borrowing strategy. Government borrowing through domestic sources is vital in stimulating investment and private savings, as well as strengthening domestic financial markets, since it provides depth and liquidity to the markets. On the downside, though, a broad expansion in domestic debt poses significant negative connotations for private investment, fiscal sustainability and ultimately economic growth and poverty reduction in case of thin financial markets and poor debt management capacity.

Pakistan's domestic debt comprises permanent debt (medium and long-term), floating debt (short-term) and unfunded debt (made up of the various instruments available under the National Savings Scheme).The composition of major components shaping the domestic debt portfolio has undergone a transformation from a high dominance of unfunded debt to an increasing dependence on floating component of the domestic debt. The unfunded category comprising about 45 percent of the aggregate domestic debt stock in 2001-02 has declined to 23 percent by end-March, 2013. Contrary to this, the share of floating debt to total domestic debt has reached 54 percent by end-March, 2013 as compared with 31 percent in 2001-02 indicating an over reliance on shorter duration instruments. The growing share of floating debt in total domestic debt in recent years has meant an inordinate reliance on the shorter end of the sovereign yield curve. Debt structures that rely heavily on short-term instruments are sources of vulnerability, because short average maturities entail high rollover and refinancing risk. In such cases, an increase in interest rates has an adverse fiscal impact.

The trends in domestic debt are discussed in the following graph:

Fig-9.3: Trends in Permanent, Floating and Unfunded Debt (Percent)



As at end-March 2013, duration of domestic debt stood at 1.9 years excluding SBP Market Related Treasury Bills (MRTBs). Duration including MRTBs stood at 1.6 years. Out of total domestic debt, Rs.3,353 billion or 38 percent of total domestic debt has maturity of less than a year by the end of March, 2013 which is causing lower duration and also raises the rollover or refinancing risk for the government. If outstanding MRTBs for the amount of Rs.1,864 billion are also included, 60 percent of total domestic debt would have a maturity of less than a year. This estimate of duration may be a little inconsistent owing to the non-availability of actual maturity profile of National Savings Schemes (NSS) and manual operations of Central Directorate of National Savings (CDNS). A behavioral analysis was undertaken to estimate the maturity of NSS instruments.

9.3.1 Outstanding Domestic Debt

The total domestic debt was positioned at Rs.8,796 billion at end-March 2013, represented an increase of Rs.1,159 billion in the first nine months of the current fiscal year. This increase stems from net issuance of market debt namely Treasury Bills (Rs.528 billion), Special Savings Certificate and Accounts (Rs.159 billion), Pakistan Investment Bonds (Rs.144 billion), Market Related Treasury Bills (Rs.105 billion) and Ijara Sukuk (Rs.76 billion). In relation to GDP, the domestic debt stood at 38.4 percent which is higher than end-June 2011 level at 38 percent. The domestic debt grew by 15 percent in first nine months of current fiscal year. The focus on deficit financing through internal sources owing to lower external receipts has been the major cause.

Table-9.5: Outstanding Domestic Debt (Rs. in billion)

	2008	2009	2010	2011(P)	2012(P)	2013(P)*
Permanent Debt	**616.8**	**685.9**	**797.7**	**1125.6**	**1,696.9**	**1957.3**
Market Loans	2.9	2.9	2.9	2.9	2.9	2.9
Government Bonds	9.4	7.3	7.2	0.7	0.7	0.7
Prize Bonds	182.8	197.4	236.0	277.1	333.4	374.6
Foreign Exchange Bearer Certificates	0.2	0.2	0.1	0.1	0.1	0.1
Bearer National Fund Bonds	0.0	0.0	0.0	0.0	0.0	0.0
Federal Investment Bonds	1.0	1.0	0.0	0.0	0.0	0.0
Special National Fund Bonds	0.0	0.0	0.0	0.0	0.0	0.0
Foreign Currency Bearer Certificates	0.0	0.0	0.0	0.0	0.0	0.0
U.S. Dollar Bearer Certificates	0.0	0.0	0.0	0.0	0.0	0.0
Special U.S. Dollar Bonds	8.3	7.7	2.7	1.0	0.9	0.9
Government Bonds Issued to SLIC	0.6	0.6	0.6	0.6	0.6	0.6
Pakistan Investment Bonds (PIB)	411.6	441.0	505.9	618.5	974.7	1118.2
Government Bonds issued to HBL	0.0	0.0	0.0	0.0	-	0.0
GOP Ijara Sukuk	0.0	27.8	42.2	224.6	383.5	459.2
Floating Debt	**1,637.4**	**1,904.0**	**2,399.1**	**3,235.4**	**4,143.1**	**4776.1**
Treasury Bills through Auction	536.4	796.1	1,274.1	1,817.6	2,383.4	2911.6
Rollover of Treasury Bills discounted SBP	0.6	0.5	0.5	0.5	0.5	0.5
Market Related Treasury Bills(MRTBs)	1,100.4	1,107.3	1,124.4	1,417.3	1,759.2	1864.0
Unfunded Debt	**1,020.4**	**1,270.5**	**1,457.5**	**1,655.8**	**1,798.0**	**2063.6**
Defence Savings Certificates	284.6	257.2	224.7	234.5	241.8	270.0
Khas Deposit Certificates and Accounts	0.6	0.6	0.6	0.6	0.6	0.6
National Deposit Certificates	0.0	0.0	0.0	0.0	0.0	0.0
Savings Accounts	27.7	16.8	17.8	17.2	21.2	20.5
Mahana Amadni Account	2.5	2.4	2.2	2.1	2.0	2.0
Postal Life Insurance	67.1	67.1	67.1	67.1	67.1	67.1
Special Savings Certificates and Accounts	227.6	377.7	470.9	529.1	537.4	695.9
Regular Income Scheme	51.0	91.1	135.6	182.6	226.6	253.6
Pensioners' Benefit Account	87.7	109.9	128.0	146.0	162.3	176.4
Bahbood Savings Certificates	229.0	307.5	366.8	428.5	480.8	517.7
National Savings Bonds	-	-	3.6	3.6	3.6	0.2
G.P. Fund	42.5	40.1	39.9	44.3	54.5	57.2
Short Term Savings Certificates	-	-	-	-	-	2.5
Total Domestic Debt	**3,274.5**	**3,860.4**	**4,654.3**	**6,016.7**	**7,638.1**	**8796.9**
Total Domestic Debt (excluding foreign currency debt included in external debt)	**3,266.0**	**3,852.5**	**4,651.4**	**6,015.5**	**7,637.0**	**8,795.8**

Source: State Bank of Pakistan, Budget Wing & Debt Policy Coordination Office Staff Calculations
P: Provisional, *: end-March,2013

The following section highlights the developments in the various components of domestic debt during first nine months of outgoing fiscal year:

I. Permanent Debt

Permanent Debt mainly consists of medium to long term instruments including Pakistan Investment Bonds (PIBs), Government Ijara Sukuk bond, Prize Bond etc. PIBs are non-callable instruments, with fixed and semi-annual coupon payment. PIBs are issued in tenors of 3, 5, 10 and 20 years maturity. The 3, 5 and 10 years tenor are most liquid. Government Ijara Sukuk are medium term Shariah compliant bonds currently issued in 3 years tenor. The purpose of issuance was to raise money from Islamic banking which has grown substantially in Pakistan in recent years.

The total share of permanent debt in the government's domestic debt stood at Rs.1,957 billion as at end-March 2013, an increase of Rs.260 billion or 15 percent higher than the stock at the end of last fiscal year. Sizeable receipts from Pakistan Investment Bond (Rs.144 billion) and Government Ijara Sukuk (Rs.76 billion) majorly contributed to this expansion.

II. Floating Debt

Floating debt consists of short term domestic borrowing instruments such as Treasury Bills and State Bank borrowing through the purchase of Market Related Treasury Bills (MRTBs). Treasury Bills are zero coupon or discounted instruments issued in tenors of 3 months (introduced in 1997), 6 months (introduced in 1990) and 12 months (introduced in 1997). The share of 3 months, 6 months and 12 months maturity in total Treasury Bills portfolio is 17 percent, 39 percent and 44 percent respectively as at end-March 2013. In order to raise short term liquidity, the government borrows from the domestic banks through auction in the form of Treasury Bills. The auction of Treasury bills is arranged by the State Bank of Pakistan (SBP) twice a month.

Floating Debt share in overall public debt and domestic debt stood at 35 percent and 54 percent respectively as at end-March 2013. During July-March, 2012-13, the floating debt grew by Rs.633 billion or 15 percent. Around 55 percent of the total increase in government domestic debt stock was contributed by floating debt instruments during July-March, 2012-13.

Much of the proceeds accrued through Treasury Bills as Rs.528 billion was added to the stock of June 30, 2012. On the other hand, government borrowed Rs.105 billion through Market Related Treasury Bills (MRTBs).

III. Unfunded Debt

Unfunded Debt made up of the various instruments available under the National Savings Scheme (NSS). A number of different schemes are offered under NSS in the investment horizon of 3 years to 10 years. The total share of unfunded debt in the government's domestic debt stood at Rs.2,064 billion or 23 percent at end-March, 2013. The stock of unfunded debt increased by Rs.266 billion compared with last fiscal year. Net receipts in Special Savings Certificate and Accounts were up by 29 percent during July-March, 2012-13, as the stock increased from Rs.537 billion in June, 2012 to Rs.696 billion at end-March 2013. Special NSS Schemes including Bahbood Savings Certificates and Pensioner's Benefits Accounts registered a combined increase of Rs.51 billion.

National Savings Scheme plays an important role in mobilizing retail savings in the economy. Over past few years, government took various measures to rationalize the National Savings Schemes including linkage of profit rates on major NSS instruments with PIBs yield, levy of withholding tax on profits, service charges/penalty interest on early redemption and introduction of several new schemes to meet the diverse investor base demand. However, interest rate arbitrage – due to time lag involved in resetting the profit rates – and put option embedded in most of NSS instruments remained the source of vulnerability.

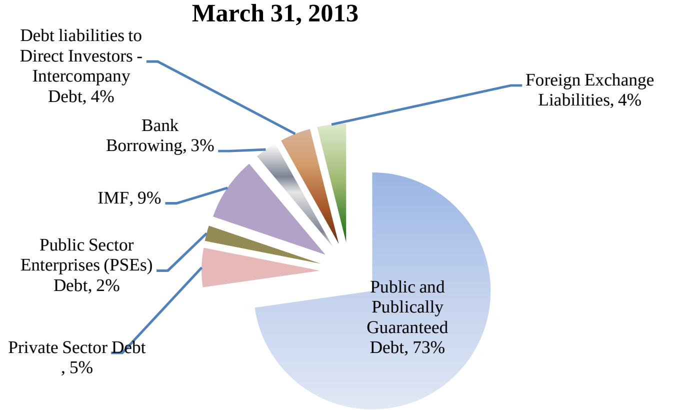
9.4 External Debt and Liabilities

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

As on March 31, 2013, EDL has been dominated by Public and Publically Guaranteed Debt having share of 73 percent owing to current account deficit which is financed through loans from multilateral and bilateral donors. Debt obligations of the private sector are fairly limited and have been a minor proportion of EDL (5 percent). Borrowing from IMF contributed 9 percent in EDL Stock as compared with 11 percent at the end of 2011-12 owing to hefty repayments during first nine months of current fiscal year.

The composition and structure of External Debt and Liabilities as at end-March, 2013 is depicted through following graph:

Fig-9.4: Composition of External Debt and Liabilities - March 31, 2013



EDL stock was recorded at US$ 60.9 billion as at end-March 2013, represented a decrease of US$ 5 billion during first nine months of current fiscal year majorly due to repayment of IMF loans and appreciation of US$ against other major currencies. As a percentage of GDP in dollar terms, EDL stock was down by 362 basis points in first nine months of current fiscal year as compared to end-June 2012 and approximated to 25.5 percent of GDP. The stock of multilateral and bilateral debt decreased by US$ 1.4 billion and US$ 0.8 billion respectively during first nine months of current fiscal year. The outstanding stock of IMF loans also witnessed significant decrease of over US$ 2 billion owing to hefty repayments scheduled in the current fiscal year. During first nine months of 2012-13, appreciation of the US Dollar against other major currencies caused the foreign currency component of public debt to decrease by US$ 1.5 billion.

Table-9.6: Pakistan External Debt and Liabilities

	2008	2009	2010	2011(P)	2012 (P)	2013 (P)*
	(US$ in billion)					
1. Public and Publically Guaranteed Debt	**40.6**	**42.6**	**43.1**	**46.5**	**46.3**	**44.3**
i) Public debt	**40.4**	**42.4**	**42.9**	**46.4**	**46.1**	**43.7**
A. Medium and Long Term(>1 year)	**39.7**	**41.8**	**42.1**	**45.7**	**45.7**	**43.6**
Paris Club	13.9	14.0	14.0	15.5	15.0	13.9
Multilateral	21.4	23.0	23.7	25.8	25.4	24.0
Other Bilateral	1.1	1.4	1.8	1.9	2.5	2.8
Euro Bonds/Saindak Bonds	2.7	2.2	1.6	1.6	1.6	1.6
Military Debt	0.0	0.2	0.2	0.1	0.1	0.1
Commercial Loans/Credits	0.1	0.2	-	-	-	-
Local Currency Bonds	0.0	-	0.0	0.0	-	-
Saudi Fund for Development	-	-	0.2	0.2	0.2	0.2
SAFE China Deposits	-	0.5	0.5	0.5	1.0	1.0
NBP/BOC Deposits	0.4	0.3	0.2	0.1	-	-
B. Short Term (<1 year)	**0.7**	**0.7**	**0.9**	**0.6**	**0.4**	**0.2**
IDB	0.7	0.7	0.8	0.6	0.4	0.2
Local Currency Securities (T-Bills)	0.0	-	0.1	0.0	0.0	0.2
ii) Publicly Guaranteed Debt	**0.2**	**0.2**	**0.2**	**0.1**	**0.2**	**0.5**

Table-9.6: Pakistan External Debt and Liabilities

	2008	2009	2010	2011(P)	2012 (P)	2013 (P)*
A. Medium and Long Term(>1 year)	0.2	0.2	0.2	0.1	0.2	0.3
Paris Club	-	-	-	-	-	-
Multilateral	0.1	0.1	0.1	0.0	0.0	0.0
Other Bilateral	0.1	0.1	0.0	0.0	0.2	0.3
Commercial Loans/Credits	0.0	-	0.1	-	-	-
Saindak Bonds	-	-	-	-	-	-
B. Short Term (<1 year)	-	-	-	-	-	0.3
IDB	-	-	-	-	-	0.3
2. Private Non-Guaranteed Debt (>1 year)	**1.9**	**2.4**	**3.8**	**4.4**	**4.5**	**3.3**
3. Public Sector Enterprises (PSEs Debt)	**1.0**	**0.9**	**1.4**	**1.3**	**1.3**	**1.3**
4. IMF	**1.3**	**5.1**	**8.1**	**8.9**	**7.3**	**5.3**
of which Central Government	-	-	1.1	2.0	1.9	1.7
Monetary Authorities	1.3	5.1	7.0	6.9	5.4	3.6
5. Banks	**-**	**-**	**0.7**	**1.1**	**1.8**	**1.8**
Borrowing	-	-	0.2	0.4	0.9	0.9
Nonresident Deposits (LCY & FCY)	-	-	0.6	0.7	1.0	0.9
6. Debt liabilities to direct investors - intercompany debt	**-**	**-**	**1.9**	**1.6**	**2.1**	**2.5**
Total External Debt (1 through 6)	**44.9**	**51.1**	**59.0**	**63.8**	**63.4**	**58.5**
7. Foreign Exchange Liabilities	1.3	1.3	2.6	2.6	2.4	2.4
Total External Debt & Liabilities (1 through 7)	**46.2**	**52.3**	**61.6**	**66.4**	**65.8**	**60.9**
(of which) Public Debt	**40.7**	**46.4**	**49.8**	**54.5**	**53.2**	**49.1**
Official Liquid Reserves	8.6	9.1	13.0	14.8	10.8	7.1
(In percent of GDP)						
Total External Debt (1 through 6)	**26.4**	**30.4**	**33.2**	**29.8**	**28.2**	**24.5**
1. Public and Publically Guaranteed Debt	23.9	25.3	24.3	21.7	20.6	18.6
A. Medium and Long Term(>1 year)	23.4	24.8	23.7	21.4	20.3	18.3
B. Short Term (<1 year)	0.4	0.4	0.5	0.3	0.2	0.1
2. Private Sector Debt	1.1	1.4	2.1	2.0	2.0	1.4
3. Public Sector Enterprises (PSEs) Debt	0.6	0.5	0.8	0.6	0.6	0.5
4. IMF	0.8	3.1	4.6	4.2	3.3	2.2
5. Banks	0.0	0.0	0.4	0.5	0.8	0.8
6. Debt liabilities to direct investors - Intercompany debt	0.0	0.0	1.1	0.8	0.9	1.1
7. Foreign Exchange Liabilities	0.8	0.8	1.5	1.2	1.1	1.0
Total External Debt & Liabilities (1 through 7)	**27.1**	**31.1**	**34.7**	**31.0**	**29.2**	**25.5**
Official Liquid Reserves	5.0	5.4	7.3	6.9	4.8	3.0
Memo:						
GDP (Rs. in billion)	10,638	13,200	14,867	18,285	20,091	22,909
Exchange Rate (Rs./US$, Period Average)	62.5	78.5	83.8	85.5	89.2	96.2
Exchange Rate (Rs./US$, End of Period)	68.3	81.4	85.5	86.0	94.5	98.4
GDP (US$ in billion)	170	168	177	214	225	238

Source: State Bank of Pakistan, Economic Affairs Division & Debt Policy Coordination Office Staff Calculations
P: Provisional *: end-March,2013

The following section highlights the developments in the various components of EDL during first nine months of the current fiscal year:

I. Public and Publicly Guaranteed Debt (PPG)

Public and publicly guaranteed debt is dominated by the loans from bilateral and multilateral donors having largest share of 67 percent in EDL. Multilateral debt is the largest component of Pakistan's EDL. It witnessed a decrease of US$ 1.4 billion during first nine months of 2012-13. The project-based nature of loans contracted under this category hinges on Pakistan's ability to instill project efficiency. Debt from bilateral sources includes loan contracted with Paris Club countries and other countries outside the Paris Club. It is second largest component of Pakistan's EDL. It witnessed a decrease of US$ 0.8 billion during first nine months of 2012-13.

II. IMF Debt

At the end-March, 2013, debt owed to IMF aggregated up to US$ 5.3 billion out of which US$ 1.7 billion accrued to the Federal Government. The remaining IMF funds were recorded on SBP books to strengthen the foreign exchange reserves of the country. During first nine months of 2012-13, no fresh disbursements were received from IMF, however, an amount of around US$ 2 billion were repaid.

9.4.1 Composition of Foreign Economic Assistance

The total amount of US$ 1,782 million was received in the first nine months of 2012-13 against foreign economic assistance. The composition of this assistance is as follows:

I. Commitments

The commitments of foreign economic assistance were US$ 4,679 million during 2011-12, while during July-March, 2012-13, total commitments amounted to US$ 1,642 million. About 68 percent of total commitments during July-March, 2012-13 were in the shape of project aid while the remaining comprised non-project aid. Out of total non-project aid, share of BOP/budgetary support was 80 percent.

II. Disbursements

During July-March, 2013, disbursements of US$ 1,782 million were for different purposes like Project Aid (US$ 1,209 million), Non-Food Aid (US$ 46 million), Programme-Loans/Budgetary Support (US$ 403 million) and relief (US$ 124 million). Project aid accounted for 68 percent of the total disbursements.

9.4.2 External Debt Servicing

During 2011-12, external debt servicing summed to US$ 6,051 million that was 11 percent higher than the previous year. A segregation of this aggregate number shows a payment US$ 3,489 million in respect of maturing EDL stock while interest payments were US$ 1,019 million. US$ 1,543 million was rolled-over.

Among the principal repayments, US$ 1,090 million of multilateral debt and US$ 1,154 million of IMF accounted for most of the share. Similarly, hefty interest payments worth US$ 1,019 million on foreign currency public debt contributed to the bottom line. In 2011-12, the central bank deposits were mostly rolled-over.

Table-9.7: Pakistan's Public External Debt Servicing (US Dollar in million)

Years	Actual Amount Paid	Amount Rolled Over	Total
2008	3,182.6	1,200.0	4,382.6
2009	4,747.2	1,600.0	6,347.2
2010	4,607.0	1,723.0	6,330.0
2011	3,947.7	1,488.0	5,435.7
2012	4,507.7	1,543.0	6,050.7
2013*	4,602.1	700.0	5,302.1

Source: State Bank of Pakistan and Debt Policy Coordination Office Staff Calculations
*July-March

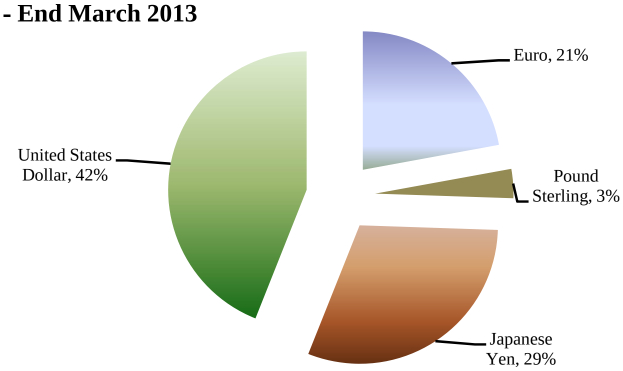
During July-March, 2012-13, the servicing on external debt was recorded at US$ 5,302 million. An amount of US$ 3,944 million was repaid out of which US$ 1,974 million was against IMF loans. Interest payments were US$ 658 million. The roll-overs amounted to US$ 700 million in the first nine months of 2012-13.

9.4.3 Impact of Exchange Rate Fluctuations

In Pakistan, external loans are contracted in various currencies but disbursements are effectively converted into Pak Rupee. As Pak Rupee is not an internationally traded currency, the other 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. This two-pronged exchange rate risk has been a major source of increase in the stock of EDL over a period of time in contrast to actual inflows.

As at end-March, 2013, 95 percent of total External Debt is contracted in 4 major currencies as depicted in the following graph:

Fig-9.5: Currency Wise Composition of External Debt - End March 2013



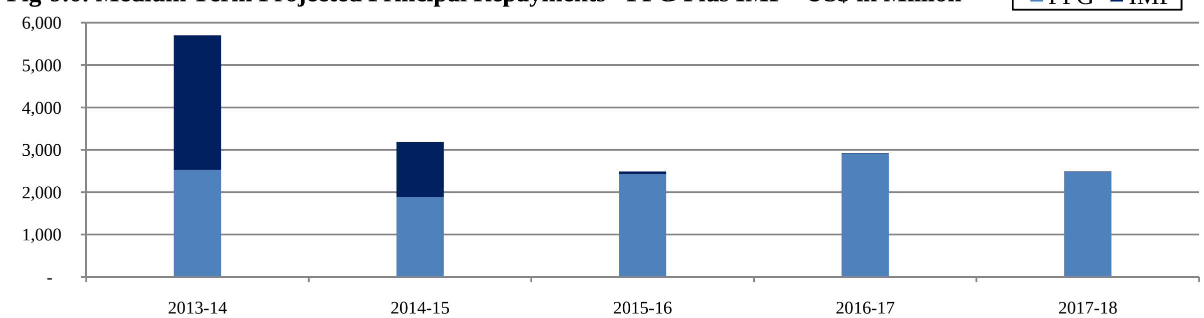
During first nine months of 2012-13, appreciation of the US Dollar against other major currencies caused the foreign currency component of public debt to decrease by US$ 1,543 million. This translational gain is majorly attributed to appreciation of US$ against Japanese yen (US$ 1,065 million), SDR (US$ 311 million), Euro (US$ 137 million) etc.

The external debt portfolio of Pakistan is contracted in multiple currencies and the historical losses borne by Pakistan in this respect call for a sophisticated currency hedging framework to be installed within the government. If currency movements over a longer period of last 20 years is analyzed, though the cost of foreign currency borrowing adjusted for exchange rates movement has been 1.5 percent lower than the average domestic interest rates, the saving on this account could have been higher had the government adopted a currency hedging framework.

9.4.4 Maturity Profile of External Debt

The Average Time to Maturity (ATM) of Public and Publically Guaranteed Debt was approximately 11.2 years as of March 31, 2013. The ATM including IMF loans stood at 10 years. The ATM reduced with the inclusion of IMF loans as hefty repayments against IMF loans are expected in next fiscal year.

Fig-9.6: Medium Term Projected Principal Repayments - PPG Plus IMF - US$ in Million



9.4.5 External Debt Sustainability

Managing the levels of external debt, and the risks associated with them pose policy makers with a different set of challenges. In this case, if the growth in Foreign Exchange Earnings (FEE) exceeds the growth in External Debt and Liabilities (EDL), the ratio of EDL-to-FEE will continue to decline. Although external debt expressed as a percentage of GDP and export earnings depicts the levels and burden of external debt, a clear insight in to the future path of debt can be gained by analyzing the non-interest current account deficit. A nil current account balance before interest payment and higher growth in FEE compared to the interest rate paid on EDL will ensure a decline in EDL-to-FEE over time. Similarly, maintaining exchange rate stability is also a pre-requisite for external debt sustainability.

Table-9.8: External Debt Sustainability						
(In percent)	**2008**	**2009**	**2010**	**2011**	**2012**	**2013***
Non Interest Current Account/GDP	(6.9)	(4.4)	(1.4)	0.8	(1.3)	(0.01)
Growth in Exports	18.2	(6.4)	2.9	28.9	(2.6)	(0.01)
Growth in Imports	31.2	(10.3)	(1.7)	14.9	12.8	(1.9)
Growth in EDL	14.9	13.4	17.6	7.8	(0.8)	(7.5)
Growth in FEE	12.8	(5.1)	7.9	25.1	1.1	3.5
Growth in Non Interest Foreign Currency Payments	27.2	(12.8)	(4.9)	13.3	11.4	(1.5)
EDL/FEE (times)	1.2	1.5	1.6	1.4	1.4	1.6
EDL/FER (times)	4.0	4.2	3.7	3.6	4.3	5.0
EDL/GDP	27.1	31.1	34.7	31.0	29.2	25.5
EDL Servicing/FEE	11.8	18.0	16.6	11.4	12.5	14.2
Rollover Ratio (Principal Repayments/Disbursements) public debt	41.7	60.9	54.4	82.3	59.9	115.6

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

FEE: Foreign Exchange Earnings; **EDL:** External Debt and Liabilities; **FER:** Foreign Exchange Reserves

During 2010-11, the non interest current account showed a surplus of 0.8 percent of GDP because of improved trade balance (higher cotton prices) and higher inflows in remittances. This indicator showed a downward trend in 2011-12 by recording a deficit of 1.3 percent of GDP owing to high value of oil imports. During first nine months of 2012-13, non interest current account showed a deficit of 0.01 percent of GDP as compared with a deficit of 0.8 percent during the same period last year.

EDL as a percentage of Foreign Exchange Earnings (FEE) gives a measure of a country's debt repayment capacity by comparing levels of external debt to the sum of exports, services receipts, and private unrequited transfers. Pakistan's external debt and liabilities and its servicing in terms of foreign exchange earnings stood at 1.4 times and 12.5 percent during 2011-12 which is within the acceptable threshold of 2 times and 20 percent. During first nine months of current fiscal year, external debt and liabilities and its servicing in terms of foreign exchange earnings stood at 1.6 times and 14.2 percent respectively. It is imperative for the government to take measures for attracting both debt and non-debt foreign currency flows, as hefty repayments of IMF loans are due in the next fiscal year, which will put further pressure on external debt servicing.

A major improvement has been witnessed in EDL-to-GDP ratio as it improved from 31.0 percent in 2010-11 to 29.2 percent in 2011-12. By end-March 2013, EDL as a percent of GDP further improved and stood at 25.5 percent mainly due to hefty repayments against IMF Loans, translational gain on account of US Dollar appreciation against other major currencies and faster growth in nominal GDP in relation to slower growth in external debt.

A decrease in EDL in relations to Foreign Exchange Reserves (FER) reflects the consolidation of foreign exchange reserves and a general improvement of the country's repayment capacity or vice versa. On the onset of IMF-SBA, the ratio declined to 3.7 in 2009-10 as EDL growth slowed and foreign exchange reserves shored up. The ratio improved slightly in 2010-2011 mainly because of stagnation in reserves and lower growth in EDL stock. By end-June 2012, the ratio deteriorated to 4.3 times compared to 3.6 times by end-June 2011. During first nine months of current fiscal year, the indicator further deteriorated and stood at 5.0 times mainly because of drawdown on reserves owing to lower Foreign Direct Investments, repayment to IMF and other lower non-debt creating flows.

9.5 Pakistan's Link with International Capital Market

9.5.1 Recent Performance of 2016, 2017 And 2036 Eurobonds

A decreasing trend has been observed in spreads of Pakistan's 2016, 2017 and 2036 Eurobond since mid-year of 2012 with bond yield benefiting from the rally in credit spreads, with the shorter dated bonds now trading below 9 percent. The 2016 Eurobond was trading at UST + 840 basis points, 2017 Eurobond at UST + 782 basis points and 2036 Eurobond at UST + 804 basis points as on 30th April, 2013. This is against spread level of July 2012 of more than 1,000 basis points over UST for all these Eurobonds.

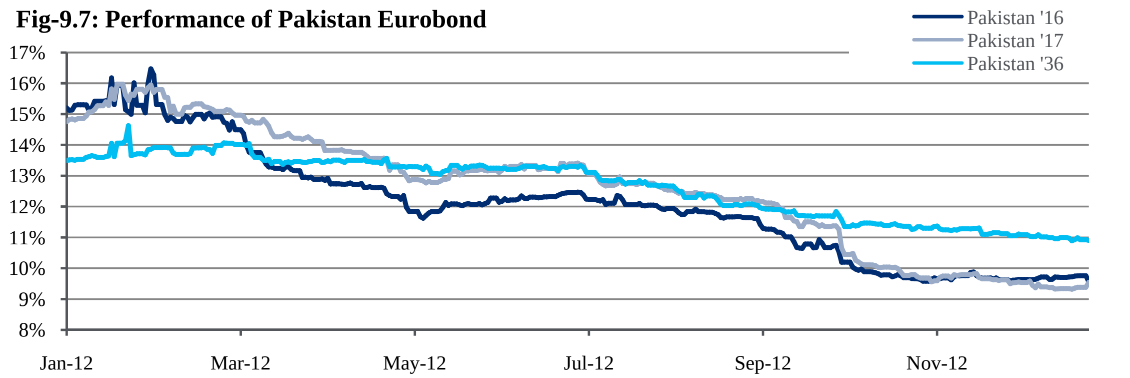
The gradual improvement in course of trading level suggests confidence of international investors in Pakistan's credit. This outlook is further affirmed by Standard and Poor's which maintained its stable outlook on the country credit. The following table contains the latest position of bonds issued by Pakistan:

Table-9.9: Selected Secondary Market Benchmarks

Issuer	Ratings (Moody's/S&P)	Coupon (%)	Maturity	Spread over UST (bps)	Yield (%)
Pakistan	Caa1/B-	7.125	March 2016	840	8.707
Pakistan	Caa1/B-	6.875	June 2017	782	8.496
Pakistan	Caa1/B-	7.875	March 2036	804	10.926

Source: Bloomberg, as at April 30, 2013

Fig-9.7: Performance of Pakistan Eurobond



9.6 Conclusion

Pakistan's public debt position declined slightly in the current fiscal year owing to host of internal and external factors. Internally, the fragile law and order situation, growing burden of subsidies, ailing Public Sector Enterprises (PSEs) and increasing debt servicing requirement caused substantial fiscal imbalance. On the other hand, things remained equally challenging on the external front where the foreign exchange outflows outstripped foreign inflows, putting immense pressure on the exchange rate and drawdown on official foreign currency reserves. Despite rising absolute debt levels, the debt as a percentage of GDP has remained in proximity to around 60 percent since 2007-2008. Prudent government policy will be necessary to address the issue of public debt.