

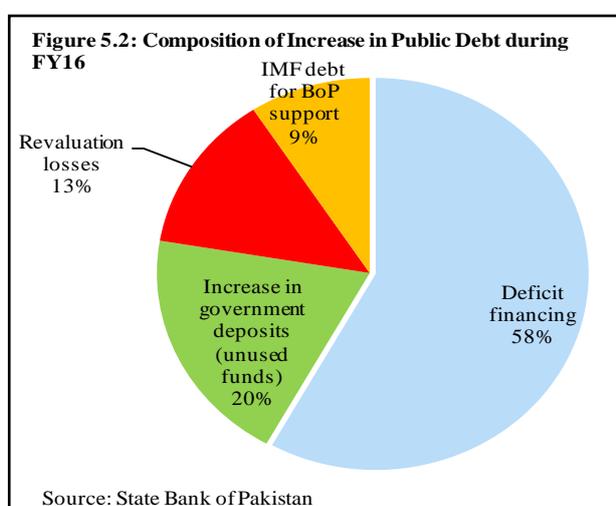
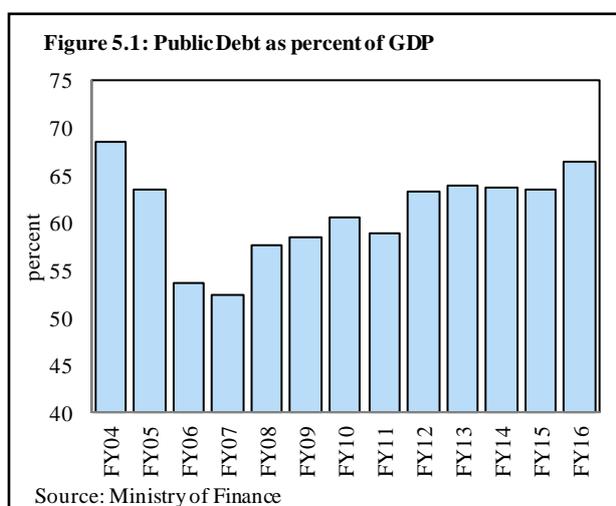
5 Domestic and External Debt

5.1 Overview

After remaining stable during the previous two years, the public debt-to-GDP ratio increased to 66.5 percent (excluding external liabilities, as defined in Fiscal Responsibility and Debt Limitation Act 2005, which takes the public debt as the debt of the government serviced out of its consolidated fund and debts owed to the IMF).¹ External liabilities stood at 1.3 percent of GDP as on end-June 2016 (**Figure 5.1**).

However, higher pace of public debt accumulation does not indicate higher fiscal deficit: as noted in **Chapter 4**, the government has been able to contain the volume of fiscal deficit for the third year in a row. In fact, the increase in public debt during FY16 was Rs 944 billion higher than the nominal volume of fiscal deficit during the year. In this context, the increase in public debt during FY16 basically represents (i) revaluation losses that stemmed from the appreciation of Japanese Yen against the US Dollar, and depreciation of PKR against the US Dollar during the year;² (ii) increase in balance of payment support from the IMF, which is not used for budgetary funding; and (iii) borrowings over and above the budgetary requirements, which the government has placed in deposits with the banking system (**Figure 5.2 & 5.3**).³

Encouragingly, the government's overall interest expenditure in FY16 remained lower than last year: interest payments stood at 34.5 percent of tax revenue during FY16 as compared with 43.2 percent in FY15. Two factors explain this trend: firstly, interest rates on domestic debt instruments fell quite sharply due to easy monetary policy as well as downward revision in PIB



¹ According to the amended FRDL Act (June 2016), “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”. The Act further states 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 up to 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”. Source: The Gazette of Pakistan, Extraordinary, Registered No. M-302/L-7646, Islamabad, June 24, 2016, National Assembly Secretariat.

² Appreciation of Japanese Yen against US Dollar led to an increase of Rs 125.0 billion (US\$ 1.3 billion) in the stock of public external debt. Similarly, the PKR depreciation of 2.9 percent against US Dollar caused an additional increase of Rs 182.0 billion in the external debt stock (for details, see **Section 5.3**).

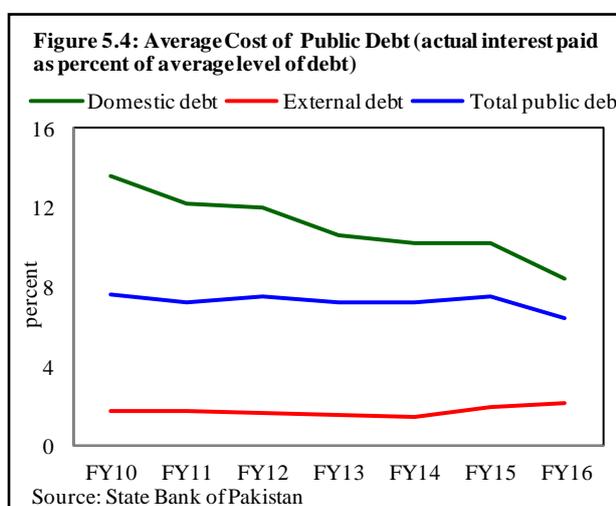
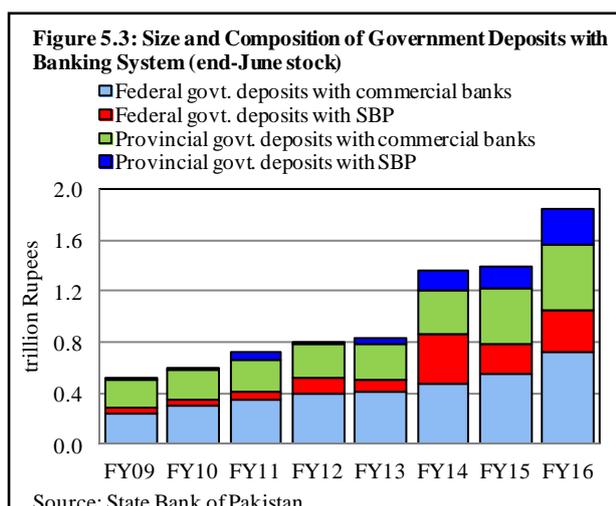
³ Government deposits with the banking system have posted an increase of Rs 459.4 billion during the year.

coupon rates during the last two fiscal years (Section 5.2).⁴ This led to a sharp reduction in the average cost of domestic debt (Figure 5.4). Secondly, though the bulk of the accumulation continued to come from domestic sources during the year, the share of external debt posted an increase after falling consistently over the past 5 years (Table 5.1). Since a major fraction of external debt is comprised of concessionary lending from multilaterals, a rise in its share has also caused the overall average debt cost to fall.

The shift in the composition of public debt is welcome not just from the perspective of servicing cost, but also from overall debt management standpoint. Specifically, most external loans have a longer maturity (especially those from multilaterals), which reduces the refinancing and re-pricing risks for the government.⁵ Here, a cushion has been provided by the existing volume of FX reserves in the country, which allowed the government to borrow from relatively cheaper external sources without compromising much on the liquidity front over the short-to-medium term.

Nonetheless, caution needs to be exercised going forward. Some challenges have lately emerged with respect to the tenor and cost of fresh external borrowings. While most of the fresh borrowings still have a longer maturity, the government borrowing from foreign commercial lenders has also increased, which is both relatively short-term as well as expensive than other sources of its debt portfolio.⁶ Importantly, it is not just the government, but also domestic private banks that have resorted to short-term FX borrowings. As a result, the share of short-term debt (both public and private) in total external debt of the country has increased from 5.2 percent in FY15 to 6.2 percent in FY16.⁷

In terms of domestic debt also, key risk indicators pertaining to refinancing and re-pricing have deteriorated slightly, though their levels remained within the indicative ranges under the MTDS 2016-19.



⁴ Within borrowing from banking system, the government borrowed mainly from commercial banks and retired a sum of Rs 475.0 billion with SBP. This enabled the government to meet the IMF ceiling on borrowing from SBP and zero quarterly limit under the amended SBP Act 1956 during the year.

⁵ The average time to maturity for Pakistan’s public debt at end-March 2016 was 9 years for external component, and only 2.1 years for domestic component (the corresponding information for end-June 2016 is not yet available).

⁶ For FY17 also, the government is planning to borrow Rs 211.5 billion from foreign commercial banks. Additional source of foreign borrowings of government for FY17 include The World Bank, ADB and through issuance of sovereign bonds (Source: Federal budget documents for 2016-17).

⁷ Within public external debt, the share of short-term debt has increased from 2.0 percent in FY15 to 2.9 percent in FY16.

To sum up, the government has adhered strictly to its objective of fiscal consolidation. It has significantly brought down the deficits in its primary and revenue accounts in accordance with the debt reduction strategy.⁸ However, gross debt numbers do not reflect the positive impact of this fiscal consolidation due to accumulation of government deposits with the banking system. A better management of public accounts with unified structure of government deposits can address this issue, as practiced in many other developed and emerging countries.⁹

Table 5.1: Pakistan's Debt and Liabilities-Summary
Billion rupees

	Debt stock (end-Period)			Absolute change		Percent of GDP	
	FY14	FY15	FY16	FY15	FY16	FY15	FY16
A. Total debt and liabilities (sum I to IX)	18,214.3	19,846.4	22,461.9	1,632.2	2,615.4	72.2	75.9
B. Total public debt (sum I to III)	15,991.2	17,380.1	19,676.7	1,388.9	2,296.5	63.2	66.5
I. Government domestic debt	10,906.5	12,192.5	13,625.9	1,286.0	1,433.4	44.3	46
II. Government external debt	4,786.3	4,770.0	5,417.7	-16.3	647.7	17.3	18.3
III. Debt from IMF	298.4	417.6	633.1	119.2	215.4	1.5	2.1
IV. External liabilities	324.2	377.6	377.1	53.3	-0.4	1.4	1.3
V. Private sector external debt	500.4	537.7	630.7	37.3	92.8	2	2.1
VI. PSEs external debt	203.8	252.7	288.0	48.9	35.4	0.9	1
VII. PSEs domestic debt	366.2	458.7	568.1	92.6	109.3	1.7	1.9
VIII. Commodity operations	492.4	564.5	622.4	72.0	58.0	2.1	2.1
IX. Intercompany external debt	335.9	275.1	298.9	-60.8	23.8	1	1

Source: State Bank of Pakistan

From sustainability perspective, however, recent changes in the public debt profile are encouraging: the short-term external debt coverage of FX reserves is comfortable, and the domestic debt does not pose any imminent risk on solvency or liquidity front.¹⁰ Nonetheless, a quick recovery in Pakistan's export earnings is required to sustain the prevailing comfort in servicing external debt *without* creating additional debt. Furthermore, the pace of debt accumulation needs to be slowed down through continuous fiscal consolidation. This is important to further reduce debt servicing burden so that more resources are allocated for strategically important sectors like physical (e.g., transport) and social infrastructure (especially, education and health).

Moreover, it is important to develop and expand a diversified investor base domestically and globally for government securities to reduce the reliance on banking system for budgetary funding. In Pakistan, there is no dearth of savings institutions, like pension funds, mutual funds and insurance firms; however, despite a healthy growth over the past few years, their size and outreach is still quite small. General public is not fully aware about these institutions and their investment offers, which makes it difficult for these institutions to arrange funding. The government and SECP must start focusing on how to divert household savings towards financial sector (awareness campaigns; contributing to marketing costs; financial literacy programs, etc.), in order to deepen the debt market.

5.2 Domestic debt

Domestic debt increased by Rs 1.4 trillion during FY16, compared with Rs 1.3 trillion last year (Table 5.2). Similar to last year, most of the increase came from permanent debt, which includes

⁸ The gradual reduction in primary deficit is very encouraging. In fact, primary surpluses in successive years will be instrumental in servicing government's debt without generating additional debt.

⁹ One way is having a treasury single account (TSA), which is a bank account or a set of linked bank accounts through which the government transacts all its receipts and payments and gets a consolidated view of its cash position at the end of each day." The control over individual cash transactions is achieved via the accounting system and *not* by holding and/or depositing cash in "transaction-specific individual bank accounts". In addition to developed countries like the US, UK, France, Sweden and Australia, a number of emerging economies also have TSAs in place, e.g., India, Brazil, Russia, Indonesia and Cambodia. For details, see Pattanayak, Sailendra and Fainboim, Israel (2010), "Treasury Single Account: Concept, Design and Implementation Issues". IMF Working Paper WP/10/143, May 2010.

¹⁰ Short-term external debt is only 19.7 percent of the country's total FX reserves at end-June 2016.

longer tenor instruments like PIBs, Ijara Sukuk and prize bonds. Meanwhile, from an institutional viewpoint, commercial banks financed the bulk of the government's funding requirements, as the share of non-bank financial institutions declined. Key features of domestic debt during the year are discussed below.

Table 5.2: Change in Government Domestic Debt

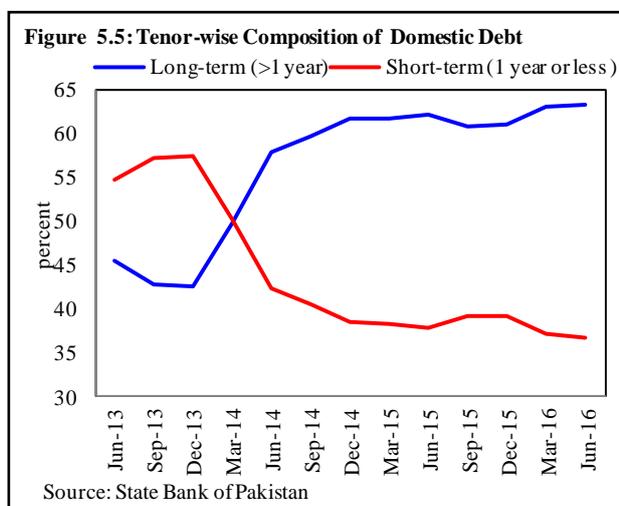
Billion rupees

	Stock			Flow		Share in total stock %	
	FY14	FY15	FY16	FY15	FY16	FY15	FY16
Government domestic debt	10,906.5	12,192.5	13,625.9	1,286.0	1,433.4	100.0	100.0
Permanent debt	3,999.1	5,008.2	5,935.9	1,009.1	927.6	41.1	43.6
o/w PIBs	3,222.0	4,155.2	4,921.4	933.2	766.2	34.1	36.1
Ijara Sukuk	326.4	326.4	363.9	0.0	37.6	2.7	2.7
Prize bonds	446.6	522.5	646.4	75.9	123.9	4.3	4.7
Floating debt	4,599.1	4,609.4	5,001.7	10.2	392.3	37.8	36.7
o/w Bai Muajjal	0.0	0.0	212.6	0.0	212.6	0.0	1.6
MTBs	1,746.8	2,148.9	2,771.4	402.1	622.5	17.6	20.3
MRTBs	2,852.3	2,281.40	2,017.6	-570.9	-263.8	18.7	14.8
Unfunded debt	2,303.8	2,570.3	2,683.6	266.5	113.3	21.1	19.7
Foreign currency loans	4.5	4.6	4.7	0.1	0.1	0.0	0.0

Source: State Bank of Pakistan

Maturity profile improved further

The auction profile of government securities shows that bidding by commercial banks underwent changes during the year, depending on their perception of changes in interest rates, inflation, liquidity conditions, and external sector developments (for details, see **Chapter 3**). From the government's perspective, supportive market conditions allowed it to borrow more via PIBs (mainly 3 and 5 year tenor) compared to T-bills. As a result, the composition of domestic debt continued to shift from short-term to long-term during the year (**Figure 5.5**). So effectively, declining interest rates scenario made it more practical and cost-effective for the government to further lengthen the maturity profile of domestic debt in FY16.



Risk indicators urge caution

Improvements in maturity profile notwithstanding, some risk indicators for domestic debt showed a deterioration during FY16 compared to a year earlier. Specifically, interest rate risk and refinancing risk – gauged with reference to debt re-pricing due in one year and debt maturing in one year, respectively – both increased during the fiscal year.¹¹ However, their level remains within the indicative range prescribed by the MTDS 2016-2019, simply meriting the need to exercise caution going forward.¹²

¹¹ Debt re-fixing in one year rose from 47.7 percent at end-June 2015 to 53.7 percent at end-March 2016, while debt maturing in one year rose from 47.3 percent at end-June 2015 to 52.4 percent at end-March, according to the Public Debt Management Risk Report released by the Debt Policy Coordination Office.

¹² The MTDS indicative ranges are between 50 to 65 percent (maximum) for 'debt re-fixing in one year' and 'debt maturing in one year' respectively.

Government debt market is still skewed heavily towards banking system

The holding of government securities by non-banks increased by only Rs 177.2 billion during FY16, which is less than half the increase seen in FY15.¹³ This reduced the non-bank share in total debt holding from 36.8 percent last year to 34.3 percent in FY16. Three factors explain this trend: (i) fall in profit rates along with increase in withholding tax (WHT) on profits earned on NSS instruments for non-filers; (ii) a continued vibrancy in local bourses that further shifted portfolio of asset management companies (AMCs) away from debt instruments; and (iii) structural constraints that limited investment appetite of non-bank financial institutions.

Table 5.3: Owner-wise Holding of Tradable Government Securities (Outstanding Stock Basis – Face Value)*

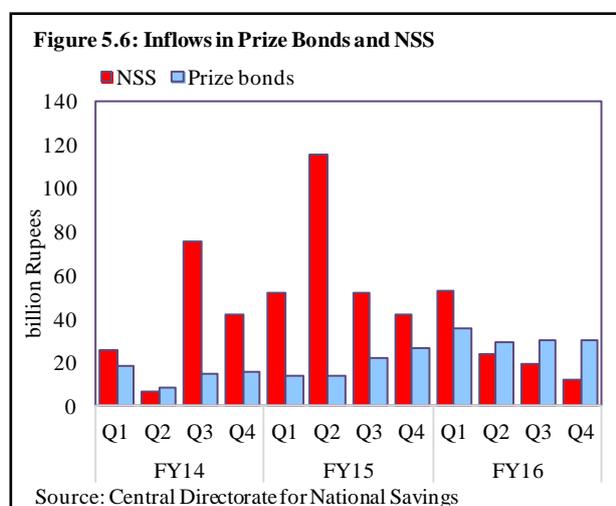
Billion rupees						
	FY11	FY12	FY13	FY14	FY15	FY16
A. PIBs	618.5	974.7	1,321.9	3,223.5	4,158.3	4,925.0
Banks	263.7	510.5	727.6	2,170.5	2,992.7	3,687.0
Non-banks**	354.8	464.2	594.3	1,053.1	1,165.7	1,238.0
Insurance companies	139.2	231.7	267.4	409.9	493.4	566.7
Funds	129.8	173.1	147.3	344.8	284.5	293.2
Corporations/Others	85.7	59.5	179.6	298.4	387.8	378.0
B. T-bills	1,971.0	2,592.1	3,151.0	1,878.9	2,470.4	2,909.8
Banks	1,550.0	1,942.1	2,681.5	1,603.3	2,205.2	2,710.3
Non-banks**	421.0	650.0	469.4	275.6	265.2	199.5
C. Ijara Sukuk	224.6	383.6	459.2	326.4	326.4	363.9
Banks	203.5	340.9	413.0	293.6	302.1	339.5
Non-banks**	21.1	42.7	46.2	32.8	24.2	24.4
Insurance companies	0.8	1.4	1.5	0.9	3.4	2.6
Funds	16.8	38.4	38.0	24.6	15.8	18.3
Corporations/Others	3.5	2.8	6.7	7.3	5.1	3.5
Grand total (A+B+C)	2,814.2	3,950.4	4,932.0	5,428.8	6,955.1	8,198.7
Total non-banks	797.0	1,156.9	1,109.9	1,361.5	1,455.1	1,461.9

*The information in this table does not match with **Table 5.2**, which includes investment in government securities by residents only. Moreover, in case of T-bills, the difference also stems from the accounting treatment: **Table 5.2** is based on realized value of t-bills, whereas **Table 5.3** is based on face value of these securities. ** Includes non-resident holding
Source: Economic Affairs Division & State Bank of Pakistan

Within non-bank holding of *tradable* securities, there was a shift in the composition across institutions: while the share of insurance firms increased, holding of government papers by AMCs continued to fall. Since insurance firms invested primarily in long-term instruments, aggregate holding of PIBs and Ijara by non-banks went up during the year (**Table 5.3**). On the contrary, AMCs usually make short-term placements; their lower participation led a fall in aggregate T-bill holding by non-banks.

Increase in WHT had implications for NSS and prize bonds

The stated objective behind introduction (and adjustments) of WHT was to broaden the tax net, help document the economy, increase the government's financial resources, and encourage return filing culture in the country. Its imposition, however, had some unintended consequences. The first significant consequence was a marked slowdown in investment in NSS instruments (**Figure 5.6**).^{14,15}



¹³ In FY15, non-bank holding of government debt had increased by Rs 367.8 billion.

¹⁴ Mobilization via NSS increased by Rs 108.2 billion compared to an increase of Rs 261.2 billion in FY15.

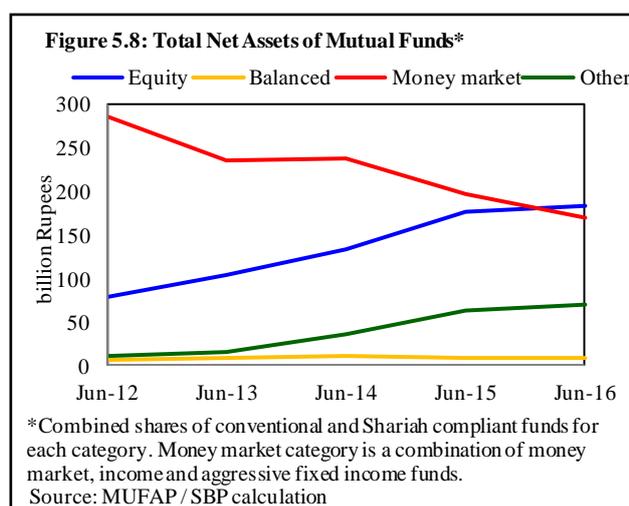
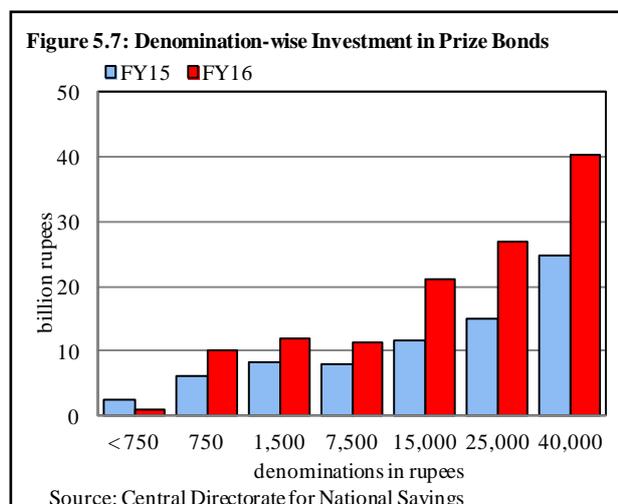
In addition, the downward revision in profit rates, following the cuts in policy rate, also contributed to lower investment.¹⁶ Meanwhile, some deceleration was expected as higher mobilization in FY15 was primarily driven by one-off spike in institutional investments (during the month of November 2014, when SBP began to cut policy rates).¹⁷

Since both Bahbood Savings Certificates (BSCs) and Pensioner Benefit Accounts (PBAs) were exempted from WHT, the investment in these instruments remained higher than last year.¹⁸ The contrasting outcome for these two schemes compared to other instruments affected by WHT is glaring: BSCs and PBAs accounted for around 80 percent of net inflows in NSS during the year, while most other schemes witnessed either a decline in inflows, or net retirements.

A second unintended consequence of the increase in WHT was the higher inflows for prize bonds during FY16 (Figure 5.6). Anecdotal evidence suggests that businesses have been using these instruments to settle their transactions instead of using banking instruments like demand drafts, cheques, etc.¹⁹ This is the major reason why the increase was more pronounced for larger denomination bonds, including Rs 40,000 and Rs 25,000 (Figure 5.7). Hence, higher investments in prize bonds have come at the expense of bank deposit growth (Chapter 3).

Money market funds continue losing ground to equities

With respect to AMC's (the predominant investor for T-bills among non-banks), downward revisions in the policy rate have shifted investment priorities away from less risky money market funds towards more volatile – but more profitable – equity funds.²⁰ This is evident from the fact that net assets of money market funds are going through contraction over the past few years, whereas the equity funds have been expanding



¹⁵ Specifically, the government increased WHT on profit on NSS to 17.5 percent for non-filers in Finance Act 2015, while it was left unchanged at 10 percent for filers.

¹⁶ The profit rates on NSS schemes are generally linked to PIBs of the same tenors and declined by almost 130 to 200 bps during FY16.

¹⁷ By November 2014, oil prices had crashed in the international market, and a recovery was not in sight. Expectations of further rate cuts were strong, therefore institutions opted to invest in these instruments at prevailing rates.

¹⁸ BSCs and PBA's also offer higher monthly returns compared to other saving schemes.

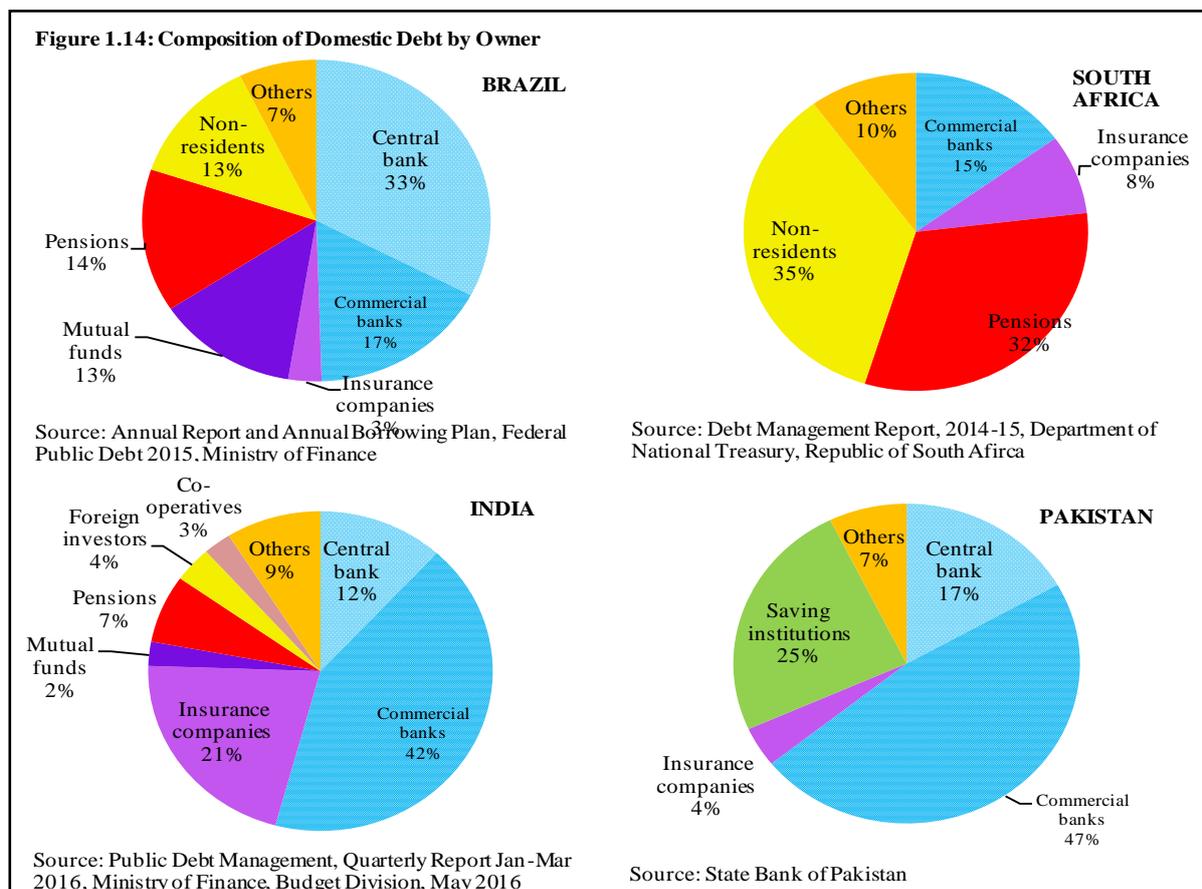
¹⁹ Since prize bond is a bearer instrument, which can be used as a substitute for cash to settle some transactions, there is reason to suspect that the penalty resulting from WHT induced a segment of the population to increase their cash and near-cash holdings in order to settle transactions outside the ambit of the banking system.

²⁰ The KSE-100 Index rose from 13,801 points at end-June FY12 to close at 35,742 points at end-June FY16, with a CAGR of 26.9 percent for the period. This is a much higher return, on average, compared to returns from money market instruments like PIBs, T-bills etc.

correspondingly (Figure 5.8).²¹

Structural factors impeding the deepening of domestic debt market

Pakistan is among those countries where domestic debt dominates the overall public debt. With largest pool of investible funds, commercial banks are the major financier of budget deficits in Pakistan. In other countries with fairly big volumes of domestic debt, like Brazil, India and South Africa, government's dependence on the banking system is much less (Figure 5.9). Pension fund and insurance companies also share the burden of budgetary financing. Furthermore, foreign investment in government papers (local currency denominated) is also sizable in some countries, but in Pakistan, this funding source is very low.²²



Non-bank financial institutions (NBFIs) struggle to realize their full potential due to low investor base. Instead of placing their savings with NBFIs, households either deposit their savings with commercial banks, or convert their financial savings into physical assets, e.g., livestock, property, gold, etc.²³ Thus, even though these institutions provide diversified investment avenues, their assets are fairly small compared with overall national savings.²⁴ Efforts to increase the retail investor base –

²¹ The share of money market funds in the asset under management of open-end funds went down from 45 percent in FY12 to only 11 percent in FY16, while the share of equity funds rose from 17 percent to 40 percent during the same period.

²² Foreigners can invest in domestic securities via special convertible rupee accounts. As of end-June 2016, the outstanding investment in domestic PIBs and T-bills using these accounts stood at only Rs 2.6 billion (or 0.01 percent of domestic debt).

²³ According to the Access to Finance Survey, which SBP conducted in 2015, 11 percent of respondents mentioned livestock as their major saving vehicle, whereas 16 percent mentioned gold and jewelry.

²⁴ Net Assets of mutual funds, on average, remained at around 11 percent of total national savings, while premium paid insurance was around 6 percent.

by raising public awareness, instilling investor confidence, better marketing strategies, and simplification of the investment process – are required to boost the industry’s growth. The growth in mutual funds industry is being held back also by taxation anomalies. The premise is that investment through mutual funds is subject to multiple taxes, which investors can avoid by investing *directly* in equities or money market instruments. Mutual funds are subject to provincial sales tax (at 14 percent), federal excise duty, and workers welfare funds, which they pass on to investors (in the form of reduced profits). In addition, the FBR requirement for tax-exempt entities, like mutual funds, to obtain a tax exemption certificate every year – effective July 1, 2015 – is reportedly creating cumbersome operational difficulties which the industry could do without.

5.3 External debt & liabilities

Pakistan’s total external debt and liabilities (EDL) increased by 12.0 percent during the year, to reach US\$ 73.0 billion by end June 2016 (**Table 5.4**). As is customary, most of this increase was driven by public component, which contributed 87 percent to the total increase.

Table 5.4: Pakistan's External Debt and Liabilities
Billion US dollar

	Stock			Absolute change	
	FY14	FY15	FY16	FY15	FY16
Total external debt (sum 1 to 7)	65.3	65.1	73.0	-0.1	7.8
Public debt & liabilities (1+2+3)	54.7	54.7	61.4	-0.1	6.7
Public debt (1+2)	51.5	51.0	57.8	-0.5	6.8
1. Government external debt	48.4	46.9	51.7	-1.6	4.9
i) Long term (>1 year)	47.8	45.8	50.0	-1.9	4.2
<i>of which</i>					
Paris club	13.6	11.7	12.7	-1.9	1.0
Multilateral	25.8	24.3	26.4	-1.6	2.1
Other bilateral	3.4	3.9	4.4	0.6	0.5
Commercial loans/credits	0.2	0.3	0.9	0.2	0.6
Euro/Sukuk global bonds	3.6	4.6	4.6	1.0	0.0
ii) Short term (<1 year)	0.7	1.0	1.7	0.3	0.7
2. From IMF	3.0	4.1	6.0	1.1	1.9
3. Foreign exchange liabilities	3.3	3.7	3.6	0.4	-0.1
4. Public sector enterprises (PSEs)	2.1	2.5	2.7	0.4	0.3
5. Commercial banks	2.0	2.3	2.7	0.3	0.4
<i>of which: Borrowing</i>	1.1	1.3	1.6	0.3	0.3
6. Private sector	3.0	3.0	3.3	-0.1	0.3
7. Debt liabilities to direct investors	3.4	2.7	2.9	-0.7	0.2

Source: State Bank of Pakistan & Economic Affairs Division

Higher accumulation of public external debt stemmed from both the increased government borrowings from IFIs as well as revaluation losses that inflated the stock of debt (reflected mainly in Paris Club loans) in US dollar terms. Specifically, Japanese Yen posted an appreciation of 19.6 percent against the US dollar during FY16, which led to an increase in the dollar value of external debt denominated in Japanese Yen.²⁵ As for the IFIs, the stock of loans from the IMF, World Bank and ADB recorded prominent increases (**Table 5.4**). In addition to this, the government also borrowed around half a billion from China and commercial lenders during the year.

Within external debt, the largest component is the multilateral debt, constituting around 45.7 percent of the public external debt. These loans include funding from the World Bank and ADB that are presently engaged in the economy’s reform process, especially in the areas of taxation; doing business; trade facilitation; and education. Moreover, these loans are concessional, therefore add less to the country’s servicing burden.

²⁵ Debt denominated in Japanese Yen constituted 18 percent of Pakistan’s outstanding external debt stock at end June 2016.

Projects financed via external funding²⁶

Gross external disbursements recorded a 16.0 percent YoY increase in FY16. Major increase came from multilateral donors, for the financing of various public projects (**Figure 5.10**). For instance, the support from World Bank came primarily in the areas of education and power, whereas ADB extended loans for energy, infrastructure development, social spending and for public sector management.²⁷ Within bilateral flows, China had the major share and funding largely came for infrastructure and power sector projects.²⁸

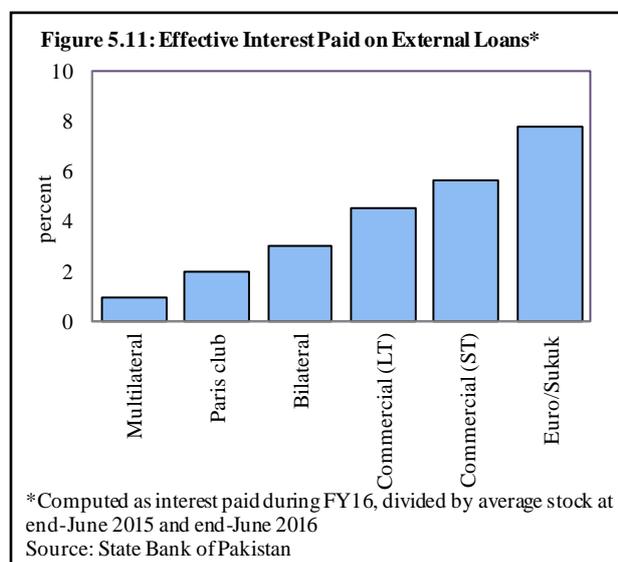
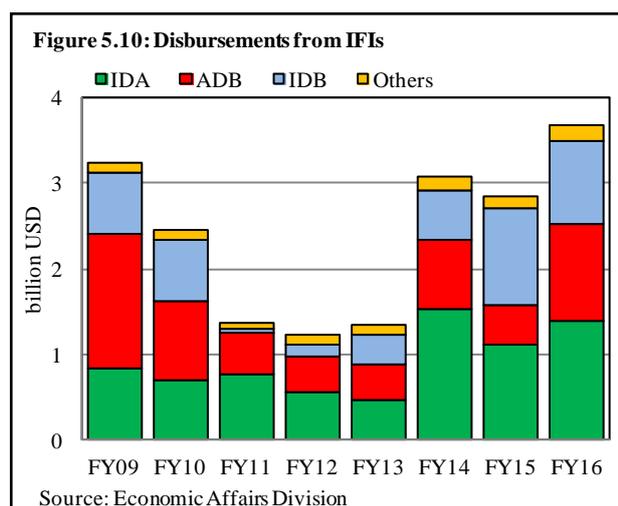
Commercial borrowings

In addition to project and program loans, the government also resorted to commercial borrowings from external sources. Not only did the government issue a 10-year Eurobond during the year, it also continued with last year's practice of borrowing from foreign commercial banks. As a result of this, and the increase in LIBOR (at which most of the variable rate loans are contracted), the effective interest rate on the stock of public external debt inched up.²⁹

For instance, the coupon for US\$ 500 million Eurobond issued in September 2015 was set at 8.25 percent – equal to April 2014 issuance. Similarly, the effective mark-up the government paid on borrowings from commercial banks was also high (**Figure 5.11**). It is important to note here that unlike FY15, when the government borrowing from foreign commercial banks was only in the long-term, the FY16 disbursements of US\$ 1.3 billion from foreign commercial banks was almost equally divided among the long-term and short-term categories.

Servicing of external debt remained low

Pakistan's external debt servicing declined slightly during FY16 as compared to last year (**Table 5.5**). While the servicing of private sector debt increased, that for public sector declined for the second consecutive year. The decline in public debt servicing was mainly due to lower principal repayments made to the IMF. In contrast, interest payments on public external debt rose due to higher payment made on sovereign bonds, multilateral debt, and commercial borrowings.



²⁶ This discussion is based on data available on Economic Affairs Division website.

²⁷ Some important projects financed by IFIs include: (i) Public Sector Enterprises Reform Program (US\$ 300 million); (ii) Sustainable Energy Sector Reform Program (US\$ 400 million); (iii) Power Sector Reform Development Policy Credit (US\$ 489.3 million); (iv) 2nd Sindh Education Project (US\$ 107.3 million); and (v) Pak Competitiveness & Growth Development Policy-3 (US\$ 492 million).

²⁸ Some major projects financed by China include: (i) Chashma Nuclear Power Project, III & IV (US\$ 112 million); (ii) Karachi Coastal Power Project-PBC (US\$ 174 million); (iii) Neelum Jhelum Hydro power project (US\$ 106.5 million); and (iv) Orange Line in Lahore (US\$ 403.7 million).

²⁹ The average cost of external debt has increased from 1.97 percent in FY15 to 2.1 percent in FY16. For details see **Figure 5.4**.

Table 5.5: External Debt Servicing

Million US dollar

	FY11	FY12	FY13	FY14	FY15	FY16
1. Public external debt	2,689.6	3,580.9	5,204.7	5,738.6	3,863.2	3,605.2
Principal	1,759.6	2,700.0	4,404.3	4,964.0	2,888.7	2,478.5
Interest (incl. short-term)	930.0	880.9	800.4	774.6	974.5	1,126.7
2. External liabilities	136.9	111.8	111.6	124.3	89.7	87.2
3. PSEs debt	358.9	248.9	280.6	232.8	274.4	303.2
4. Private sector debt	346.8	370.8	381.3	471.6	445.2	419.5
5. Total external debt and liabilities (sum 1 to 4)	3,532.2	4,312.3	5,978.3	6,567.3	4,672.5	4,415.1
Principal	2,457.8	3,293.8	5,045.6	5,658.6	3,499.0	3,076.0
Interest (incl. short-term)	1,074.4	1,018.5	932.7	908.7	1,173.5	1,339.1
Short-term (principal)						
1. Government debt	325.1	0.0	390.3	256.0	611.6	734.5
2. PSEs non-guaranteed debt	91.2	149.0	115.5	151.2	64.3	56.4
3. Private non-guaranteed debt	0.0	46.0	1.0	22.1	68.8	104.4
4. Total	416.3	195.0	506.8	429.2	744.7	895.4

Source: State Bank of Pakistan

5.4 External debt sustainability

The evaluation of a country's external debt sustainability includes assessment of debt carrying and servicing capacity through standard indicators of solvency and liquidity. Debt bearing capacity of the country, measured in terms of the country's external debt to GDP has declined slightly during the year (Table 5.6). As mentioned before, public debt management is a complex job and requires maintaining a fine balance between associated risks and costs. Therefore, some increase in this ratio does not necessarily imply a significant liquidity discomfort. Similarly, SBP reserves coverage of country's external debt has also improved to a 9-year high level of 24.9 percent. That said, this level is still low compared to the coverage in most emerging market economies.³⁰

Table 5.6: Indicators of External Debt Sustainability

percent

	Jun-10	Jun-11	Jun-12	Jun-13	Jun-14	Jun-15	Jun-16
Solvency indicators							
Total external debt and liabilities/GDP	35.4	31.2	30.9	27.0	25.7	24.1	25.8
Public external debt/GDP	29.3	26.0	25.2	21.3	20.3	18.9	20.4
Total reserves/total external debt & liabilities	27.2	27.5	23.3	18.1	21.7	28.7	31.7
SBP reserves/total external debt & liabilities	21.0	22.3	16.5	9.9	13.9	20.8	24.9
External debt servicing/FX earnings	12.1	8.3	9.3	12.9	13.7	10.2	10.3
External debt servicing/export earnings	18.5	12.7	15.2	20.6	23.0	18.1	19.4
Liquidity indicators							
Short-term external debt/TEDL	2.2	1.9	2.5	2.5	4.0	5.2	6.2
Short-term external debt/total reserves	8.0	7.0	10.6	13.9	18.3	18.2	19.7
Short-term external debt/SBP reserves	10.4	8.7	14.9	25.4	28.4	25.2	25.1

Source: SBP calculations

Finally, liquidity indicators show an increased reliance on short-term external debt, which now constitutes 19.7 percent of the country's liquid FX reserves, compared to 18.2 percent a year ago. Not only the government, but domestic commercial banks have also been taking short-term loans from foreign banks to bridge the payment gaps. In this context, it is important to focus on long-term borrowing, which is not only a less costly resource, but also carries low roll-over and re-fixing risk for the country.

³⁰ For details, see International Debt Statistics prepared by the World Bank.