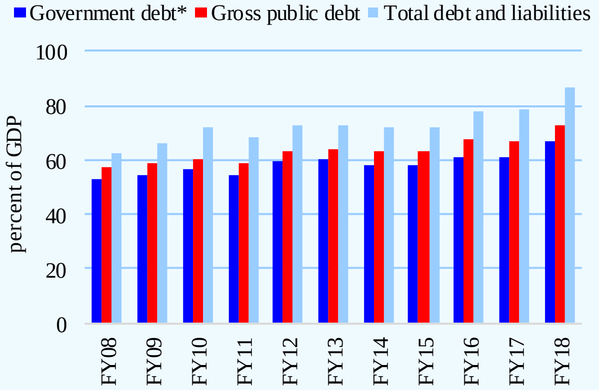
5 Domestic and External Debt

5.1 Overview

The rising macroeconomic imbalances, the widening of twin deficits in particular, quickened the pace of debt accumulation. The gross public debt grew by 16.6 percent during FY18, almost twice the rate of increase recorded in FY17. As a result, the gross public debt rose by 5.6 percentage points to 72.5 percent of GDP by end-June 2018. Similar trends were observed in government debt – public debt minus government deposits held with the banking system. Thus, debt-to-GDP ratio remained higher than the 60 percent limit envisaged in the Fiscal Responsibility & Debt Limitation Act (FRDLA), 2005 (**Figure 5.1**).[1]

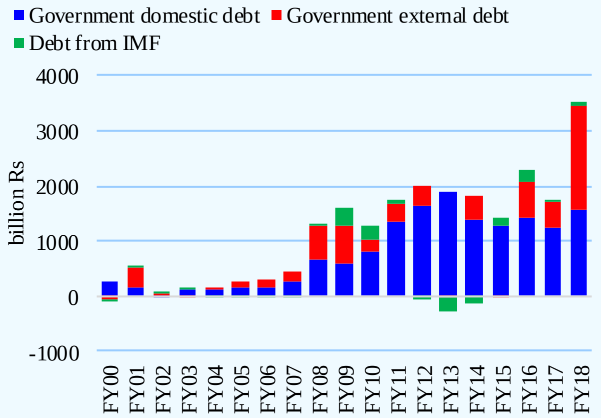
Figure 5.1: Debt Indicators



*As per FRDLA
Data sources: State Bank of Pakistan and Economic Affairs Division

In absolute terms, gross public debt reached Rs 25.0 trillion by end-June 2018, showing an increase of Rs 3.5 trillion during FY18. More than half of this record accumulation in gross public debt in a single year was contributed by public external debt, which grew by 30.1percent (**Figure 5.2**). Most of the rise in public external debt came from fresh disbursements from China, foreign commercial banks and proceeds from Eurobond/ Sukuk issuance. Besides, revaluation losses due to appreciation of international currencies against US dollar and depreciation of PKR against US dollar, explain this high growth in public external debt during FY18. Out of Rs 2.0 trillion expansion in external public debt, around Rs 1.1 trillion was due to PKR depreciation against dollar and appreciation of major currencies against dollar.[2]

Figure 5.2: Composition of Change in Gross Public Debt



Data sources: State Bank of Pakistan and Economic Affairs Division

Most of the fresh external loans were contracted on floating interest rates. Though a large share of external debt still comprises of concessionary loans from multilateral agencies, it may pose challenges for future debt servicing when looked in the context of the rising global interest rates and stressed external account position. In addition, the rising share of external debt may intensify the revaluation impact in case of excessive exchange rate fluctuations. Interest payments on external debt have already started to rise owing to increase in stock of external debt and upward trend in LIBOR. From the sustainability perspective, the solvency and liquidity ratios show deterioration, while indicators

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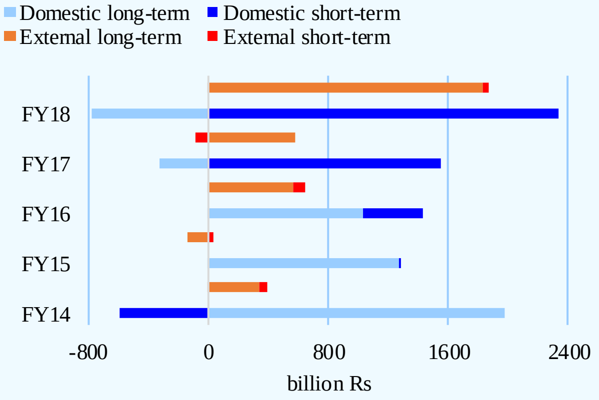
[1] FRDL Act, 2005, as amended in June 2016, requires government to contain the fiscal deficit at 4.0 percent and public debt to GDP ratio at 60 percent in FY18. Moreover, the debt of the government, defined as public debt minus government deposits held with the banking system stood at 67.0 percent at end-June 2018.

[2] The impact of other currencies' appreciation against US dollar on the external public debt recorded at US$ 407 million in FY18.

measuring servicing capacity show improvement due to both increase in exports and decline in debt servicing (**Section 5.4**).

In terms of maturity structure, the government continued to rely on short-term borrowing during FY18. In particular, the short-term domestic borrowing of central government was almost 1.5 times higher in FY18 than in FY17 **(Figure 5.3)**. In the case of external debt, the average time to maturity of new loans also shortened in FY18 relative to FY17.[3] The rising share of short-term instrument in outstanding debt stock has increased the government exposure to refinancing and interest rate risk.[4] The risk indicators including the share of domestic debt maturing in 1-year and average time to maturity deteriorated further in FY18 (**Section 5.2**).

Figure 5.3: Tenor-wise Composition of Net Addition in Public Debt



Data sources: State Bank of Pakistan and Economic Affairs Division

Table 5.1: Summary of Pakistan's Debt and Liabilities
billion rupees

	Stock			Absolute change		Percent of GDP	
	FY16	**FY17**	**FY18**	**FY17**	**FY18**	**FY17**	**FY18**
A. Total debt and liabilities (sum I to IX)	22,577.1	25,109.3	29,861.2	2,532.2	4,751.9	78.6	86.8
B. Gross public debt (sum I to III)	19,676.6	21,408.7	24,951.8	1,732.0	3,543.1	67.0	72.5
Total debt of the government (I+II+III-X)	17,823.2	19,635.4	23,050.5	1,812.2	3,415.1	61.4	67.0
I. Government domestic debt	13,625.9	14,849.2	16,415.2	1,223.3	1,566.0	46.5	47.7
II. Government external debt	5,417.6	5,918.7	7,795.8	501.1	1,877.0	18.5	22.7
III. Debt from IMF	633.1	640.8	740.8	7.7	100.0	2.0	2.2
IV. External liabilities	377.1	373.8	622.3	-3.3	248.5	1.2	1.8
V. Private sector external debt	709.1	1,171.2	1,600.6	462.1	429.5	3.7	4.7
VI. PSEs external debt	294.0	285.2	325.2	-8.9	40.0	0.9	0.9
VII. PSEs domestic debt	568.1	822.8	1068.2	254.7	245.4	2.6	3.1
VIII. Commodity operations	636.6	686.5	819.7	49.9	133.2	2.1	2.4
IX. Intercompany external debt	315.6	361.2	473.4	45.5	112.2	1.1	1.4
X. Deposits with banking system	1,853.5	1,773.3	1,901.3	-80.2	128.0	5.5	5.5

Data sources: State Bank of Pakistan and External Affairs Division

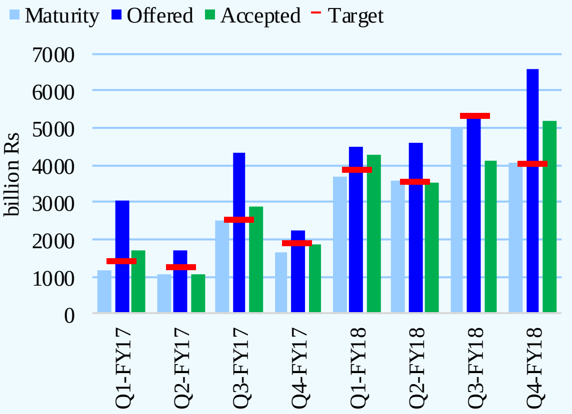
In addition to public debt, considerable increase in PSEs debt, loans for commodity operations and external liabilities pushed Pakistan's total debt and liabilities (TDL) to 86.8 percent of GDP at end-Jun 2018 from 78.6 percent as of end-Jun 2017 (**Table 5.1**).

5.2 Domestic Debt

Notwithstanding the increased external financing, the government had to rely on domestic sources to finance increased fiscal deficit during FY18. The domestic debt grew by 10.5 percent during FY18 compared to 9.0 percent increase in FY17 (**Table 5.2**). Similar to last year, entire increase in domestic debt came from short-term debt, as the government continued to retire its long-term debt.[5]

[3] As shown in **Figure 5.3**, the extraordinarily high increase in long-term external debt (in rupee terms) was mainly due to currency revaluation changes.
[4] The share of short-term debt in domestic debt reached 54.2 percent in June 2018 from 44.1 percent in June 2017
[5] The government retired PIBs worth Rs 1.5 trillion and 12-month T-bills worth 1.8 trillion during last two years.

Figure 5.4a: Auction Profile of T-bills



Data source: State Bank of Pakistan

Figure 5.4b: Tenor-wise Stock of Outstanding T-bills

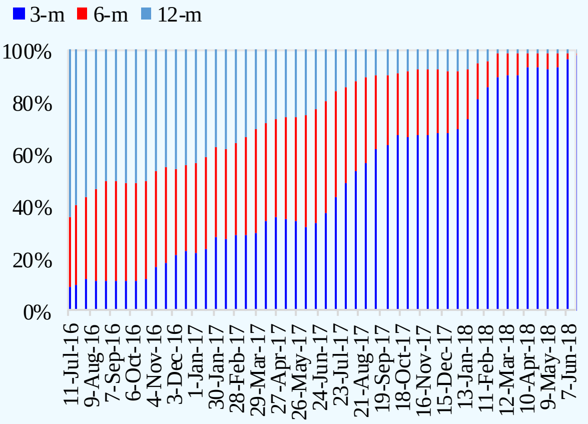


Table 5.2: Government Domestic Debt
billion rupees

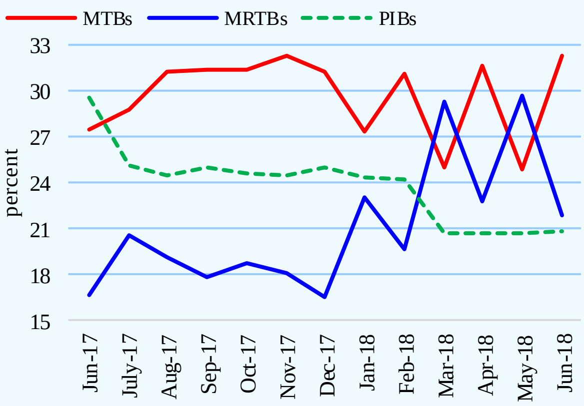
	Stock			Flow		Growth (percent)	
	FY16	FY17	FY18	FY17	FY18	FY17	FY18
Domestic debt	13,625.9	14,849.2	16,415.2	1,223.3	1,566.0	9.0	10.5
I. Permanent debt: *of which*	5,935.9	5,528.4	4,653.8	-407.5	-874.6	-6.9	-15.8
PIBs	4,921.4	4,391.8	3,413.3	-529.6	-978.5	-10.8	-22.3
Ijara Sukuk	363.9	385.4	385.4	21.5	0.0	5.9	0.0
Prize bonds	646.4	747.1	851.0	100.7	103.9	15.6	13.9
II. Floating debt: *of which*	5,001.7	6,550.9	8,889.1	1,549.2	2,338.2	31.0	35.7
MTBs	2,771.4	4,082.0	5,294.9	1,310.5	1,212.9	47.3	29.7
MRTBs	2,017.6	2,468.9	3,594.2	451.3	1,125.3	22.4	45.6
III. Unfunded debt	2,683.7	2,765.3	2,867.0	81.6	101.7	3.0	3.7

Data source: State Bank of Pakistan

Expectations about higher inflation and concurrent rise in interest rate drove banks' bidding pattern towards short-term instruments (**Figure 5.4a**). Within T-bills, government borrowing was heavily tilted towards 3-months bill, as banks participation in 6-month and 12 month T-bill auctions was quite low. This has pushed the share of 3-month T-bills to 97.7 percent at the end of Jun 18 from around 40 percent at the start of the fiscal year (**Figure 5.4b**). Similar trends were observed in case of non-bank holding of government securities, i.e. retirement of PIBs/Ijara and 12-month T-bills and new investment almost entirely going into 3-month T-bills.

The changing market dynamics made it difficult for the government to rollover long-term debt, and raise additional financing. In this backdrop, the government relied on the central bank borrowings. Hence, a record amount of MRTBs worth Rs 2.2 trillion was created in Q3-FY18 alone.[6] A part of this deficit monetization was retired through

Figure 5.5: Instrument-wise Share in Domestic Debt



Data source: State Bank of Pakistan

[6] However, government retired Rs 1.1 trillion to SBP during Q4-FY18, hence net addition to the central bank's borrowing remained at Rs 1.1 trillion during FY18.

borrowing from scheduled banks in the last quarter of FY18; still the share of MRTBs in domestic debt was recorded at around 22 percent in June 2018, higher than 16.6 percent June 2017 **(Figure 5.5)**.

This has worsened the maturity profile of the domestic debt. The concentration of short-term debt has also increased refinancing risk. The latest available estimates show that share of domestic debt maturing in 1-year rose significantly from 52.7 percent in December 2016 to 60.1 percent in December 2017. Similarly average time to maturity reduced from 2.3 years in June 2015 to less than 2 years in December 2017 (**Table 5.3**).

Table 5.3: Refinancing Risk for Domestic Debt

	Debt maturing in 1 year (% of total)	Average time to maturity (years)
Jun-15	47.3	2.3
Mar-16	52.4	2.1
Jun-16	51.9	2.1
Dec-16	52.7	2.1
Jun-17	55.6	2.0
Dec-17	60.1	1.8

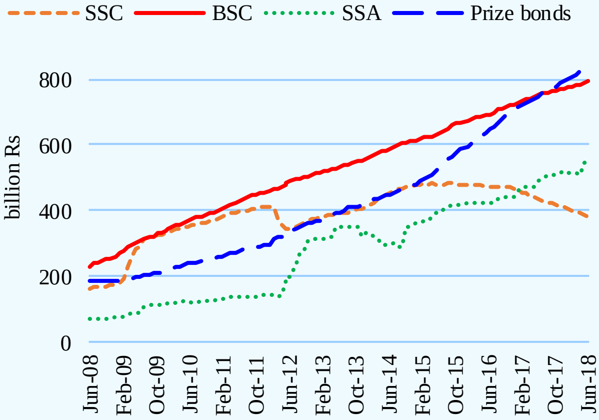
Data source: Ministry of Finance

Inflows in NSS remained low

Net inflow in National Saving Schemes (NSS) was recorded at Rs 98.0 billion in FY18, marginally lower than Rs 104.1 billion realized in FY17. In fact, the inflows have been falling persistently for the past three years. This falling trend mainly reflects lower profit rates and higher incidence of withholding tax on non-filers. A disaggregated analysis shows that gross inflows in major schemes increased; however, considerable retirements led to a fall in net terms. In the case of SSC and SSA in particular, net mobilization declined sharply despite substantial increase recorded in gross inflows.

Prize bonds witnessed a marginal rise in net mobilization during FY18 compared to the previous year. This was despite introduction of the premium prize bond in April 201, which offered an additional profit rate of 1.5 percent on biannual basis in addition to the traditional prize money (**Figure 5.6**).

Figure 5.6: Stock of Prize Bonds and Major NSS Categories

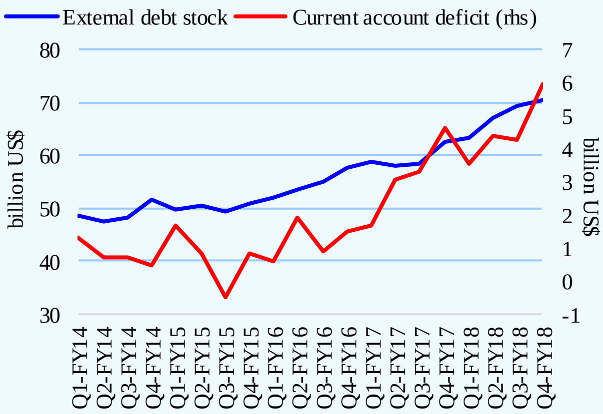


Data source: Central Directorate of National Savings (CDNS)

5.3 External Debt and Liabilities

Total external debt and liabilities (TEDL) reached US$ 95.1 billion by end June 2018, an increase of US$ 11.7 billion during FY18 (**Table 5.4**). Most of this increase was driven by the public component, which contributed two-thirds of the total increase in EDL. Widening of the current account deficit led to a considerable increase in external financing needs and thus accumulation in external debt during FY18 (**Figure 5.7**). The increase in the external public debt primarily came from disbursements from China, foreign commercial banks and the Eurobond/Sukuk proceeds.

Figure 5.7: External Debt and Current Account Deficit

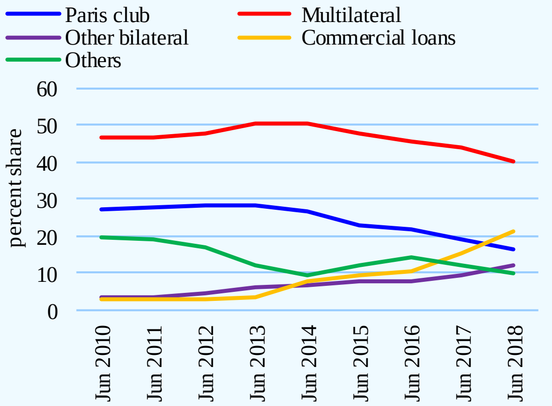


Data source: State Bank of Pakistan

Along with higher external borrowings, revaluation losses due to appreciation of major currencies against US dollar also added around US$ 407 million to country's external debt. The revaluation loss has come down from US$ 1.7 billion, as reported for Jul-Mar period in

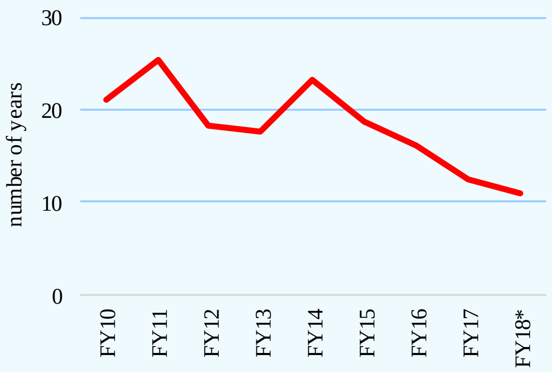
Third Quarterly Report for FY18, due to strengthening of US dollar against major currencies in Q4. In particular, the Japanese Yen and SDR – carrying out around 38 percent of Pakistan's external debt – depreciated by 4.1 and 3.4 percent during fourth quarter, against appreciation of 5.2 and 4.3 percent during Jul-Mar period respectively.

Figure 5.8: Composition of Public External Debt



Data sources: State Bank of Pakistan and Economic Affairs Division

Figure 5.9: Average Time to Maturity of New Loans



*Based on Jul-Feb data
Data source: SBP calculations

Within the external borrowing, the reliance on commercial and other bilateral (mainly China) sources has increased considerably during the last couple of years (**Figure 5.8).** Importantly, the government borrowing from commercial lenders is relatively at higher rates and of shorter tenor compared to multilateral/bilateral loans. Average maturity of the new loan contracted is an important measure to gauge the refinancing risk. As shown in **Figure 5.9**, this has declined to 10.9 years in FY18 against 21.1 years in FY10 and is one of the reasons for increase in interest payments.

Table 5.4: Pakistan's External Debt and Liabilities

billion US dollars

	End-June stock			Absolute change					
						FY18			
	FY16	FY17	FY18	FY17	FY18	Q1	Q2	Q3	Q4
Total external debt & liabilities (sum 1 to 7)	**73.9**	**83.4**	**95.1**	**9.5**	**11.7**	**2.0**	**3.8**	**3.0**	**3.0**
External public debt & liabilities (1+2+3)	**61.4**	**66.1**	**75.4**	**4.7**	**9.3**	**0.9**	**3.5**	**2.5**	**2.3**
External Public debt (1+2)	**57.8**	**62.5**	**70.2**	**4.8**	**7.7**	**0.9**	**3.5**	**2.4**	**1.0**
1. Government external debt	51.7	56.4	64.1	4.7	7.7	0.8	3.4	2.3	1.2
i) Long term (>1 year): *of which*	50.0	55.5	63.0	5.5	7.4	0.7	3.0	1.9	1.8
Paris club	12.7	12.0	11.6	-0.7	-0.3	0.1	-0.2	0.4	-0.7
Multilateral	26.4	27.6	28.1	1.2	0.5	0.3	0.0	0.5	-0.3
Other bilateral	5.4	6.3	8.7	0.9	2.3	0.4	0.2	0.7	1.0
Commercial loans/credits	0.9	4.8	7.3	3.9	2.4	-0.1	0.5	0.3	1.8
Euro/Sukuk global bonds	4.6	4.8	7.3	0.3	2.5	0.0	2.5	0.0	0.0
ii) Short term (<1 year)	1.7	0.9	1.2	-0.8	0.3	0.0	0.4	0.4	-0.5
2. From IMF	6.0	6.1	6.1	0.1	0.0	0.1	0.0	0.1	-0.2
3. Foreign exchange liabilities	3.6	3.6	5.1	0.0	1.6	0.0	0.0	0.1	1.4
4. Public sector enterprises (PSEs)	2.8	2.7	2.7	-0.1	0.0	0.3	-0.1	-0.1	-0.1
5. Banks: *of which*	2.7	4.5	4.4	1.8	-0.1	0.5	-0.3	-0.1	-0.2
Borrowing	1.6	3.3	3.0	1.7	-0.3	0.5	-0.3	-0.1	-0.4
6. Private sector	4.1	6.6	8.8	2.6	2.1	0.3	0.5	0.6	0.8
7. Debt liabilities to direct investors	3.0	3.4	3.9	0.4	0.5	0.1	0.2	0.1	0.2

Data sources: State Bank of Pakistan and Economic Affairs Division

External debt servicing declined

Despite increase in interest payments, Pakistan's external debt servicing declined during FY18, mainly due to lower principal repayment of public debt (**Table 5.5**). The decline in principal repayment was primarily due to absence of Euro/Sukuk bond repayment in FY18, as Pakistan repaid Eurobond worth $750 million issued in 2007. However, repayment to Paris club and the multilateral donors recorded some increase during FY18, as repayment of the restructured debt began in FY18. In contrast, interest payments on external public debt continued to increase, mainly on account of higher interest payment made on sovereign bonds, multilateral debt, and commercial borrowings. Importantly, the interest payment on public debt almost doubled during FY18 compared to FY14. Both the higher external borrowings from commercial sources and rise in the benchmarks rates were responsible for this increase.

Table 5.5: External Debt Servicing
million US dollars

	Principal			Interest		
	FY16	**FY17**	**FY18**	**FY16**	**FY17**	**FY18**
1. External public debt	2,478.5	3,733.8	2,704.5	1,126.7	1,313.2	1,683.7
Paris club	219.9	411.8	611.2	243.8	242.0	240.3
Multilateral	1,220.9	1,255.2	1,316.6	239.2	295.3	357.4
Other bilateral	220.2	788.0	202.0	136.4	198.9	203.3
Euro/Sukuk global bonds	500.0	750.0	0.0	354.0	366.4	422.8
Commercial loans /credits	225.0	488.8	488.9	54.9	72.9	270.3
Others	92.6	40.0	85.9	98.4	137.6	189.6
2. External liabilities	0.0	0.0	0.0	87.2	86.6	102.8
3. PSEs debt	269.5	289.0	297.8	33.7	35.1	78.5
4.Scheduled banks' borrowing	2.9	0.0	1.0	8.3	23.2	61.3
5. Private sector debt	325.4	416.6	331.6	90.0	165.9	366.4
6. Total external debt and liabilities (sum 1 to 5)	3,076.2	4,439.4	3,335.0	1,345.9	1,623.9	2,292.7
Memorandum Items						
Short-term debt servicing - principal						
Government debt	734.5	1,392.9	1,486.3			
PSEs non-guaranteed debt	56.4	42.7	33.7			
Private non-guaranteed debt	104.7	647.6	331.8			

Data source: State Bank of Pakistan

However, the servicing of the external public debt is likely to increase in coming years as the repayment of rescheduled Paris Club debt and IMF's EFF would start to increase from FY19 onwards. Moreover, the commercial loans and 5-year sovereign bonds issued in FY14 and FY15 would be maturing in FY19 and FY20.

5.4 External Debt Sustainability

The assessment of external debt sustainability shows a deterioration in debt bearing capacity of the country, but servicing capacity improved with the recovery in exports as well decline in debt servicing during the year. The most common measure used to assess debt-bearing capacity is the external debt and liabilities to GDP ratio, which increased to 33.6 percent by end of June 2018, after remaining stable at an average of almost 26.0 percent over the last five years. Similarly, another measure of solvency, reserves to TDL, also deteriorated by around 8 percentage points, due to both higher external borrowings and a drawdown in reserves during FY18 **(Table 5.6)**.[7]

All the liquidity measures, used to assess the ability to meet short-term obligations, also showed deterioration. Particularly, the ratio of short-term external public debt to reserves increased

[7] Given the element of volatility due to exchange rate movement in debt to GDP ratio, solvency measured in terms of reserve to TEDL provide better inference.

significantly, mainly due to decline in reserves. Similarly, there was a moderate increase in the share of short-term debt in TEDL.

In contrast, both indicators used to assess servicing capacity, export earnings and total foreign exchange earnings, improved due to low debt servicing and revival in exports during FY18. The ratio of external debt servicing to government revenue, which shows resources available with government for servicing of external debt, also improved to 1.0 in FY18 from 1.3 in FY17. This suggests that government revenues during FY18 were just sufficient to repay the maturing external debt and interest expense.

Table 5.6: Indicators of External Debt Sustainability
percent

	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17	Jun-18
Solvency indicators						
Total external debt and liabilities/GDP	27.0	25.6	24.2	26.6	27.4	33.6
External public debt/GDP	21.3	20.2	18.9	20.8	20.5	24.8
Total reserves/total external debt & liabilities	18.1	21.7	28.7	31.2	25.7	17.3
SBP reserves/total external debt & liabilities	9.9	13.9	20.8	24.5	19.3	10.3
External debt servicing/FX earnings	12.9	13.7	10.2	10.4	15.7	13.7
External debt servicing/export earnings	20.6	23.0	18.0	19.4	29.6	25.0
Liquidity indicators						
Short-term external public debt/PEDL	0.5	1.3	1.9	2.8	1.3	1.9
Short-term external public debt/total reserves	2.4	5.2	5.4	7.3	4.1	7.1
Short-term external public debt/SBP reserves	4.4	8.0	7.5	9.3	5.5	11.9

Data source: State Bank of Pakistan calculations