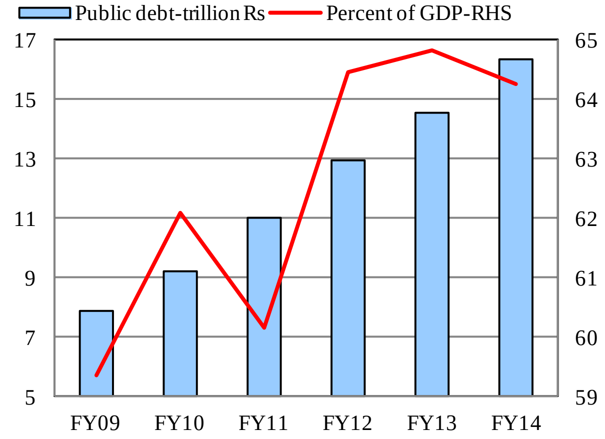
6 Domestic and External Debt

6.1 Overview

Following an improvement in the budget deficit, the pace of debt accumulation witnessed a marginal decline in FY14. The public debt-to-GDP ratio, an indicator of the country's indebtedness, recorded a slight decrease of 50 bps during the year (**Figure 6.1**).[1] Similarly, there was a 40 bps reduction in public debt to government revenues, indicating some easing in government indebtedness. In addition, the composition of public debt also improved due to: (a) higher disbursements from International Financial Institutions (IFIs); (b) the successful issuance of Eurobonds; and (c) the significant substitution of T-bills with PIBs, helped improve maturity profile of domestic debt.

Figure 6.1: Profile of Public Debt



Source: State Bank of Pakistan & Economic Affairs Division

Table 6.1: Profile of Pakistan's Debt and Liabilities

	FY12	FY13	FY14	FY12	FY13	FY14
	billion Rupee			percent of GDP		
Total debt & liabilities	14,552	16,339	18,241	72.6	72.7	71.8
Public debt[1]	12,923	14,575	16,321	64.5	64.8	64.3
Total debt	13,887	15,561	17,424	69.3	69.2	68.6
Govt. domestic debt	7,638	9,521	10,907	38.1	42.3	42.9
PSEs domestic debt	281	312	366	1.4	1.4	1.4
External debt	5,968	5,728	6,151	29.8	25.5	24.2
Govt. external debt	4,364	4,311	4,791	21.8	19.2	18.9
IMF loans	694	435	298	3.5	1.9	1.2
PSEs external debt	144	209	205	0.7	0.9	0.8
Private sector external debt	513	466	486	2.6	2.1	1.9
Intercompany debt	253	308	370	1.3	1.4	1.5
Total liabilities	665	778	817	3.3	3.5	3.2
Domestic liabilities	438	470	492	2.2	2.1	1.9
External liabilities	227	308	324	1.1	1.4	1.3

[1]Public debt include Govt. Domestic Debt, Govt. External Debt, IMF loans & External Liabilities
Source: Economic Affairs Division & State Bank of Pakistan.

Despite these positives, there is much to remain concerned about. More specifically: (a) the public debt to GDP ratio of 64.3 percent, is higher than the 60 percent ceiling under the Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005; (b) the government was unable to meet the quarterly limit of zero (net) budgetary borrowing from SBP (as prescribed in SBP Act, 1956) for three quarters of the

[1] Public debt-GDP ratio is based on SBP data, which is slightly different from numbers reported by the Ministry of Finance. The disparity in debt numbers is due to differences in coverage of public debt reported by the two sources. Public debt reported by SBP is composed of: (i) government domestic debt; (ii) government external debt; (iii) IMF loans; and (iv) external liabilities. While both MoF and SBP follow the same definition of domestic public debt, the coverage of external debt compiled by MoF differs from that of SBP. Specifically, MoF does not include short-term debt, military debt and external liabilities in its compilation of external public debt (see Data Explanatory Notes at the end of the Report).

year; (c) public debt, a charge on the exchequer, stood at 4.5 times government revenues in FY14; and (d) interest payments accounted for one-fifths of total government expenditures.

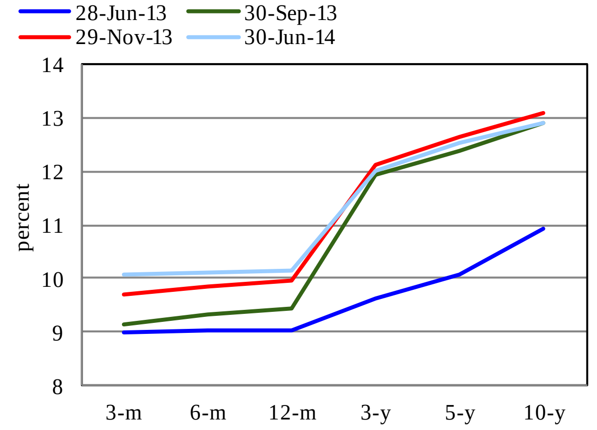
In absolute term, Pakistan's public debt saw an increase of Rs 1.7 trillion during the year, to reach Rs 16.3 trillion by end FY14 (**Table 6.1 & Figure 6.1**). Unlike the previous year when the entire increase came from domestic debt, external debt contributed around one-fifths of the increase in FY14. In fact, Pakistan's external debt and liabilities posted an increase of US$ 4.6 billion in FY14, after falling in FY12 and FY13. The government's decision to re-engage with the IMF at the beginning of the fiscal year not only helped reduce pressure on the external account, but also facilitated the resumption of inflows from other IFIs. This is clearly evident from the US$ 1.6 billion increase in multilateral loans during the year. Another important development was the government decision to tap the international bond market, after a gap of seven years. Pakistan was able to borrow US$ 2.0 billion by issuing Eurobonds in April 2014, against the initial target of only US$ 0.5 billion.

While the revival of external inflows is encouraging (after a persistent decline in external loans since FY09), the risks attached to borrowing from the international market, should be managed carefully. Although there is some erosion in external debt sustainability indicators (external debt to GDP ratio, external debt servicing to foreign exchange earnings and export ratios), these concerns should be managed by strengthening repayment capacity in the years to come.

Looking again at the composition of Pakistan's public debt, the single most important development was the significant substitution of short term debt (T-bills) with medium to long term debt (PIBs). With an unprecedented increase of Rs 1.9 trillion in FY14, the share of *permanent debt* has jumped to 37.1 percent by end-FY14, from only 22.8 percent a year before. In addition to fresh investments in PIBs, institutional investors (banks and non-banks) also substituted their investment in T-bills and NSS, with PIBs to benefit from the exceptionally high term premium that prevailed during the year. As shown in **Figure 6.2**, there was a clear disconnect between the T-bill and PIB sections of the yield curve.

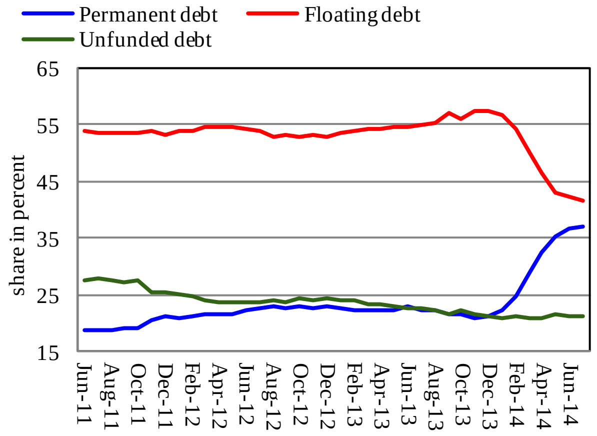
While these changes have improved the maturity profile of the country's domestic debt and reduced government exposure to rollover and re-pricing risks, its cost in terms of higher interest payments entails a fiscal burden in the future. It is important to note that interest payments have already emerged as a major drain on scarce fiscal resources. Specifically, the government paid Rs 1,148 billion as interest payments in FY14, which were 31.6 percent of government revenues, 21.9 percent of total expenditures, and constituted 4.5 percent of total GDP.

Figure 6.2: Secondary Market Yield Curves



Source: State Bank of Pakistan

Figure 6.3: Composition of Domestic Debt



Source: State Bank of Pakistan

In fact, debt payments were much higher than government spending on its public sector development program. The persistence of a *revenue deficit* indicates that the government is not only borrowing to finance all its development spending, but partially to finance its current expenditures. This undermines the repayment capacity of the country. Facing such dynamics, the need for effective debt management and fiscal consolidation, can hardly be over emphasized.

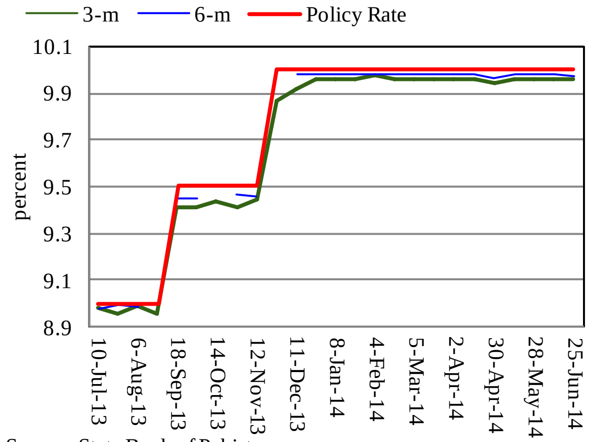
6.2 Domestic Debt

Unlike FY13, when the onus of deficit financing fell entirely on domestic sources, 37.2 percent of the budget deficit in FY14 was financed through external borrowing. This, along with the relatively smaller budget deficit, reduced the pace of domestic debt accumulation. In absolute terms, Pakistan's domestic debt expanded by Rs 1.4 trillion in FY14, compared to an increase of Rs 1.9 trillion in the previous year. In addition, there was a notable improvement in the maturity profile of domestic debt as well.

Re-profiling of the domestic debt towards longer term maturity

As shown in **Figure 6.3**, there was a marked shift in the composition of domestic debt in the second half of FY14. Specifically, the share of permanent debt reached 37.1 percent by end FY14, from only 21.2 percent just six months ago (end-December 2013). Correspondingly, the share of floating debt declined from 57.4 percent to 41.6 percent over the same period. Although this re-profiling of domestic debt was targeted in the Medium Term Debt Management Strategy 2014-18, the scale and the speed of this re-profiling, was unprecedented. In this context, the following points are worth noting.

Figure 6.4: T-bill Cut-off Rates vs. Policy Rate



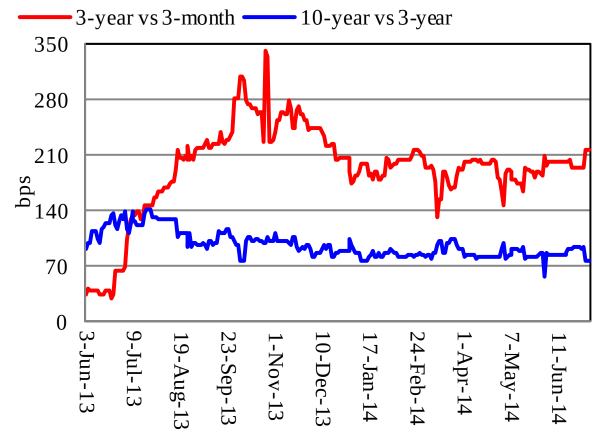
Source: State Bank of Pakistan

Increase in term premium

One of the key factors behind this re-profiling, was the sharp increase in term premium for PIBs. In fact, secondary market yields on PIBs started inching up from June 2013, due to issuance of PIBs for the settlement of circular debt, pressures on the external account, and possible increase in interest rate with the start of the IMF program. At the same time, T-bill yields remained almost unchanged as the cut-off rates (in the primary auctions) were already very close to the policy rate (**Figure 6.4**).[2]

Moreover, the term premium between 3 and 12-month T-bills, was almost negligible, which rendered the T-bill section of the yield curve almost flat. As a result, the term premium between 3-month T-bills and 3-year PIBs, more than doubled from the first week of June to mid July 2013 (**Figure 6.5**).

Figure 6.5: Change in Term Premium



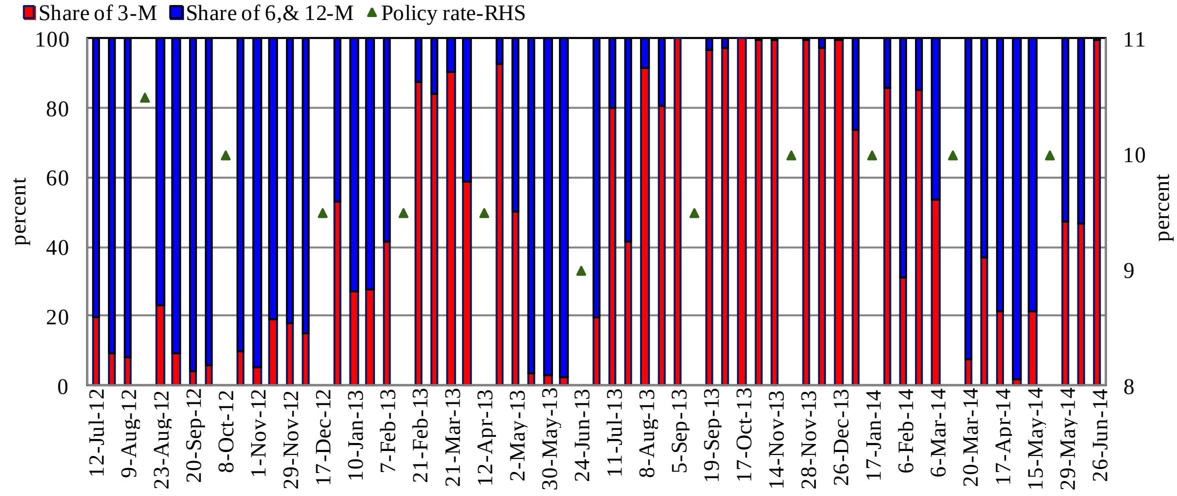
Source: State Bank of Pakistan

[2] Compared with the policy rate at 9.0 percent, the cut-off rates in T-bill auction held on 26th June 2013 (the last auction of FY13) stood at 8.96, 8.97 and 8.98 for 3, 6, and 12 months T-bills respectively.

Initial monetary tightening: less than market expectations

The pace of monetary tightening, signaled by a 50 bps increase in the policy rate in September 2013, fell short of market expectations. In fact, the term premium between T-bill and PIB yields increased by over 150 bps in anticipation of an interest rate hike before the announcement of the monetary decision. From the market perspective, this signaled a pending upward adjustment in T-bill section of the yield curve, which is inextricably linked to the policy rate. Although cut-off rates in the primary auctions swiftly moved up following the 50 bps increase in the policy rate in September 2013, the term premium between T-bills and PIBs, increased further (**Figure 6.4 & 6.5**). In other words, the yield curve continued to reflect a disconnect between its two sections. Having said this, the market didn't react to this disconnect, perhaps considering it a transitionary phase in an increasing interest rate environment.[3]

Figure 6.6: Composition of Offered Amount in T-bill Auctions



Source: State Bank of Pakistan

It is interesting to note that market expectations of a further increase in interest rates, were not entirely misplaced. The ceilings on SBP's NDA and government borrowing from SBP under the IMF program, elevated yields carried by PIBs; and SBP's initial inflation projections of 11 to 12 percent for FY14 were factored in by the market in formulating its outlook of a further increase in interest rates. With this backdrop, banks were not only reluctant to rollover maturing T-bills, but the offered amounts were almost entirely concentrated in 3-month T-bills (**Figure 6.6**). These expectations worsen the maturity profile of domestic debt, as maturing 6 & 12-month T-bills were largely substituted with 3-month T-bills. Furthermore, the government was unable to realize the targeted amount through PIBs over the same period.

Change in market sentiments-post November 2013

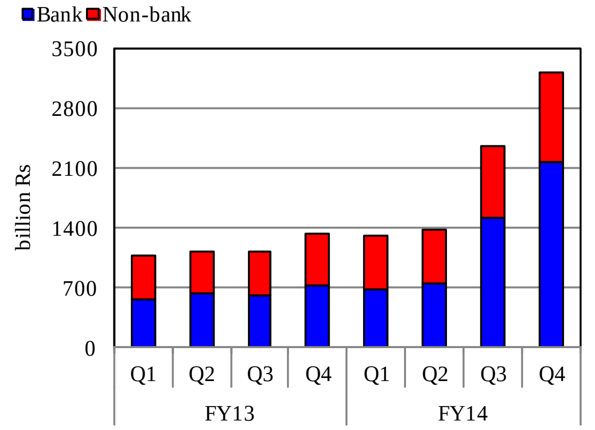
With an increase in the policy rate in November, the notable fall in YoY inflation in December 2013, and an improvement in external account; the market realized that interest rates had perhaps already peaked. Given the huge gap between T-bill and PIB yields, commercial banks suddenly jumped into PIBs to take advantage of higher yields. Specifically, banks offered Rs 1.9 trillion in PIBs auctions during the second half of the year, against the pre-auction cumulative target of Rs 480 billion. On the other hand, the government accepted almost the entire amount and yet managed to keep cut-off rates almost unchanged. This shows that banks were more than willing to over invest in PIBs at the

[3] Specifically, the market offered only Rs 84.2 billion in three PIB auctions during the first quarter of the year, against the cumulative target of RS 150 billion. The government could mobilize only Rs 16.1 billion from these auctions, primarily by 3 and 5 year PIBs.

prevailing rates. This improved the maturity profile of Pakistan's domestic debt, and made it easier for the government to meet the ceiling targets on its borrowing from SBP under the IMF program.[4]

It is important to note that the aggressive bidding in PIBs was largely financed by maturing T-bills[5], which pushed PIBs holdings by banks to a record high (**Figure 6.7**). As of end FY14, commercial banks were holding more PIBs (Rs 2,171 billion) on their books than T-bills (Rs 1,603 billion). Given the short term nature of banks deposits, the surge in banks PIBs holdings has implications for the maturity risk currently run by commercial banks.

Figure 6.7: PIBs Holdings by Banks



Source: State Bank of Pakistan

Unplanned nature of substitution

While the significant shift from T-bills to PIBs is a welcome development for domestic debt management, the unplanned nature of this substitution made market management quite challenging (see **Chapter 4**). As shown in **Figure 6.8a**, the cumulative amount offered in T-bill auctions, fell short of the quarterly targets for three (of four) quarters in FY14. Similarly, the accepted to target ratio was also well below one. As per procedure, if the realized amount in T-bill auction fell short of target, the residual amount is provided by SBP. This has strong and direct implications for liquidity management, and IMF ceilings on SBP's NDA (i.e. government borrowing from SBP).

Like T-bills, the realized amount from PIBs was also off target for all four quarters of the year. Specifically, while the realized amount was well below target during the first two quarters of the year, it was more than *five times* the target in Q3, and *three times* the target in the fourth quarter of the year (**Figure 6.8b**). Besides having implications for liquidity management, these developments clearly indicate the government was unable to foresee the extent of substitution that had taken place during the second half of the year.

Figure 6.8a: T-Bill Auctions

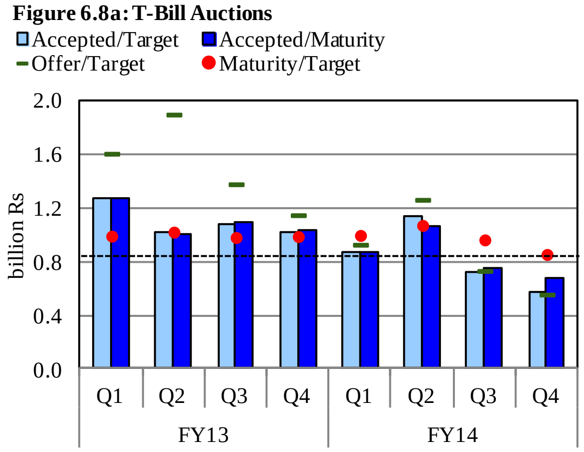
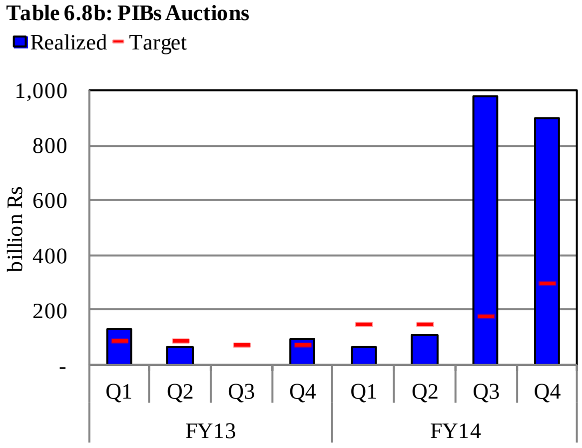


Table 6.8b: PIBs Auctions



Source: State Bank of Pakistan

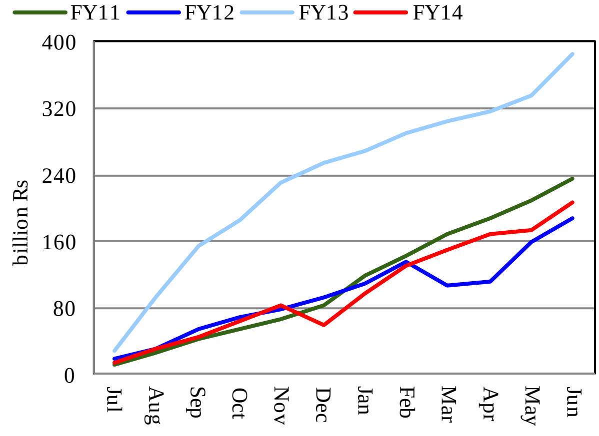
[4] Specifically, the government accepted bids amounting to Rs 1,873.6 billion in PIBs auction during H2-FY14, which was 97.1 percent of the offered amount.

[5] Specifically, the banks' offered Rs 3.1 trillion in T-bill auctions held during H2-FY14 against the maturity of Rs 4.3 trillion and the cumulative target of Rs 4.7 trillion.

Unfunded Debt

Pakistan's unfunded debt, primarily comprised of the national savings schemes (NSS), saw an expansion of Rs 178.6 billion in FY14, which was almost half the increase seen in FY13 (**Figure 6.9**). In fact, some deceleration was expected as the exceptionally high net mobilization in FY13, was primarily driven by the institutional investment in NSS.[6] In addition, the government decision to withdraw the exemption of withholding tax on profits (w.e.f. 1st July 2013)[7], and the relatively higher returns on PIBs (despite two upward revision in profit rates)[8], also dampened net inflows via NSS during the year.

Figure 6.9: Net Investments in NSS (cumulative)



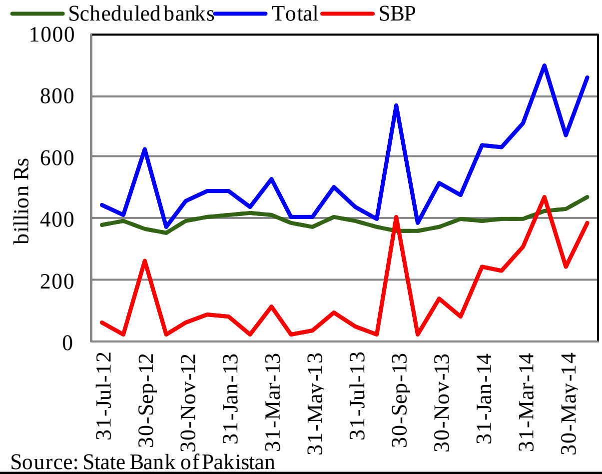
Source: Central Directorate of National Savings

The composition of NSS indicates that Special Savings Accounts (SSAs), were the hardest hit; this reflects a shift in institutional investment from SSAs to PIBs. Specifically, net investment in SSAs saw a contraction of Rs 53.5 billion in FY14, compared with an increase of Rs 150.8 billion in the previous year. In sharp contrast to SSAs, all other saving schemes, witnessed positive net inflows during the year. Among these, Behbood Savings Certificates (BSCs) were the most popular among the various schemes, posted a net inflow of Rs 54.0 billion in FY14, which pushed the outstanding amount to an all time high of Rs 582.4 billion. In fact, not only were the profit rates on BSCs higher compared to other saving schemes, investment in BSCs is still exempted from withholding tax. Moreover, BSCs are also exempted from Zakat deduction, which increases the effective return on these investments. While such attractive features help mobilize needed funding for the government, there is a need to weigh the cost of this scheme in term of higher debt servicing and implications for the development of the financial sector (especially the bond market).

Interest payment on Domestic debt

With an increase of Rs 135.6 billion during the year, domestic interest payments have reached over Rs 1.0 trillion in FY14. A number of factors are responsible: (a) the growing volume of domestic debt; (b) the increase in interest rates during the first half of the year; (c) upward adjustment in profit rates on NSS instruments; and (d) the heavy encashment in SSAs due to the shift in institutional investment. In addition, weak cash management also continued to inflate interest payment on domestic debt. Specifically, government deposits with SBP saw an increase of Rs 287.3 billion during the year (**Figure 6.10**); had the government utilized these deposits to retire some of its borrowing from

Figure 6.10: Government Deposits with the Banking System



Source: State Bank of Pakistan

[6] In April 2012, the government allowed institutional investment in selected NSS instruments. As a result, not only the repayment claims related to institutional investments reduced, the gross mobilization also benefited from this policy change.
[7] The government withdrew the exemption of withholding tax on profits of investment upto Rs 150,000 w.e.f 1st July 2013. It may be noted that the investments exceeding Rs 150,000/- were already subject to the withholding tax.
[8] Profit rates on NSS were adjusted upward in October 2013 and January 2014. The returns on these schemes are linked to yields on PIBs that increased with the 100 bps increase in the policy rate in H1-FY14.

SBP, net interest payments by the government would have been much lower.

Given the elevated level of interest payments on domestic debt, the massive investment in PIBs will increase interest payments further. In fact, it could be argued that a more gradual re-profiling would have been cost effective for the government. More specifically, the bid pattern of PIBs suggests that yields would have declined considerably, had the government stuck to its pre-auction targets.

Table 6.2: Pakistan's External Debt and Liabilities

billion US Dollar

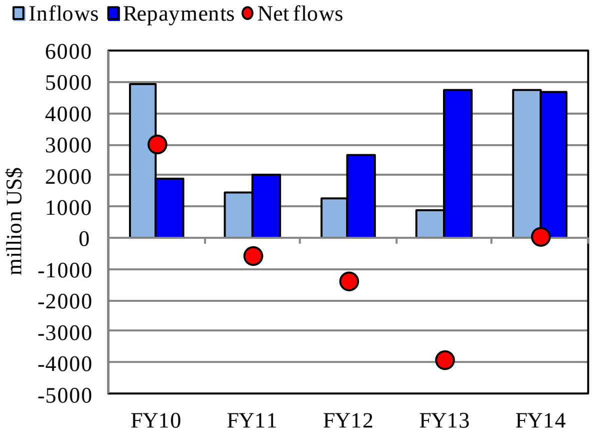
	FY11	FY12	FY13	FY14	Abs change
Public debt (1+2+3)	**57.9**	**55.9**	**51.0**	**54.8**	**3.8**
1. Government external debt	46.4	46.1	43.5	48.5	5.0
i) Long term(>1 year)	45.7	45.7	43.5	47.8	4.3
of which					
Paris club	15.5	15.0	13.5	13.6	0.1
Multilateral	25.8	25.4	24.2	25.8	1.6
Bilateral	1.9	2.5	2.9	3.5	0.5
Euro/Sukuk global bonds	1.6	1.6	1.6	3.6	2.0
ii) Short term (<1 year)	0.6	0.4	0.0	0.7	0.7
2. From IMF	8.9	7.3	4.4	3.0	-1.4
3. Foreign exchange liabilities	2.6	2.4	3.1	3.3	0.2
4. Public sector enterprises (PSEs)	1.4	1.5	2.1	2.1	0.0
5.Banks	1.1	1.8	1.6	2.0	0.4
i. Borrowing	0.4	0.9	0.7	1.1	0.4
ii. Nonresident deposits (LCY & FCY)	0.7	1.0	0.8	0.9	0.1
6. Private Sector	4.4	3.6	3.1	2.9	-0.2
7. Debt liabilities to direct investors - Intercompany debt	1.6	2.7	3.1	3.7	0.6
Total external debt (1+2+3+4+5+6+7)	**66.4**	**65.5**	**60.9**	**65.5**	**4.6**

Source: Economic Affairs Division & State Bank of Pakistan.

6.3 External Debt & Liabilities

After falling in the past two years, Pakistan's external debt & liabilities posted a US$ 4.6 billion increase, reaching US$ 65.5 billion by the end of FY14 (**Table 6.2**). This increase was driven by the US$ 2 billion raised through Eurobonds; and the disbursements from International Financial Institutions (IFIs).[9] In addition, revaluation losses from the depreciation of the US Dollar against major currencies also increased the country's public debt by US$ 483.7 million during the year. This was the first time in three years that net flows from the IFIs turned positive (**Figure 6.11**).

Figure 6.11: Flows from IFIs



Source: State Bank of Pakistan & Economic Affairs Division

Although the revival of external loan disbursements in FY14 is encouraging (after a persistent decline since FY09), their implications for the sustainability of the country's external debt, raises some concerns.

[9] The country also received US$ 1.675 billion from the IMF during FY14, however, on account of large repayments, net flows from the Fund stood at negative US$ 1.5 billion this year.

In the past few years, while external debt repayments have seen a large expansion since FY12 due to heavy repayments to the IMF, the growth in foreign exchange earnings of the country, particularly exports, has largely remained modest. This has led to the worsening of the debt servicing capacity of the country.

Having said this, since the country has already made large repayments to the Fund in FY14, the repayment pressure is likely to ease in FY15 and FY16. However, this will resurface FY17 onwards, with the onset of repayments of rescheduled *Paris Club* debt, Eurobonds and the current EFF with the IMF (**Section 6.3.2**). This scenario emphasizes the need for caution while framing debt management strategy of Pakistan.

Disbursements

Gross external loan inflows soared to US$ 7.9 billion in FY14, compared to only US$ 2.5 billion in FY13: this was even higher than the US$ 5.1 billion budget target announced at the beginning of FY14.[10] As anticipated, the IMF program, which was signed in September 2013, proved to be a precursor of inflows from other IFIs (**Figure 6.12**). As a result, gross inflows from IFIs stood at US$ 4.7 billion in FY14, compared to only US$ 1.3 billion in the previous year.[11] Specifically, disbursements from World Bank and ADB increased sharply during FY14, as GoP signed new contracts with these agencies to finance energy and fiscal reforms in the country. Not surprisingly, the energy sector is the biggest claimant on foreign lending in the past few years (**Figure 6.13**). Some of important power projects financed with external funding during FY10-13 are listed below:

Figure 6.12: Disbursements from IFIs

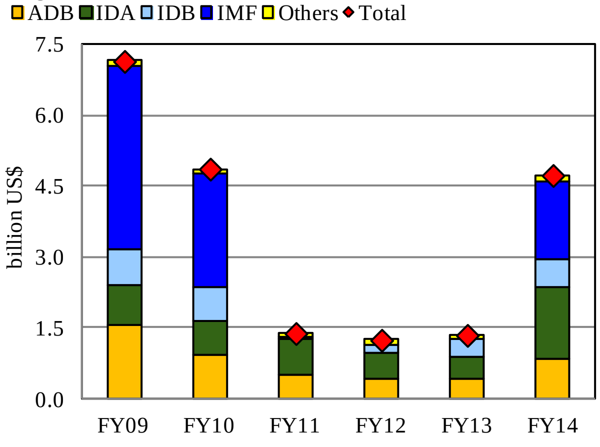
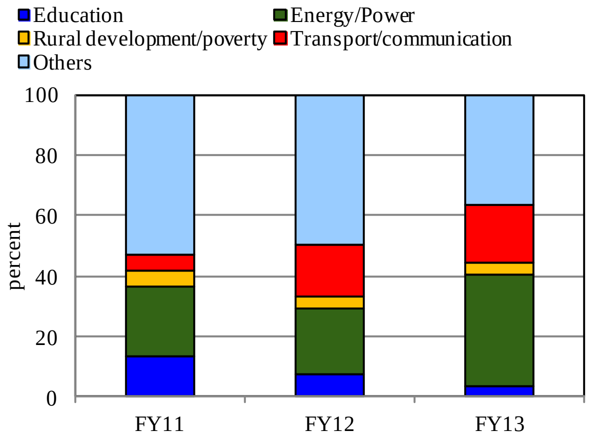


Figure 6.13: Uses of Foreign Lending



Source: State Bank of Pakistan & Economic Affairs Division

- The Chashma nuclear project (China) - US$ 690.2 million;
- The Guddu power plant (China) - US$ 312.5 million;
- The Neelum Jhelum hydropower plant. This project is being financed by multiple donors that include the IDB; Kuwait; Saudi Arabia; and China. The government has so far received US$ 154.7 million for this project;
- Power Distribution enhancement (ADB): This project was proposed by GoP for the extension in the distribution network of eight Discos. The country has so far received US$ 166.9 million for the project; and

[10] This includes US$ 1.675 billion received from IMF during FY14, also.
[11] On the other hand, inflows from bilateral creditors stood at US$ 1.1 billion in FY14, compared to US$ 1.2 billion last year.

- Power Transmission enhancement (ADB): This is to improve electricity transmission in the provinces of Punjab and Sindh. The external financing for this project stands at US$ 105.7 million.

The pace of external inflows is likely to continue in the future, as a number of fresh agreements have been signed by the government with the following donor agencies:

ADB: (i) *Jamshoro Power Generation Project* (US$ 900 million) to finance a 600 megawatt coal fired power project;(ii) *Social Protection Development Project* (US$ 436 million) to increase the coverage of the *Benazir Income Support Program;*

World Bank: *Country partnership strategy FY15-19* (US$ 11 billion) to be disbursed during the length of the program focuses on energy, education, and efforts to discourage extremism.

IDA: *Dasu hydropower stage I project* (US$ 588.4 million) to improve the supply of hydropower by i

nstalling 2,160 MW hydropower plant on the main Indus River.

Eurobonds

After a gap of seven years, Pakistan entered the international capital market in FY14, raising US$ 2 billion from two issues of Eurobonds against a target of only US$ 500 million (**Table 6.3)**. This huge oversubscription can be explained by availability of funds in the international market, besides the attractive rates offered by GoP for these issues. Specifically, these bonds were issued at higher rates compared to not only similar bonds issued by a number of other countries,[12] but also the same tenor notes issued by Pakistan in FY04, FY06 and FY07. This was because of higher risk premium of the country emanating from its external and fiscal outlook.[13] However, the fact that the country was able to obtain fixed rates for these bonds alleviates concerns regarding their pricing, as a fixed rate bond is not susceptible to adverse movements in interest rates. Furthermore, the performance of the bonds issued by the country is satisfactory: as shown in **Figure 6.14**, the spread of 10-year paper issued in April 2014 against the US Benchmark (10 year Treasury Bonds) was almost stable till August, while a slight increase can be linked to the onset of the current political uncertainty in the country.

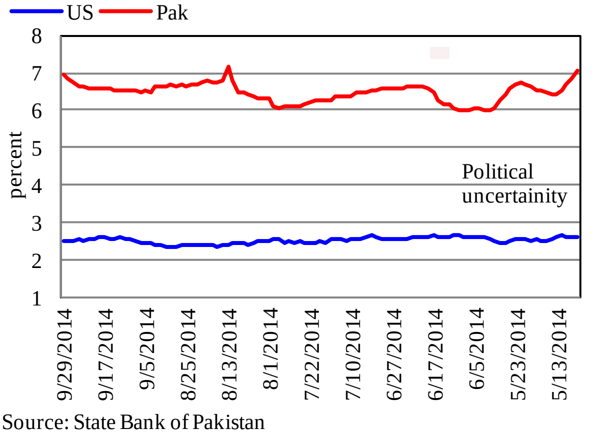
Table 6.3: Sovereign Euro Bonds Issued by Pakistan

Value in million US Dollar

	Tenor	Value	Interest rates
FY04	5 years	500	6 m Libor + 323 bps (6.75%)
FY06	10 years	500	10 years US t-bill + 240 bps (7.125%)
	30 years	300	30 year US t-bill + 302 bps (7.875%)
FY07	10 years	750	10 year US t-bill + 200 bps (6.875 %)
FY14	5 years	1,000	7.25%
	10 years	1,000	8.25%

Source: Economic Affairs Division

Figure 6.14: Performance of 10-Year Bond Issued by Pakistan in Secondry Market



Source: State Bank of Pakistan

[12] Turkey, Indonesia, and Philippines issued 10 year Eurobonds in January 2014, at coupon rates of 5.75 percent, 5.9 percent and 4.2 percent, respectively. Similarly, Brazil and Sri Lanka issued 5 year Eurobonds in April 2014 at coupon rates of 4.25 percent and 5.125 percent, respectively.

[13] Pakistan was assigned Caa1 rating by Moody's, compared to Vietnam's B2 and Baa3 of Philippines and Indonesia, because of low institutional and fiscal strength, weakened external position and large government borrowing needs.

6.3.1 External Debt Sustainability

The recent increase in Pakistan's external debt has renewed concerns about the sustainability of external debt. To evaluate this issue, we have analyzed the solvency and liquidity indicators of external debt sustainability, which measure the long-term and short-term ability of a country to make debt repayments. Our analysis shows that almost all indicators of external debt sustainability witnessed some erosion in FY14 (**Table 6.4**). More Specifically: (i) debt bearing capacity of Pakistan, measured in terms of external debt & liabilities (EDL)-to-GDP, witnessed a marginal increase in FY14, after posting a consistent improvement in the past three years; (ii) external debt servicing (EDS)-to-foreign exchange earnings (FEE) ratio also weakened, primarily because of bulky repayments to the IMF; and (iii) the share of short-term debt (STD) in overall EDL increased slightly, after posting a consistent decline since FY10. However, this is not a source of concern as the ratio of STD-to-EDL is much lower in Pakistan, compared to our regional peers.

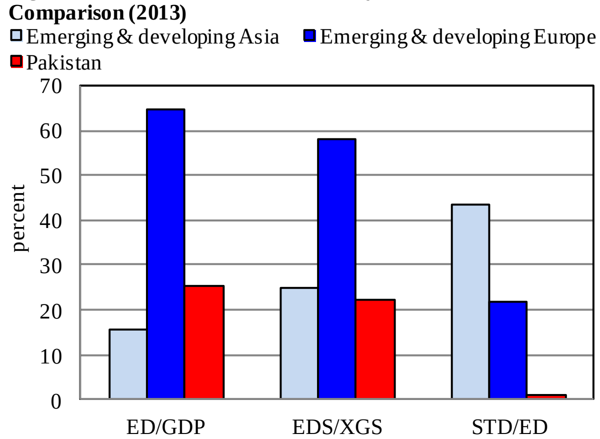
Table.6.4: Indicators of External Debt Sustainability
percent

	FY10	FY11	FY12	FY13	FY14
Solvency Indicators					
Debt bearing capacity					
ED/GDP	33.3	29.9	28.1	24.9	25.2
EDL/GDP	34.7	31.1	29.2	26.2	26.6
Debt servicing capacity					
EDS/FEE	11.0	7.5	9.0	12.0	13.3
EDS/XE	21.0	13.8	17.4	24.0	26.9
Liquidity indicators					
STD/EDL	1.4	1.0	0.6	0.0	1.1
RES/STD (ratio)	19.7	29.9	40.3	---	20.3

ED: Total external debt; EDL: External debt and liabilities; EDS: External debt servicing; STD: Short term debt; FEE: Foreign exchange earnings; XE: Exports earnings; RES: Total liquid reserves
Source: SBP calculations

An international comparison of Pakistan's external debt indicators with emerging and developing economies, alleviates some concerns about the sustainability of the country's external debt. Although Pakistan's external indebtedness is higher compared to our regional peers (emerging & developing Asia), it is much lower than the Euro zone (**Figure 6.15**). Similarly, the country's debt repayments capacity is relatively stronger compared to that observed in both emerging & developing Asia & Europe. Furthermore, short-term debt captures a mere 1.1 percent share of the country's total external debt, compared to 43.5 percent and 22.0 percent seen in both these regions, respectively.

Figure 6.15: External Debt Sustainabilty -International Comparison (2013)



Source: IMF World Economic Outlook 2014 & SBP

6.3.2 Servicing of External Debt

External debt servicing posted a 16 percent increase in FY14 (**Table 6.5**), compared to the same period last year. In addition to IMF, higher repayments to China, IDB and Saudi Arabia, caused this increase in debt servicing.[14] More specifically: (i) debt servicing to China increased as the settlement of a military loan fell due this year; (ii) in Q2-FY09, Saudi Arabia had placed US$ 200 million with the central bank as part of the Saudi Fund for Development, the repayment of this fund has started since last year; (iii) the repayment of loans for fertilizer imports; and finally (iv) the settlement of a short-term loan from IDB in FY14, which was rolled over in December 2011, also added to the servicing pressure in FY14.

[14] The repayments to China, IDB and Saudi Arabia during FY14, stood at US$ 262.9 million, US$ 195.1 million and US$ 172.6 million respectively, compared to US$ 185 million, US$ 22.8 million and US$ 80.2 million in FY13.

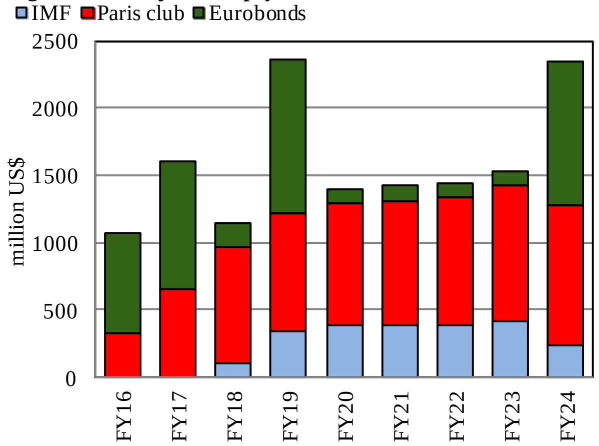
Table 6.5: External Debt Servicing
million US Dollar

	FY10	FY11	FY12	FY13	FY14	Change FY14 over FY13
i. Public external debt (a+b+c)	**3,321.9**	**2,826.4**	**3,692.6**	**5,316.4**	**5,849.4**	**533.0**
Principal	2,445.1	1,881.6	2,800.0	4,504.3	5,064.0	559.6
Interest	876.9	944.9	892.6	812.0	785.4	(26.6)
a. Govt. external debt	2,784.1	2,247.8	2,263.0	2,205.3	2,543.5	338.1
Principal	2,053.4	1,491.3	1,546.3	1,505.4	1,834.1	328.7
Interest	730.7	756.4	716.7	699.9	709.3	9.4
b. IMF loans	359.4	441.8	1,317.9	2,999.4	3,181.6	182.1
Principal	239.8	268.2	1,153.7	2,898.9	3,129.8	230.9
Interest	119.6	173.6	164.1	100.5	51.7	(48.8)
c. FX liabilities	178.4	136.9	111.8	111.6	124.3	12.7
Principal	151.9	122.0	100.0	100.0	100.0	-
Interest	26.5	14.9	11.8	11.6	24.3	12.7
ii. PSEs debt	**351.9**	**358.9**	**248.9**	**280.6**	**500.2**	**219.6**
Principal	290.4	310.1	211.0	238.0	452.0	213.9
Interest	61.4	48.7	38.0	42.6	48.2	5.7
iii. Private sector debt	**481.2**	**346.1**	**370.8**	**381.3**	**471.6**	**90.3**
Principal	404.5	266.1	282.9	303.3	398.7	95.4
Interest	76.7	80.1	88.0	78.1	72.9	(5.1)
External debt (i+ii+iii)	**4,155.0**	**3,531.4**	**4,312.4**	**5,978.3**	**6,821.1**	**842.9**
Principal	3,139.9	2,457.8	3,293.8	5,045.6	5,914.6	869.0
Interest	1,015.0	1,073.7	1,018.5	932.7	906.6	(26.1)

Source: State Bank of Pakistan

While the country has already made the bulk of repayments of its IMF loan, servicing of US$ 1.3 billion is scheduled for FY15. As discussed above, the increase in debt servicing is likely to stoke pressure on the country's FEE in the medium term, due to a number of factors, which include: (i) maturity of 10-year Eurobonds issued in FY06 (US$ 500 million) and FY07 (US$ 750 million) is due in FY16 and FY17; (ii) repayment of rescheduled Paris Club debt under Official Development Assistance (ODA) will start from FY17; (iii) servicing the Extended Fund Facility (EFF) program with the IMF will begin in FY18; and (iv) the 5-year Eurobond issued in April 2014 (US$ 1 billion) will mature in FY19 (**Figure 6.16**).[15]

Figure 6.16: Projected Repayments



Source: Economic Affairs Division & IMF website

[15] The IMF repayments plotted in Figure correspond to the amount of EFF loan disbursed till July 2014.