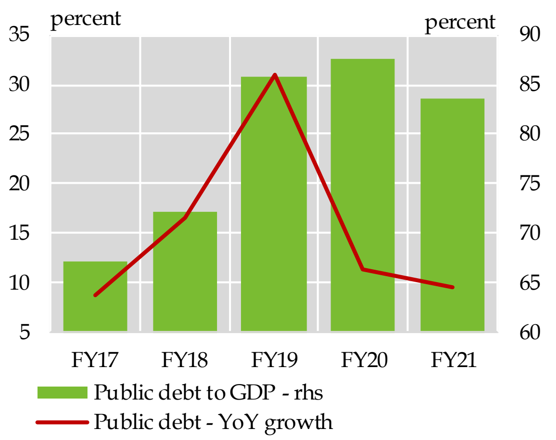
Chapter 5
Domestic and External Debt

Pakistan's public debt in terms of GDP declined to 83.5 percent in FY21 from 87.6 percent in FY20. The improvement in the twin deficits, along with revaluation gains due to the appreciation of the PKR against the US Dollar, helped contain the pace of debt accumulation. Notably, the addition in the country's public debt was the lowest among international peers despite the Covid-induced increase in fiscal spending. The maturity profile of debt continued to improve towards long-term instruments and the government was also able to diversify the financing resources. In this regard, the introduction of the Naya Pakistan Certificates (NPC) provided investment opportunities to the Pakistani diaspora in both Rupee- and foreign currency-denominated debt instruments. The country also successfully tapped the international capital markets after a gap of three years. The sustainability of public debt also strengthened, with a turnaround in economic activity, expansion in foreign exchange earnings, and the availability of debt relief under the G-20's Debt Service Suspension Initiative (DSSI).

5.1 Public Debt

Pakistan's public debt dynamics improved considerably in FY21. The pace of expansion in public debt was the lowest since FY17 (**Figure 5.1**). The composition of public debt further tilted towards long-term debt, while the country was also able to diversify the financing resources during FY21.

Public Debt Profile **Figure 5.1**

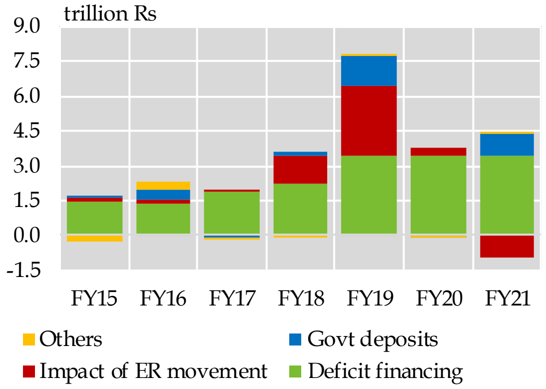


Source: State Bank of Pakistan

The reduction in the debt burden emanated from an improvement in the twin deficits and the revaluation gains on the external debt stock due to the appreciation of the PKR against the US Dollar (**Figure 5.2**).[1] Moreover, the debt sustainability indicators also strengthened in FY21, helped by recovery in economic activity, higher tax revenues, a strong increase in foreign exchange earnings(FEE), and debt relief of around US$ 2.3 billion under the G-20's Debt Service Suspension Initiative (DSSI).

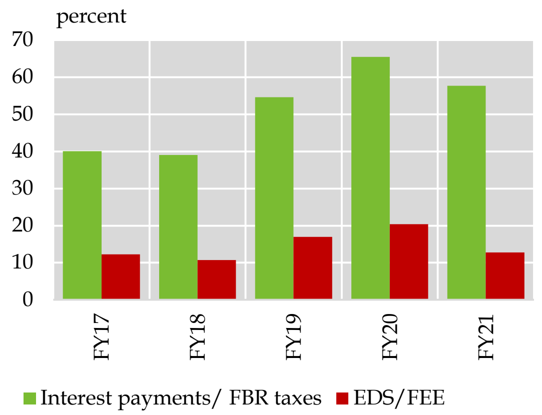
Specifically, the public debt-to-GDP ratio, edged down to 83.5 percent in FY21, from 87.6 percent in FY20 (**Table 5.1**), which indicates an improvement in the debt- bearing capacity of the economy. Meanwhile, the debt repayment capacity as measured by the interest payment-to-FBR tax revenues, and by external debt servicing (EDS)-to-FEE, also improved during FY21 (**Figure 5.3**). Furthermore, an international comparison shows that the incremental addition to Pakistan's gross debt in FY21 was lower than the average for both emerging and low-income economies, despite the Covid-led increase in spending (**Box 5.1**).

Composition of Increase in Public Debt **Figure 5.2**



Source: Ministry of Finance and State Bank of Pakistan

Debt Repayment Capacity **Figure 5.3**



Source: Ministry of Finance and State Bank of Pakistan

Around 86 percent of the expansion in public debt in FY21 came from domestic sources (**Figure 5.4**). This increase was driven by both deficit financing requirement, as well as a rise in the government's deposits with the banking

[1] The fiscal deficit declined to 7.1 percent of GDP in FY21 from 8.1 percent last year. The current account deficit reduced to 1.8 percent of GDP from 4.4 percent in FY20.

Summary of Pakistan's Debt and Liabilities **Table 5.1**

billion rupees

	Stock			Flows		Percent of GDP	
	FY19	**FY20**	**FY21**	**FY20**	**FY21**	**FY20**	**FY21**
A. Total debt and liabilities (sum I to IX)	40,223.1	44,591.5	47,829.1	4,368.4	3,237.6	107.3	100.3
B. Gross public debt (sum I to III)	32,707.9	36,398.6	39,859.2	3,690.7	3,460.6	87.6	83.5
C. Total debt of the government (I+II+III-X)*	29,520.7	33,235.3	35,738.1	3,714.6	2,550.7	80.0	74.9
I. Government domestic debt	20,731.8	23,282.5	26,265.3	2,550.7	2,982.8	56.0	55.1
II. Government external debt	11,055.1	11,824.5	12,432.4	769.4	607.9	28.5	26.1
III. Debt from IMF	921.0	1,291.5	1,161.5	370.5	(130.0)	3.1	2.4
IV. External liabilities	1,710.1	1,663.3	1,378.4	(46.8)	(284.9)	4.0	2.9
V. Private sector external debt	2,481.3	2,628.2	2,540.9	146.9	(87.3)	6.3	5.3
VI. PSEs external debt	630.6	869.5	1,061.0	238.9	191.5	2.1	2.2
VII. PSEs domestic debt	1,394.2	1,490.5	1,436.7	96.3	(53.8)	3.6	3.0
VIII. Commodity operations	756.4	813.4	904.0	57.0	90.6	2.0	1.9
IX. Intercompany external debt	542.7	727.9	648.7	185.2	(79.2)	1.8	1.4
X. Deposits with banking system	3,187.2	3,163.3	4,121.1	(23.9)	957.8	7.6	8.6

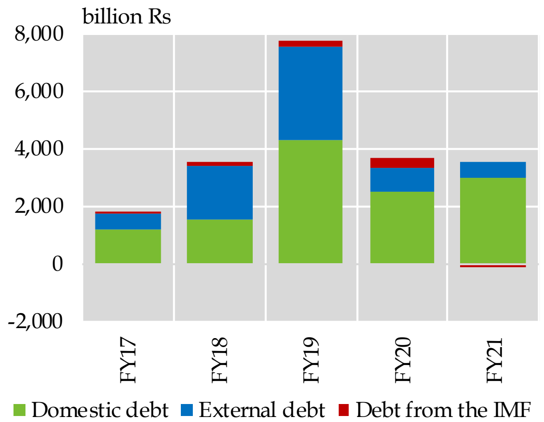
*As per FRDLA definition

Source: State Bank of Pakistan

system. The government adhered to its commitment of zero fresh borrowing from the SBP and largely relied on commercial banks to finance the fiscal gap. On the other hand, the lower contribution of external debt to the public debt accumulation was primarily due to the 6.7 percent appreciation of the PKR against the US Dollar during the year, which led to a deceleration in the Rupee value of external debt.

The government was able to lengthen the maturity profile of public debt for the second consecutive year, even in a low interest rate environment. Almost 72 percent of the increase in central government debt mobilized during the year was sourced through long-term instruments, which pushed the share of these instruments in total government debt to 82.3 percent by end-June 2021 (**Figure 5.5**).[2] The improvement in the maturity profile augurs well for the debt sustainability because of the reduction in rollover risk.

Category-wise Change in Public **Figure 5.4**



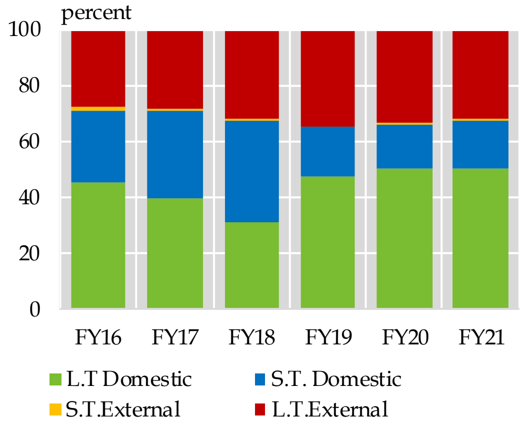
Source: State Bank of Pakistan

The improvement in the maturity profile was achieved through the introduction of various new and diversified debt instruments. In the domestic debt market, the government introduced floating-rate Pakistan Investment Bonds (PIBs) with quarterly coupon payments, and it continued to mobilize funds through the Shariah-compliant instruments.[3] Furthermore, the government launched the Naya Pakistan Certificates (NPCs) in September 2020, to provide investment opportunities to overseas Pakistanis (residents and non-residents). These certificates attracted gross inflows worth US$ 1.0 billion during FY21. The government also re-entered the international capital market in April 2021 and issued Eurobonds worth US$

[2] The entire increase in government external debt came from long-term instruments during FY21. More than 60 percent of the rise in government domestic debt was sourced through long-term instruments.

[33] The government issued Ijara Sukuk in April 2020 after a gap of three years; last time the government issued Sukuk, in June 2017.

Tenor-wise Share in Public Debt **Figure 5.5**



Source: State Bank of Pakistan

2.5 billion. These instruments helped the government lengthen the maturity profile of external debt and repay some of its short-term external debt.

Despite the improvement in the debt sustainability indicators during FY21, further efforts are required on part of the government to reduce vulnerability of debt portfolio. First, the high level of public debt has given rise to a substantial increase in interest payments, which stood at 57.7 percent of FBR tax revenues in FY21. Second, the increasing share of floating rate instruments entails repricing risk, in case of an increase in interest rates. Third, the excessive reliance on commercial banks for fulfilling the financing needs is fueling the risk-averse behavior of banks, with concerns over potential crowding out of the private sector.[4] Finally, after the phasing out of the DSSI, the country will have to repay both the deferred principal and interest payments on the external debt, which may pose pressures on the external account, in the absence of a corresponding expansion in FEE.

A persistent improvement in the debt sustainability position warrants restraining the twin deficits to manageable levels. This would require concerted efforts to address the structural issues that have impeded country's exports and foreign direct investment.[5] Similarly, efforts on the fiscal side should focus on widening the tax base and expediting reforms in the public sector enterprises (PSEs) that cause huge financing burden for the government.[6]

Box 5.1: The Debt Ramifications of Covid-related Spending: Pakistan vis-a-vis Peer Countries

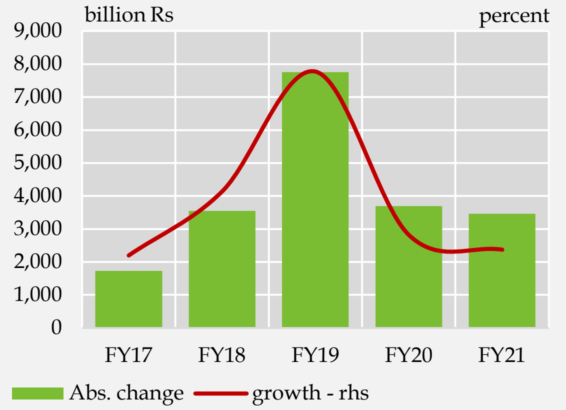
Pakistan announced an unprecedented fiscal support of Rs 1.3 trillion (almost 2.0 percent of GDP) in response to the Covid pandemic.[7] However, unlike the global experience, Covid-related spending did not result in a surge in Pakistan's public debt. Not only was the absolute addition in public debt during FY21 the lowest since FY17, but the public debt-to-GDP ratio actually declined in Pakistan (**Figure 5.1.1**). Importantly, Pakistan is one of the few countries out of 39 emerging market economies, in which the change in government debt as percent of GDP was less than the Covid-related spending (**Figure 5.1.2**).[8]

Covid has taken a significant toll on the global economy. The pandemic brought serious challenges for the health system, disrupted economic activity and mobility, and gave rise to widespread unemployment in almost all parts of the world. In response to the pandemic, countries around the globe provided a swift policy response by rolling out extensive fiscal and monetary support, including via tax concessions, wage subsidies, increase in social security spending, and additional spending on the health sector. As of September 2020, this support amounted to a sizable 12 percent of global GDP.[9] While these policy measures helped contain the impact of the outbreak, the fiscal imbalances and hence general government debt levels also increased around the globe as a consequence.

[4] For details, see Chapter 7 of the SBP's Annual Report on State of Pakistan's Economy for FY20.
[5] For details, see Special Section 1 of the SBP's First Quarterly Report of State of Pakistan's Economy for FY20.
[6] For details, see Special Section 2 of the SBP's Second Quarterly Report on State of Pakistan's Economy for FY19.
[7] Source: IMF Fiscal Monitor, October 2020.
[8] For economies whose fiscal years end before June 30, data are recorded in the previous calendar year. For economies whose fiscal years end on or after June 30, data are recorded in the current calendar year.
[9] IMF, Fiscal Monitor, October 2020.

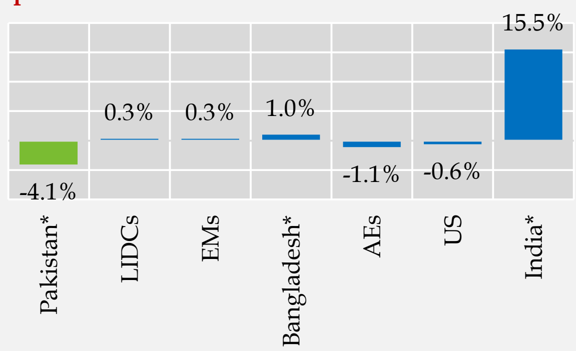
Figure 5.1.1

Public Debt Accumulation



Source: State Bank of Pakistan

Increase in Government Debt as percent of GDP in 2021

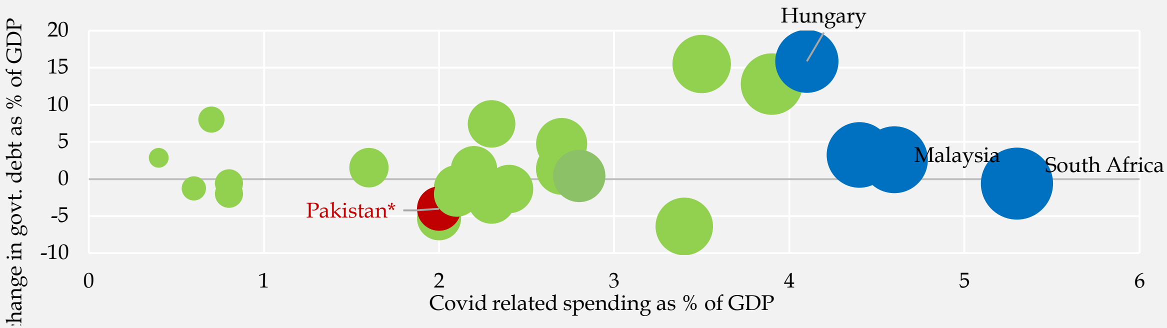


* Fiscal year basis for Pakistan, Bangladesh & India; projections of calendar year 2021 for all others.

Source: IMF Fiscal Monitor, State Bank of Pakistan

Pakistan's relative better position vis-a vis other countries stemmed from a prudent fiscal policy stance that entailed strengthening revenue administration efforts and containment of non-priority current spending such as running of civil government. Importantly, Pakistan witnessed a large increase in tax revenues. On the other hand, the overall rise in expenditures as percent of GDP was relatively low in the case of Pakistan, despite the sizeable Covid-related spending.

Covid Related Spending and Rise in Government Debt in 2021 Figure 5.1.2



The bubble size refers to the share of covid related spending. Blue bubble indicates a spending of 4 percent of GDP or higher, green bubble implies spending of less than 4 percent.

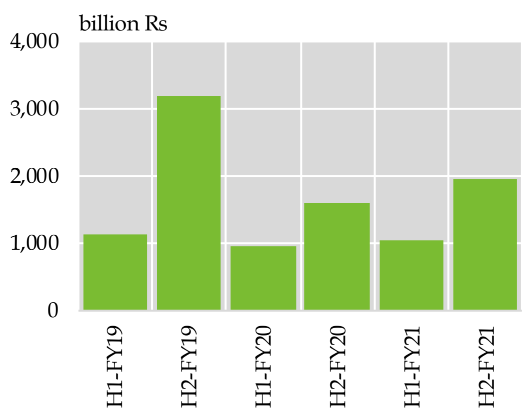
* Fiscal year basis for Pakistan; projections of calendar year 2021 for all others.

Source: IMF Fiscal Monitor, State Bank of Pakistan

5.2 Domestic Debt

With the accumulation of Rs 3.0 trillion over June 2020, the stock of domestic debt reached Rs 26.3 trillion by end-June 2021. This expansion was contributed by two factors. The first was the sustained deficit financing requirement, with 60.7 percent of the budget deficit being financed through internal sources. The second was the increase in the government's deposits with the banking system. Although, the government had been mobilizing deposits, however the emphasis increased since the end of FY19, with the goal to smoothen future debt repayments.

Change in Domestic Debt Figure 5.6



Source: State Bank of Pakistan

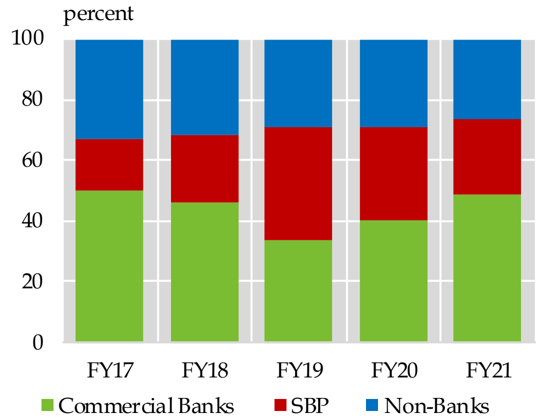
The dynamics of domestic debt present some notable improvements during the year. First, the government continued to adhere to the commitment of zero fresh borrowing from the SBP, thus avoiding deficit monetization. Second, the authorities were able to secure long-term loans despite the low interest rate environment. Specifically, around 62 percent of the expansion in domestic debt during FY21 was sourced through long-term instruments. Third, the government also diversified its instrument base by introducing several new instruments, including floater PIBs with quarterly coupon payments, and conventional and Shariah-compliant Naya Pakistan Certificates (NPCs).

These new securities are expected to improve debt management by providing alternative sources of financing, and some of these, especially the NPCs, have already helped attract new investors, such as resident and non-resident overseas Pakistanis and Islamic Banking Institutions (IBIs).
Most of the increase in domestic debt was recorded during H2-FY21, in line with the past trend (**Figure 5.6**) and mainly due to a high deficit financing requirement. In overall terms, around 84.0 percent of the increase in debt during H2-FY21 was mobilized through short-term floating debt.

Ownership of Domestic Debt

In terms of institutional composition, commercial banks were the main financiers of the government in FY21. The share of banks in total domestic debt increased from 40.3 percent during FY20 to 48.6 percent in FY21 (**Figure 5.7**). The government adhered to its commitment of zero fresh borrowing from the central bank for the second consecutive year. In fact the government made retirements of Rs 0.6 trillion to SBP during FY21. As a result, the share of domestic debt owned by the SBP declined.

Ownership of Domestic Debt **Figure 5.7**



Source: State Bank of Pakistan

The provision of funds by non-banks to the government was also limited as compared to FY20. This was due to a number of reasons. First, the government imposed a ban on institutional investment in the National Savings Schemes with effect from July 2020 in order to enhance institutional participation in the competitive primary and secondary markets of long-term debt.[10] Second, the government discontinued the sale and purchase of various denominations of prize bonds with the objective to improve documentation. Third, overall low profit rates compared to last year kept the NSS relatively less attractive for savers and investors.

Permanent debt

The share of permanent debt (which mainly includes PIBs, Ijara Sukuk and prize bonds) in total domestic debt almost remained unchanged during FY21 (**Table 5.2**). With regards to PIBs, the government mobilized funds worth Rs 1.7 trillion (net of maturity) from these bonds during FY21, against Rs 2.0 trillion during FY20. This increase for the second consecutive year is attributed to the introduction of new instruments in the

[10] Non-bank investment in government securities was on the lower side compared to last year. Non-bank investment in government marketable securities increased by Rs 446.2 billion compared to an increase of Rs 601.7 billion last year.

Change in Government Domestic Debt **Table 5.2**

billion rupees; share in percent

	Stock			Flow		Share in total stock	
	FY19	FY20	FY21	FY20	FY21	FY20	FY21
Domestic debt	**20,731.8**	**23,282.5**	**26,265.3**	**2,550.8**	**2,982.8**	**100.0**	**100.0**
Permanent debt	12,080.0	14,023.5	15,904.1	1,943.4	1,880.6	60.2	60.6
of which							
PIBs	10,933.2	12,886.0	14,590.0	1,952.8	1,704.0	55.3	55.5
Ijara Sukuk	71.0	198.2	665.3	127.2	467.1	0.9	2.5
Prize Bonds	893.9	734.1	443.7	-159.8	-290.4	3.2	1.7
Floating debt	5,500.6	5,578.3	6,680.4	77.7	1,102.1	24.0	25.4
of which							
MTBs	4,930.5	5,575.5	6,676.9	645.1	1,101.4	23.9	25.4
Unfunded debt	3,144.1	3,673.6	3,645.9	529.5	-27.7	15.8	13.9
Naya Pakistan Certificates (NPC)	0.0	0.0	28.1	0.0	28.1	0.0	0.1

Source: State Bank of Pakistan

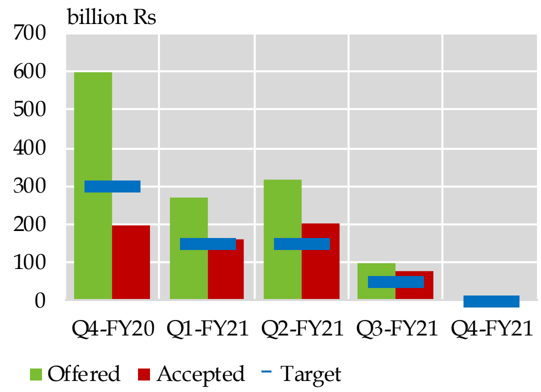
market. For instance, 3-year and 5-year floating rate PIBs were launched in June 2020, which attracted market interest.

Similarly, the government launched a 2-year floater PIB (PFL) in FY21, with a unique feature of fortnightly reset – quarterly payment coupon. The government also offered new coupon structures for the existing 3-year, 5-year and 10-year maturities PFL. These instruments were offered with quarterly coupon and quarterly resets, which were linked with the yields of 3-month T-bills. The pre-auction target allocation to floaters was almost three times higher in FY21 than the target of FY20.

The presence of floating long-term instruments in the market helped the government to mobilize funds of longer tenors in a low interest rate environment. The accepted amount of floater PIBs almost doubled in FY21, while the accepted amount of fixed rate PIBs remained one-half as compared to last year.

It is important to highlight that the market's participation in fixed PIBs remained lower compared to last year, primarily due to the market's perception of the bottoming out of interest rates. However, with the forward guidance issued in the January 2021 Monetary Policy Statement and reiterated in the subsequent MPC meetings (**Chapter 3**), the market's participation in fixed PIBs increased in the fourth quarter (**Table 5.3**). Here, it is worth mentioning that with a reversal in the current monetary policy stance, the increased recourse to long-term floating PIBs will increase debt servicing cost going forward.

Government Ijara Sukuk - Auction Summary **Figure 5.8**



Source: State Bank of Pakistan

Meanwhile, the relaunch of the Shariah-compliant Ijara Sukuk of 5-year tenor with fixed rates after a gap of three years and variable rental rates after a gap of four years in April 2020– had helped the government mobilize Rs 0.1 trillion during FY20, and another Rs 0.5 trillion in FY21.

A large share of fund mobilization through Sukuk took place during the first two quarters of FY21. Both the offered and accepted amounts remained above the pre-auction target (**Figure 5.8**). However, in Q3, only one auction was held, whereas no auction took place during the fourth quarter.

The relaunch of the Sukuk in late FY20 bodes well in terms of both diversification of the government's financing mix, and for the liquidity perspective of Islamic banks. One of the main objectives of the Medium-Term Debt Management Strategy is to increase the share of Shariah-compliant instruments in public debt, as these instruments are an important avenue to attract the liquidity available with IBIs.

On the other hand, prize bonds recorded net outflows for the second consecutive year. In December 2020, the government discontinued prize bonds of Rs 25,000 denomination to improve the documentation of the economy (**Figure 5.9**).

In this regard, the holders of these prize bonds were given three options: 1) convert to premium prize bonds (which are registered in the investor's name); 2) replace with special savings certificate/defense savings certificates; or 3) encash at face value, where the proceeds are transferred to the bond-holder's bank account. Anecdotal evidence suggests that only a fraction of the holders converted these bonds into premium bonds.

Specifically, net outflows of around Rs 150 billion were recorded from the discontinued Rs 25,000 prize bonds, but the net inflows into the premium (registered) Rs 25,000 prize bonds were only Rs 15 million (**Figure 5.9**). It appears that most of the bondholders encashed the bonds at face value. Furthermore, in April 2021, the government discontinued sales of Rs 15,000 and Rs 7,500 prize bonds.

Auction Summary of PIBs* **Table 5.3**

billion rupees

	Fixed PIBs			Floater PIBs		
	T	O	A	T	O	A
Q1-FY20	325.0	2521.2	963.5	300.0	334.2	219.4
Q2-FY20	300.0	1003.5	411.4	150.0	468.7	178.6
Q3-FY20	300.0	736.5	296.3	150.0	421.3	179.4
Q4-FY20	375.0	765.7	399.6	250.0	353.9	241.2
Q1-FY21	420.0	448.9	249.2	830.0	1970.4	870.6
Q2-FY21	390.0	186.1	42.4	930.0	622.7	455.1
Q3-FY21	325.0	436.8	182.4	515.0	206.8	112.2
Q4-FY21	375.0	1467.9	582.4	450.0	371.0	223.5

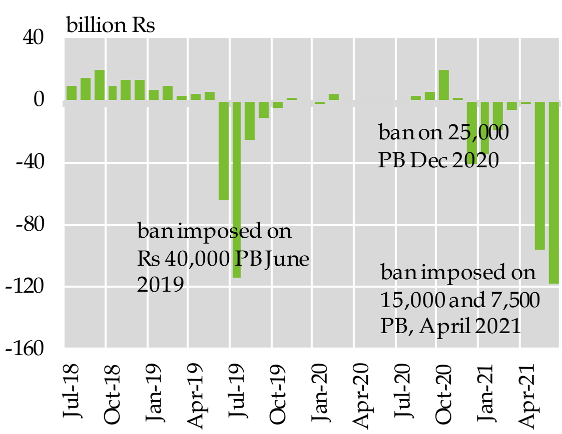
*Competitive & non-competitive combined
T: Targeted; O: Offered; A: Accepted

Source: State Bank of Pakistan

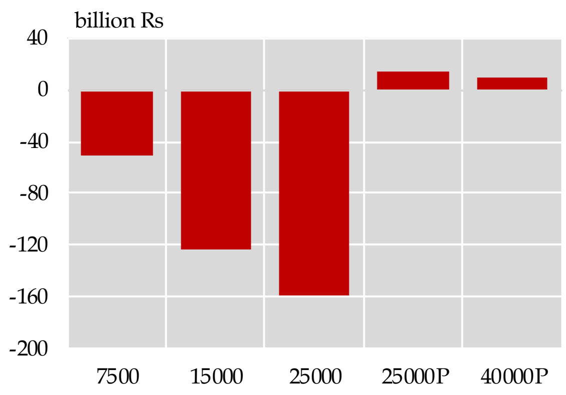
Floating debt

Floating debt (maturity within a year) increased by Rs 1.1 trillion during FY21, compared to a smaller rise of Rs 0.1 trillion in the previous year. The demand for T-bills during FY21 remained at elevated levels. However, within T-bills, the government was able to lengthen the maturity profile across quarters of FY21. The share of 3-month T-bills in the total outstanding stock of T-bills

Monthly Inflows in Prize Bonds during FY21

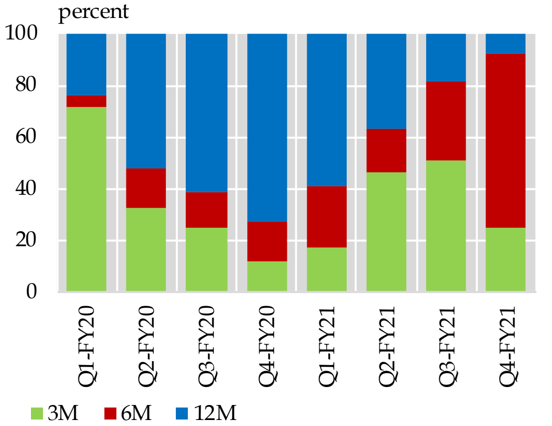


Denomination-wise Net Inflows in Prize Bonds during FY21 **Figure 5.9**



Source: Central Directorate of National Savings

Share in Outstanding Stock of T-Bills Figure 5.10



Source: State Bank of Pakistan

declined, whereas that of 6-month instruments increased during FY21 (**Figure 5.10**).

During the first two quarters of FY21, the market remained interested in 3-month T-bills. However, with the forward guidance provided in the January 2021 monetary policy statement about no immediate rise in interest rates, the market's interest also increased towards 6-month T-bills in H2-FY21 (**Figure 5.10**).

Unfunded debt

Unfunded debt, which mainly comprises National Saving Schemes, recorded net outflows of Rs 27.7 billion during FY21, against an increase of Rs 529 billion in the previous year. The following factors explain the decline in NSS instruments. First, the government banned institutional investment in NSS in order to enhance institutional participation in competitive primary and secondary markets of long-term debt.

This ban not only kept the gross investment lower than last year, but also prompted the institutions to withdraw their funds from these schemes, which led to overall net withdrawals from NSS in FY21 (**Table 5.4**). Second, due to the prevailing low interest rate environment, the profit rates on various instruments remained, on average, 100-150 bps lower than FY20 (**Table 5.4**).

Profit Rates and Investment in NSS Table 5.4

billion rupees

	FY19	FY20	FY21	FY20		FY21	
	Profit rates (%)			GI	NI	GI	NI
DSC	10.0	10.1	9.0	149.9	97.8	38.0	-9.1
BSC	11.8	11.9	10.8	235.3	83.4	172.8	2.5
RIC	9.6	10	8.6	205.8	82.2	87.1	26.7
SSC	8.6	9.7	7.9	37.4	19.3	95.5	-6.3
PBA	11.8	11.9	10.8	78.9	33.8	67.6	16.3

* average profit rates during the year; GI = Gross inflows, NI =Net inflows

Source: Central Directorate of National Savings

Naya Pakistan Certificates

An important highlight of the fiscal year was the inclusion of Naya Pakistan Certificates held by Pakistani residents in the category of domestic debt. The government was able to mobilize funds worth Rs 28.1 billion from these investors in the NPCs during FY21. [11] It is important to note that the NPCs are offered both in conventional as well as Shariah-compliant modes. The available data suggests that both versions of NPCs remained attractive during the period under review.

Interest payments on domestic debt remain at an elevated level

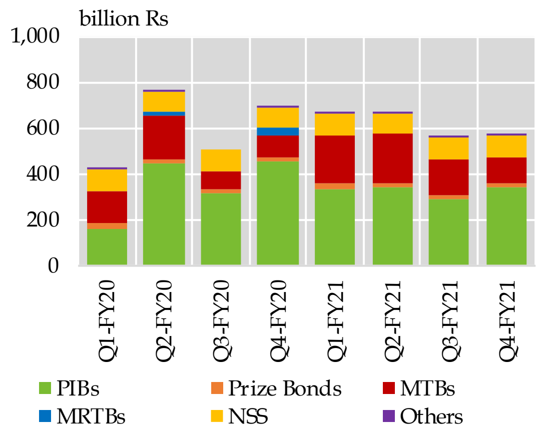
Interest payments on domestic debt grew 9.1 percent during FY21 compared to 27.0 percent during FY20. This deceleration was mainly due to high base effect from last year. In absolute terms, the interest payments on domestic debt stood at Rs 2.5 trillion during FY21, against Rs 2.3 trillion during FY20. It must be recalled that at end- June 2019, the government had converted the stock of MRTBs held by the SBP to PIBs, with maturities of 3 to 10 years. The spread between the 6-month T-bills (benchmark for MRTBs) and PIBs booked at end-June 2019 stood at almost 100bps; this had contributed to the sudden rise in the servicing cost in FY20.

[11] This amount includes the NPCs held by residents only. NPCs held by non-residents are part of external debt. Aggregate (gross) inflows worth US$ 1.0 billion were recorded during FY21.

On a positive note, this debt re-profiling helped avoid the roll-over risks associated with MRTBs.

Analysis of instrument-wise interest payments indicates that almost one-half of the increase in debt servicing during FY21 stemmed from higher coupon payments on PIBs (**Figure 5.11**). Nearly 70 percent of the SBP's debt stock was converted into 10-year Floating Rate PIBs (FR-PIBs). With the cumulative 625 bps reduction in the policy rate from March 2020 onwards, the pace of debt servicing on domestic debt also decelerated. The weighted average rate on PIBs during the time of this re-profiling was around 13.7 percent, which had dropped to 9.6 percent in FY21. This reduction of almost 400 bps explains the gains achieved during FY21.[12]

Instrument-wise Interest Payments **Figure 5.11**



Source: State Bank of Pakistan

Pakistan's External Debt and Liabilities **Table 5.5**

billion US$

	End-June Stock			Absolute change	
	FY19	FY20	FY21	FY20	FY21
Total external debt & liabilities	106.3	113.0	122.2	6.7	9.2
Public external debt (1+2)	73.4	78.0	86.4	4.5	8.4
1. Govt. external debt	67.8	70.3	79.0	2.5	8.7
i) Long term (>1 yr)	66.5	68.8	78.2	2.2	9.4
of which					
Paris club	11.2	10.9	10.7	-0.3	-0.2
Multilateral	27.8	30.9	33.8	3.1	2.9
Other bilateral	12.7	13.4	14.8	0.7	1.4
Euro/Sukuk global bonds	6.3	5.3	7.8	-1.0	2.5
Commercial loans/credits	8.5	8.1	9.7	-0.4	1.6
Local government securities (PIBs)	0.0	0.1	0.5	0.1	0.4
NPC	0.0	0.0	0.8	0.0	0.8
ii) Short term (<1 year)	1.3	1.5	0.9	0.3	-0.7
of which					
Multilateral	0.8	0.8	0.5	0.0	-0.3
Commercial loans	0.5	0.1	0.0	-0.3	-0.1
Local currency securities	0.0	0.6	0.4	0.6	-0.2
2. From IMF	5.6	7.7	7.4	2.0	-0.3
3. Foreign exchange liabilities	10.5	9.9	8.8	-0.6	-1.1
4. Public sector enterprises (PSEs)	3.9	5.2	6.7	1.3	1.6
5. Commercial banks	4.7	4.6	5.3	-0.1	0.6
6. Private sector	10.5	11.0	10.9	0.5	-0.1
7. Debt liabilities to direct	3.3	4.3	4.1	1.0	-0.2

Source: State Bank of Pakistan

[12] The amount of short-term debt converted into long-term debt at end-June 2019 stood around Rs 6.4 trillion. Around 70 percent (Rs 4.5 trillion) of this stock was converted on floating rates. The remaining amount of almost Rs 1.9 trillion was converted on fixed rate of around 13.75 percent (almost 100 bps higher than the rate of MRTBs). This conversion to fixed rate long-term instruments led to an additional debt servicing of roughly Rs 20 billion in FY20. However, with the fall in interest rates by almost 400 bps since the re-profiling, the interest amount paid on floating PIBs stood at Rs 400 billion in FY21, which would have been Rs 580 billion if the interest rate had remained the same. Hence, the difference of almost Rs 160 billion represents savings on interest payments arising from lower interest rates during FY21.

Meanwhile, interest payments on T-bills increased to Rs 0.7 trillion in FY21, from Rs 0.5 trillion last year. As highlighted earlier, the rise in the outstanding stock of T-bills led to higher interest payments during FY21. In contrast, as the government did not borrow from the SBP over the last two years, there were no interest payments on MRTBs.

5.3 Public External Debt & Liabilities

Public external debt reached US$ 86.4 billion by end-June 2021, registering a 10.8 percent increase. The pace of accumulation of external debt also increased, with the addition of US$ 8.4 billion during FY21 against US$ 4.5 billion in the previous year (**Table 5.5**).[13] This acceleration in external debt growth is explained by revaluation losses due to the depreciation of US Dollar against other international currencies, which inflated the value of external debt in Dollar terms. More than one-half of the revaluation losses were due to the appreciation of the SDR against the US Dollar.

The profile of public external debt improved during FY21 on two counts. First, the entire increase in external debt emanated from long-term instruments, whereas, the government retired a part of short-term debt. Second, the government was able to mobilize funds through diversified sources, such as Eurobonds, Naya Pakistan Certificates, and foreign portfolio investment in local government securities. These were in addition to the traditional sources of external financing, such as multilateral, bilateral and commercial creditors.

Importantly, in an effort to diversify the investor base and attract foreign inflows, the SBP launched the Roshan Digital Accounts (RDAs) in FY21; these accounts also provide an opportunity to the Pakistani diaspora to invest in a wide range of avenues, including NPCs, stock market, mutual funds and real estate **(Chapter 6)**.

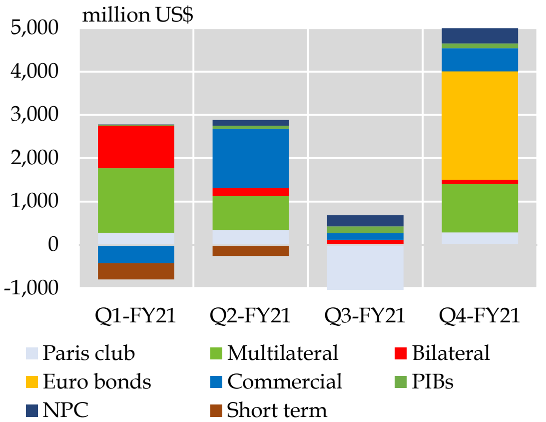
The NPCs attracted significant interest from non-resident Pakistanis, with US$ 0.8 billion inflows till end-June 2021.[14] Similarly, foreign investment in long-term local government securities increased by US$ 0.4 billion during FY21, compared to US$ 0.1 billion last year. It must be recalled that the tax regime for non-residents was simplified in FY20 to encourage investment in long-term government securities.[15] Ample liquidity in the international market and stability of Pakistan's external account largely explains the higher investment in FY21. The diversification of financing resources is an important reform to address the vulnerability of the external account. The country has witnessed frequent episodes of BoP crisis in the past because of inadequate availability of external financing. Furthermore, the government secured debt relief of US$ 2.3 billion under the G-20's Debt Service Suspension Initiative (DSSI) during FY21. This deferment eased the external debt servicing and helped improve the sustainability of Pakistan's external debt during FY21.

A large (57.0 percent) increase in external debt came in Q4-FY21.

A higher fiscal deficit compared to first three quarters and a slight deterioration in the current account balance led to higher mobilization of funds from multilateral and commercial sources during the quarter. Public external debt stock increased US$ 4.8 billion during Q4-FY21, out of which US$ 2.5 billion were mobilized via the issuance of Eurobonds (**Figure 5.12**). In addition, foreign investment in local government securities and non-residents' investment in the NPCs also picked up in Q4.

[13] Foreign exchange liabilities recorded net outflows of US$ 1.1 billion during FY21, compared to net retirements of US$ 0.6 billion during FY20.
[14] Gross inflows into the NPCs stood at US$ 1.0 billion during FY21, whereas US$ 0.8 billion were recorded in external debt.
[15] Source: ERD/M&PRD/PR/01/2020-01 dated January 2, 2020

Change in Public External Debt **Figure 5.12**



Source: State Bank of Pakistan

Gross External Disbursements

Gross external disbursements (public grants & loans) soared to US$ 13.0 billion in FY21 from US$ 10.7 billion in FY20, and US$ 12.2 billion commitments envisaged in the Budget

Source of Foreign Disbursements[16] **Table 5.6**

million US$

	FY20		FY21	
	Commit.	**Disb.**	**Commi**	**Disb.**
Multilateral	6,791.0	5,670.0	5,253.8	4,370.2
of which				
ADB	3,112.0	2,824.0	1,470.0	1,368.3
IDA		1,179.2	1,467.5	1,596.4
Bilateral	193.0	1,648.3	457.0	453.5
Safe deposit	-	-	-	1,000.0
Bonds	-	-	1,500.0	2,500.0
Commercial	3,463.0	3,373.3	3,922.5	4,721.2
Total disbursements	**10,447.0**	**10,691.7**	**12,233.4**	**13,044.9**
Grand total				**14,282.9**

Commit.: Commitment; Disb: Disbursement

Source: Economic Affairs Division

FY21. The government expanded external financing sources during FY21 by mobilizing funds from Eurobonds and NPCs. This led to a slight decline in loan disbursements from multilateral and bilateral creditors during FY21 **(Table 5.6)**.

Within multilateral sources, major inflows came from the ADB and the IDA. The volume of disbursements through commercial sources also increased during the year, though the terms of foreign commercial loans contracted by Pakistan were favorable during the year (Jul-Mar) as compared to the previous year **(Table 5.7)**.

Terms of Foreign Commercial Loans Contracted **Table 5.7**

	FY20	FY21 (Jul-Mar)
Lender	**Terms**	
USSE AG, UBL, ABL	Lib-3M + 3.25	Lib 12M+2
Dubai Bank	Lib- 3M + 2.2	Lib 12M+2.05
Bank of China	Lib- 6M+2.93	
China Development	Lib- 6M+3	
Citi Bank	Lib- 3M+2.2	
Ajman Bank	Lib- 6M+2.2	
ICBC		Lib 3M+2.75
Emirates NBD		Lib 12M+2.05

Lib=LIBOR

Source: Economic Survey of Pakistan 2020-21

Utilization of foreign disbursements

Disaggregated analysis of gross disbursements indicates that more than one-half of the inflows were utilized for budgetary support and around 12 percent (US$ 1.8 billion) financed the ongoing projects; the utilization of the major loan inflows received during FY21 are presented in **Table 5.8**. Some of the important projects pertained to the power sector – including the Karachi Nuclear Power Project (almost US$ 1.0 billion, financed by China) and the Jamshoro power generation project (US$ 0.2 billion, financed by the ADB). The country also received US$ 0.2 billion from the ADB for emergency assistance for Covid-19.

Issuance of Eurobond in FY21

In April 2021, Pakistan entered the international capital market after a gap of more than three years.[17] Importantly, this was

[16] Excluding inflows from IMF, Pakistan Banao Certificates, Naya Pakistan Certificates and non-resident investment in government securities.

[17] The Medium-Term Note Program allows continuous fund raising from investors through the designated or appointed dealers. Under this programme, a bond is registered only once. However, the issuer can reenter the market more easily to raise additional capital.

Major Foreign Economic Assistance during FY21[18] **Table 5.8**

million US$

Donor	Name of project	Purpose	Amount
Total disbursements			**13,044.9**
of which			
Project and Budgetary Support			
China	Karachi Nuclear Power Project	Project	1,114.0
China Development Bank	Term facility agreement	Budgetary support	1,000.0
IDB	Purchase of crude oil	Short-term contract	533.0
IDA	2nd Securing Human Investment	Budgetary support	397.4
ADB	Trade & Competitiveness Sub program-II	Budgetary support	300.0
ADB	3rd Capital Markets Development Program-I	Budgetary support	290.2
Emirates NBD	Emirates NBD Financing facility	Budgetary support	285.0
IDA	RISE Development Policy Financing	Budgetary support	256.1
IBRD	Resilient Institutions for Sustainable Economy	Budgetary support	250.0
AIIB	RISE Program	Budgetary support	249.4
ADB	Thermal for Installation of New Coal Fired Power	Project	204.1
ADB	Emergency Assistance for fighting Covid-19	Project	198.2
IDA	Crisis Resilient Social protection	Budgetary support	147.9
IDB	Polio Eradication Program	Project	75.0
IDA	Pakistan Raises Revenue	Project	70.7
IDA	Punjab Cities Program	Project	54.4
IDA	Sindh Barrages Improvement Project	Project	52.2
Euro Bonds			**2,500**

Source: Economic Affairs Division

the first time that Pakistan adopted a program-based approach for the bond issuance, with the registration of the Global Medium-Term Note (GMTN) program. The country raised US$ 2.5 billion through a multi-tranche transaction of 5-year, 10-year and 30-year Eurobonds. It was the largest conventional bond issued by Pakistan with an order book of US$ 5.3 billion – 2.1 times over subscription. [19]

The rates offered on these bonds are slightly higher compared to what the country had offered last time **(Table 5.9)**. Furthermore, it is important to mention that as these bonds are issued at a fixed rate, they are not faced with repricing risk with adverse movements in interest rates. In addition, the oversubscription for the country's sovereign bonds reflects foreign investors' confidence and a positive economic outlook of Pakistan. [20]

Eurobonds and Sukuk Issued by GoP **Table 5.9**

value in million US$

	Tenor	Value	Rate offered
FY04	5 years	500	6m libor + 323 bps
FY06	10 years	500	10y US T-bill + 240 bps
FY06	30 years	300	30y US T-bill+302bps
FY07	10 years	750	10y US T-bill + 200bps
FY14	5 years	1000	7.25%
FY14	10 years	1000	8.25%
FY16	10 years	500	8.25%
FY18	5 years	1000	5.63%
FY18	10 years	1500	6.88%
FY21	5 years	1000	6%
FY21	10 years	1000	7.38%
FY21	30 years	500	8.88%

Source: Economic Affairs Division

[18] The amount of US$ 13,044.9 million is the total of public grants and loans. If the amount of publicly guaranteed inflows is also included, then the grand total for FY21 comes out to US$ 14,282.9 million.

[19] Pakistan Economic Survey 2020-21, Chapter 9 Public Debt. A green bond by WAPDA worth US$ 500 million was also issued during FY21, however this transaction is part of PSEs debt and is not included in public debt.

[20] For reference, Egypt issued sovereign bonds worth US$ 3.75 billion in February 2021 of various tenors (5, 10 and 40 years) in the international capital market at rates relatively lower offered by Pakistan. Egypt issued sovereign bonds of 5y, 10y and 40y at 3.875, 5.875 and 7.5 percent respectively. Turkey also issued two sovereign bonds worth US$ 3.5 billion of 5 and 10 year tenors in January 2021. The coupon rate offered on the 5-year bond

The successful issuance of sovereign bonds has improved the maturity profile of external debt. Also, the availability of these funds has boosted the adequacy of the FX reserves to finance external payments.

5.4 External Debt Sustainability

The sustainability of the country's external debt and liabilities is gauged through solvency and liquidity indicators. The solvency indicators, such as debt-to-GDP, debt-to-Foreign Exchange Earnings (FEE) and debt servicing-to-FEE, measure the country's ability to service its external payments on an ongoing basis. On the other hand, liquidity indicators measure the country's ability to service its immediate liabilities. These include short-term debt-to-reserves, etc.

Pakistan's external debt sustainability improved during FY21 in terms of both solvency and liquidity indicators. The turnaround in GDP and FEE during the year enhanced the debt-bearing capacity of the economy. The ratio of total external debt & liabilities (TDL)-to-GDP declined from 45.7 percent in FY20 to 40.3 percent in FY21 (**Table 5.10**). This ratio indicates that the growth in nominal GDP outpaced the growth in TDL during the year. Similarly, with the improvement in the external account, the ratio of total reserves-to-TDL also improved in FY21.

Furthermore, the indicators of repayment capacity, such as external debt servicing (EDS)-to-FEE, strengthened on two counts: the revival in export earnings (EE) and the record increase in workers' remittances; these inflows increased the stream of FEE available to service external debt. Second, the debt relief provided under the DSSI substantially reduced debt servicing needs.[21] Specifically, the country secured deferment of US$ 2.3 billion (US$ 1.8 billion of principal payments

Indicators of External Debt Sustainability **Table 5.10**

percent

	FY16	FY17	FY18	FY19	FY20	FY21
Solvency indicators						
TDL/GDP	26.6	27.4	33.4	45.7	45.7	40.3
PED/GDP	20.8	20.5	24.7	31.5	31.2	28.2
TR/TDL	31.2	25.6	17.2	13.6	16.7	20.0
SBP R/TDL	24.5	19.3	10.3	6.9	10.7	14.2
EDS/FEE	8.5	12.3	10.7	17.0	20.4	12.8
EDS/EE	15.8	23.1	19.2	31.3	39.6	26.6
Liquidity indicators						
STPED/PEDL	2.8	1.3	2.1	1.5	1.8	0.9
STPED/TR	7.3	4.1	9.9	8.7	8.2	3.5
STPED/SBP R	9.3	5.5	16.6	17.4	12.7	5.0

TDL: Total debt and liabilities; PED: Public external debt; TR: Total reserves; SBPR: SBP reserves; STPED: Short-term public external debt; PEDL: Public external debt and liabilities; EDS: External debt servicing; FEE: Foreign exchange earnings; EE: Export earnings; GDP: Gross domestic product
Sources: EAD, PBS, SBP

and US$ 0.5 billion in interest payments) during FY21. According to the terms of the DSSI, these payments will fall due in next 4-6 years. Hence, the absence of these heavy payments during FY21 led to an improvement in the debt-repaying capacity of the country.

The liquidity indicators bolstered with declining reliance on short-term loans during FY21. As mentioned earlier, the government aimed to lengthen the maturity profile of external debt and repaid some of its short-term loans during the year. The declining share of short-term debt reduces roll-over risk and bodes well for the sustainability of external debt.

External Debt Servicing

The country repaid sovereign debt (including short-term) worth US$ 6.9 billion during FY21, against US$ 9.0 billion last year **(Table 5.11)**. This decline in debt servicing is largely attributed to the debt relief secured under the DSSI. With the exception of multilateral

was 5.25 percent and pricing of the 10-year bond was 6.25 percent – almost 100 bps higher than the coupon rate offered by Pakistan.
[21] For details, see Box 4.1 in SBP Third Quarterly Report on State of Pakistan's Economy for FY21.

Pakistan's External Debt Servicing - Principal **Table 5.11**

million US$

	FY20	FY21	Q1-FY21	Q2-FY21	Q3-FY21	Q4-FY21
1. Public debt (a+b)	**7,862.0**	**6,151.0**	**1,423.5**	**1,381.1**	**1,597.9**	**1,749.0**
a. Government debt	**7,118.1**	**5,072.2**	**1,170.2**	**1,078.5**	**1,375.5**	**1,448.0**
Paris Club	375.8	8.7	0.0	4.7	0.0	4.0
Multilateral	1,455.1	1,555.2	442.7	319.1	454.4	339.0
Other Bilateral	407.2	90.7	70.0	4.7	11.1	5.0
Euro/Sukuk global bonds	1,000.0	0.0	0.0	0.0	0.0	0.0
Commercial loans /credits	3,879.3	3,417.5	657.5	750.0	910.0	1,100.0
b. To the IMF	**744.0**	**1,079.0**	**253.3**	**302.6**	**222.4**	**301.0**
2. Foreign exchange liabilities	**500.0**	**3,000.0**	**1,000.0**	**1,000.0**	**1,000.0**	**0.0**
Memorandum Items						
Short-term government debt	**1,181.0**	**784.0**	**272.3**	**154.5**	**318.1**	**39.0**

Source: State Bank of Pakistan

sources, servicing to all other sources remained lower than last year. Meanwhile, a net reduction of US$ 3.0 billion was also recorded in the stock of foreign exchange liabilities. The country repaid US$ 1.0 billion each in the first three quarters of FY21 to a bilateral partner. These liabilities were held in the form of deposits with the central bank.

Interest payments on public external debt stood at US$ 1.5 billion during FY21, against US$ 2.0 billion during FY20. Debt relief of US$ 0.5 billion under the DSSI primarily explains the slowdown in interest payments during the year. In addition, the relatively lower global benchmark rates (such as LIBOR) also helped decelerate interest payments to commercial lenders from US$ 450 million in FY20 to US$ 336 million in FY21.