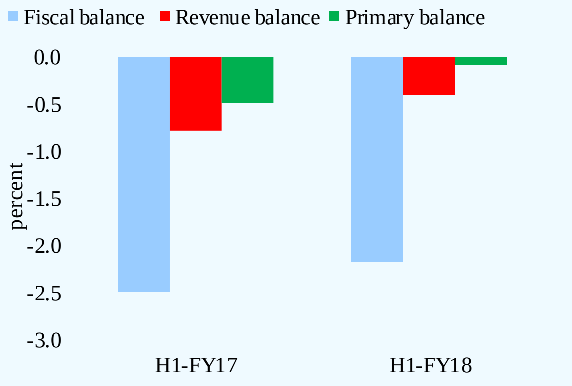
4 Fiscal Policy and Public Debt

4.1 Overview

The growth in revenue collection continued to outpace expenditure for the second consecutive quarter in Q2-FY18. This helped in containing fiscal deficit to 2.2 percent of GDP during H1-FY18, slightly lower than 2.5 percent recorded in the same period last year. Other indicators of fiscal performance also showed a marked improvement over the last year: the revenue deficit declined to 0.4 percent of GDP in H1-FY18 from 0.8 percent last year, and primary deficit fell to 0.1 percent in H1-FY18 compared to 0.5 percent in last year **(Figure 4.1)**.

Figure 4.1: Fiscal Balance Indicators (percent of GDP)



Data source: Ministry of Finance

This across-the-board improvement in the fiscal indicators was primarily due to a strong growth in revenue collection. Both tax and non-tax revenue contributed to acceleration in growth in revenue collection. The rebound in tax collection particularly reflects expansion in economic activity and strengthening of domestic demand. The surge in imports and sale of consumer durables, along with increase in regulatory duties as well as higher international commodity prices, have contributed considerably to indirect taxes. In the same vein, higher growth in withholding taxes and upward revision in government employees' salary has pushed up direct tax collection.

Meanwhile the non-tax revenues also recovered strongly during H1-FY18, led by higher SBP profit, dividends, and mark-up income. While increase in dividend income is consistent with the overall expansion in economy, higher mark-up income is the result of increase in federal government lending to PSEs. The increase in SBP profit mainly reflects its liquidity operations in the interbank market and government borrowing from central bank in FY17. Moreover, transfer of revaluation gains accumulated during the last year added to higher SBP profit during H1-FY18.

Though slower than revenue growth, the consolidated federal and provincial expenditures grew sharply compared to last year. Mainly reflecting government compulsion to complete most of infrastructure and social uplift projects before the elections, the development spending continue to build on its last year's robust growth. Also, the current expenditures grew much more sharply in H1-FY18, more than twice the growth observed last year. Servicing of public debt and continued efforts to improving security and public safety to create conducive environment for growth and investment accounted for a major chunk of the increase in current expenditures (**Table 4.1**).

Table 4.1: Summary of Fiscal Operations
billion Rupees

	Budget	Actual		% of GDP	
	FY18	**H1-FY17**	**H1-FY18**	**H1-FY17**	**H1-FY18**
A. Total revenue	6,167.2	1,990.6	2,384.7	6.2	6.6
Tax revenue	4,912.5	1,741.2	2,026.9	5.5	5.6
Non-tax revenue	1,254.7	249.4	357.8	0.8	1.0
B. Total expenditure	7,646.8	2,789.7	3,181.0	8.8	8.9
Current	5,393.9	2,241.6	2,545.2	7.0	7.1
Interest payments	*1,363.0*	*647.4*	*751.4*	2.0	2.1
Defence	920.2	*336.3*	*393.4*	1.1	1.1
Development	2,265.2	497.4	613.9	1.6	1.7
Net lending	-12.3	-6.4	2.0	0.0	0.0
C. Statistical discrepancy	0.0	57.2	19.9	0.2	0.1
Fiscal balance (A-B-C)	-1,479.6	-799.1	-796.3	-2.5	-2.2
Revenue balance	773.3	-251.0	-160.5	-0.8	-0.4
Primary balance	-116.6	-151.7	-44.9	-0.5	-0.1
Financing	1,479.5	799.1	796.3	2.5	2.2
External sources	511.4	240.9	384.1	0.8	1.1
Domestic sources	968.1	558.2	412.2	1.8	1.1
Banks	390.1	407.1	331.8	1.3	0.9
Non-bank	528.0	151.1	80.4	0.5	0.2
Privatization	50.0	0.0	0.0	0.0	0.0
% Growth					
Total revenue		-0.7	19.8		
Tax revenue		6.2	16.4		
Non tax revenue		-31.8	43.4		
Total expenditure		10.7	14.0		
Current		6.5	13.5		
Development		16.7	23.4		

Data source: Ministry of Finance

The resulting fiscal deficit was financed through a combination of external and domestic sources. The former dominated as the requirement for financing of enlarged current account deficit necessitated more reliance on the external loans. In particular, the issuance of Eurobonds and Sukuks complemented somewhat slower multilateral loans. In case of financing from domestic sources, government shifted its borrowing from SBP to scheduled banks. In the last year, government had borrowed heavily from SBP and retired its borrowing, mostly long-term, to scheduled banks.

Thus, most of the accumulation in overall public debt stemmed from external loans. Besides, revaluation losses due to strengthening of major international currencies against Dollar, as well as depreciation of Rupee, also added on to the external debt in local currency terms.

4.2 Revenue

The total revenue collection surged by 19.8 percent during H1-FY18 against a decline of 0.7 percent in H1-FY17. The acceleration in revenue growth was also fairly broad-based with strong showing by both tax and non-tax revenues. Also, robust growth in federal revenue was supplemented by a healthy growth in provincial tax and non-tax revenue.

FBR taxes

FBR tax collection grew by 16.9 percent during H1-FY18 compared to 7.4 percent growth last year. The acceleration in growth was despite higher tax refunds, especially to exporters. The refunds grew by 27.0 percent to Rs 76.1 billion in H1-FY18, compared to Rs 59.9 billion in the same period last year.

Table 4.2: FBR Tax Collection
billion Rupees

		Collections		% growth	
	Budget FY18	**H1-FY17**	**H1-FY18**	**H1-FY17**	**H1-FY18**
Direct taxes	1,594.9	591.5	663.5	9.4	12.2
Indirect taxes	2,418.1	880.8	1,058.1	6.1	20.1
Customs duty	581.4	218.0	281.5	22.6	29.2
Sales tax	1,605.2	577.4	686.5	-0.2	18.9
FED	231.5	85.4	90.1	15.9	5.5
Total taxes	**4,013.0**	**1,472.3**	**1,721.7**	**7.4**	**16.9**

Data source: Federal Board of Revenue

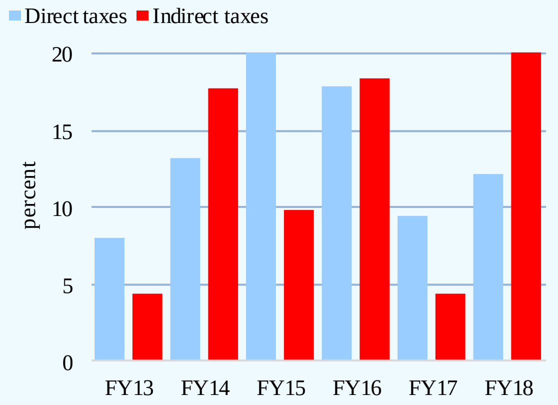
Both the direct and indirect taxes contributed to growth in FBR taxes. Yet, the proportionate increase was higher in case of indirect taxes than from direct taxes. Imposition of regulatory duty at the time of rising import and increase in prices of petroleum products, particularly boosted tax collection from indirect sources.

Moreover, strong domestic demand together with an increase in the general income level in the economy, resulted in higher direct tax collection **(Table 4.2)**.

Direct taxes

The direct taxes grew by 12.2 percent during H1-FY18, compared to 9.4 percent growth in H1-FY17. A higher growth in direct taxes was mainly on account of a sharp growth in withholding taxes and a rise in salaries of government employees also contributed to increase in direct tax collection.[1] Moreover, introduction of risk-based audit improved efficiency of audit cases along with generation of some additional revenue. Yet, the growth in direct tax collection was significantly lower compared to growth in indirect tax collection **(Figure 4.2)**.

Figure 4.2: Growth in Direct and Indirect Taxes during H1

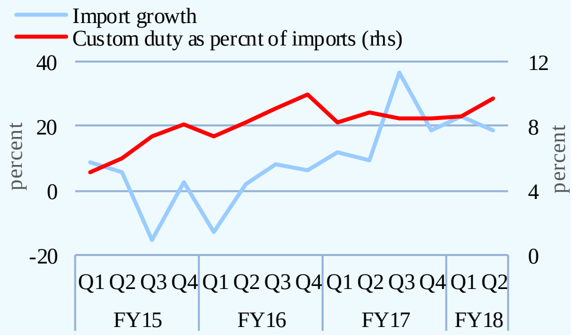


Data source: Federal Board of Revenue

Indirect taxes

The indirect tax collection grew by 20.1 percent during H1-FY18, compared to a subdued growth of 6.1 percent in last year. This sharp growth was an outcome of both an expansion in custom duty collection as well as a rebound in sales tax collection. The custom duty collection grew by 29.6 percent, on top of 22.6 percent growth in H1-FY17, which can be traced to increase in regulatory duty on a number

Figure 4.3: Imports and Custom Duty Collection



Data source: Federal Board of Revenue and Pakistan Bureau of Statistics

[1] The salary income was increased by 10 percent by the Federal; Punjab; KP and Balochistan governments while it was raised by 15 percent by the government of Sindh; (Source: budget documents).

of non-essential consumer items, which was primarily aimed at curtailing imports to address external sector imbalance **(Figure 4.3)**.

The recovery in sales tax collection was even sharper, rising by 18.9 percent during H1-FY18 against a decline of 0.2 percent in the same period of last year. The surge in sales tax collection can be attributed to increase in the prices of petroleum products in line with trends in international market and higher sales volume. Moreover, increase in the overall sales activity commensurate with the growing economy is evident from higher consumption of cement, steel, automobiles, electronics, etc.

In contrast to acceleration in growth of customs and sales tax, the collection from federal excise duty grew by only 5.5 percent in H1-FY18, compared to a 15.5 percent growth in the corresponding period of last year. This slowdown can be attributed to a fall in revenue collection from cigarettes by 11.8 percent, despite a substantial increase in cigarette production. The sudden fall in FED collection from cigarettes was an outcome of a reduction in tax rate on lower tier brands.[2]

Going forward, the pace of FBR tax collection observed in H1-FY18 needs to be enhanced further in H2-FY18 to achieve the FY18 target of Rs 4,013 billion. This would require FBR revenue to grow roughly by 22 percent in the second half of FY18, compared to 16.9 percent realized in first half of the year.

Table 4.3: Non-tax Revenues
billion Rupees

	Budget	Actual	
	FY18	**H1-FY17**	**H1-FY18**
Mark-up (PSEs & others)	96.0	8.9	13.9
Dividends	93.3	12.2	19.2
SBP profits	260.0	87.8	125.2
Defense (incl. CSF)	141.8	4.6	6.1
Profits post office/PTA	11.3	0.6	8.6
Royalties on gas & oil	58.5	24.4	26.6
Passport & other fees	28.0	7.1	7.5
Discount retained	10.0	3.6	4.1
Windfall levy	8.0	0.5	0.8
Other	547.8	99.7	145.8
Total non-tax revenue	**1,254.7**	**249.4**	**357.8**

Data source: Ministry of Finance

<u>Non-tax revenue</u>

The non-tax revenue also bounced back, growing by 43.4 percent during H1-FY18 compared to a sharp decline of 31.8 percent in the same period of last year (**Table 4.3**). The recovery in non-tax revenue was broad-based, with major contributions coming from higher SBP profit, mark-up income, dividends and PTA

[2] Effective from 1st July 2017, duty structure on cigarettes was revised by FBR in which duty on lower tier cigarettes was reduced to Rs 800 per thousand cigarettes (Source: SRO 407(I)/2017).

profit. Higher dividend income and PTA profits are consistent with growth in corporate profitability in an expanding economy.

Higher SBP profit reflects government's increased recourse to SBP borrowing during FY17, higher OMO injections in FY18, and transfer of last year's revaluation gains. Similarly, increased lending to PSEs fetched higher markup/dividend income. Moreover, rise in passport fee income reflects increase in number of people availing this facility to travel abroad for study, work and leisure trips. In the backdrop of recovery in international petroleum prices, royalty on oil and gas escalated. Likewise, revenues from windfall levy and discount retained on crude oil also inched up.

Table 4.4: Analysis of Fiscal Spending
billion Rupees

	Actual		Growth	
	H1-FY17	**H1-FY18**	**FY17**	**FY18**
Current expenditures	**2,241.6**	**2,545.2**	**6.5**	**13.5**
Federal	1,473.5	1,656.0	2.6	12.4
of which				
Interest payment	647.4	751.4	2.4	16.1
(i) Domestic	587.7	678.0	1.7	15.4
(ii) Foreign	59.8	73.5	9.3	23.0
Defense	336.3	393.4	10.9	17.0
Public order and safety	51.4	59.5	9.5	15.8
Others	438.4	451.6	-3.4	3.0
Provincial	768.1	889.3	15.0	15.8
Development expenditures	**497.4**	**613.9**	**16.7**	**23.4**
PSDP	445.7	558.8	17.9	25.4
Federal	198.3	242.1	27.2	22.1
Provincial	247.4	316.8	23.5	28.0
Others (including BISP)	51.7	55.0	7.1	6.5
Net lending	**-6.4**	**2.0**	252.4	-131.4
Total expenditure*	**2,732.6**	**3,161.1**	**8.1**	**15.7**

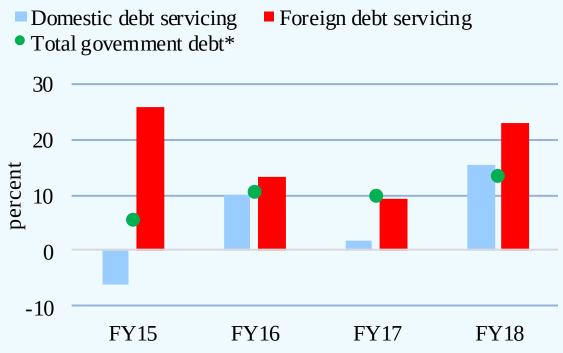
* Excluding statistical discrepancy
Data source: Ministry of Finance

4.3 Expenditures

The consolidated fiscal spending rose by 15.7 percent during H1-FY18, almost twice the growth in the corresponding period of last year. The growth in both current and development spending accelerated during the first half of FY18. While development spending grew both at federal and provincial levels, the acceleration in current expenditure was almost entirely due to faster increase in federal current expenditures (**Table 4.4**).

The federal current expenditures grew by 12.4 percent as compared to 2.6 percent increase recorded in the similar period of last year. This increase was largely due to higher interest payments, both on domestic and external debt (**Figure 4.4**). Increase in interest payments despite continuation of low interest rate environment, in fact, reflects the impact of rising debt stock as well as depreciation of PKR against US dollar. Moreover, spending on defence and public order and safety also rose sharply during H1-FY18 compared to last year.

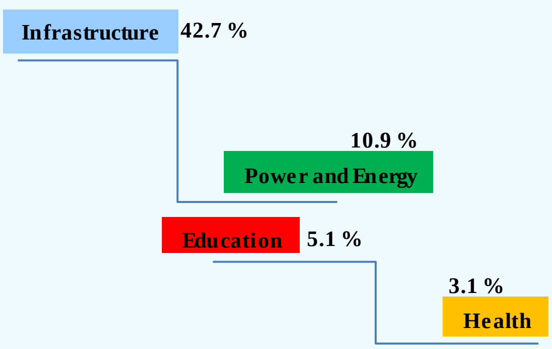
Figure 4.4: Growth in Government Debt and Markup Payments during H1



* As per FRDLA
Data source: Ministry of Finance and State Bank of Pakistan

The development spending continued to maintain its upward momentum, rising by 23.4 percent during H1-FY18 compared to 16.7 percent in last year. This is largely attributed to 25.4 percent increase in releases under PSDP. The spending consideration at the federal level was more tilted towards infrastructure and energy sectors, especially delivering on its commitments under CPEC (**Figure 4.5**). This indicates government's continued focus on developing infrastructure and providing base for sustainable growth, going forward.

Figure 4.5: The Development Concerns at Federal Level during H1-FY18 (as percent of total PSDP)



Data source: PSDP releases as on 29-12-2017, Planning Commission of Pakistan

4.4 Provincial Fiscal Operations

The provinces posted a surplus of Rs 203.9 billion – about 59 percent of the target of Rs 347.3 billion for the year – during H1-FY18. The major contribution to this surplus came from Punjab, followed by Sindh and Balochistan; the surplus of KP almost halved in H1-FY18 compared to last year. The higher provincial surplus was a result of a considerable increase in the provincial revenue (**Table 4.5** and **Figure 4.6**).

Table 4.5: Provincial Fiscal Operations during Jul-Dec
billion Rupees

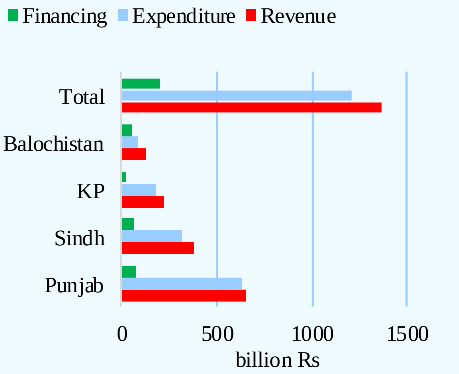
	Punjab	Sindh	KP	Balochistan	Total	Growth
FY18						
A. Total revenue	649.2	374.8	218.1	121.7	1,363.8	28.2
Provincial share in federal revenue	533.2	276.5	176.8	107.3	1093.8	26.1
Provincial revenue (I+II)	113.1	80.7	36.0	11.1	240.9	33.0
I. Taxes	91.8	72.2	8.4	4.0	176.4	21.1
II. Non-tax revenue	21.3	8.5	27.6	7.1	64.5	82.3
Fed loans and transfers	2.8	17.6	5.3	3.4	29.1	82.5
B. Total expenditure	636.7	319.5	176.4	80.4	1,213.1	18.7
Current	422.3	263.3	135.2	75.5	896.3	15.7
Development	214.4	56.2	41.2	4.9	316.8	28.0
Gap (A-B)	12.5	55.3	41.6	41.3	150.8	257.5
Financing* (overall balance)	**-69.5**	**-60.7**	**-21.0**	**-52.7**	**-203.9**	**125.2**
FY17						
A. Total revenue	503.5	293.5	159.6	107.6	1,064.2	1.3
Provincial share in federal revenue	410.4	220.6	136.8	99.4	867.1	-0.1
Provincial revenue (I+II)	83.9	67.8	24.5	5.0	181.1	17.9
I. Taxes	71.4	64.3	7.0	3.0	145.7	19.1
II. Non-tax revenue	12.4	3.5	17.5	2.0	35.4	13.2
Fed loans and transfers	9.3	5.1	-1.7	3.3	15.9	-45.5
B. Total expenditure	490.2	263.2	193.6	75.0	1,022.0	14.1
Current	348.6	210.8	146.6	68.6	774.6	15.0
Development	141.7	52.4	47.0	6.3	247.4	11.4
Gap (A-B)	13.3	30.2	-34.0	32.6	42.2	-72.8
Financing* (overall balance)	**32.9**	**-37.4**	**-49.6**	**-36.4**	**-90.6**	**-56.6**

Negative sign in financing means surplus.
Data source: Ministry of Finance and SBP calculations

The total provincial revenue grew by 28.2 percent during H1-FY18 as compared to a meager 1.3 percent growth reported in last year. This improvement is attributed to increase in federal transfers, bolstered by an impressive growth in FBR tax collection, and provinces' own tax revenue (**Figure 4.7**). The provinces' own tax revenue continued to build on expanding coverage of general sales tax on services (GSTS), increasing by 33 percent during H1-FY18 compared to 17.9 percent growth last year.

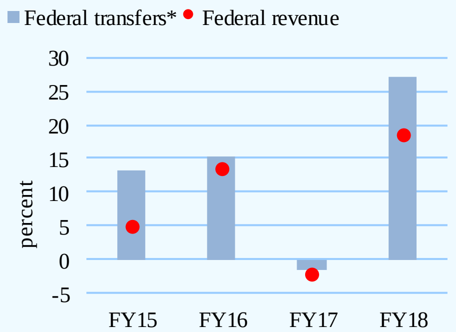
Improved economic activity had a spillover effect on provinces' own revenue collection as well. Besides collection from sales tax on services, provinces saw an encouraging growth in excise and stamp duties, followed by property and motor vehicle taxes.

Figure 4.6: Provincial Fiscal Position during H1-FY18



Data source: Ministry of Finance

Figure 4.7: Growth in Federal Transfers to Provinces and Federal Revenue during H1



*Provincial share in federal revenue and federal loans/grants
Data source: Ministry of Finance and SBP calculations

The provincial non-tax revenue also grew sharply by 82.3 percent during H1-FY18. This mainly came from KP with Rs 27.6 billion, out of which Rs 18.2 billion was received under *profits from hydroelectricity*. Moreover, non-tax revenue of Punjab also almost doubled to Rs 21.3 billion during H1-FY18.

Higher revenue collection created more fiscal space for provincial spending, which is reflected in 18.7 percent increase in provincial expenditure during H1-FY18, compared to 11.4 percent last year. Most of the increase in spending during H1-FY18 was meant for development purposes, as growth in current expenditures was slightly higher compared to last year.

However, the province-wise analysis shows that growth in provincial development spending was primarily due to Punjab, as the other three provinces reported either a negligible growth or decline. Therefore, provinces spent only Rs 316.8 billion during H1-FY18 out of total PSDP allocation of Rs 1,112 billion given in provincial Annual Development Programs (ADPs).[3] Since most of the development functions have been devolved to provinces after 18^{th} Amendment, provinces need to set a road map for the effective allocation of resources in view of new opportunities such as CPEC.

[3] Source: Public Sector Development Programme 2017-2018, Planning Commission, Ministry of Planning, Development and Reform.

Table 4.6: Pakistan's Public Debt Profile
billion Rupees

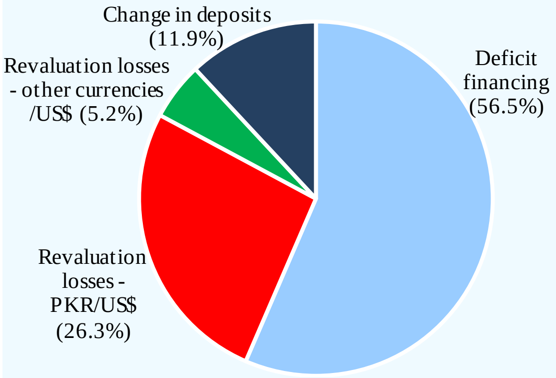
	End period stocks		Share in total		Flow			
					H1		FY18	
	Jun-17	Dec-17	Jun-17	Dec-17	FY17	FY18	Q1	Q2
Gross public debt	21,408.7	22,820.8	100.0	100.0	595.6	1,412.1	651.2	761.0
Government domestic debt	14,849.2	15,437.4	69.4	67.6	566.7	588.2	526.3	61.9
Government external debt	5,918.7	6,692.5	27.6	29.3	43.0	773.8	111.1	662.7
Debt from the IMF	640.8	690.9	3.0	3.0	-14.1	50.1	13.8	36.4
Total debt of the government*	19,635.4	20,879.3	-	-	562.5	1,243.9	558.8	685.1

*Gross public debt minus government deposits with the banking system.
Data source: State Bank of Pakistan

4.5 Public debt

The budget deficit in the face of widening current account deficit necessitated more external borrowing during H1-FY18 compared to last year. However, domestic borrowings also increased slightly during the period.[4] As a result, Pakistan's public debt stock rose by 6.6 percent during H1-FY18, reaching Rs 22.8 trillion as of end-December 2017 (**Table 4.6**).

Figure 4.8: Composition of Change in Gross Public Debt during H1-FY18



Data source: State Bank of Pakistan

The increase in external debt signifies both higher borrowings and revaluation losses due to PKR depreciation against US dollar as well as appreciation of other currencies against US dollar (**Figure 4.8**). It is worth noting that PKR depreciation increases the rupee value of external debt, but does not add to foreign currency liability of the country (**Box 4.1**). In case of domestic debt, the government borrowed over and above its budgetary needs and built up its deposits with the banking system.

[4] Despite lower fiscal deficit in nominal terms, the increase in domestic debt was reflected in build-up of government deposits with the banking system, which increased to Rs 168.3 billion during H1-FY18, compared with only Rs 33.1 billion same period last year.

Domestic debt

Domestic debt increased by Rs 588.2 billion during H1-FY18, slightly higher than the level observed in the same period last year. Most of the increase in domestic debt was concentrated in the first quarter of FY18, since the government borrowing needs from domestic sources shrank in the second quarter due to increased borrowings from external sources (**Figure 4.9**). Moreover, almost the entire increase in domestic debt came from short-term debt, as there was net retirement of long-term debt during the period.

Table 4.7:Absolute Change in Government Domestic Debt

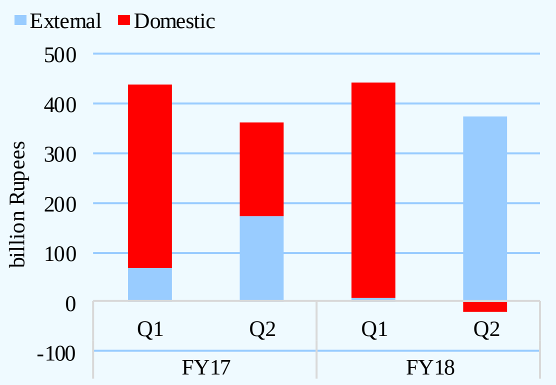
billion Rupees

	FY17	FY18	FY18	
	H1		Q1	Q2
Government domestic debt	**566.7**	**588.2**	**526.3**	**61.9**
Permanent debt	-720.2	-495.4	-510.5	15.2
Of which				
PIBs	-780.9	-541.0	-541.0	0.0
Prize bond	60.7	45.6	30.4	15.2
Floating debt	1236.2	1038.2	1017.8	20.4
Of which				
MTBs	631.0	747.7	745.9	1.8
MRTBs	817.8	83.2	271.9	-188.7
Outright basis by SBP	0.0	207.3	0.0	207.3
Unfunded debt	50.7	45.1	19.0	26.1
Foreign currency loans	0.0	0.2	0.0	0.2

Data source: State Bank of Pakistan

Similar to H1-FY17, the government continued to rely on short-term borrowings from scheduled banks (**Table 4.7**). With the expectation of monetary tightening that prevailed throughout the first half, the banks' interest in PIB auctions was almost non-existent. In absolute terms, banks offered only Rs 158.4 billion in PIB auctions during H1-FY18 compared to Rs 9.1 trillion offered in T-bills auctions. Within T-bills, around 85.6 percent of the offers were for 3-month T-bills only.

Figure 4.9: Financing of the Budget Deficit



Data source: Ministry of Finance

Given the market sentiments, the government managed to meet most of its financing requirements from the external sources, and the rest almost entirely from 3-month T-bills. As an outcome, the share of 3-month T-bills in total outstanding T-bills reached 62.6 percent in December 2017 from 32.8 percent in June 2017 (**Figure 4.10**).

Fund mobilization through NSS

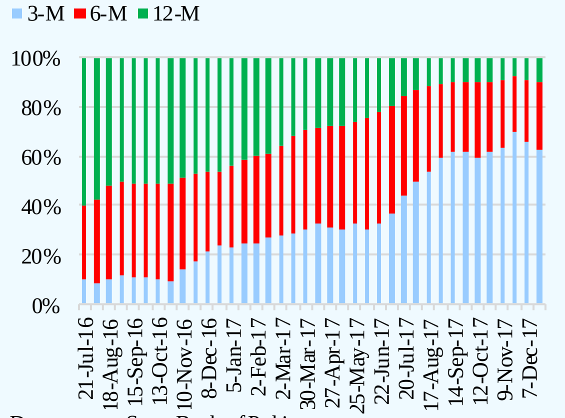
Net investments in national saving schemes saw an expansion of Rs 46.4 billion during H1-FY18, lower than the increase seen in the same period last year (**Table 4.8**). This was primarily because the profit rates on these schemes have remained unchanged since February 2017.

In fact, the rate on most NSS schemes is linked with rates on similar tenor PIBs, determined in the primary auctions. As the government rejected most of the bids in PIB auctions since February 2017, the NSS rates have remained essentially unchanged since then. As a result, institutional investors shifted their investment to PIBs in the secondary market where returns are still relatively higher (**Figure 4.11**). This was particularly reflected in a major outflow from medium-tenor schemes (like SA, SSC etc.), eligible for institutional investment whereas other major scheme recorded increase during H1-FY18.

Public external debt

Pakistan's stock of public external debt increased by US$ 4.3 billion during first half of FY18, reaching US$ 66.9 billion as of end-December 2017 (**Table 4.9**).

Figure 4.10: Tenor-wise Share in Outstanding T-bills



Data source: State Bank of Pakistan

Table 4.8: Receipts under NSS Instruments*

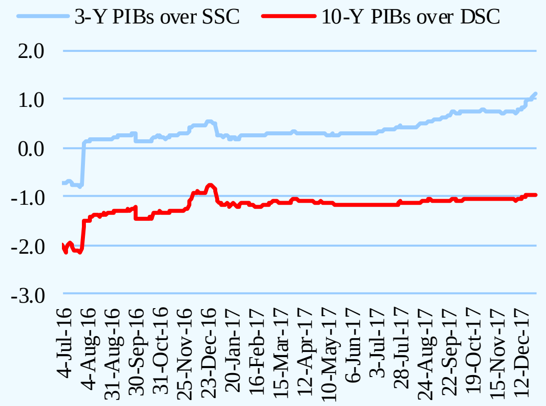
billion Rupees

	H1-FY16		H1-FY17		H1-FY18	
	Gross	**Net**	**Gross**	**Net**	**Gross**	**Net**
DSC	13.3	1.1	25.2	13.4	27.6	6.1
SSC	87.1	4.9	41.1	-5.2	91.0	-25.5
RIC	35.3	-5.3	24.8	-15.9	43.2	5.1
BSC	80.3	39.5	75.5	31.2	73.3	21.2
SSA	77.1	25.3	38.0	18.2	164.5	29.4
SA	93.4	0.4	107.5	0.9	126.1	0.9
Others	25.5	11.4	25.8	10.3	30.5	9.1
Total	412.1	77.2	338.0	52.8	556.2	46.4

*excludes short-term savings certificates

Data source: Central Directorate of National Savings

Figure 4.11: Term Premuim-PIBs over NSS



Data source: MUFAP and CDNS

Table 4.9: Public External Debt & Liabilities
billion US$

	Stock		Flows			
			H1		FY18	
	Jun-17	Dec-17	FY17	FY18	Q1	Q2
Public external debt & liabilities	66.1	70.5	0.1	4.4	0.9	3.5
Public external debt (i+ii)	62.5	66.9	0.2	4.3	0.9	3.5
i) Govt. debt	56.4	60.6	0.4	4.2	0.8	3.4
Of which;						
Paris club	12.0	11.9	-1.1	-0.1	0.1	-0.2
Multilateral	27.6	27.9	-0.7	0.3	0.3	0.0
Other bilateral	5.8	6.5	0.7	0.7	0.4	0.2
Euro/Sukuk bonds	4.8	7.3	1.0	2.5	0.0	2.5
Commercial loans (LT)	4.8	5.3	1.0	0.5	-0.1	0.6
ii) IMF	6.1	6.3	-0.1	0.1	0.1	0.0
iii) Foreign exchange liabilities	3.6	3.7	-0.1	0.1	0.0	0.0

Data source: State Bank of Pakistan and Economic Affairs Division

Despite higher repayments, the increase in external debt was largely due to US$ 2.5 billion mobilized through Euro bond/Sukuk issuance and borrowings from commercial banks during the period.

In addition, strengthening of other currencies against US dollar resulted in US$ 669.3 million as revaluation losses. Specifically, the Dollar weakened against Euro and SDR by 4.9 percent and 2.3 percent respectively, which added significantly to dollar value of Pakistan's external debt.

Table 4.10: External Loan Disbursement during H1
million US$

	FY17	FY18	Absolute change
ADB	674.6	443.3	-231.3
IDA	72.3	132.3	60.0
IDB	30.2	55.4	25.2
IBRD	127.5	86.7	-40.8
IDB (short term)	212.4	695.2	482.8
China	848.0	506.9	-341.1
Japan	42.8	47.4	4.6
Euro/Sukuk bond	1,000.0	2,500.0	1,500.0
Commercial banks	900.0	1,164.0	264.0
Others	45.1	0.0	-45.1
Total	3,952.9	5,692.2	1,739.3

Data source: Economic Affairs Division

Gross loan disbursements increased by 44 percent during H1-FY18. Around two-thirds of the inflows came from bond issuance and the government borrowings from the foreign commercial banks (**Table 4.10**). In addition to commercial borrowings, the support from the multilateral donors came largely for energy and infrastructure projects. Within bilateral loans, major inflow came from China, meant for infrastructure projects under CPEC.

It is worth noting that the Euro/Sukuk bonds issuance was oversubscribed by more than US$ 8 billion. The investor base was also quite diversified; with 44 percent from Europe, 24 percent from Asia, 20 percent from North America, 8 percent Middle East and 12 percent from other regions. Encouragingly, the rate of return on 10-year bonds was lower compared with fixed rate bonds issued during last 10 years (**Table 4.11**). This development bodes well in terms of lengthening the maturity profile, cost effectiveness and the interest rate risk on external debt portfolio.

Table 4.11: Sovereign Eurobonds Issued by Pakistan

Value in million US$

	Tenor	Value	Interest rates
FY14	5 years	1,000	7.25%
	10 years	1,000	8.25%
FY15	5 years	1,000	6.75%
FY16	10 years	500	8.25%
FY17	5 years	1,000	5.5%
FY18	5 years	1,000	5.625%
	10 years	1,500	6.875 %

Data source: Economic Affairs Division

The servicing of public external debt was US$ 720.2 million higher during H1-FY18 compared to the same period last year (**Table 4.12**). The main servicing burden was due to repayment to the foreign commercial (bank) loans that reached around US$ 537.4 million during H1-FY18. In addition, the repayment to Paris club and other multilateral donors also increased significantly during the period.

Table 4.12: Servicing of Public External Debt during H1 (Principal + Interest)

million US$

	FY17	FY18	Change
Government debt	1,479.7	2,198.6	718.9
Of which			
Paris club	250.6	416.4	165.8
Multilateral	787.5	831.3	43.8
Other bilateral	200.7	198.0	-2.6
Euro/Sukuk bonds	169.4	171.3	1.9
Commercial loans	21.4	537.4	516.0
IMF	37.3	60.7	23.4
External liabilities	32.6	10.5	-22.1
Total	**1,549.6**	**2,269.7**	**720.2**

Data source: State Bank of Pakistan

Box 4.1: Depreciation and Public Debt

Typically, public debt is issued to finance the fiscal and current account deficits. Within public debt, the external debt is contracted in different currencies and then converted into US$ and then to PKR for the reporting purposes. Thus, any movement in the international currencies (in which debt is contracted) and PKR vis-à-vis US$ can change the dollar and PKR value of external debt respectively. On the contrary, the domestic debt does not carry currency risk.

In Dollar terms, Pakistan's public external debt stood at US$ 66.9 billion as of end December 2017, registering a growth of 6.9 percent over June 2017. In Rupee terms, however, the debt increased by 12.6 percent to reach at Rs 7.3 trillion as of end December 2017 (**Table 4.1.1**). The difference in growth primarily reflects the impact of PKR depreciation during the first half of FY18.

As of end December 2017, Pakistan's public debt amounted to Rs 22.8 trillion, of which around Rs 15.4 trillion is denominated in local currency. This means around two-third of the public debt is not prone to any currency risk. On the other hand, the PKR depreciation against US$ increased the PKR value of the external debt; however, this has not added to foreign currency liability of the country.

Table 4.1.1: Growth in Stock of Public External Debt

	Dec-13	Jun-14	Dec-14	Jun-15	Dec-15	Jun-16	Dec-16	Jun-17	Dec-17
Billion US$	47.5	51.5	50.4	51.0	53.4	57.8	58.0	62.5	66.9
Growth (%)	*-1.4*	*8.4*	*-2.0*	*1.1*	*4.7*	*8.2*	*0.4*	*7.8*	*6.9*
Billion PKR	5,017.3	5,084.7	5,064.2	5,187.6	5,596.1	6,050.8	6,079.6	6,559.4	7,383.4
Growth (%)	*5.2*	*1.3*	*-0.4*	*2.4*	*7.9*	*8.1*	*0.5*	*7.9*	*12.6*

Data source: State Bank of Pakistan

The impact of depreciation on government accounts is realized when the repayment of external debt is actually made. Here, it is also important to highlight that the entire amount of debt does not mature on the same day; rather, it becomes due over a period of time. Usually countries with higher short-term debt suffer most from the exchange rate depreciation, only when creditors refuse to roll over the debt while reserves are also insufficient to cover the debt maturities. In case of Pakistan, the short term external debt accounts for only 1.7 percent of total public external debt, of which around 80 percent is IDB short-term financing for oil imports. Moreover, Pakistan's short term debt is equivalent to 8 percent of country' FX reserves, which provides sufficient liquidity buffer in case of any repayment difficulties.

The available literature on public debt sustainability suggests that the depreciation could have both negative and positive impact on debt sustainability. Once currency depreciates, servicing cost increases and that has the negative balance sheet impact on public debt. At the same time, the depreciation increase the price competiveness, boosts net exports, government revenues and hence has a positive income effect on GDP.

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