

PROFILE OF PUBLIC DEBT AND IMPLICATIONS FOR THE ECONOMY

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The purpose of this report is to apprise investors of the capital market of Pakistan, about economic developments and progress of the country through independent views of a well-known and reputed economist, in order to facilitate their top-down investment decision making process.

Profile of public debt and implications for the economy

Pakistan Economy

This article describes the debt profile and the implications on the federal budget and the balance of payments.

Public Debt Profile

The total debt of Pakistan at the end of 2020-21 was Rs 47,829 billion, equal to 100.2 percent of the GDP. It has increased by Rs 18,950 billion since 2017-18 when it stood at 86.3 percent of the GDP.

The composition of the debt is shown in Figure 1.

The dollar magnitude of the total external debt is \$122.1 billion, over 40 percent of the GDP. The level of public external debt and liabilities is \$95.2 billion. Within public external debt and liabilities, the share of government debt is \$79 billion. The rest, \$16.2 billion, is the debt of the Public Sector Enterprises (PSEs) and the private sector.

The composition of government external debt is given in Figure 2.

Figure 1: Composition of the debt of Pakistan, 2020-21

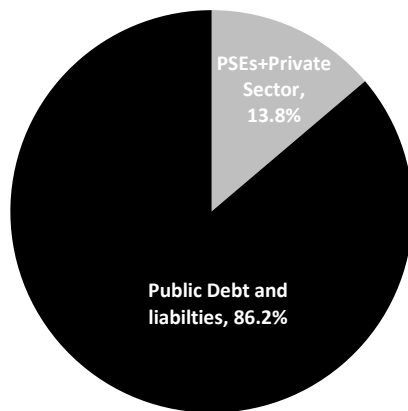
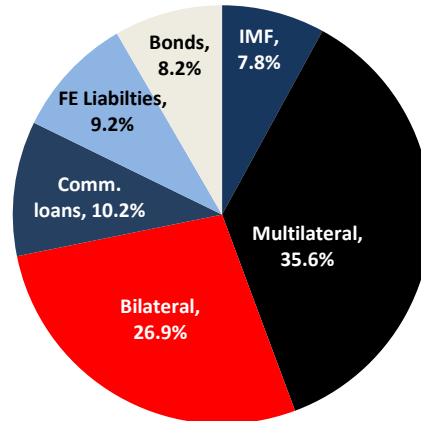


Figure 2: Composition of Government External Debt in 2020-21*



*= Excluding others adding up to 2.1%

Turning to the cost of debt servicing, the effective interest rates on external and domestic borrowing are given in Table 1. The overall effective interest rate on public debt was 7.32 percent in 2020-21.

Table 1: Effective Interest Rates on Public External and Domestic Debt, 2020-21

(Rs in Billion)	Outstanding Debt*	Interest Cost	Effective Interest Rate (%)
External Debt	12,784	226	1.77
Domestic Debt	24,774	2,524	10.19
Total	37,558	2,750	7.32

*= Outstanding debt is average for the year

Implications for the economy

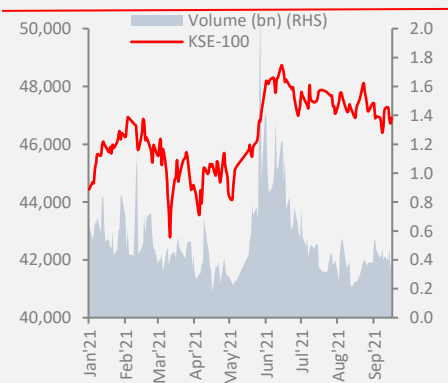
The impact on the budgetary position in 2021-22 is analyzed first, followed by the implications on the balance of payments and foreign exchange reserves.

Key Data

KSE100 Index	46,636
KSE-All Share Value (PKRmn)	16,238
KSE-All Share Value (USDmn)	95.5
KSE-All Share Volume (Shmn)	387.3
Market Capitalization (PKRtn)	5.9
Market Capitalization (USDbn)	34.8
1 Year High	48,982
1 Year Low	38,569

Source: PSX, Next Research

KSE100 Index & Volume



Source: PSX, Next Research

The first claim on budgetary resources in 2021-22 is in the form of debt servicing, shown in Table 2.

Table 2: Projected Level of Debt Servicing in 2021-22

(Rs in Billion)	Debt Servicing		
	2020-21 Actual	2021-22 Budget Est.	Growth Rate %
Domestic Debt	2,524	2,757	8.0
External Debt	226	302	34.1
Total	2,750	3,059	11.3

Debt servicing is expected to rise by over 11 percent in 2021-22, with much faster growth in the cost of servicing external debt. Debt servicing is by far the largest claimant of public resources. It is expected to be over 68 percent of the net revenue receipts of the federal government in 2021-22. The expected level of borrowing is Rs 3,990 billion in 2021-22, equivalent to 7.3 percent of the GDP in 2021-22.

The break-up of this borrowing is given in Table 3.

Table 3: Projected Level of Borrowing by Type in 2021-22

(Rs in Billion)	2020-21	2021-22
Domestic	2,065	2,491
• Bank Borrowing	1,869	2,417
• Non-Bank Borrowing	196	74
External*	1,339	1,246
Total**	3,404	3,737

* Valued at the exchange rate of Rs 160 per US\$

** Privatization proceeds are anticipated at Rs 253 billion thereby reducing the borrowing requirements.

Consequently, the level of public debt is expected to increase from Rs 39,859 billion in 2020-21 to Rs 43,596 billion, with a growth rate of 9 percent. The nominal GDP is projected to increase by over 13 percent. This implies that the public debt to GDP ratio could fall from 83.5 percent to 79.9 percent.

However, this is based on the following very optimistic assumptions.

- (i) The budget deficit is significantly understated for the reasons (refer to table on the right)
- (ii) Privatization receipts may be shorter by Rs 150 billion. Therefore, the total borrowing could be as high as Rs 4637 billion, with bulk of the increase in domestic borrowing. This will raise the public debt to GDP ratio to 81.5 percent of the GDP
- (iii) The exchange rate for 2021-22 has been assumed at Rs 160 per US \$. It has already fallen to Rs 168 per \$. The expectation is that it will fall to between Rs 175 and 185 per \$, depending upon the nature of developments described below.

• Shortfall in revenue from petroleum levy	500 bn
• Higher cost of debt servicing (for reasons given below)	250 bn
Total	750 bn

Total projected public external debt at the end of 2021-22, is \$102 billion as per the middle scenario described below. This will simply an external debt of Rs 18,360 billion, when valued at Rs 180 per \$. As such, **the total public debt will be Rs 47,116 billion, equivalent to 86.3 percent of the GDP, as compared to 83.5 percent of the GDP in 2020-21.** Already, in the first month of 2021-22 it has increased by 3 percent.

The other important implication arises from the projected level of domestic borrowing of Rs 3391 billion, almost entirely from the banking sector. This will represent an increase of as much as 81 percent over the level of bank borrowing last year.

The implications of this big jump in domestic bank borrowing are as follows:

- (i) **Substantial 'crowding-out' of the private sector from bank credit and pressure on interest rates.**
- (ii) **Faster increase in money supply, which will contribute to higher inflation.**
- (iii) **The third implication could be increase in the cost of debt servicing of over Rs 250 billion as indicated above.**

The expectations of the government are of the quantum of external borrowing from the following sources:

	Borrowing (\$ million)
Projected Aid	1,922
Program Assistance and Budgetary Supply	7,623
• Program Assistance	4,523
• Budgetary Support from IMF	3,100
Bonds	3,500
Short-Term Credits	1,000
Allocation of SDRs*	2,800
Total	16,845
Less	
Debt Repayment	9,381
Net External Borrowing	7,464

*Since March 2010 onwards, allocation of SDRs to be recorded as foreign liability as per BPM 6

Three scenarios are developed of the balance of payments in 2021-22 in Table 4.

The scenarios vary according to the following:

- The current account deficit could be in the range of \$10 to \$13 billion in 2021-22.
- Net inflow of external borrowing could vary from the expected level of \$7.5 billion if the IMF program continues, including \$3.1 billion of budgetary support received from the Fund, to a low of \$3.7 billion if the IMF program does not continue after the sixth review due shortly. This will also lead to decline in support from the World Bank and the Asian Development Bank. The government then goes for more high-cost commercial loans and flotation of Sukuk/Euro Bonds.

Table 4: The Scenarios for the Balance of Payments, Reserves and Level of External Debt

(\$ Billion)	POSITIVE	MIDDLE	NEGATIVE
Current Account Deficit	-10.0*	-11.5*	-13.0*
Financial Account Surplus	10.4	9.7	5.7
• Net Inflow of Public Borrowing	7.5	6.8	3.7
• Foreign Direct Investment	1.2	1.2	1.0
• Others	1.7	1.7	1.0
Others	0.3	0.3	0.2
Balance of Payments	0.7	-1.5	-7.1
IMF Debt Repayment	-1.1	-1.1	-1.1
Change in FE Reserves	-0.4	-2.6	-8.2
Level of Reserves – (end June 2022)	17.0	14.8	9.2
Import Cover – (months)	2.6	2.2	1.3

*These are significantly higher than the earlier report on Outlook for 2021-22 because of the big unanticipated upsurge in imports in July and August 2021

The implications of each scenario in 2021-22 are as follows:

- The Positive Scenario:** The financial account surplus is over \$10 billion due to the continuation of the IMF Program and positive sentiments about the economy of Pakistan. Also, global prices of commodities stabilize after the recent peaks. Home remittances continue to show positive growth.
- The Negative Scenario:** The current account deficit rises to \$13 billion due to continuing upsurge in import prices throughout 2021-22. Home remittances show little growth or even fall somewhat after resumption of air travel. With the IMF program coming to an end the inflow into the financial account falls by about \$5 billion. There are greater pressures on the exchange rate which could fall by over 10 percent from the present already low level by the end of 2021-22.
- The Middle Scenario:** This is a scenario intermediate between the positive and negative scenarios respectively. The level of reserves in all three scenarios is not high enough to provide at least three months import cover. This is due to the quantum jump in the current account deficit and big increase in external debt payment in 2021-22 compared to last year. Even in the positive scenario, the import cover is at 2.6 months. In the negative scenario, reserves fall to a single-digit level of \$9.2 billion,



equivalent to import cover of only 1.3 months. This could usher in a period of instability. The projected level of total external debt ranges from \$131.4 billion in the positive scenario to \$126.9 billion in the negative scenario. The external debt to GDP ratio is likely to be close to 43 percent of the GDP at the end of 2021-22, showing some increase from 41 percent of the GDP in 2020-21.

Summary of Implications

- The total increase in the Government domestic debt is expected to be Rs 3391 billion, due to a higher budget deficit than the level reported in the Budget Estimates. This will imply an increase of 64 percent over the previous year's level of domestic borrowing, which will lead to some 'crowding out' of the private sector from bank credit, faster expansion in money supply and greater pressure on inflation.
- The total public debt and liabilities is expected to increase from 83.5 percent of the GDP in 2020-21 to 86.3 percent of the GDP in 2021-22.
- Despite record level of foreign exchange reserves at over \$20 billion currently, the quantum jump in the current account deficit and the increase in external debt repayment will increase the pressure on the external balance of payments of Pakistan in 2021-22. In the three scenarios developed, the reserves at the end of 2020-21 are likely to range from \$17 billion in the positive scenario to only \$9.2 billion in the negative scenario, when the IMF program does not continue beyond September 2021.
- Total external debt and liabilities are likely to be in the range of \$126.9 billion to \$131.4 billion. The latter magnitude will be 43.4 percent of the projected GDP, as compared to 41.3 percent in 2020-21.

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Under Weight	< Weight in KSE 100 Index

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Rating	Expected Total Return
Buy	$R \geq 15\%$
Neutral	$0\% \geq R < 15\%$
Sell	$R < 0\%$

Where;

$R = \text{Expected Dividend Yield} + \text{Expected Capital Gain}$

R' is before tax

Investment horizon is between six months to twelve months

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