

Medium Term Debt Management Strategy (FY20-FY23)



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(Naveed Kamran Baloch)
Finance Secretary

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Medium Term Debt Management Strategy (2019/20 - 2022/23)

1.0 INTRODUCTION

- 1.1 The Medium-Term Debt Management Strategy (MTDS) reflects the optimum combination of borrowing from various sources keeping in view the tradeoff between cost and risk. Within the medium-term fiscal framework, that aims at ensuring debt sustainability, the focus of debt management strategy is towards composition and risk exposure of the public debt. Borrowing is undertaken with an aim of ensuring low cost in the medium term, while taking risk into account.
- 1.2 The MTDS will be periodically reviewed and updated along with the Medium-term Fiscal Framework (MTFF) and Medium-term Budgetary Framework (MTBF).
- 1.3 An annual report will be published which will provide information on strategy implementation.

2.0 OBJECTIVES

Cost of Debt:	Cost of debt should be competitive and reasonable.
Availability of Financing:	Government should be able to borrow in a timely manner to cover its financing needs and payment obligations.
Domestic Debt Capital Market:	Development of domestic debt capital market remains a priority for the government.

3.0 ASSUMPTIONS UNDERLYING THE DEBT STRATEGY

- 3.1 Adherence to Medium-Term Fiscal Framework (MTFF) is paramount for effective implementation of MTDS. Specifically, adherence to key macro-fiscal targets such as GDP growth, inflation and fiscal balances need to be complied to achieve the desired results with respect to public debt management over the medium-term.

4.0 INDICATIVE THRESHOLDS/BENCHMARKS

- 4.1 Clear and quantitative targets for debt management demonstrate the sustainability of public debt portfolio. Based on the strategic guidelines and analysis of alternative strategies, following are the indicative ranges for the key risk indicators that reflect the desired composition of public debt portfolio:

Table-1: Indicative Benchmarks and Targets for Key Risk Indicators (FY 2019/20 - FY 2022/23)

Risk Exposure	Indicators	Indicative Benchmarks (FY20-FY23)	Targets			
			FY20	FY21	FY22	FY23
Currency Risk	Share of External Debt in Total Public Debt	40% (Maximum)				
Refinancing Risk	ATM of Domestic Debt (Years)	3.5 (Minimum)	4.0	4.0	4.0	4.0
	ATM of External Debt (Years)	6.5 (Minimum)	7.0	7.0	7.0	7.0
	Gross Financing Needs (% of Total)	35% (Maximum)	32	30	27	25
Share of Shariah Compliant Instruments in Government Securities (%)		-	2.0	5.0	7.5	10
Share of Fixed Rate Debt in Government Securities (%)		25% (Minimum)	30	30	30	30

Note: Total Means Total Public Debt at the end of relevant period

5.0 LIMITATIONS OF DEBT MANAGEMENT STRATEGY

- Level of public debt is primarily determined by the size of fiscal deficits;
- Debt repayment capacity of the government is determined mainly by the size of the economy which in turn is driven by underlying GDP growth rate;
- MTDS focuses mainly on mix of borrowings that make up the debt portfolio.

6.0 SCOPE

- 6.1 The scope for coverage of public debt portfolio includes the debt contracted by the federal government. It also includes debt extended to provinces and SOEs under on-lending arrangement by the federal government. The analysis also includes the portion of IMF debt which was utilized towards budgetary support. However, the balance of payment portion of IMF debt is not included in the analysis since it is not a financing source for the government budget.
- 6.2 Time horizon of MTDS is 2019/20 - 2022/23. The starting point for the analysis is the debt portfolio at end June 2019.

7.0 STRATEGIC GUIDELINES

- **Lengthening of Maturity Profile:** Lengthening of maturity profile of domestic debt by mobilizing financing from medium and longer tenor instruments will remain priority over the medium-term.
- **Smooth Redemption Profile:** Government aims to have a smooth redemption profile of its debt portfolio, whereby more or less constant proportion of the debt is redeemed each year to reduce the risk of refinancing the debt at a time when market conditions are unfavourable.
- **Transparency in Borrowing Operations:** Transparency in domestic securities issuance process will be enhanced by providing clear information on borrowing programme to investors and having continuous investor interaction and appropriate consultation.
- **Diversification of instruments and Investor Base:** Government priority is to borrow through multiple instruments to lower its borrowing costs and manage the fiscal risks arising out of the borrowing operations. Lenders/investors, on the other hand, will have more options to choose investments which are closer to their investment horizons, income preferences and risk appetite. It will also help in expanding and diversifying the investor base of government securities, deepening of capital markets and promotion of a saving culture in the country.
- **More Issuance of Shariah Compliant Instruments:** In order to support the budgetary position and promote Islamic banking industry in the country, government intends to issue Sukuks in the domestic capital market on regular basis over the medium-term. Sukuks are expected to be issued at competitive pricing due to its asset backed structure while attracting diversified investor base, in particular financiers preferring Shariah-compliant investments.

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- **Concessional External Financing:** Government will continue to avail maximum available concessional external financing from bilateral and multilateral development partners to benefit from favorable terms and conditions.
- **Presence in International Capital Markets:** Government will also diversify its sources of external borrowing, by accessing international capital markets by way of issuing Eurobonds, Pakistan International Sukuk, Panda Bonds etc.
- **Facilitate investment by non-residents in Government Securities:** Government strategy is to encourage foreign portfolio investments. This will enhance the liquidity and competition in domestic capital markets which in turn is expected to lower borrowing cost of the government, decrease government's reliance on domestic resources and reduce the crowding-out effect.
- **Liquidity Buffer:** In the wake of government's commitment to zero borrowing from State Bank of Pakistan (SBP), the MTDS makes provision of a revolving cash buffer to cater for liquidity and liability management.

8.0 PROGRESS ON MTDS (2015/16-2018/19)

8.1 In accordance with MTDS (2015/16-2018/19), the government was required to lengthen the maturity profile of its domestic debt portfolio while certain indicative ranges were defined to monitor the risks of total public debt portfolio.

Table-2: Public Debt Risk Indicators*

Risk Indicators		Indicative Ranges (MTDS 2015/16 - 2018/19)	Domestic Debt	External Debt	Public Debt
			End-June 2019		
Refinancing Risk	Average Time to Maturity (ATM) - Years	1.5 (minimum) and 2.5 - DD 3.0 (minimum) and 4.5 - PD	4.2	7.0	5.2
	Debt Maturing in 1 Year (% of total)	50% and 65% (maximum) - DD 35% and 50% (maximum) - PD	36.8	17.2	29.9
Interest Rate Risk	Average Time to Re-Fixing (ATR) - Years	1.5 (minimum) and 2.5 - DD 3.0 (minimum) and 4.5 - PD	1.7	6.1	3.2
	Debt Re-Fixing in 1 year (% of total)	50% and 65% (maximum) - DD 40% and 55% (maximum) - PD	64.9	36.1	54.9
	Fixed Rate Debt (% of total)	**	71.9	68.3	70.6
Foreign Currency Risk (FX)	Foreign Currency Debt (% of total debt)	20% (minimum) and 35%			34.8
	Short Term FX Debt (% of reserves)	**			158.7
Government Guarantees	Guarantees Stock Outstanding (Rs in billion)				1,917

* As per modalities of MTDS (2015/16 - 2018/19)

**Not Applicable

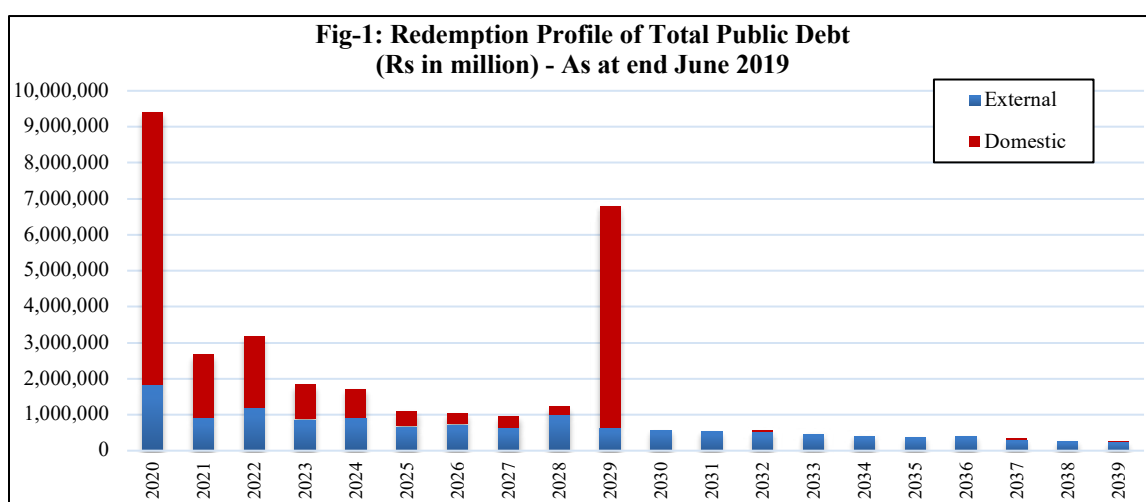
PD: Public Debt, DD: Domestic Debt

Source: Debt Policy Coordination Office, Ministry of Finance

8.2 As evident from the table above, the government was not in breach of any risk indicator thresholds at end June 2019. One of the notable developments from debt management perspective in FY 2018-19 was the re-profiling of domestic debt, where government re-profiled the existing stock of SBP borrowing from short term (6 months) to medium to long term (1 to 10 years). The re-profiling took into effect in the month of June 2019 and helped the government in reducing the rollover/refinancing risk of its domestic debt portfolio.

Refinancing Risk

8.3 The re-profiling of SBP borrowing helped the government in reducing the refinancing risk of its domestic debt portfolio at end June 2019 as domestic debt maturing in one year reduced to 37 percent compared with 66 percent at end of previous fiscal year. Accordingly, average time to maturity of domestic debt portfolio significantly increased to 4.2 years at end June 2019 compared with 1.6 years at end June 2018, which is very close to long-term target set by the government for its domestic debt portfolio. External debt's average time to maturity is already 7 years and government intends to maintain or slightly improve it over medium to long term. The redemption profile of domestic and external debt at end June 2019 is shown in the graph below:



Interest Rate Risk

8.4 It is important to note that 70 percent of the re-profiling of SBP borrowing was carried out through floating-rate Pakistan Investment Bonds (PIBs). Therefore, the government remained very close to maximum limit set for debt re-fixing / interest rate risk. Exposure to interest rate risk slightly reduced as percentage of debt re-fixing in one year decreased to around 55 percent at end June 2019 compared with 56 percent at end June 2018. Going forward, government preference is to borrow more through fixed rate instruments to reduce interest rate risk of its public debt portfolio.

Foreign Currency Risk

8.5 Short-term external public debt maturities as percentage of official liquid reserves stood at 159 percent at end June 2019 compared with 81 percent at end June 2018. The higher proportion of external public maturities falling within a year compared with the level of official liquid reserves resulted in an increase in this ratio.

8.6 Around 35 percent of total public debt stock was denominated in foreign currencies at end June 2019, exposing public debt portfolio to exchange rate risk. Currency wise composition of public debt portfolio at end June 2019 is depicted through the table below:

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Table-3: Currency Wise Total Public Debt

Currencies	Percentage
Pak Rupee	65.2
US Dollar	20.0
Special Drawing Right	8.9
Japanese Yen	3.9
Euro	1.9
Total	100.0

Source: Debt Policy Coordination Office, Ministry of Finance

9.0 OVERVIEW OF PUBLIC DEBT PORTFOLIO

9.1 Fiscal Responsibility and Debt Limitation Act 2005 defines “Total Public Debt” as debt owed by government (including Federal Government and Provincial Governments) serviced out of consolidated fund and debts owed to the International Monetary Fund. Whereas, “Total Debt and Liabilities” of the country include “Total Public Debt” (Government Debt) as well as debt of other sectors as presented in the table below:

Table-4: Pakistan's Debt and Liabilities Summary

(Rs in billion)	FY13	FY14	FY15	FY16	FY17	FY18	FY19	DEC19
I. Government Domestic Debt	9,520	10,907	12,193	13,626	14,849	16,416	20,732	21,676
II. Government External Debt	4,336	4,786	4,770	5,418	5,919	7,796	11,055	10,993
III. Debt from IMF	435	298	418	633	641	741	921	1,042
IV. External Liabilities ¹	308	324	378	377	374	622	1,710	1,539
V. Private Sector External Debt	466	500	539	709	1,183	1,654	2,465	2,393
VI. PSEs External Debt	183	204	253	294	285	325	654	638
VII. PSEs Domestic Debt	312	366	459	568	823	1,068	1,394	1,392
VIII. Commodity Operations ²	470	492	564	637	687	820	756	728
IX. Intercompany External Debt from Direct Investor abroad	308	336	277	316	354	437	535	593
A. Total Debt and Liabilities (sum I to IX)	16,338	18,214	19,849	22,577	25,114	29,879	40,223	40,994
B. Total Public Debt (sum I to III)	14,292	15,991	17,380	19,677	21,409	24,953	32,708	33,712
C. Total Debt of the Government³	13,457	14,624	15,986	17,823	19,635	23,024	29,521	29,969
(As percent of GDP)								
Total Debt and Liabilities	73.0	72.4	72.3	77.6	78.7	86.3	105.9	98.1
Total Public Debt	63.8	63.5	63.3	67.7	67.1	72.1	86.1	80.8
Total Debt of the Government	60.1	58.1	58.3	61.3	61.5	66.5	77.7	71.8
Memorandum Items								
GDP (current market price)	22,386	25,169	27,443	29,076	31,922	34,616	37,972	41,727
Government Deposits ⁴	834	1,367	1,394	1,853	1,773	1,929	3,187	3,742
US Dollar, last day average exchange rates	99.1	98.8	101.8	104.8	104.9	121.5	163.1	154.9

P: Provisional

1. External liabilities include Central Bank Deposits, SWAPS, Allocation of Special Drawing Rights (SDR) and Non-Resident LCY Deposits with Central Bank.

2. Includes borrowings from banks by provincial governments and PSEs for commodity operations.

3. As per Fiscal Responsibility and Debt Limitation Act, 2005 amended in June 2017, "Total Debt of the Government" means the debt of the government (including the Federal Government and the Provincial Governments) serviced out of the consolidated fund and debts owed to the IMF less accumulated deposits of the Federal and Provincial Governments with the banking system.

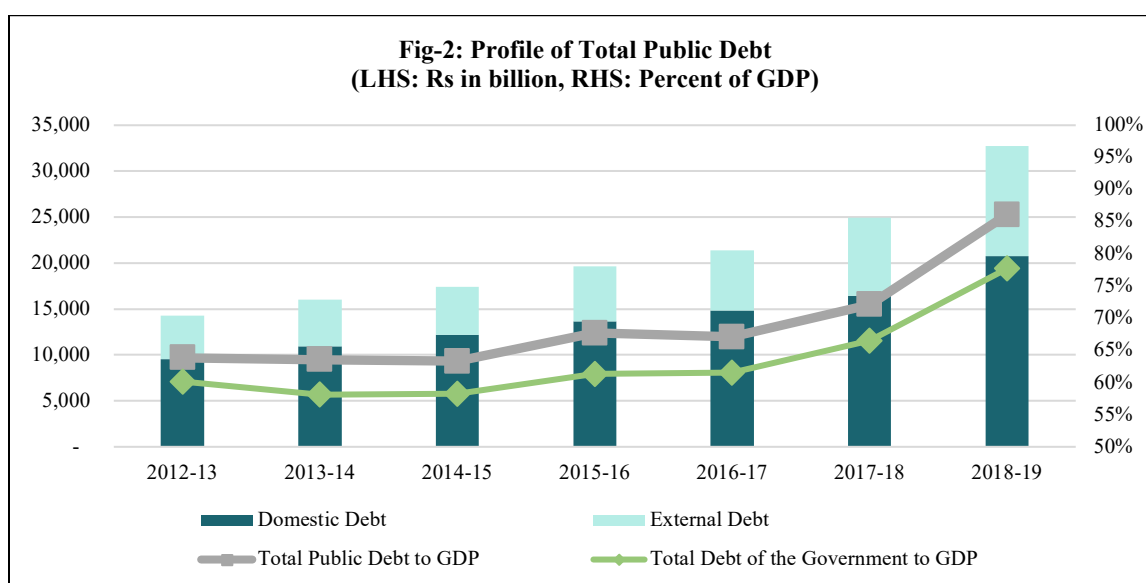
4. Accumulated deposits of the Federal and Provincial Governments with the banking system.

Source: State Bank of Pakistan

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9.2 Total public debt was recorded at Rs 32,708 billion at end June 2019. Total public debt was increased by Rs 7,755 billion during FY 2018-19, out of which:

- Rs 3,635 billion (47 percent) was borrowed for meeting the federal budget deficit;
- Rs 3,061 billion (39 percent) was due to currency depreciation;
- Rs 927 billion (12 percent) was offset by higher cash balances necessary for effective cash management as the government is committed to zero borrowing from SBP in future; and
- Rs 132 billion (2 percent) is difference between the face value (which is used for recording of debt) and the realized value (which is recorded as budgetary receipt) of PIBs issued during the year.



9.3 One of the notable developments from debt management perspective in FY 2018-19 was the re-profiling of domestic debt, where government re-profiled the existing stock of SBP borrowing from short term (6 months) to medium to long term (1 to 10 years). The re-profiling took into effect in the month of June 2019, which increased the share of long-term debt (permanent and unfunded) in total domestic debt from 46 percent at end June 2018 to 73 percent at end June 2019. This structural shift has reduced the refinancing risk for the government as average time to maturity of domestic debt portfolio increased from 1.6 years at end June 2018 to 4.2 years at end June 2019 which is very close to the long-term target set by the government for its domestic debt portfolio.

9.4 Development of debt capital market is essential to reduce financial risks of the overall economy, provide the government with a non-inflationary source of financing, create a well-balanced financial environment and promote economic growth. Government is taking various steps to provide an efficient and liquid secondary debt markets to the investors (Box-1).

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BOX-1 - STEPS TAKEN FOR THE DEVELOPMENT OF DEBT CAPITAL MARKET

- i. **Listing of Privately Placed Debt Securities:** To encourage and facilitate listing of Privately Placed Debt Securities (PPDS), PSX has been empowered to grant relaxation to companies for their listing.
- ii. **Cost of Doing Business:** To facilitate growth in debt market and reduce associated costs, Central Depository Company (CDC) tariff structure for debt market securities has been significantly reduced.
- iii. **Issuance of Notification under Section 66 of the Companies Act, 2017:** In order to enhance the investors base, facilitate debt issues and to provide additional investment avenues to corporates, mutual funds and employees' funds, SECP has notified the following persons as other persons to whom privately placed debt securities being instrument of redeemable capital can be issued:
 - Mutual Funds, Voluntary Pension Schemes and Private Funds being managed by NBFC;
 - Insurer registered under the Insurance Ordinance, 2000 (XXXIX of 2000);
 - a Securities Broker;
 - a Fund and Trust as defined in the Employees Contributory Funds (Investment in Listed Securities) Regulations, 2018; and
 - A Company and Body Corporate as defined in the Companies Act, 2017.
- iv. **Allowing sponsors of the issuer to invest in Privately Placed Debt Securities:** In order to develop the debt market and broaden the investor base, PSX permits sponsors of the issuer to invest in Privately Placed Debt Securities by making necessary amendments in Private Placement of Debt Securities Listing Regulations.

Future Plans with Regard to Development of Debt Capital Market:

- I. Introduce measures for inclusion of investors in primary market debt auction;
- II. In continuation of creating ease of doing business, revisiting debt listing requirements and simplifying regulatory framework/requirements for Government Debt Listing;
- III. Review of Market Makers existing regime to enhance effectiveness;
- IV. Study to look into factors attributable to inefficient use of debt market platform placed at PSX and suggesting reforms to make Bonds Automated trading System (BATS) a vibrant trading platform;
- V. Efforts to be made for launching Derivative products based on Government debt instruments (such as futures) at PSX.

Source: Securities and Exchange Commission of Pakistan

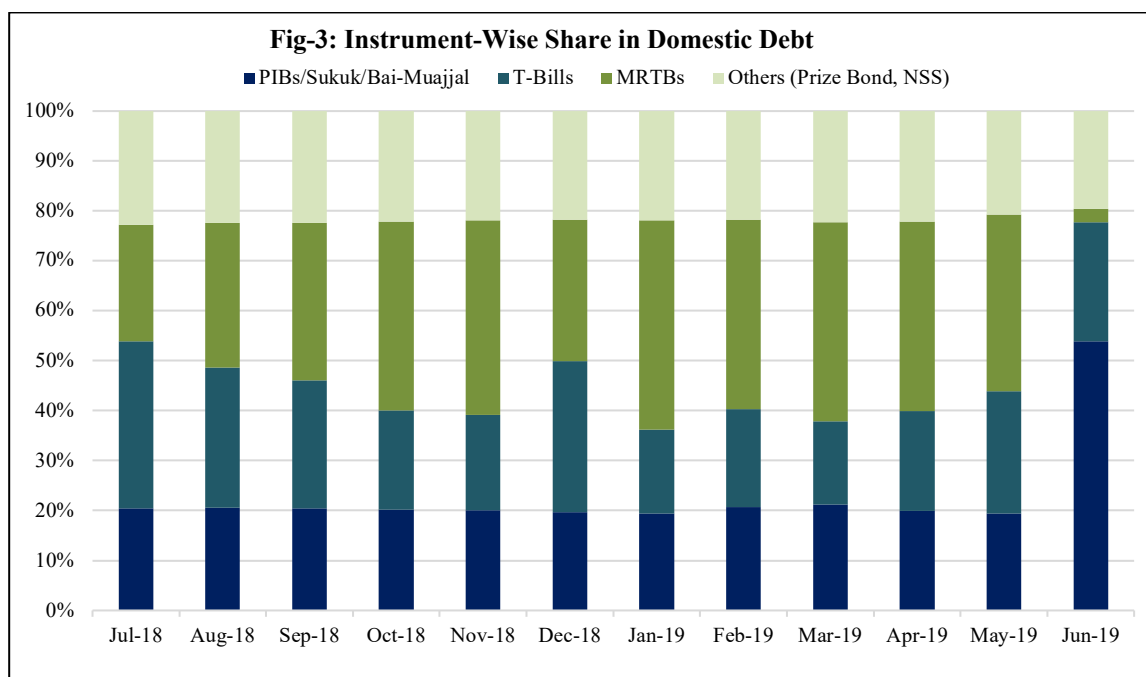
9.5 Total public debt reached Rs 33,712 billion at end December 2019, registering an increase of Rs 1,004 billion during first half of current fiscal year while Federal Government borrowing for financing of its fiscal deficit was Rs 1,343 billion during the said period. This differential is primarily attributable to exchange rate gains on account of strengthening of Pak Rupee against US Dollar i.e. external public debt recorded an increase of US\$ 4.3 billion during first half of FY 2019-20 while in Pak Rupee terms, it only increased by Rs 59 billion.

9 (i) Domestic Debt

9.6 Domestic debt was recorded at Rs 20,732 billion at end June 2019, registering an increase of Rs 4,315 billion during FY 2018-19. Apart from reliance on domestic sources for financing of fiscal deficit, build-up of cash buffers and difference between cash and realized value of PIBs contributed towards this increase. Within

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domestic debt, the government relied mainly on short-term borrowing from SBP through Market Related Treasury Bills (MRTBs) until May 2019 which helped the government to retire its maturing debt to the market. Nonetheless, the government re-profiled its existing stock of SBP borrowing from short term (6 months) to medium to long term (1 to 10 years) in June 2019. As a result of this re-profiling, the refinancing risk of the government greatly reduced as domestic debt maturing within a year reduced to 37 percent at end June 2019 compared with 66 percent at end June 2018. The month-wise and instrument-wise composition of domestic debt during FY 2018-19 is depicted through following graph:



9.7 Domestic debt reached Rs 21,676 billion at end December 2019. Domestic borrowing operations remained quite successful during July - December 2019 despite a challenging macroeconomic situation as highlighted below:

- All of the net domestic debt raised during this period was through long-term government securities and National Saving Schemes (NSS).
- The cost of borrowing through long-term government bonds declined by 2 to 3 percent per annum. In fact, the government was able to borrow in long tenors at rates well below the policy rate of SBP.
- The market's willingness to lend to the government for long tenors at rates below the policy rate reflects the general confidence in macroeconomic policies of the government and the expectations of a significant decline in inflation and short-term interest rates in the near future.
- Interest expense remained significantly less than the budgeted amount during this period. Against budget estimate of Rs 1,400 billion, actual interest expense was recorded at Rs 1,281 billion. This was achieved partly due to reprofiling of short-

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term debt into long-term debt and partly due to sharp decline in cost of borrowing in longer tenors.

- In-line with the government's commitment, no new borrowing was made from SBP during this period. In fact, there was a net retirement of Rs 285 billion in the outstanding debt obtained from SBP in previous years.
- These trends are expected to continue and the domestic debt profile is projected to improve considerably by the end of the current financial year. The proportion of debt held by SBP is projected to decline and the proportion of debt raised through long-term instruments is projected to increase. Interest expense for the full year is projected to be significantly lower than the budgeted amount.

Table-5: Outstanding Domestic Debt - (Rs in billion)

	FY13	FY14	FY15	FY16	FY17	FY18	FY19	DEC 19
Permanent Debt	2,179.0	4,003.6	5,012.8	5,940.6	5,533.1	4,659.2	12,087.0	13,168.7
Market Loans	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Government Bonds*	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Prize Bonds**	389.6	446.6	522.5	646.4	747.1	851.0	893.9	736.1
Foreign Exchange Bearer Certificates	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Bearer National Fund Bonds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Federal Investment Bonds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign Currency Bearer Certificates	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1
U.S. Dollar Bearer Certificates	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Special U.S. Dollar Bonds	4.3	4.2	4.4	4.5	4.5	5.1	6.7	6.4
Pakistan Investment Bonds (PIBs)***	1,321.6	3,222.0	4,155.2	4,921.4	4,391.8	3,413.3	10,933.2	12,173.0
GOP Ijara Sukuk	459.2	326.4	326.4	363.9	385.4	385.4	71.0	71.0
Bai-Muajjal of Sukuk		-					177.8	177.8
Floating Debt	5,194.9	4,599.1	4,609.4	5,001.7	6,550.9	8,889.0	5,500.6	5,099.2
Market Treasury Bills***	2,919.7	1,746.8	2,148.9	2,771.4	4,082.0	5,294.8	4,929.6	4,814.1
MTBs for Replenishment	2,275.2	2,852.3	2,460.5	2,017.6	2,468.9	3,594.2	571.0	285.2
Bai Muajjal	0.0	0.0	0.0	212.6	0.0	0.0	0.0	0.0
Unfunded Debt	2,146.5	2,303.8	2,570.3	2,683.7	2,765.3	2,868.1	3,144.1	3,408.5
Defense Saving Certificates	271.7	284.6	300.8	308.9	325.5	336.2	393.6	483.0
National Deposit Certificates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Khass Deposit Certificates	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Special Savings Certificates (Registered)	388.2	445.8	474.3	472.4	433.1	381.9	413.7	403.3
Special Savings Certificates (Bearer)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Regular Income Certificates	262.6	325.4	376.0	359.8	338.8	347.5	489.6	559.5
Premium Saving Certificates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Behbood Savings Certificates	528.4	582.4	628.3	692.1	749.5	794.9	914.5	978.1
Short Term Savings Certificates	4.0	1.3	1.7	1.9	3.7	4.3	5.1	5.7
Khass Deposit Accounts	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Savings Accounts	22.3	22.6	26.4	30.2	34.9	38.3	38.2	38.1
Special Savings Accounts	346.2	292.7	392.9	423.8	489.0	549.0	416.6	448.8
Mahana Amdani Accounts	2.0	1.9	1.8	1.8	1.7	1.7	1.6	1.8
Pensioners' Benefit Account	179.9	198.4	214.1	234.7	253.4	274.9	318.3	338.2
Shuhadas Family Welfare Account	-	-	-	-	-	-	0.0	4.3
National Savings Bonds	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Postal Life Insurance Schemes	67.1	67.1	67.1	67.1	45.8	46.7	47.9	47.7
GP Fund	73.1	80.5	85.8	90.0	88.8	91.7	104.3	99.0
Total Domestic Debt	9,520.4	10,906.5	12,192.5	13,625.9	14,849.2	16,416.3	20,731.8	21,676.4

P: Provisional

*Special Government Bond for SLIC have been added into Government Bonds.

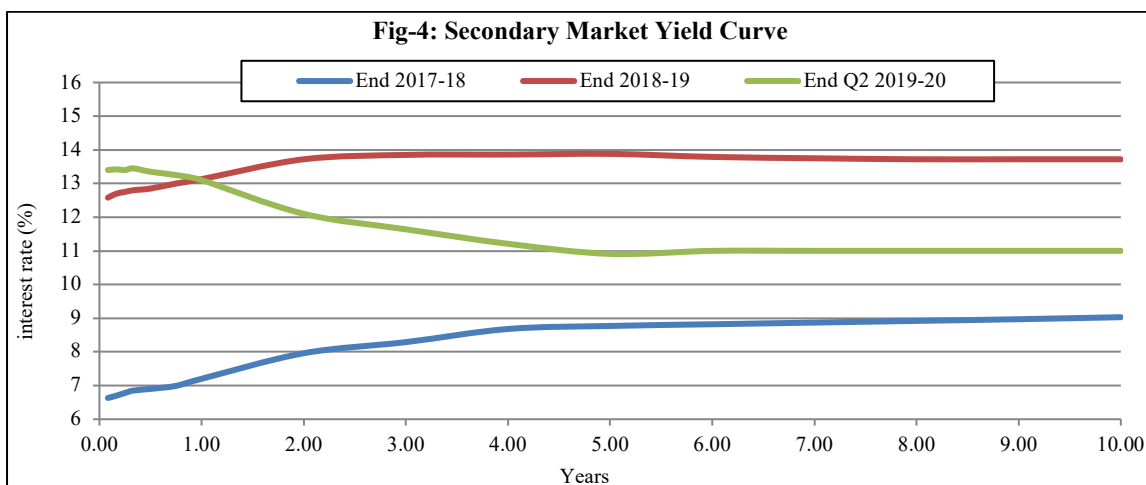
**Includes Premium Prize Bonds (Registered).

***Govt. Securities held by non-residents deducted from PIB's and T-bills.

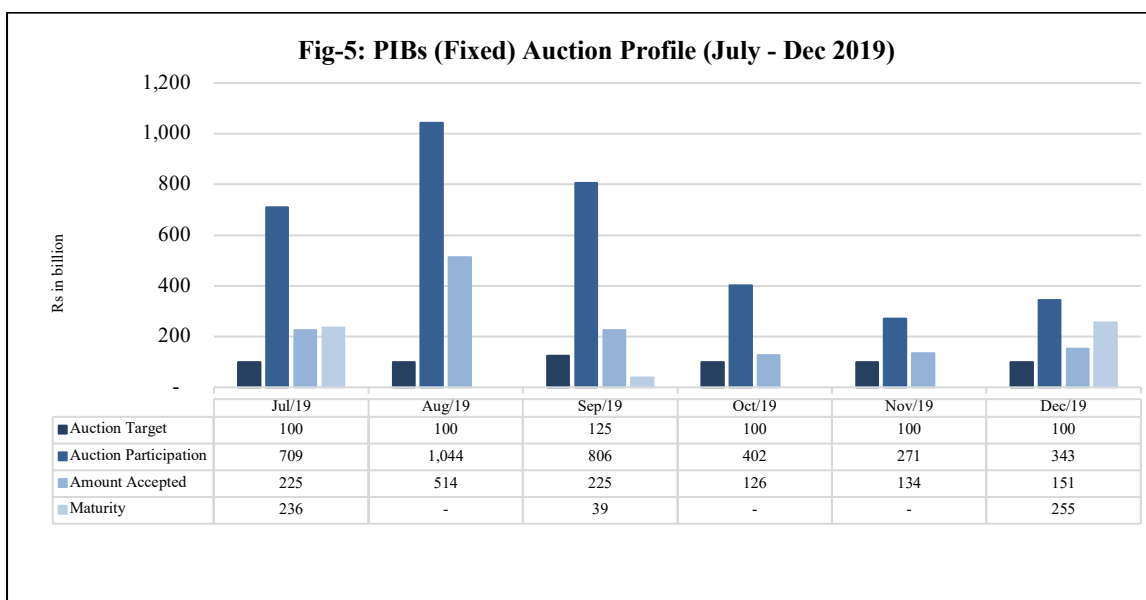
Source: State Bank of Pakistan

Auction Profile of Government Securities

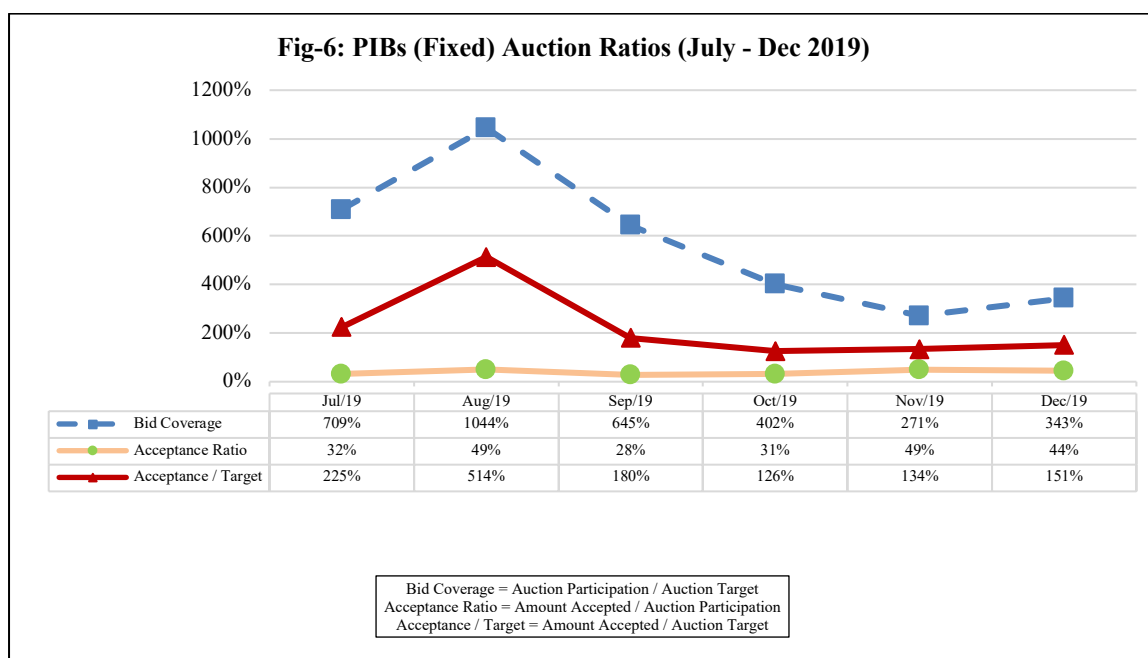
9.8 Market appetite for government securities remained strong throughout first half of FY 2019-20. In case of fixed rate PIBs, banks' offers widely surpassed the targets set by the government i.e. healthy participation amounting to Rs 3,576 billion was observed against the target of Rs 625 billion and maturity of Rs 531 billion. Out of this, the government strategically accepted Rs 1,375 billion keeping in view cost risks trade-off. Apart from expectations that interest rates had peaked up at the start of the year, overall improvement in fiscal position and estimates of higher external financing availability fueled the demand for medium to long tenor government bonds. Due to such a high demand, the government leveraged its position by slashing the cut-off rates by 250 bps, 260 bps and 255 bps for 3 years, 5 years and 10 years PIBs, respectively, during first half of FY 2019-20. In the secondary market also, the yield curve turned inverted at end December, 2019 as the demand-supply gap of long-term bonds edged up.



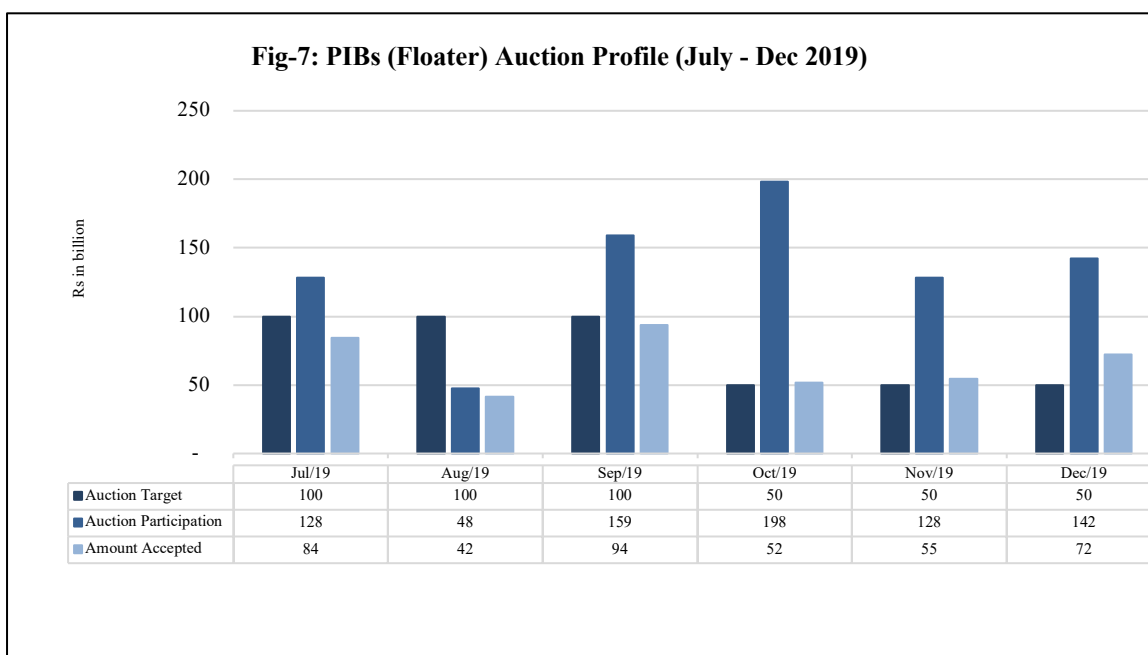
The following graphs depict the auction profile of fixed rate PIBs:



Medium Term Debt Management Strategy (2019/20 - 2022/23)

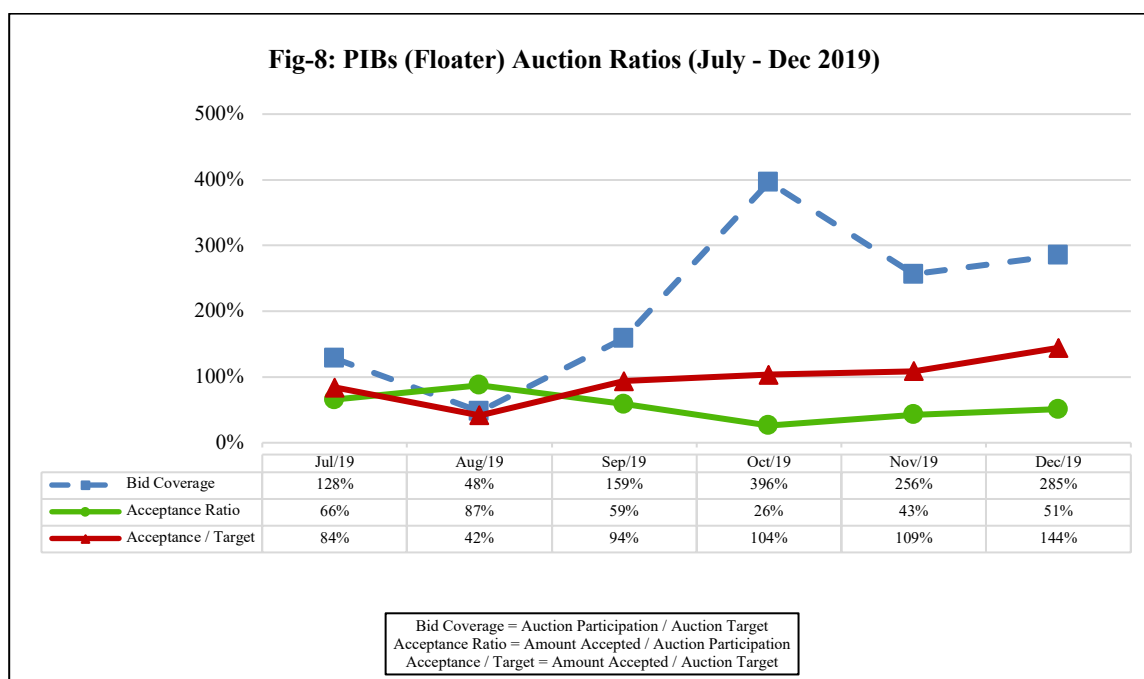


9.9 In case of floating rate PIBs, government introduced re-opening¹ of existing issue in September 2019 with the objective to increase size, potential liquidity and reduce fragmentation. Total participation of Rs 803 billion was witnessed in the auction of floating rate PIBs against the target of Rs 450 billion while government accepted Rs 398 billion during first half of FY 2019-20. In addition to existing 10 years' tenor, government is targeting to introduce tenors of 2 years and 5 years with quarterly coupon payment frequency to attract more diversified investor base. Following graphs depict the auction profile of floating rate PIBs:

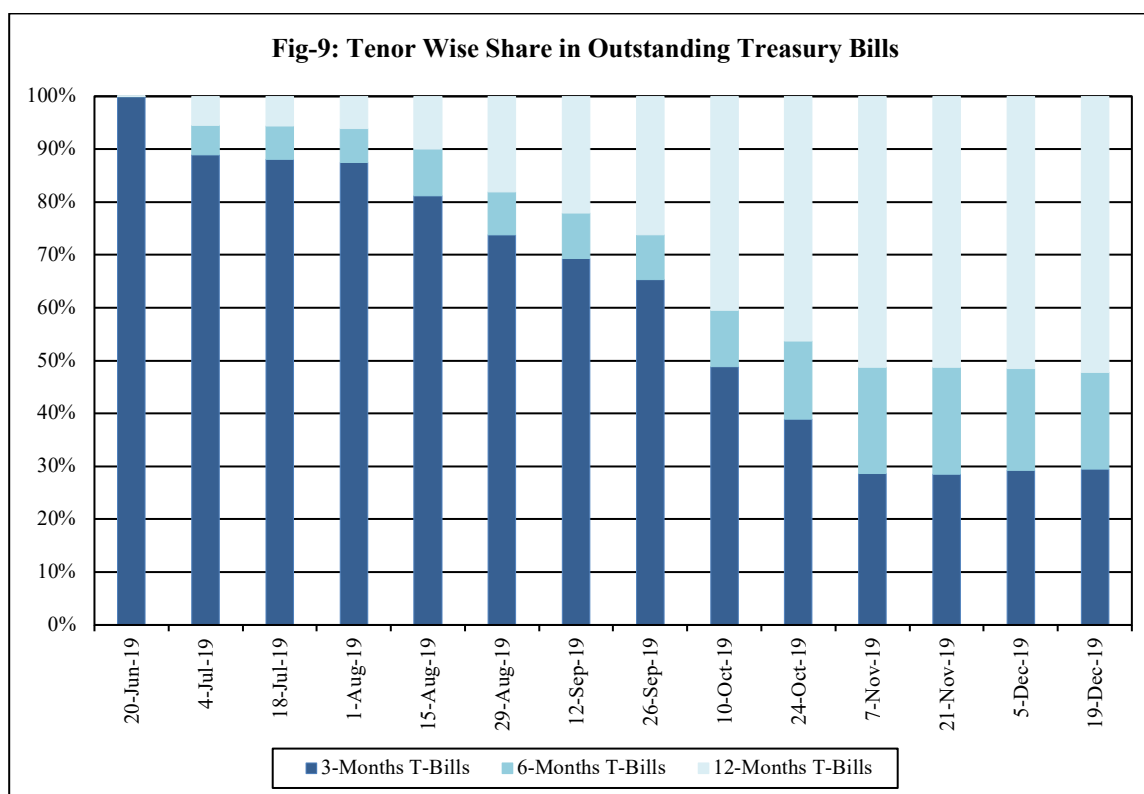


¹ SBP DMMD Circular No 22 of 2019 (<http://www.sbp.org.pk/dmmd/2019/C22.htm>)

Medium Term Debt Management Strategy (2019/20 - 2022/23)

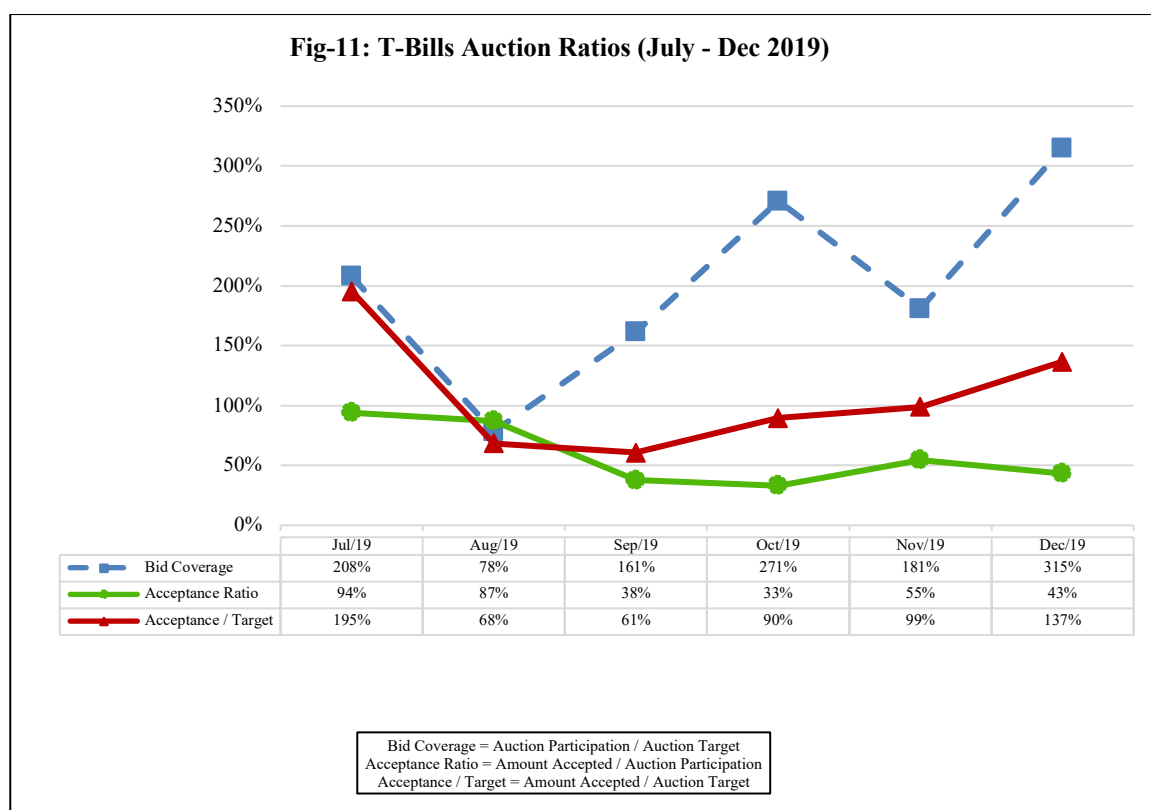
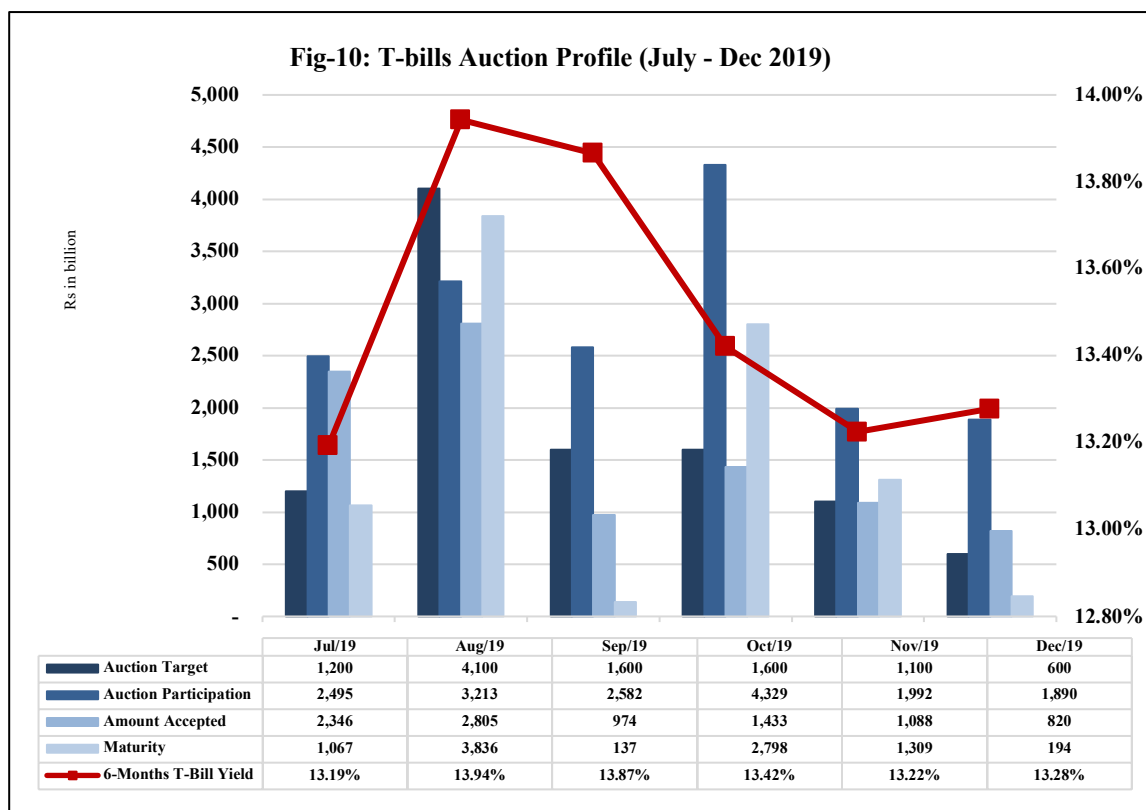


9.10 Until the first auction of August 2019, market bid mostly for the 3 months Treasury Bill (T-bills). However, this behavior changed in all the subsequent auctions, and they started bidding heavily in the 12 months paper. Resultantly, share of 3-months T-bills in total T-bills portfolio reduced to around 29 percent at end December 2019 compared with around 100 percent at end June 2019 as depicted in the graph below:



Medium Term Debt Management Strategy (2019/20 - 2022/23)

The following graphs depict the auction profile of T-bills:



Medium Term Debt Management Strategy (2019/20 - 2022/23)

9(ii) Secondary Market Activities of Government Securities

9.11 During FY 2018-19, the secondary market trading volumes witnessed a moderate increase. Outright trading volume in the government securities during the year amounted to Rs 29,109 billion, against Rs 27,557 billion recorded during FY 2017-18. Average daily trading volume and turnover ratio also grew accordingly. Daily average volumes increased to Rs 118 billion per day from Rs 112 billion per day in FY 2017-18, and the turnover ratio improved to 3.33 times from 3.00 times in FY 2017-18.

Table-6: Secondary Market Outright Trading Volume

(Rs in billion)				
Security	FY18	FY19	H1-FY19	H1-FY20
Treasury Bill - 3 Months	20,118	23,330	10,844	9,318
Treasury Bill - 6 Months	3,147	41	24	1,252
Treasury Bill - 12 Months	258	33	7	2,645
Sub Total	23,523	23,404	10,876	13,215
Pakistan Investment Bonds - 3 Years	1,062	1,596	628	1,529
Pakistan Investment Bonds - 5 Years	1,031	889	411	605
Pakistan Investment Bonds - 10 Years	928	1,017	462	630
Pakistan Investment Bonds - 15 Years	10	0.6	0.6	0.1
Pakistan Investment Bonds - 20 Years	11	0.9	0.8	8
Sub Total	3,042	3,503	1,502	2,771
Government Ijara Sukuk	992	2,202	947	1,873
Grand Total	27,557	29,109	13,325	17,860
Daily Average volume	111.6	117.8	104.1	139.5
End Period Stock	9,175	8,749	8,689	10,120
Turnover Ratio (times)	3.00	3.33	3.06	3.52

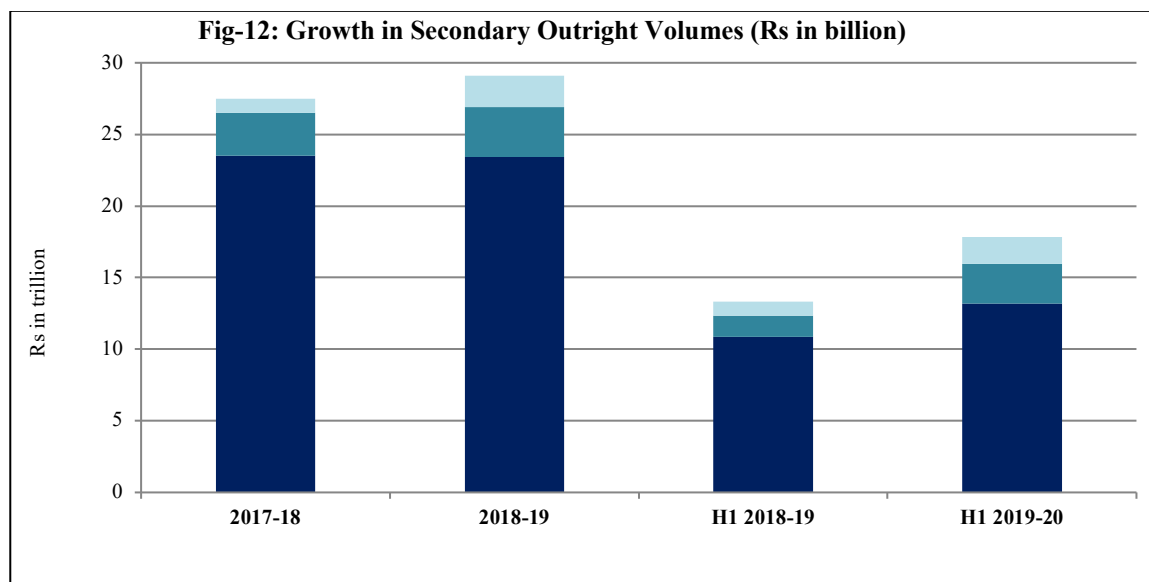
Source: State Bank of Pakistan

9.12 The increase in secondary market trading volumes is mainly attributed to higher turnover associated with issuance of short-term T-bills (3 months) during the year. With conventional banks limiting their interest-rate risk in an increasing interest scenario, participation in longer-tenure T-bills almost disappeared. Hence, secondary market trading volumes in 6M and 12M dried-up.

9.13 A security-wise break up of trading volumes indicate that the T-bills trading constitutes around 80 percent (Rs 23 trillion) of the overall secondary market trading, with almost all of the T-bills trading concentrated in 3-months. Supported by successful PIBs auctions since December 2018, PIBs trading volumes registered strong growth. Secondary market trading in PIBs increase to Rs 3,503 billion in FY 2018-19 compared to Rs 3,042 billion in FY18, registering a 15 percent growth over the previous fiscal year. Data indicates that the banks were net sellers of PIBs to the non-banks, which accounted for 46 percent of the PIBs trading volume. Demand and issuance of floating-rate PIBs remained robust, however, their trading on the market was limited as banks preferred to buy and hold the securities. Trading volumes in GIS more than doubled during the fiscal year. Despite limited outstanding stock of Rs 268 billion at the year start and Rs 197 billion worth of issues maturing during the year, GIS trading volume increased owing to Bai-Muajjal transactions. During the

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year, GIS outright trading volumes increased to Rs 2,202 billion from Rs 992 billion recorded previously.



- 9.14 During first half of FY 2019-20, secondary market trading patterns remain largely unchanged except for 6-months and 12-months T-bills and 3 years PIBs. As the market expectation that the interest rates have peaked got strengthened, Banks' participation in 6-months and 12-months T-bills recovered. Accordingly, trading in these securities registered a strong growth. During first half of FY 2019-20, Rs 18 trillion worth of the debt securities were traded. However, 3-months T-bill trading continued to have unevenly large contribution towards the total T-bills trading volumes, contributing Rs 9.3 trillion (52 percent) to the total trading. Higher PIBs issuances did not translate into higher secondary volumes, except for 3 years PIBs. Trading in 3 years PIBs increased by 240 percent to Rs 1.5 trillion in first half of FY 2019-20 compared to the similar period last year. Further, GIS trading volumes continue to remain high i.e. trading volumes almost doubled to Rs 1.9 trillion compared to same period last year. The increase is owing to Islamic institution's reliance on a single issue of GIS for their Bai-Muajjal transactions.

Repo Market:

- 9.15 The repo transaction volumes continued to depict robust growth in FY 2018-19 as well; as yearly volumes increased by 37 percent to Rs 35,879 billion from Rs 26,235 billion during FY 2017-18. Much of the repo market volumes are used for day-to-day liquidity management with 74 percent of the market volume concentrated in overnight tenor. The high volumes and increased liquidity in the repo market mean that financial institutions can efficiently meet their short-term liquidity needs from the money market.
- 9.16 During first half of FY 2019-20, repo activities clocked at Rs 18 trillion, a decline of 0.2 percent compared to that of first half of FY 2018-19. However, the outright trading registered at Rs 18 trillion during the period, showing an increase of 34

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percent compared to the same period last year. Accordingly, the market share of outright trading improved by 8 percent to 50 percent.

Table-7: Government Security Based Transactions

Type	Volume (Rs in billion)				Market Share (Percentage)			
	FY18	FY19	H1-FY19	H1-FY20	FY18	FY19	H1-FY19	H1-FY20
Repo	26,235	35,879	18,477	18,075	49	55	58	50
Outright	27,557	29,109	13,325	17,859	51	45	42	50
Total	53,792	64,988	31,802	35,935	100	100	100	100

Source: State Bank of Pakistan

9(iii) External Debt and Liabilities

9.17 Pakistan's External Debt and Liabilities (EDL) represent debt and liabilities of public as well as the private sector. The part of EDL which falls under government domain is debt which is serviced out of consolidated fund and owed to the International Monetary Fund. While the remaining includes liabilities of central bank, debt of public sector entities, private sector and banks.

9.18 EDL was recorded at US\$ 106.3 billion by end June 2019, registering an increase of US\$ 11.1 billion compared to an increase of US\$ 11.8 billion recorded a year earlier. The bifurcation of this increase is as follow:

- One half of the increase in EDL was due to rise in SBP liabilities in the form of deposits placed by bilateral partners (Saudi Arabia, UAE, Qatar). It is important to note that these deposits only provide balance of payments support, adding to foreign currency reserves and do not come as an extra resource in the budget;
- External public debt increased by US\$ 3.2 billion during FY 2018-19 compared with an increase of US\$ 7.7 billion during FY 2017-18. Sizeable repayment (US\$ 7.4 billion) reduced the pace of external public debt accumulation during FY 2018-19;
- PSEs external debt increased by US\$ 1.3 billion mainly driven by development loans; and
- Private sector loans recorded an increase of US\$ 1.2 billion.

9.19 EDL reached US\$ 111 billion by end December 2019, registering an increase of US\$ 4.7 billion during first six months of FY 2019-20. The main components of this increase were:

- External public debt stock increased by US\$ 4.3 billion. This increase reveals the following:
 - Debt from multilateral and bilateral sources increased by US\$ 3 billion. These multilateral and bilateral loans are mostly contracted on concessional terms (low cost and longer tenor);
 - The stock of commercial loans/Eurobonds registered a decrease of US\$ 359 million, which was a positive development;
 - Non-resident investment in government securities was recorded at US\$ 1.6 billion. It is important to highlight that Government of Pakistan does not have any currency exposure on these securities as these are denominated in Pak Rupee;

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- SBP foreign exchange liabilities decreased by US\$ 553 million mainly due to repayment of Qatar deposit;
- PSEs borrow in-line with their business plans. PSEs debt increased by US\$ 106 million; and
- External borrowing by the private sector is a healthy sign indicating the private sector's capacity to borrow for local investments. Private sector debt and liabilities increased by US\$ 865 million.

Table-8: Pakistan's External Debt and Liabilities

(US\$ in million)	FY13	FY14	FY15	FY16	FY17	FY18	FY19	DEC 19
A. Public External Debt (1+2)	48,139	51,460	50,964	57,757	62,539	70,237	73,449	77,714
1. Government External Debt	43,752	48,440	46,861	51,714	56,430	64,142	67,800	70,984
i) Long term (>1 year)	43,488	47,709	45,849	50,026	55,547	62,525	66,536	68,177
Paris Club	13,548	13,607	11,664	12,678	11,973	11,643	11,235	10,924
Multilateral	24,198	25,826	24,262	26,376	27,605	28,102	27,788	29,359
Other Bilateral	3,939	4,385	4,941	5,445	6,323	8,674	12,717	13,227
Euro/Sukuk Global Bonds	1,550	3,550	4,550	4,550	4,800	7,300	6,300	5,300
Military Debt	71	36	0	0	0	0	0	0
Commercial Loans/Credits	0	150	300	882	4,826	6,806	8,470	9,311
Local Currency Securities (PIBs)	2	16	32	35	0	0	0	11
Saudi Fund for Development (SFD)	180	140	100	60	20	0	0	0
NBP/BOC deposits/PBC*	0	0	0	0	0	0	26	45
ii) Short term (<1 year)	264	731	1,012	1,688	882	1,617	1,264	2,807
Multilateral	256	443	983	1,112	832	961	778	955
Local Currency Securities (T-bills)	8	116	29	1	51	0	0	1,566
Commercial Loans/Credits	0	173	0	575	0	655	486	286
2. From IMF	4,387	3,020	4,103	6,043	6,109	6,095	5,648	6,730
i) Federal Government	1,519	655	52	0	0	0	0	1,444
ii) Central Bank	2,868	2,366	4,051	6,043	6,109	6,095	5,648	5,287
B. Foreign Exchange Liabilities	3,106	3,281	3,709	3,600	3,564	5,121	10,488	9,935
i) Central Bank Deposits	800	700	700	700	700	700	6,200	5,700
ii) Foreign Currency Bonds (NHA / NC)	0	0	0	0	0	0	0	0
iii) Other Liabilities (SWAP)	814	1,045	1,612	1,507	1,482	3,022	2,912	2,865
iv) Allocation of SDR	1,487	1,528	1,390	1,383	1,375	1,390	1,374	1,367
v) Nonresident LCY Deposits with Central Bank	6	8	7	10	8	9	1	3
C. Public Sector Enterprises (PSEs)	1,848	2,063	2,482	2,807	2,719	2,671	4,013	4,119
a. Guaranteed Debt	598	537	970	1,265	1,214	1,384	2,800	2,881
Paris Club	0	0	0	0	0	0	0	0
Multilateral	30	25	19	11	6	5	0	0
Other Bilateral	568	512	951	1,254	1,208	1,179	2,600	2,531
Commercial Loans	0	0	0	0	0	200	200	350
Sandak Metal Bonds	0	0	0	0	0	0	0	0
b. Non-Guaranteed debt	1,250	1,525	1,512	1,541	1,505	1,287	1,213	1,238
i) Long Term (>1 year)	638	726	534	466	403	334	410	519
ii) Short Term (<1 year)	612	799	978	1,075	1,102	953	803	719
D. Banks	1,554	1,989	2,286	2,695	4,522	4,417	4,706	4,502
a. Borrowing	710	1,080	1,334	1,618	3,303	2,967	3,157	2,794
b. Nonresident Deposits (LCY & FCY)	843	909	952	1,078	1,220	1,450	1,550	1,708
E. Private Sector	3,143	3,076	3,011	4,073	6,759	9,195	10,414	10,949
F. Debt Liabilities to Direct Investors - Intercompany Debt	3,110	3,400	2,717	3,013	3,375	3,597	3,278	3,828
Total External Debt and Liabilities (A+B+C+D+E+F)	60,899	65,268	65,170	73,945	83,477	95,237	106,348	111,047

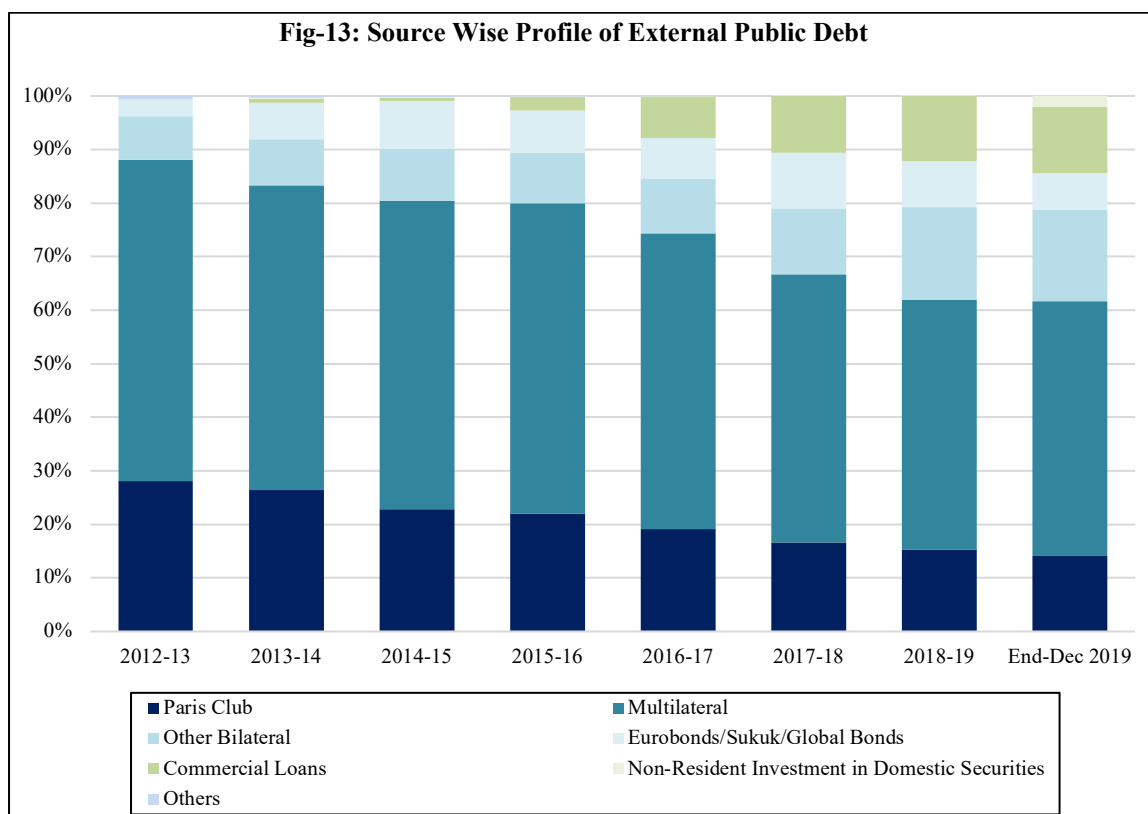
P: Provisional

*: Pakistan Banao Certificates (PBC) issued by Government of Pakistan for overseas Pakistanis, effective from 4 February 2019.

Source: State Bank of Pakistan and Debt Policy Coordination Office, Ministry of Finance

Medium Term Debt Management Strategy (2019/20 - 2022/23)

9.20 Pakistan's external debt is derived from four key sources, with 48 percent coming from multilateral loans, 31 percent from bilateral loans, 7 percent from Eurobonds/Sukuk and 14 percent from commercial loans². Although borrowing from commercial sources has relatively increased during the last few years, multilateral and bilateral sources still cumulatively constitute 79 percent of external public debt portfolio as of end December 2019. These multilateral and bilateral loans are contracted at concessional terms (low cost and longer tenor) and are primarily utilized to address structural issues and promote reforms in the areas of energy, taxation, business, trade, education and others. The following graph summarizes the component wise break-up of external public debt stock:



Performance of Emerging Markets and Pakistan:

9.21 In the second half of 2019 (July -December 2019), Emerging Market ("EM") assets experienced a record surge in new issuances and a significant compression in spreads. From September to October 2019, overall EM Sovereign BB/B credits compressed 78 bps on a yield basis, and this trend continued until the end of December 2019, where the yield represented 141 bps compression versus beginning of July levels. These spread levels, paired with historically-low rates that were pushed down by two additional rate cuts by the Federal Reserve in its September and October 2019 meetings, resulted in record-low all-in funding costs for issuers, triggering a boost in primary issuance volumes. September alone saw US\$ 89 billion

² Including Non-Resident investments in government domestic securities

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equivalent in EM bond issuances, contributing to a total US\$ 314 billion equivalent in EM supply for the period of July to December 2019.

- 9.22 Continued fund flows into the EM asset class during this time supported record new issuance volumes, as investors “hunted for yield” in the low rate environment. As a result, total fund flows for 2019 stood strongly positive at US\$ 33 billion net inflow, compared to a net outflow of US\$ 8 billion for 2018.
- 9.23 While Pakistan’s outstanding bonds experienced some volatility at the beginning of the July to December 2019 period, they followed the tightening trend of the market, seeing 50 bps tightening from July to December 2019. This tightening was largely supported by Moody’s upgrade of outlook from Negative to Stable on 2nd December 2019. From 1st December till the end of the year alone, Pakistan’s curve compressed by 41 bps.

Global and Emerging Market (“EM”) Credit

- 9.24 The trend of 2019 is likely to continue in the first half of 2020 i.e. low rates, compressed spreads and robust EM primary activity. Even with US-Iran tensions and concerns about the spread of coronavirus, January 2020 was the most active month on record for Emerging Markets in terms of primary issuance activity, with US\$ 114 billion equivalent printed. Pakistan’s outstanding bonds have outperformed the wider EM Sovereign BB/B space (which has remained stable YTD), with 73 bps tightening on a yield basis across its curve. On a spread basis, Pakistan’s bonds have moved 44 bps tighter on average.
- 9.25 It is expected that EM primary issuance activity will remain robust, supported by strong fund inflows in the EM asset class (US\$ 4 billion net inflow already YTD) and high levels of EM bond redemptions in 2020 (US\$ 428 billion).

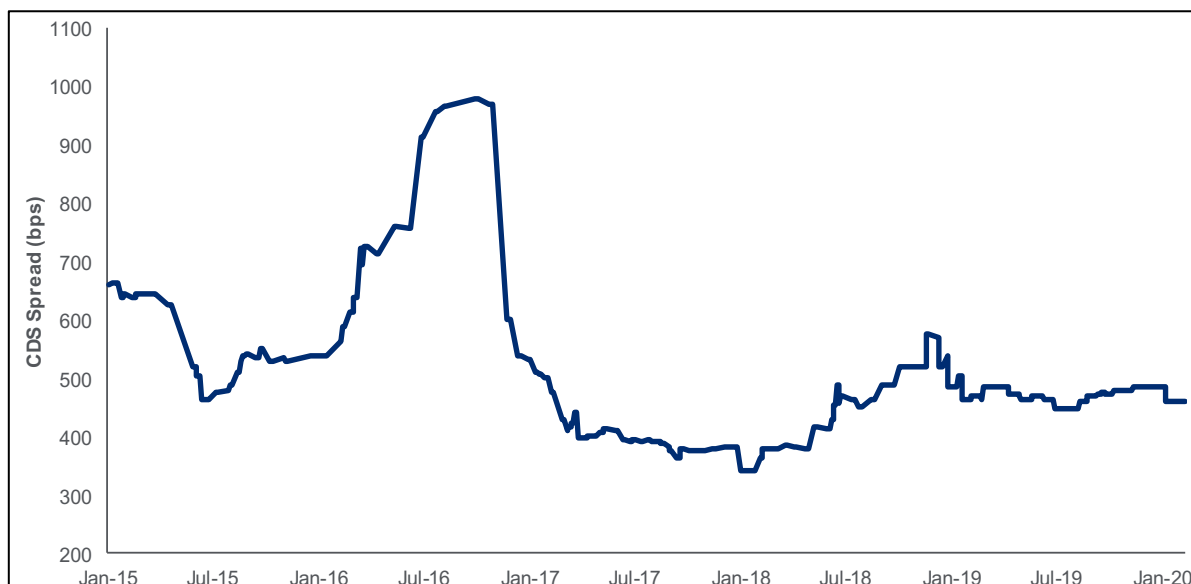
Table-9: Pakistan Sovereign Bonds - Secondary Trading Levels

Bond	Ratings			Maturity	Size (\$ in million)	Coupon (%)	Price	Yield %	Z-Spread (bps)
	M	S&P	F						
Sukuk	B3	B-	B-	Oct-21	1,000	5.500	103.0	3.608	211
Sukuk	B3	B-	B-	Dec-22	1,000	5.625	104.4	3.953	251
Eurobond	B3	B-	B-	Apr-24	1,000	8.250	114.5	4.392	296
Eurobond	B3	B-	B-	Sep-25	500	8.250	116.1	4.925	348
Eurobond	B3	B-	B-	Dec-27	1,500	6.875	108.4	5.536	404
Eurobond	B3	B-	B-	Mar-36	300	7.875	111.3	6.720	509

Source: Bloomberg as of 14th February 2020

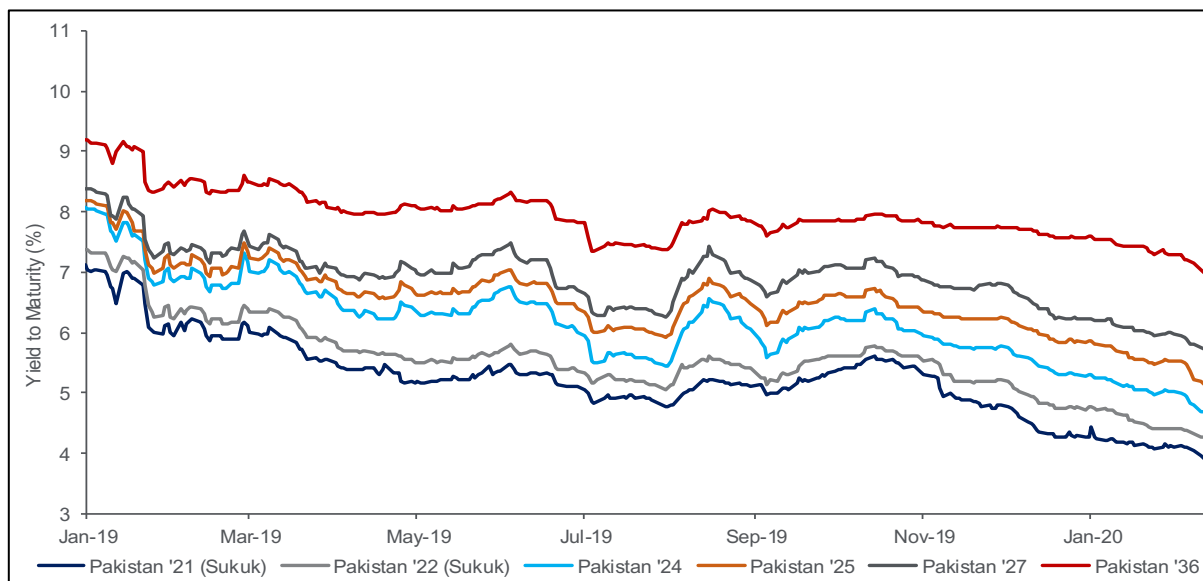
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Fig-14: CDS Levels for Pakistan - 5 Years



Source: Bloomberg as of 14th February 2020

Fig-15: Bond Trading Levels



Source: Bloomberg as of 14th February 2020

10.0 MEDIUM-TERM MACROECONOMIC FRAMEWORK (MTMF)

10(i) Macroeconomic Assumptions

- 10.1 Government is committed to address the deep-rooted financial problems which would improve the fiscal position and reduce the debt burden of the country over the medium-term.

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Following are the key features of medium-term projections:

Table-10: Macroeconomic Indicators (As percentage of GDP)

	FY20	FY21	FY22	FY23
Overall Primary Balance	(2.7)	(0.3)	0.8	1.5
Federal Primary Balance	(2.2)	(0.9)	(0.2)	0.2
Overall Fiscal Balance	(9.2)	(6.5)	(5.0)	(4.0)
Federal Fiscal Balance	(8.7)	(7.1)	(6.0)	(5.3)

10(ii) Risks Associated with Macroeconomic Indicators

- 10.2 The estimates of key economic indicators are prone to certain risks and vulnerabilities that could cause deviations from the projections. These risks can undermine the achievement of key fiscal targets i.e. fiscal balance and public debt levels which in-turn can complicate or compromise the management of other macroeconomic variables including GDP growth, inflation, interest rates, exchange rate etc. Thus, Identifying, analyzing and mitigating such risks is an important aspect of fiscal and debt management.
- 10.3 Lower tax revenues lead to greater fiscal deficits that may need to be financed through higher borrowings, and also reduce the fiscal space for expenditure pertaining to development and social sectors. Government is targeting higher growth in FBR revenues over next 4 years. Any shortfall in achievement of these targets in tax revenue collection will have adverse consequences for the projected fiscal position of the government. One of the consequences of falling short on revenue targets would be curtailment in development expenditure.
- 10.4 Public debt to GDP ratio is expected to reduce over next 4 years from its level of 86.1 percent at end June 2019. This will require a combination of factors including achieving Primary Surplus, lowering overall Fiscal Deficit, achieving higher GDP growth, lowering the borrowing cost and achieving stability in real exchange rate. Failure to achieve these multidimensional economic targets can make it challenging to achieve the goal of debt sustainability.
- 10.5 Government has projected sufficient external financing over the medium-term for financing of its budget deficit. Any shortfalls in external financing pose a significant risk to fiscal health as well as overall macroeconomic stability of the country. Domestic borrowing needs of the federal government are also projected to remain high over the next few years. Apart from the crowding out effect, large domestic borrowing needs make the domestic markets susceptible to macroeconomic shocks. Expectations of rising inflation and interest rates can disrupt the domestic markets with adverse implications for government's liquidity management and cost of borrowing.

- 10.6 Government is maintaining a cash buffer to meet unexpected liquidity requirements on account of cashflow mismatches and/or other contingencies. It has helped the government to effectively manage its cashflows without causing disruptions in the market. However, considering the fiscal vulnerabilities arising out of various risk exposures, it is important for the government to have additional buffers that can provide support in managing risks to fiscal stability in case of adverse shock scenarios such as COVID-19 pandemic.
- 10.7 Various types of fiscal risks confront Pakistan and a lot of effort is needed to overcome or mitigate the potential adverse effects of such risks. The silver lining is that the country has already made considerable progress in certain areas, and a number of strategies are available to address the risks that remain. The risk management strategy envisages a range of Public Financial Management (PFM) reforms that bring discipline, transparency and credibility at all stages of the budget cycle and follows a two-pronged approach i.e.
- Preventing the risks from materializing or lowering the exposure in case such risks materialize; and
 - Creating buffers for the risk exposures that still remain.

11.0 POTENTIAL FUNDING SOURCES

- 11.1 Government meets its financing requirements from both domestic and external sources. Domestic sources mainly include issuance of government securities and receipt of deposits through National Savings Schemes. External sources mainly include loans from multilateral and bilateral development partners, issuance of bonds in the international capital markets and short to medium term foreign currency loans from commercial banks.

11(i) Domestic Sources

Marketable Government Securities

- 11.2 Government currently issues two broad types of marketable government securities in order to raise domestic debt i.e. T-bills and PIBs.
- T-bills are considered short-term securities and have maturities of 12 months or less at the time of issuance.
 - PIBs are considered longer-term securities and have maturities of more than 12 months at the time of issuance. Government currently issues fixed-rate PIBs with 3-year, 5-year, 10-year and 20-year maturities and floating-rate PIBs with 10-year maturity. All of these PIBs pay profit on semi-annual basis.
 - Shariah compliant securities program has also been in place since FY 2008-09, however, it constitutes a small proportion of government domestic securities portfolio.

National Savings Schemes

- 11.3 NSS are designed to attract savings mainly from retail investors which were 18 percent of total domestic debt at end-December 2019. Number of different schemes are being offered under NSS in the investment horizon of 3 months to 10 years. In the recent past, government has taken many initiatives to bring innovation in the operations and management of Central Directorate of National Savings (CDNS). In this regard, AML/CFT Rules 2019 has also been approved by the government while an independent Supervisory Board has been formed to oversee the implementation of AML/CFT measures.
- 11.4 The setting of profit rates on National Savings Schemes (NSS) were previously carried out with the time lag of two months. Government has now reduced this gap and linked the rate setting of NSS with the timing of government securities auctions and NSS rates are now being reset every month immediately after auction of Pakistan Investment Bonds.

11(ii) Expectations for 2019/20 - 2022/23 from Domestic Sources

- 11.5 The domestic market shall remain the main source of funding to finance the fiscal deficit and for refinancing of existing domestic debt. Government intends to continue building liquid benchmarks across the yield curve with a transparent issuance policy that will define the number of benchmark securities, range of issue sizes, as well as information in advance of the market in terms of volume and frequency of issues.
- 11.6 Government is planning to introduce multiple instruments in order to broaden the investor base and offer diversified instruments to investors which are closer to their investment horizons, income preferences and risk appetite.
- Government has already introduced a conventional long-term (10-year maturity) floating-rate PIBs which proved to be a good addition to its securities portfolio. Government also intends to issue floating-rate PIBs with 3-year and 5-year maturities and quarterly coupon payments. These are expected to be useful additions to the portfolio of government securities for the following reasons:
 - These PIBs will be attractive for investors with medium-term investment horizons who want to avoid interest rate risk. These include banks, mutual funds, certain segments of insurance businesses and employee retirement funds, and most individuals. Currently, such investors have limited options of government securities which match their time horizons and risk appetite.
 - Financial intermediaries such as banks, insurance companies and mutual funds will be able to design more products around these PIBs to fulfill the needs of many of their depositors and investors, particularly those individuals and institutions with higher and frequent liquidity needs.
 - During periods of rising interest rates, investors tend to concentrate their exposures to very short-maturity instruments, such as 3-month T-bills, which poses high rollover and liquidity risks for the government. These PIBs, whose profit payments will vary in-line with the 3-month T-bills yields, will act as a

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substitute to 3-month T-bills. Many of the investors may prefer to invest in these PIBs which, despite their longer maturities, carry low interest rate risk like the 3-month T-bills. This will lower the rollover and liquidity risks for the government.

- These PIBs will be the preferred borrowing instruments for the government in an environment of temporarily high interest rates. Despite high interest rates, Government will be able to borrow for longer periods knowing that its borrowing costs will automatically decline when short term interest rates decrease.
- Government may also consider issuing 2 years Floating Rate Notes to attract more diversified investor base. The rationale of this instrument is to minimize the interest rate risk of Floating Rate instruments. This instrument, when introduced, will carry interest rate risk of only two weeks.
- Government may also introduce zero coupon bonds³ and inflation linked bonds⁴. Insurance companies, pension funds and mutual funds prefer to buy these instruments for their liability management.
- Presently, the government is issuing PIBs in 3, 5, 10 and 20-years tenor. Government is considering to start auction of 15 years PIBs again with the view of lengthening maturities of domestic debt over the medium term and provide an additional tenor/option to the investors.
- Currently there is only one issue of Sukuk outstanding (amounting Rs 71 billion) which shall mature in June 2020. Ample liquidity available with Islamic banks will be tapped through issuance of Shariah compliant instruments against assets which have become available after maturity of previously issued GoP Ijara Sukuk with the following modalities⁵:
 - Similar to conventional bond, Sukuk will be re-opened in multiple auctions (with identical profit coupon and maturity dates). The objective is to attract investors, increase liquidity of the Sukuk issue and lower costs for the government;
 - The tenor of the Sukuk will be fixed at 5 years consistent with the objective of the government to lengthen the maturity profile of domestic debt portfolio;
 - Non-Competitive Bids (NCBs) may also be introduced in Sukuk auctions to meet the demand of the non-banking sector.
- Government may also conduct Bai-Muajjal transactions against its maturing Sukuk.
- Government will also consider option of asset light structures based on Musharaka, Ijara, Murabaha or any other Shariah compliant mode to raise funds, as assets available with government are limited.

³A bond that is issued at a deep discount to its face value but pays no interest.

⁴ Inflation-Indexed bonds are securities with the principal linked to the Consumer Price Index. The principal changes with inflation, guaranteeing the investor that the real purchasing power of the investment will keep pace with the rate of inflation.

⁵ Subject to approval of Shariah Advisory Board of State Bank of Pakistan and Islamic Banks.

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- Government may also consider undertaking bond exchanges and buyback operations to manage roll-over and refinancing risk by consolidating the large number of outstanding securities into fewer and more liquid instruments.
 - Government has approved Sarwa Islamic Savings Account Rules 2019. Sarwa Islamic Savings Account (SISA) is expected to be a good addition to the existing product basket of CDNS.
- 11.7 Within non-banking sector, most of the incremental proceeds are expected to be mobilized through NSS. Government is taking various steps to increase mobilization from non-banking sector. Efforts are geared towards increasing the retail investor participation in government securities in both primary and secondary markets. The ultimate aim is to utilize the stock exchanges for primary market / auction of the government debt securities to enable wider outreach and improve participation of retail segment.
- 11.8 Sufficient external financing is expected to be available over the medium-term for financing of budget deficit. On domestic front, the government aims to meet most of its net domestic financing requirements through the issuance of medium to long term instruments (60 percent - 70 percent), around 10 to 15 percent from NSS while remaining shortfall would be met through issuance of T-bills.
- 11(iii) Expectations for 2019/20 - 2022/23 from External Sources**
- 11.9 Government intends to secure external financing mainly from multilateral and bilateral development partners and financial markets over the medium term keeping in view cost risk tradeoffs. Pakistan is not considered to be a low-income country anymore. Gradual increase in market-based loans from banks or through Eurobonds is also a positive sign.
- 11.10 Government reached an agreement with the International Monetary Fund (IMF) in July 2019 for a US\$ 6 billion Extended Fund Facility (EFF). The disbursements under EFF would be available for the government as budgetary resource.
- 11.11 Government intends to continue its partnership with international development partners to take advantage of concessional / semi-concessional funding. Disbursement of project loans is dependent on the implementation capacity and efficiency of the implementing entity. It is expected that as a result of renewed efforts to speed-up the pace of project implementation, disbursements will increase over the medium-term. Policy based funding is linked with the macroeconomic stability. The structural reforms initiated by the government are producing results and are expected to increase macroeconomic stability. With improved macroeconomic indicators coupled with fasten project implementation, disbursement from multilateral and bilateral creditors is expected to increase in the medium-term.
- 11.12 Government plans to maintain its presence in international capital market over the medium-term. Flexibility in terms of timing, size, interest rate type, maturity and repayment structure will be maintained keeping in view cost and risk considerations. Existing external commercial loans from foreign banks will mostly be rolled-over/refinanced over the medium-term while incremental external inflows from

commercial sources would not be significant. Government is committed to reprofile its commercial loan portfolio from short-term to medium-term to reduce the refinancing risk of external public debt portfolio.

12.0 ALTERNATIVE DEBT STRATEGIES

12.1 Macroeconomic projections indicate a declining trajectory of public debt to GDP ratio over the medium-term. Average Time to Maturity (ATM) of domestic debt portfolio remained mostly below 2 years in the past, however, it increased significantly to over 4 years at end June 2019, primarily supported by one-off re-profiling of SBP borrowing. Therefore, government intends to maintain this ATM over the medium-term keeping in view cost risk trade-offs.

12.2 ATM of external debt has decreased over the past few years from 10 years in FY 2012-13 to 7 years in FY 2018-19. This is primarily attributable to running-off of existing portfolio and due to the fact that the government had to partially meet its growing external financing requirements from commercial avenues. Commercial borrowing is contracted at market terms i.e. at relatively higher cost and lower tenor compared with concessional terms offered by multilateral and bilateral development partners. Since Pakistan is not considered as low-income country anymore, increase in loans from banks or through Eurobonds has become necessity. Government intends to increase the ATM of its external debt portfolio over the medium-term through a combination of following measures:

- Government will continue to avail maximum concessional external financing from bilateral and multilateral development partners. These loans provide maximum flexibility to the borrower in the choice of grace period, final maturity, and amortization structure. In such cases, the government will prefer to choose relatively higher ATM while ensuring smooth redemption profile of its external public debt portfolio;
- Government preference is to borrow more in 10 years and 15 years tenors in international capital market while keeping in consideration cost risks tradeoffs; and
- Government intends to contract fresh commercial loans in relatively higher tenors (3 years or more). In addition, efforts will be geared towards re-profiling of existing stock of commercial loans from short-term to medium-to-long-term.

12.3 Based on these considerations, the government evaluated financing alternatives with the objective to reduce the exposure to refinancing and interest rate risks. Following options were analyzed to check the possibility of reducing these risks:

Option I - Balanced Approach

- **Domestic Debt:** Higher mobilization through medium to longer tenor domestic debt instruments along with the residual funding financed through short term domestic debt instrument.
- **External Debt:** Higher mobilization through concessional loans along with the residual funding financed through commercial loans and Eurobonds.

Option II- Aggressive Approach

- **Domestic Debt:** Aggressive mobilization through medium to long tenor domestic debt instrument with minimal reliance on short term instruments.
- **External Debt:** Most of the external borrowing requirement to be met from concessional sources with minimal reliance on commercial loans and Eurobonds.

Although not desirable, other borrowing strategies such as more reliance on short term domestic debt instrument along with mobilization of less than projected external funding were also simulated to evaluate their impact on debt portfolio. Aggressive mobilization from medium to long term domestic debt and concessional external sources yields best results in terms of risk reduction of debt portfolio. However, implementing this strategy will be difficult over the medium-term. Balanced approach appears to be more practical and is expected to reduce the risks of debt portfolio over the medium-term.

12(i) Implementation of MTDS

- The MTDS will be implemented through preparing an annual borrowing plan that meets the funding requirements of the government for each fiscal year. The borrowing plan will take into account the desired composition assumed in the MTDS analysis. The information of the government's domestic borrowing plan is disseminated to the market on monthly basis through the publication of auction calendar i.e. Government announces auction calendar of government securities every month for the next three months on rolling basis. The auction calendar contains tenor wise target amounts which the government intends to borrow from domestic securities for financing of its budget deficit during any particular quarter.
 - Government will continue to actively engage investors and market participants through periodic meetings, conference calls and investor presentations with Primary Dealers (PDs) and key market players. The meetings will focus on market development, financing plans, financing operations and investor views, as well as performance of the PD system. Regular meetings will also be held with mutual fund managers and insurance companies, as well as regulators including State Bank of Pakistan and Securities and Exchange Commission of Pakistan.
 - Government will continue working with development partners to deepen the domestic debt market, enhance capacity building of debt management staff and improve efficiency in debt management operations.
 - Government will ensure the transparency on debt management in accordance with international best practices through provision of accurate and timely information on public debt through various publications.
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