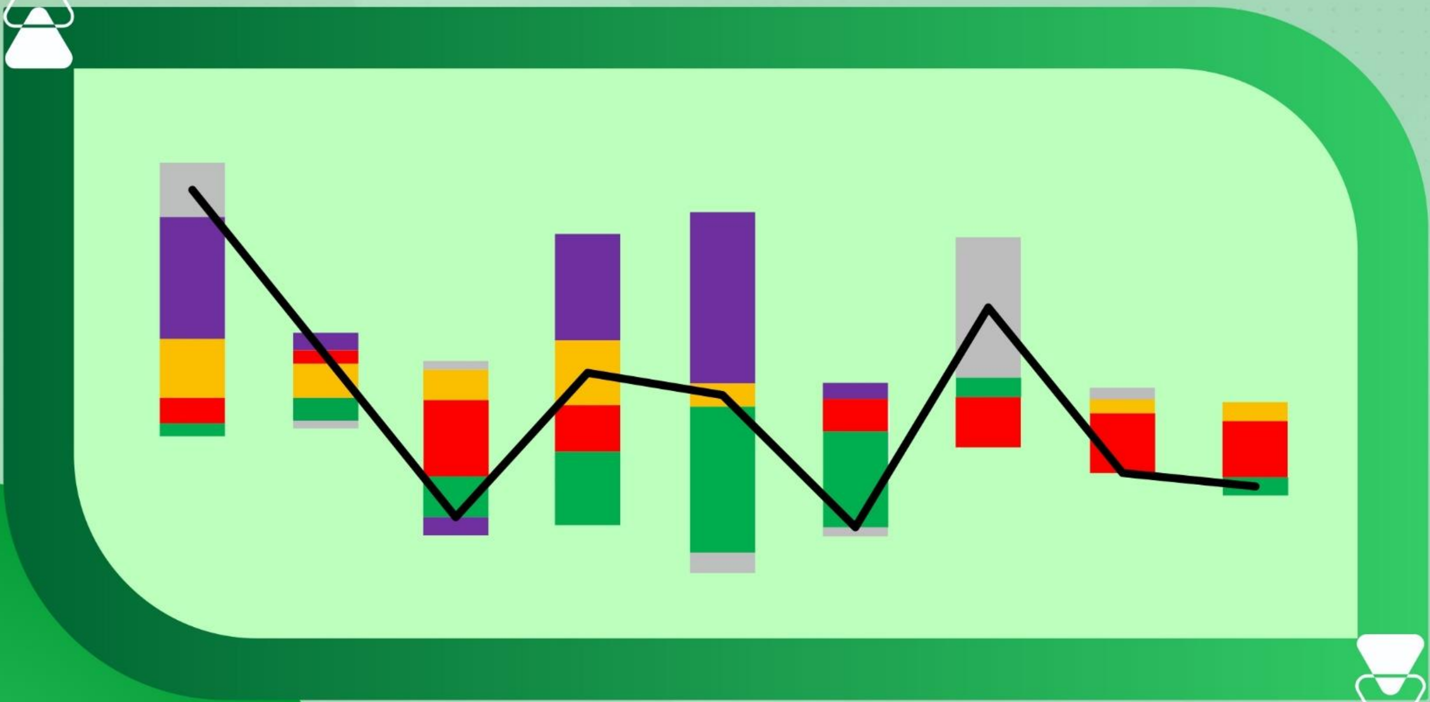
DEBT SUSTAINABILITY ANALYSIS REPORT

FY2025-2027



Economic Adviser's Wing
Finance Division
Government of Pakistan

FOREWORD

The Debt Sustainability Analysis (DSA) report presents a comprehensive assessment of debt sustainability over the medium term, FY2025-FY2027. Pakistan's economy moved towards stability in FY2024 with receding inflation, a surplus in the primary balance, a negligible current account deficit, and a stable exchange rate. However, the economy continues to face various challenges, including challenging global financial conditions, and tight domestic and global monetary policies. In light of these circumstances, this report aims to critically evaluate Pakistan's debt sustainability in the current economic environment and highlight the primary sources of risk. This analysis includes assessments of both external and domestic debt, as well as government guarantees while incorporating anticipated macroeconomic and fiscal risks over the medium term.

The understanding of debt dynamics is imperative for augmenting debt transparency, achieving fiscal sustainability, and improving debt management strategy. The DSA also sheds light on Pakistan's ability to manage its debt under continuous economic pressures and concludes with recommendations for maintaining sustainable debt in future.

I gratefully acknowledge the dedicated efforts of the officers at the Economic Adviser's Wing, Finance Division, in crafting this document. Special commendation is due to Dr. Imtiaz Ahmad, Economic Adviser, and Dr. Naseem Faraz, Deputy Economic Adviser, and Ms. Samina Khatoon, Assistant Economic Adviser, for their diligent work in preparing this comprehensive document. I also commend the valuable support of Dr. S. M Naeem Nawaz, Director (Fiscal), and Dr. Wasim Shahid (PFM-II) in finalizing this report. My gratitude is also extended to the Debt Management Office, Finance Division, for providing data and valuable feedback in completing this task. This report, offering critical insights to stakeholders, policymakers, and investors, underscores the importance of collective efforts toward achieving economic and debt stability.

Imdad Ullah Bosal
Secretary Finance

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EXECUTIVE SUMMARY

Pakistan's public debt becomes sustainable, underpinned by macroeconomic stability and fiscal consolidation. The debt-to-GDP ratio is projected to remain on a downward trajectory over the medium term, FY2025-2027. However, a moderate risk of gross financing needs (GFN) is likely to impact the debt dynamics. The GFN would be mainly covered through inflows from official multilateral and bilateral development partners as well as the debt raised from domestic financing sources. In this regard, sustainable inflows from multilateral and bilateral sources are imperative.

Although the baseline public debt-to-GDP ratio remains below its prudent benchmark, however, it is vulnerable to underlying macro-fiscal shocks, as illustrated by the shock scenarios. Specifically, an adverse movement in the primary balance, exchange rate, interest rate, economic growth rate, and contingent liabilities pose significant risks to debt sustainability leading to the debt-to-GDP ratio and GFN exceeding the benchmarks after absorbing the shock(s).

Pakistan's external debt, which accounts for 33.8 percent of the total public debt as of end June 2024, is mostly obtained from concessional bilateral and multilateral creditors. Although the maturity structure is assumed to be extended over the projection horizon, the current large part of short-term debt poses a high refinancing risk to GFN. Moreover, the significant share of external debt in total public debt fundamentally contains the currency risk, it can peril the debt sustainability in times of high current account deficit, and low foreign exchange reserves.

On the other hand, the domestic debt constitutes 66.2 percent of the total public debt as of end June 2024 which contains a large share of long-term debt. Nonetheless, the large share of floating rate debt (74 percent as of end Dec 2023[1]) in domestic debt poses a significant interest rate risk. The high share of floating debt is partly explained by the fact that the domestic commercial banks are the main investors in government securities. These banks have a strong preference for floating-rate debt because their liabilities are mostly subject to floating-rates. Their preferences are backed by ongoing price instability, which leads to a lowering demand for long-term fixed-rate government securities. Hence, a probable price hike, which prompts the rise in interest rate, exposes the domestic debt to interest rate risk. Moreover, shocks to economic growth, climate change, external shocks, changes in primary balance, and contingent liabilities can bring changes to the debt dynamics and jeopardize debt sustainability during the period of analysis.

The stakeholders envisage a comprehensive strategy encompassing proactive debt management strategies, prudent fiscal management, strengthening of the foreign exchange market, optimal policy rate and implementing structural reforms to bolster productivity, competitiveness and sustainable growth. Nevertheless, these strategies are crucial to achieve debt sustainability.

[1]https://finance.gov.pk/dpco/Public_Debt_Bulletin_Jul_Dec_2023.pdf

1. INTRODUCTION

1. **The Debt Sustainability Analysis (DSA) explains the dynamics of debt, underpinned by the macroeconomic and fiscal policy assumptions.** The underlying assumptions are based on the projections prepared for the Medium-Term National Macro Fiscal Framework FY2025-FY2027. This report transcribes the government's commitment to increase transparency in public debt assessment, ensuring fiscal sustainability and firming up debt management practices. The International Monetary Fund's Market Access Countries (MAC) DSA framework has been adopted to carry out the analysis.

2. **The public and publicly guaranteed (PPG) debt is expected to remain sustainable during FY2025-FY2027.** Although, PPG debt-to-GDP ratio was escalated to 75.7 percent in FY2021, 78.4 percent in FY2022, and 79.0 percent in FY2023, but it started following a downward trajectory in FY2024 to 70.4 percent. As such, this debt burden was compounded against the backdrop of global and domestic economic uncertainties, intensified due to the post-COVID recovery, geopolitical tensions, floods, PKR devaluation, and persistently high long-term interest rates. However, in FY2024, stabilization policies and reform efforts have helped to alleviate debt distress to some extent. Presumably, this will continue over the medium term under the baseline scenario, thereby keeping the public debt-to-GDP ratio below its prudent benchmark.

3. **Debt dynamics have been assessed under six alternative risk scenarios. These scenarios relate to the macroeconomic and fiscal risks which consequently can affect the debt path.** First scenario assumes the critical role of federal primary balance which could be as a result of deviation from the planned expenditures and revenues. Scenario 2 assumes the role of economic growth, the deviation in the baseline growth path poses a risk to fiscal sustainability vis-à-vis debt sustainability. Scenarios3 and 4 assume the changes in the real interest rate and exchange rate depreciation which transmits their direct and indirect impacts on debt stock and flows. Scenario 5 presents a more pragmatic combined macro-fiscal shock to cover the extreme risk to debt sustainability. In scenario 6, contingent liability risk has been assessed to understand the increase in non-interest expenditures which deteriorate the federal primary balance thus leading to higher debt level.

4. **The government's prudent policy efforts and continuous reform strategies to accomplish macroeconomic and fiscal stability are paramount for paving the way to reduce the national debt to a sustainable level.** Primarily, the government's commitments to attain primary balance surpluses, ensuring low and stable inflation, fostering high sustainable economic growth, and exchange rate alignment with the market fundamentals are important to ensure debt sustainability.

2. DEBT COVERAGE

5. The DSA covers the PPG debt that includes both external and domestic debt obligations and guarantees. In this analysis, total public debt (external & domestic debt obligations) refers to the government debt which is defined in 'Fiscal Responsibility and Debt Limitation (FRDL) Act 2005' as the debt owed by the Government (including Federal Government and Provincial Governments) serviced out of the consolidated fund and debts owed to the International Monetary Fund. Whereas 'guaranteed debt' refers to a loan or other financial obligation that is backed by a guarantee from a federal government. Considering the PPG debt, the DSAFY2024 assesses the debt dynamics for FY2025-FY2027.

BOX 1: DEBT COVERAGE

- Stock of total PPG debt
- Short-term debt
- Long-term debt, including guarantees
- Debt denominated in domestic currency, including guarantees
- Debt denominated in foreign currency, including guarantees

2. STYLIZED FACTS ABOUT PUBLIC DEBT

6. As of end June 2024, Pakistan's PPG debt reached around PKR 74.6 trillion, of which, PKR 48.6 trillion was domestic PPG debt and PKR 26.0 trillion was external PPG debt. In PPG debt, total public debt was PKR 71.2 trillion and publicly guaranteed debt was PKR 3.4 trillion (Table 1). During FY2024, the increase in public debt was PKR 8.3 trillion whereas publicly guaranteed debt declined by PKR 0.1 trillion. The increase in public debt was mainly due to the financing of federal fiscal deficit, primarily consisting of interest expense.

Table1: Public and Publicly Guaranteed Debt as of End June – (PKR Trillion)

	June 2023	June 2024	Change	% Growth
Public Debt	62.88	71.25	8.37	13.31
Domestic	38.81	47.16	8.35	21.52
External	24.07	24.09	0.02	0.08
External (USD billion)	84.1	86.5	2.40	2.85
Publicly Guaranteed Debt	3.52	3.38	-0.13	-3.78
Domestic	1.62	1.46	-0.16	-9.88
External	1.9	1.92	0.02	1.42
Public and Publicly Guaranteed Debt	66.4	74.63	8.23	12.41
Domestic	40.43	48.62	8.19	20.26
External	25.97	26.01	0.04	0.15
Public and Publicly Guaranteed Debt (USD bn)	231.9	268.0	36.1	15.57

Source: Debt Management Office, Finance Division

7. As of end June 2024, Pakistan's domestic PPG debt was 65.2 percent of total PPG debt, whereas external PPG debt was 34.8 percent of total PPG debt. As of end December 2023[2], within the domestic PPG portfolio:

- Fixed-rate debt accounts for 25.4 percent of total domestic PPG debt while floating-rate debt accounts for 74.6percent.
- Long-term debt accounts for 68.6 percent of total domestic PPG debt, while short-term debt accounts for 31.4 percent.

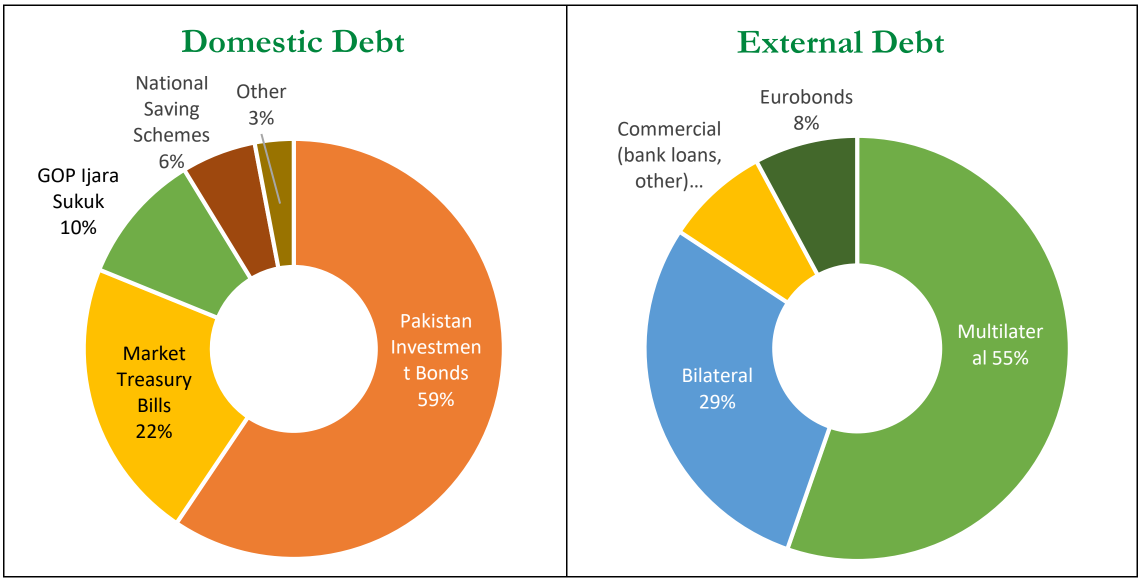
Within the external PPG debt portfolio:

- Fixed rate debt accounts for 65.4 percent of total external PPG debt while floating rate debt accounts for 34.6 percent.
- Medium to long-term debt accounts for 81.1 percent of total external PPG debt, while short-term debt accounts for 18.9 percent.

The debt portfolio is highly sensitive to interest rate and exchange rate changes for their effect on domestic and external debt, respectively.

8. Domestic debt is mainly raised through Government Securities. It includes (i) Market Treasury Bills (T-Bills), (ii) Pakistan Investment Bonds (PIBs); and (iii) Government Ijara Sukuks. Domestic debt is also composed of unfunded debt which consists of funds raised through National Saving Schemes (NSS). In addition, there are some other components, which are part of domestic debt, e.g., Naya Pakistan Certificates, foreign currency denominated domestic debt, SDR on-lending loans etc. (see Figure 1&Figure 2).

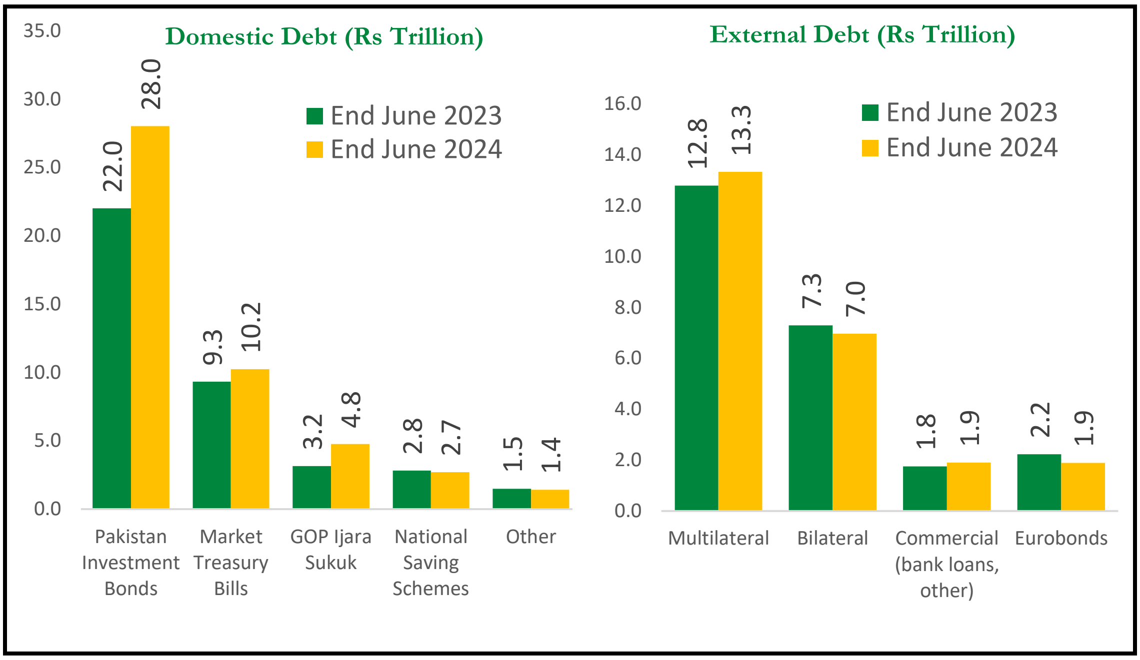
Figure 1: Composition of Domestic and External Debt Stock-End June 2024



Source: Debt Management Office, Finance Division

[2] Debt Management Office, Finance Division

Figure 2: Domestic and External Debt Stock-End June 2024

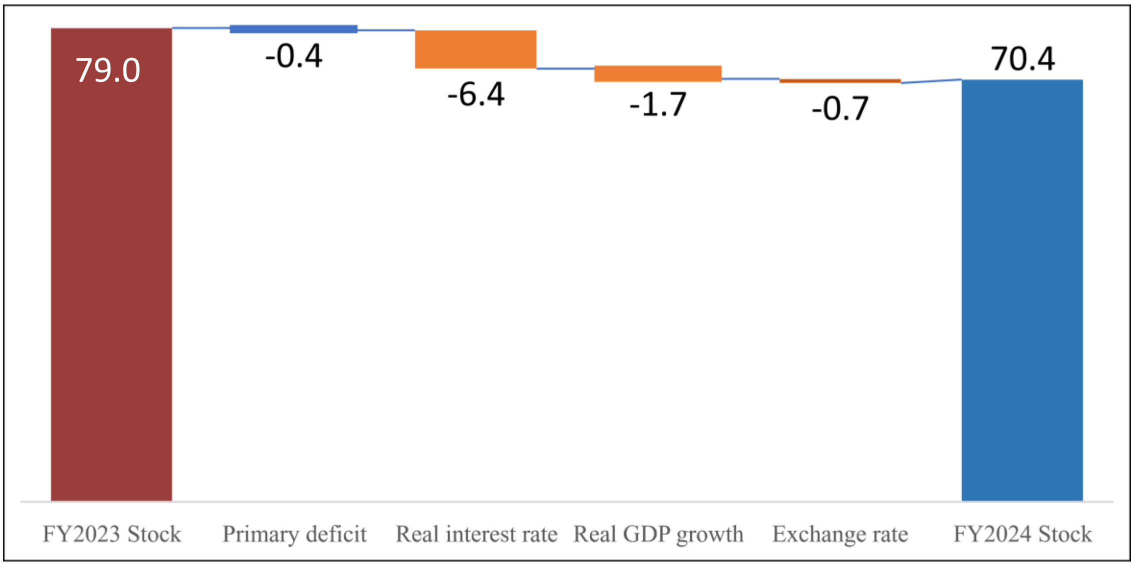


Source: Debt Management Office, Finance Division

9. **External debt is obtained from multilateral (including IMF), bilateral partners, and commercial sources (bank loans, capital market issuances and other).** As of end June 2024, debt from multilateral and bilateral sources (excluding short-term bilateral deposits of USD 9 billion) cumulatively constituted USD 63.9 billion of the external debt portfolio, which are concessional in nature (Figure1 &Figure 2).

10. **As of end June 2024, the PPG debt-to-GDP ratio stood at 70.4 percent (depicting a year-on-year decrease of 8.6 percentage points from 79.0 percent at the end June 2023).** This decrease is attributed to the stability in PKR against international currencies and federal primary surplus, with domestic debt being the main source of financing the fiscal deficit. Furthermore, the increase in real GDP owing to recovery of all economic sectors, and lower real interest rate contributed to this reduction (Figure 3). Overall, the relative decline in external PPG debt-to-GDP ratio dominates. More specifically, the external PPG debt-to-GDP ratio reduced from 30.9 percent in FY2023 to 24.5 percent in FY2024, while the domestic PPG debt-to-GDP ratio fell from 48.1 percent to 45.8 percent during the same period.

Figure3: Contributions in PPG Debt Reduction (% of GDP)



Source: calculations based on DSA-MAC, Economic Adviser's Wing, Finance Division

11. **Over the medium-term FY2025-FY2027, Pakistan's strategy is to reduce its debt burden to a sustainable level.** This is to be achieved through maintaining federal primary surplus, prioritizing measures that support sustainable long-term economic growth, and efficient debt management. With a narrower fiscal deficit, public debt is projected to achieve a stable downward path while the government makes sound efforts to improve maturity structure, which will further facilitate debt sustainability.

4. BASELINE ASSUMPTIONS

12. **The main baseline macroeconomic and fiscal assumptions for the DSA FY2024 are outlined as follows:**

Table 2: Baseline Assumptions

	FY2024	FY2025	FY2026	FY2027
Real GDP growth rate(%growth)	2.4	3.6	4.8	5.5
Inflation Average (%, YoY)	23.4	12.0	7.5	7.0
Federal Primary Balance (% of GDP)[3]	0.4	1.02	0.4	0.5

Source: Economic Adviser's Wing, Finance Division

13. **Real GDP growth is projected from 3.6 percent in FY2025 to 5.5 percent in FY2027 on account of improved external account balance and recovery in the real sector.** Pakistan's economic and financial position has gradually improved in FY2024, attributed to prudent policy management and the resumption of inflows from multilateral and bilateral partners. The country has successfully completed the IMF's Stand-By

[3]The federal primary balance for FY2024 is obtained from the Fiscal Operations, Finance Division while the projections of this indicator is based on Medium-term Budget Strategy Paper 2024, Finance Division. The consolidated primary surplus (including the provincial surplus) recorded at 0.9 percent of GDP in FY2024 whereas the consolidated primary surplus is estimated at 2.0 percent of GDP in FY2025.

Arrangement (SBA) in April 2024, and entered in the new program of Extended Fund Facility in the first quarter of FY2025. These positive developments increased the confidence of economic agents, leading to a boost in economic activity. Moreover, to drive robust growth, the government is implementing sector-specific measures in agriculture, industry, and services, coupled with governance reforms. The main focus is on investment and export-led growth. In this regard, the government is prioritizing private and foreign direct investment through SIFC, with a special focus on agriculture, minerals, information technology, telecom, and energy sectors to accomplish sustainable economic growth.

14. Over the medium term, inflation is projected to decrease from 12.0 percent to 7.0 percent. This decline will primarily be driven by exchange rate stability, improved production, and a reduction in global inflation rates. Alongside this, the combination of optimal monetary policy, fiscal consolidation, and administrative measures are expected to play a key role in ensuring steady-state inflation.

15. The exchange rate has stabilized in FY2024 against the backdrop of a favorable current account balance, and is projected to be stable over the medium term. The inflow of foreign exchange remained sound, structural reforms have been undertaken in the foreign exchange market, and the State Bank of Pakistan maintained a tight monetary policy stance; all these measures have supported the stability of the PKR. Moreover, due to the continuity of these factors, a moderate exchange rate depreciation is projected over the medium term.

16. In alignment with the government's prudent fiscal management, the federal primary balance is projected to improve significantly during FY2025-2027. The federal primary balance-to-GDP ratio is projected to increase to 1.02 percent in FY2025and 0.5 percent in FY2027. The increase in primary surplus is expected to accomplish through tax revenue mobilizations and reducing non-essential expenditures by adopting a disciplined approach to achieve reduction in fiscal deficit. Over the medium term, attaining a positive primary balance underlines the government's commitment to a sustainable fiscal policy and its strategy towards ensuring debt sustainability.

17. The DSA has been performed in FY2024; therefore, the shocks calibrations start in FY2025. The shocks under alternative scenarios are as follows:

Sr. #	Shock Scenario	Shock Description
1	Federal Primary Balance Shock	i. Minimum shock equivalent to 50 percent of planned adjustment (50 percent implemented) in the baseline, or the baseline minus half of the 10-year historical standard deviation, whichever is larger. ii. Federal primary balance is set to historical averages i.e. -1.6 percent of GDP
2	Real GDP Growth Shock	Real GDP growth is reduced by 1 standard deviation for 2 consecutive years; the revenue-to-GDP ratio remains the same as in the baseline; the level of non-interest expenditures is the same as in the baseline.

Sr. #	Shock Scenario	Shock Description
3	Interest rate Shock	Interest rate increases by the difference between the average interest rate level over the projection period and the maximum historical level, or by 200 bps, whichever is larger. We assume the 300 bps increase in the nominal interest rate.
4	Exchange Rate Shock	Estimate of the maximum historical movement of the exchange rate, whichever is higher; pass-through to inflation with an elasticity of 0.25 for emerging markets. A 15 percent exchange rate depreciation has been assumed, which transmits its direct and indirect impacts on debt stock and flows.
5	Combined Macro-Fiscal Shock	Shock size and duration are based on all underlying shocks explained above. This scenario provides a pragmatic combined macro-fiscal shock effects on debt sustainability.
6	Financial Sector Contingent Liability Shock	Under this scenario, a one-time increase in non-interest expenditures equivalent to 10 percent of banking sector assets leads to a real GDP growth shock (see above): growth is reduced by 1 standard deviation for 2 consecutive years; revenue-to-GDP ratio remains the same as in the baseline; deterioration in primary balance lead to higher interest rate; decline in growth leads to lower inflation.

5. DEBT SUSTAINABILITY UNDER SHOCK SCENARIOS

5.1 Debt Sustainability Under the Baseline Scenario

18. **The PPG debt-to-GDP ratio is estimated at 66.6 percent in FY2027, a decline from 68.6 percent in FY2025.** Fiscal consolidation and growth-interest rate differential lead to a declining path of public debt to GDP ratio. Based on the underlying assumptions in the baseline scenario, the public debt-to-GDP ratio stays below the prudent benchmark, as depicted in Table 3. The GFN to GDP ratio is declining steadily from 25.4 percent in FY2025 to 19.5 percent in FY2027 (see Annex III), reflecting a moderate risk to impact the debt dynamics over the medium term.

19. **The Heat Map depicts that the debt dynamics continue to be shaped by external and domestic factors.** Despite improvement in the debt dynamics over the medium term, public debt risks remain high. Heatmap (see Annex I) illustrates the risk, as the debt-to-GDP ratio slightly exceed the thresholds in the baseline (70.4 percent in FY2024). The MAC DSA sets benchmarks for two key metrics: the ratio of public debt to GDP and the ratio of gross financing needs to GDP. For emerging markets, these benchmarks are set at 70 percent for the public debt-to-GDP ratio and 15 percent for the gross financing needs-to-GDP ratio. However, GFN-to-GDP ratio remains high in the baseline which indicates a risk to debt sustainability. The debt dynamics of Pakistan are complicated owing to risks of deviation in federal primary balance, exchange rate depreciation, slower economic growth, and the emergence of contingent liabilities. These are the key drivers of the increasing debt ratio and gross financing needs. However, external and domestic debt risk is weighed down by the improvement in quasi-fiscal operations, external financing requirements, and better market access during period of assessment.

5.2 Federal Primary Balance Shock

20. The granularity assessment indicates that Pakistan has limited space to absorb primary balance shocks. In the baseline fiscal projections, the primary balance is consistently on the improvement path on the back of the fiscal consolidation measures and stable economic growth. However, due to limited fiscal space, the sudden shift in the primary balance is not beyond expectation. The 50 percent cut in planned primary balance leads to an increase in the debt-to-GDP ratio to 69.4 percent in FY2027 (Table 3), but will remain sustainable over the medium term. The same is anticipated for the GFN to GDP ratio (see Annex III), as this shock will increase the gross financing need as well. In contrast, assuming a shock in primary balance which leads to the primary deficit close to the historical average (i.e. primary deficit of -1.6 percent of GDP), the debt-to-GDP ratio will exceed the benchmark to 73.1 percent and affect the debt sustainability. As indicated in Table 3, the changes in debt dynamics are evolving based on the fiscal policy decision.

5.3 Real GDP Growth Shock

21. An adverse event that slows down economic growth significantly increases the PPG debt-to-GDP ratio. The stress-test analysis identifies those adverse events, which slow down economic growth, and raises debt stress. In response to a 1 percent standard deviation shock to the economic growth in FY2025, the debt-to-GDP ratio will surpass the benchmark to reach 70.7 percent in FY2027(Table 3). The GDP growth shock will adversely affect the debt dynamics, and jeopardize the debt sustain ability over the medium term.

5.4 Interest Rate Shock

22. Real interest rate risks are moderate. The large share of floating rate debt within domestic debt (around 74 percent as end of December 2023) makes domestic debt vulnerable to the nominal interest rate shock. Particularly, this shock increases the risk of deteriorated interest payments in the near term. With low foreign exchange reserves and scarce market financing, the nominal interest rate adversely impacts the debt-to-GDP ratio. However, in this scenario, the negative differential between the real interest rate and growth helps in moderating nominal interest rate impacts on the debt-to-GDP ratio and GFN (see Appendix III). The debt-to-GDP ratio is expected to reach at 68.1 percent in FY2027 compared to 66.6 percent in same period in the baseline scenario (Table 3).

5.5 Exchange Rate Shock

23. The high share of external debt poses risks to debt sustainability through exchange rate depreciation. Although Pakistan's capacity to repay its obligations on external debt remains adequate, it is subject to risks emanating from inadequate export receipts, a rise in imports, and current account balance deterioration which may exert pressure on the exchange rate. The stress analysis indicates that exchange rate depreciation has the potential to widen the financing gap, thereby, increasing the debt-to-GDP ratio to 68.2 percent in FY2027 compared to the 66.6 percent in baseline in the same period, as indicated in Table 3.

5.6 Combined Macro-Fiscal Shock

24. The PPG debt-to-GDP ratio in a combined macro-fiscal shock scenario will exceed the 70 percent threshold and thereby risk the debt sustainability. The debt-to-GDP ratio in this scenario elevates from 68.6 percent in FY2025 to 75.2 percent in FY2027(Table 3). Lower than expected economic growth, rise in federal primary deficit, increase in interest rate, and exchange rate depreciation have the potential of significantly increasing the public debt and GFN, both as ratio of GDP, over the medium term (see Annex III). The simultaneous disturbances under the combined shock that develop the interaction of both macroeconomic indicators (like GDP growth, inflation, or exchange rates) and fiscal metrics (like primary balance deviation) reflects the more practical and large implication for debt sustainability.

5.7 Contingent Liability Shock

25. The public debt is vulnerable to an increase in contingent liabilities, as the debt-to-GDP ratio remains above the benchmark, which largely risks debt sustainability. The debt-to-GDP ratio in this scenario elevates from 68.6 percent in FY2025 to 72.8 percent in FY2027. A reduction in primary balance due to an increase in non-interest expenditure has detrimental impacts on the public debt, as indicated in Table 3. The GFN also increases by 2.1 percentage points of GDP over the medium term (see Annex III).

Table 3: Summary Table- Comparison of Shock Scenarios

S.#	Shock Scenarios (Baseline)	FY2025	FY2026	FY2027
	Nominal Debt (in percent of GDP)	68.6	67.8	66.6
	Gross Financing Need (in percent of GDP)	25.4	21.3	19.5
1.i	**Primary Balance Shock (Federal)**			
	Nominal Debt (in percent of GDP)	68.6	70.0	69.4
	Gross Financing Need (in percent of GDP)	25.4	22.5	20.9
	Deviation from Baseline	0.0	2.2	2.8
1.ii	**Historical Primary Balance (Federal)**			
	Nominal Debt (in percent of GDP)	68.6	71.3	73.1
	Gross Financing Need (in percent of GDP)	25.4	24.3	22.8
	Deviation from Baseline	0.0	3.5	6.6
2	**Real GDP Growth Shock**			
	Nominal Debt (in percent of GDP)	68.6	69.8	70.7
	Gross Financing Need (in percent of GDP)	25.4	22.1	21.1
	Deviation from Baseline	0.0	2.0	4.1
3	**Interest Rate Shock**			
	Nominal Debt (in percent of GDP)	68.6	68.4	68.1
	Gross Financing Need (in percent of GDP)	25.4	21.9	20.7
	Deviation from Baseline	0.0	0.6	1.5
4	**Exchange Rate Shock**			
	Nominal Debt (in percent of GDP)	68.6	69.2	68.2
	Gross Financing Need (in percent of GDP)	25.4	21.8	20.1
	Deviation from Baseline	0.0	1.4	1.7
5	**Combined Macro-Fiscal Shock**			
	Nominal Debt (in percent of GDP)	68.6	73.5	75.2

S.#	Shock Scenarios (Baseline)	FY2025	FY2026	FY2027
	Gross Financing Need (in percent of GDP)	25.4	23.1	22.8
	Deviation from Baseline	0.0	5.7	8.6
6	**Contingent Liability Shock**			
	Nominal Debt (in percent of GDP)	68.6	71.7	72.8
	Gross Financing Need (in percent of GDP)	25.4	23.7	21.6
	Deviation from Baseline	0.0	3.9	6.2

Projections Based on DSA-MAC, Economic Adviser's Wing, Finance Division

6. CONCLUSION

26. The DSA report comprehensively analyzes the PPG debt dynamics over the medium term. The baseline scenario indicates that the debt-to-GDP ratio is projected to decline, given the optimal policy mix to achieve macroeconomic stability and sustainability, fiscal consolidation and effectively managing the debt. However, uncertainty remains due to high gross financing needs.

27. The scenario analyses highlight the evolution in debt dynamics under the possibility of different shocks to fiscal and macroeconomic stability in future. Assessment under the alternative scenarios suggests that the debt dynamics of Pakistan are sensitive to deviation in federal primary balance, slower economic growth, exchange rate depreciation, high interest rate, and changes in contingent liabilities.

28. Considering the critical role of federal primary surplus to keep the debt-to-GDP ratio on a sustainable path, the government is focusing on increasing the tax-to-GDP ratio through revenue mobilization, improving tax administration, enhancing tax compliance, and broadening the tax base. Moreover, the government is focusing on adopting a performance-based budgeting process to improve expenditure management. This approach links budget allocations to specific performance outcomes and objectives, ensuring that funds are used efficiently and effectively to achieve desired results, thereby, would improve the fiscal space.

29. Ensuring a stable exchange rate aligned with the market fundamentals is a key to maintain public debt. With sound strategies, the government reduced the widening current account deficit (through increased exports and remittances), resumed foreign exchange inflows, and implemented structural reforms to regulate the foreign exchange market which supported the stability of the PKR in FY2024. Government will further strengthen these measures to retain the stability in exchange rate.

30. The government has adopted a multi-faceted strategy to maintain debt sustainability by diversifying borrowing sources and balancing costs and risks. Key actions include extending the maturity of domestic debt, smoothing repayment schedules, and improving transparency in debt issuance. The government plans to meet the financing need and reduce the borrowing costs by introducing various financial instruments, availing concessional borrowing from diversified sources, tapping the international capital markets, and encourage non-resident investment in government securities.

31. Finally, sustainable economic growth increases the government's capacity to manage its debt. The government is implementing home-grown structural reforms to achieve sustainable export-led growth by boosting productivity across all sectors, economic diversification, enhancing competitiveness, and fostering innovation and technological development. Moreover, government is committed toward increasing private and foreign investment which is vital to boost economic growth and reinstate market confidence.

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Annex I: RISK ASSESSMENT

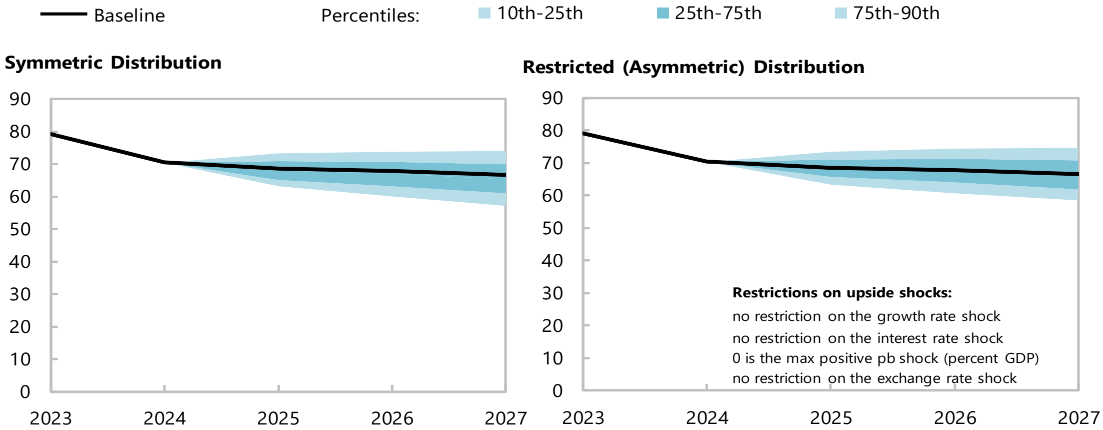
Pakistan Public DSA Risk Assessment

Heat Map

Debt level	Real GDP Growth Shock	Primary Balance Shock	Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs	Real GDP Growth Shock	Primary Balance Shock	Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

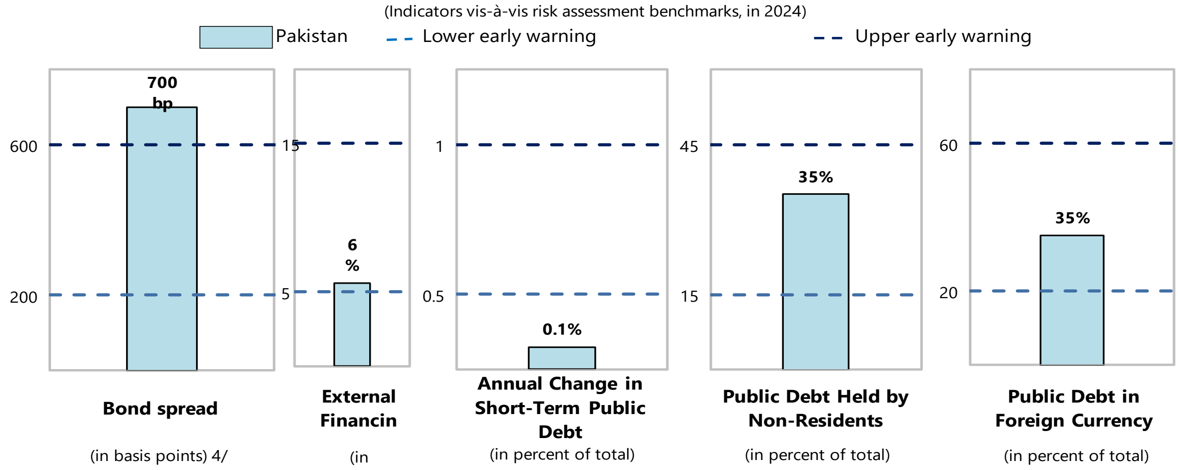
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2024)



1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG (bp), an average over the last 3 months, 16-5-24 through 9-9-24.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex II: BASELINE SCENARIO

Pakistan Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

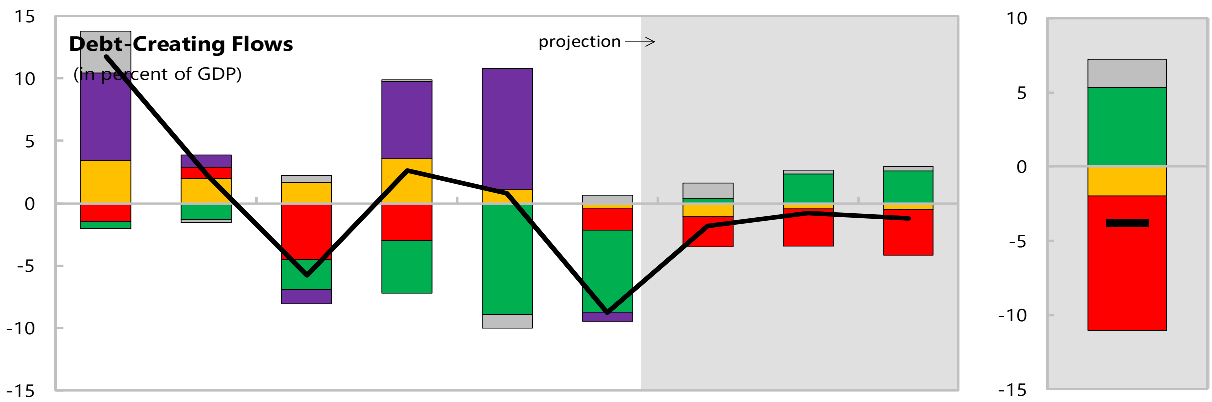
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections			As of September 09, 2024		
	2014-2022 [2/]	2023	2024	2025	2026	2027			
Nominal gross public debt	69.6	79.2	70.4	68.6	67.8	66.6	Sovereign Spreads		
Of which: guarantees	3.5	4.2	3.2	3.1	2.7	2.5	EMBIG (bp) 3/		788
Public gross financing needs	24.1	25.1	26.0	25.4	21.3	19.5	5Y CDS (bp)		1581
Real GDP growth (at market prices, in percent)	4.2	0.0	2.8	4.1	4.9	6.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	7.1	25.9	23.0	12.5	7.6	5.7	Moody's	Caa1	Caa1
Nominal GDP growth (in percent)	11.6	25.8	26.4	17.1	12.9	12.0	S&Ps	CCC	CCC
Effective interest rate (in percent) [4/]	7.7	11.6	13.1	13.7	11.8	10.3	Fitch	CCC	CCC

Contribution to Changes in Public Debt

	Actual		Projections				
	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.8	-8.8	-1.8	-0.8	-1.2	-3.8	
Identified debt-creating flows	1.9	-9.4	-3.0	-1.1	-1.6	-5.7	
Primary deficit	1.1	-0.4	-1.0	-0.4	-0.5	-2.0	-1.0
Primary (noninterest) revenue and grants	5.6	6.7	8.4	7.5	7.5	23.4	
Primary (noninterest) expenditure	6.7	6.3	7.3	7.0	7.0	21.4	
Automatic debt dynamics [5/]	0.8	-9.0	-2.0	-0.6	-1.0	-3.7	
Interest rate/growth differential [6/]	-8.9	-8.3	-2.0	-0.6	-1.0	-3.7	
Of which: real interest rate	-8.9	-6.6	0.4	2.3	2.6	5.4	
Of which: real GDP growth	0.0	-1.7	-2.4	-3.0	-3.6	-9.1	
Exchange rate depreciation [7/]	9.7	-0.7	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., privatization receipts) (+ reduces	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., other debt flows) (+ increases fir	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-1.1	0.7	1.2	0.3	0.4	1.9	

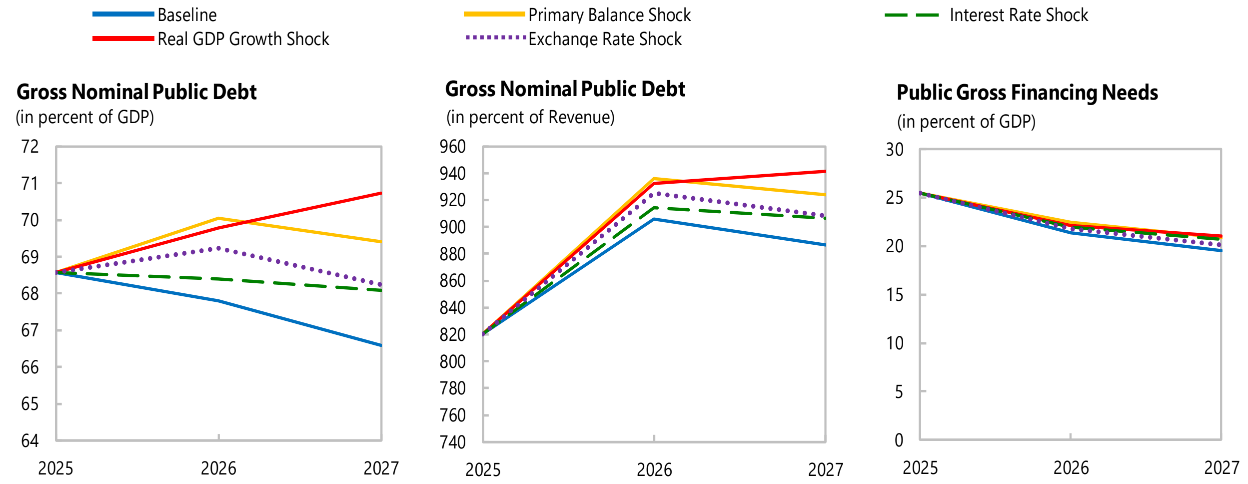


1/ Public sector is defined as general government and includes public guarantees, defined as .
2/ Based on available data.
3/ EMBIG (bp).
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ) times previous period debt ratio, with r = effective nominal interest rate; π = growth rate of GDP deflator; g = re
a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection peri
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

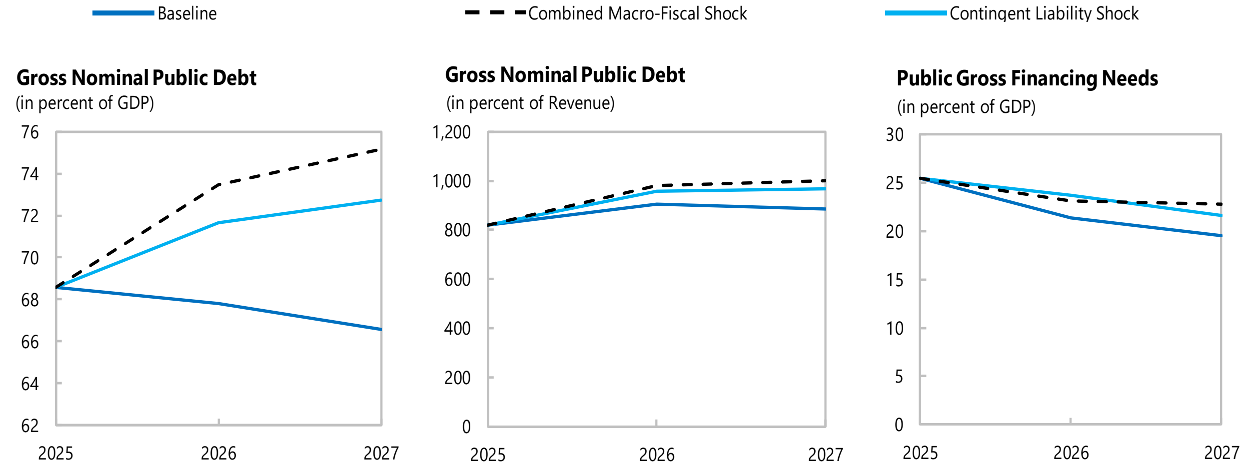
Annex III: STRESS TESTS

Pakistan Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2025	2026	2027
Primary Balance Shock			
Real GDP growth (at mkt prices)	4.1	2.5	6.0
Inflation (GDP deflator, in percer	12.5	7.6	5.7
Primary balance	1.0	-0.2	-0.1
Effective interest rate	13.7	11.8	10.2
Interest Rate Shock			
Real GDP growth (at mkt prices)	4.1	4.9	6.0
Inflation (GDP deflator, in percer	12.5	7.6	5.7
Primary balance	1.0	0.4	0.5
Effective interest rate	13.7	12.9	11.8
Combined Shock			
Real GDP growth (at mkt prices)	4.1	2.2	3.3
Inflation (GDP deflator, in percer	12.5	7.6	5.6
Primary balance	1.0	-0.2	-0.1
Effective interest rate	13.7	12.0	10.9

	2025	2026	2027
Real GDP Growth Shock			
Real GDP growth (at mkt prices)	4.1	2.2	3.3
Inflation (GDP deflator, in percent)	12.5	7.6	5.6
Primary balance	1.0	0.3	0.1
Effective interest rate	13.7	11.8	10.3
Exchange Rate Shock			
Real GDP growth (at mkt prices)	4.1	4.9	6.0
Inflation (GDP deflator, in percent)	12.5	11.3	5.7
Primary balance	1.0	0.4	0.5
Effective interest rate	13.7	13.0	10.6
Contingent Liability Shock			
Real GDP growth (at mkt prices)	4.1	2.2	3.3
Inflation (GDP deflator, in percent)	12.5	6.9	5.0
Primary balance	1.0	-0.6	0.5
Effective interest rate	13.7	12.8	10.3

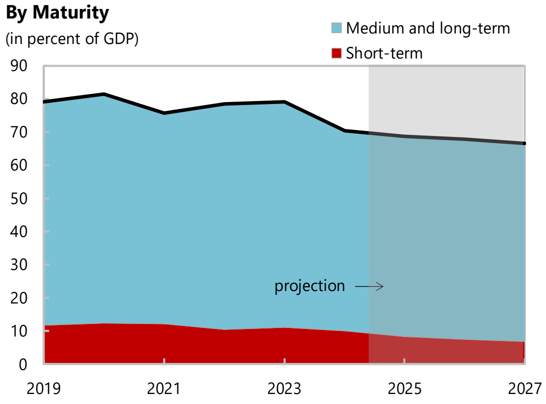
Annex IV: COMPOSITION OF PUBLIC DEBT AND ALTERNATIVE SCENARIOS

Pakistan Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

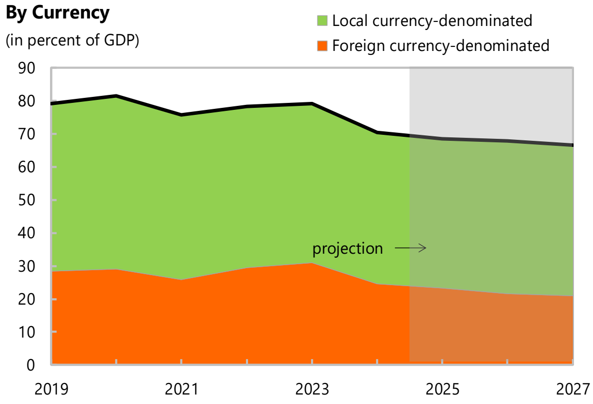
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

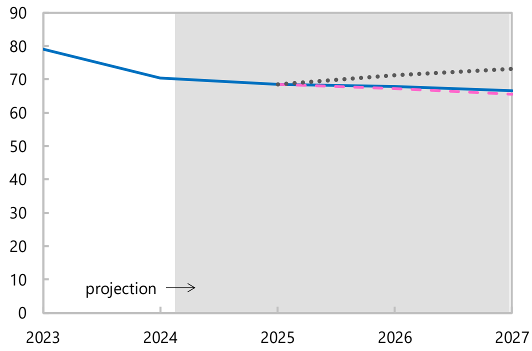


Alternative Scenarios

Baseline · Historical · Constant Primary Balance

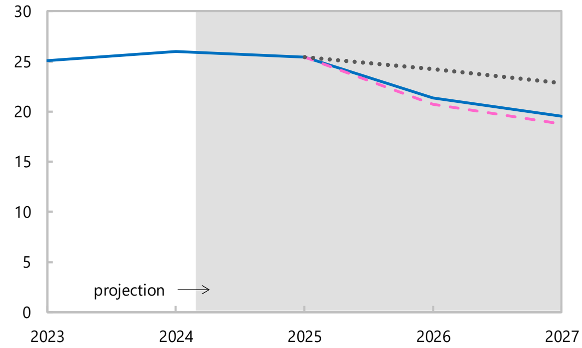
Gross Nominal Public Debt 1/

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

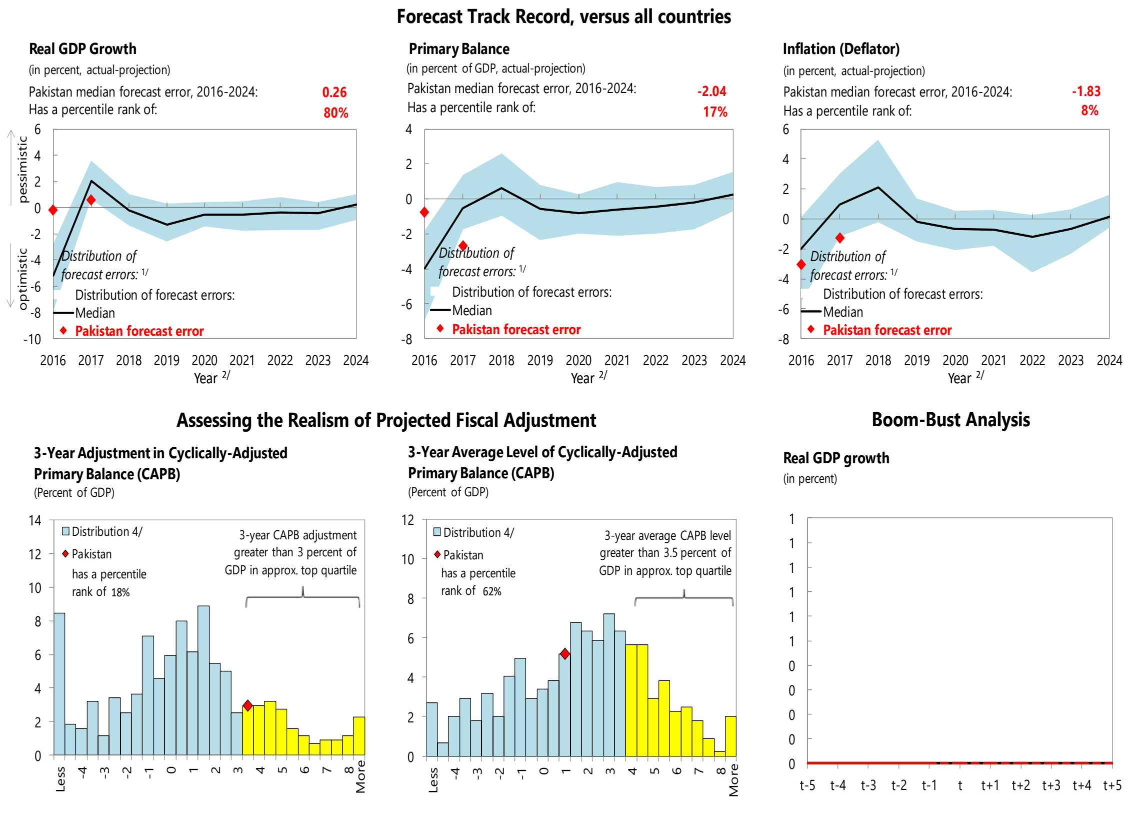
(in percent)

Baseline Scenario	2025	2026	2027
Real GDP growth (at mkt prices)	4.1	4.9	6.0
Inflation (GDP deflator, in percent)	12.5	7.6	5.7
Primary Balance	1.0	0.4	0.5
Effective interest rate	13.7	11.8	10.3
Constant Primary Balance Scenario			
Real GDP growth (at mkt prices)	4.1	4.9	6.0
Inflation (GDP deflator, in percent)	12.5	7.6	5.7
Primary Balance	1.0	1.0	1.0
Effective interest rate	13.7	11.8	10.3

Historical Scenario	2025	2026	2027
Real GDP growth (at mkt prices)	4.1	3.7	3.7
Inflation (GDP deflator, in percent)	12.5	7.6	5.7
Primary Balance	1.0	-1.6	-1.6
Effective interest rate	13.7	12.9	9.2

Annex V: REALISM OF BASELINE ASSUMPTIONS

Pakistan Public DSA - Realism of Baseline Assumptions



1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.