**DEBT SUSTAINABILITY ANALYSIS**

1. **Public debt profile.** Pakistan’s public debt reached 76.7% of gross domestic product (GDP) by the end of fiscal year FY2019 (June 2019) from 72.1% of GDP in FY2018 (without guarantee). This was primarily driven by a rise in the primary deficit (as a percentage of GDP) from 2.1% to 3.4% over the same period. As of June 2019, 54.7% of GDP was the domestic public debt.

2. **International Monetary Fund assessment.** An International Monetary Fund (IMF) debt sustainability analysis conducted on April 2020, indicates that given the temporary nature of the coronavirus disease (COVID-19) shock, debt to GDP will remain on a clear downward path, assisted by ongoing fiscal consolidation, introduction of a more flexible exchange rate, and a reduction in precautionary government cash deposits. An adjustment of 5 percentage points in primary fiscal balance to GDP ratio over five years starting from FY2020, debt to GDP ratio is expected to reach 73% by the end of FY2024 as against the expected debt to GDP ratio of 65.7% before the outbreak of the COVID pandemic (Figure 1). Notably, contingent liabilities from loss-making state-owned enterprises (SOEs), to the extent not covered by government guarantees would continue to represent additional fiscal risks above this debt stock.

3. While external debt risks remain high under the IMF Program, external debt is estimated to remain sustainable assuming a strong commitment to fiscal adjustment and economic reform by the government and a strong commitment from bilateral official lenders. External debt is projected to around 42% of GDP at end-FY2020 driven by sizable external borrowing, a significant current account deficit and currency depreciation. However, under the strong macro policy adjustments and structural reforms, external debt is projected to steadily decline after peaking in FY2021, returning to a more sustainable path primarily driven by lower current account deficit, non-debt creating capital inflows and higher growth.

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**Figure 1: Debt to GDP Ratio (%)**

Source: IMF Debt-Sustainability Assessment (Footnote 1).

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2 If we take the definition of public debt as per the Fiscal Responsibility and Debt Limitation Act, 2005 (FRDLA) 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 International Monetary Fund (IMF) less accumulated deposits of the Federal and Provincial Governments with the banking system), the debt to GDP ratio was 76.7% ([http://www.sbp.org.pk/ecodata/Summary.pdf](http://www.sbp.org.pk/ecodata/Summary.pdf)).

3 To make the two sets of analyses comparable, the IMF analysis presents the debt stock excluding guarantees. IMF analysis for pre COVID-19 situation does not include additional $1.4 billion assistance from IMF in FY2020 due to COVID-19.

4 External debt sustainability is taken from IMF’s Debt Sustainability Analysis (DSA).
4. **Asian Development Bank Assessment.** Asian Development Bank (ADB) prepared an updated Debt Sustainability Analysis (DSA) on 30 April 2020. ADB analysis presents three scenarios (Figure 2): (i) pre COVID-19, (ii) post COVID-19 with only additional IMF assistance of $1.4 billion (0.5% of GDP in FY2020)\(^5\) and (iii) post-COVID with additional financial assistance (over and above IMF assistance) from ADB, the World Bank and the Asian Infrastructure Investment Bank (AIIB). The second and third scenarios (post-COVID) are based on the revised growth projections from the Ministry of Finance (MOF), Pakistan, showing a decline in the GDP growth rate by 0.38% in FY 2020 due to the COVID-19 pandemic. The ADB analysis also incorporates a more intense fiscal adjustment which is in line with current government plans. Under the third scenario, the primary fiscal balance reaches a surplus of 2.7% of GDP by FY2024, against an IMF forecast of 1.5% of GDP. This could be attributed to slightly higher effective rate of interest assumed in the ADB analysis. The underlying adjustment to the primary balance (as a percentage of GDP) is shown in Figure 3.

![Figure 2: Figure 1: Debt to GDP Ratio (%)](image)

Source: ADB Estimates

5. **Assessment of additional ADB support for COVID-19.** The proposed ADB’s new assistance for COVID-19, totaling $852 million and on broadly concessional terms,\(^6\) represent 0.3% of GDP and 0.4% of the country’s outstanding public debt stock. While providing critical countercyclical support to the economy, these loans will neither affect the debt ratio nor increase the annual debt service obligations of the government significantly. Additional loans approved by the World Bank ($950 million) and the Asian Investment Infrastructure Bank ($500 million) will together add another 0.5% of GDP to the debt stock in FY2020. Together, additional lending from the three institutions for COVID-19 would ramp up public debt by another 0.8% of GDP (without guarantee) in FY2020. With additional financial support from ADB, AIIB, IMF, and the World Bank, the debt to GDP ratio will be 72.0% by FY2024 as against 71.3% in the post-COVID scenario with only IMF assistance (Figure 2).

\(^5\) However, with rescheduling of two disbursements under EFF in March and June 2020, net additional disbursement from IMF, over the baseline, will be 0.2% of GDP in the post-COVID scenario.

\(^6\) Of this $852 million, (i) ADB provided $30 million from the ongoing National Disaster Risk Management Fund (NDRMF) project; (ii) NDRMF Board allocated $20 million of earned interest from the Endowment Fund capitalized under the project; and (iii) $2 million is a grant from the Asia Pacific Disaster Response Fund.
The higher fiscal adjustment required in the ADB assessment will require a small primary surplus to emerge in FY2021, to achieve the projected debt stock by FY2024 (Figure 3). This will be an intense fiscal consolidation effort and require strong political commitment and a return to move favorable economic circumstances.

The availability of adequate concessional financing will also play a critical role in the government’s ability to meet these fiscal consolidation target. Non-availability of adequate multilateral financing will have an adverse impact on the debt trajectory due to higher effective interest rate if the government has to borrow from more expensive sources. This is attributed to higher cost of borrowings.

There are three major risks that could undermine these assessments and lead to higher debt trajectories. These include: (i) weak adherence to fiscal consolidated targets and a lower primary surplus; (ii) lower than expected growth; and (iii) a higher real effective interest rate. This underscores the importance of sustained fiscal consolidation efforts and continued commitment to the targets and reform objectives outlined under the IMF’s Extended Fund Facility program.

![Figure 3: Primary Balance (Percentage of GDP)](image)

**Figure 3: Primary Balance (Percentage of GDP)**

ADB = Asian Development Bank, GDP = gross domestic product, IMF = International Monetary Fund.

Source: IMF Debt-Sustainability Assessment and ADB.

Conclusion. Major challenges remain to achieve a 5-6 percentage points reduction in the primary deficit and bring down the debt stock to GDP ratio by FY2024. This depends on four key parameters: (i) early control of the COVID-19 outbreak; (ii) global growth and employment recovery phase begins; (iii) tax buoyancies return to the pre-COVID levels; and (iv) a swift exit from temporary tax and fiscal incentives and transfer payments implemented as part of the Government’s COVID-19 Response Plan.

Three counterfactual simulations with primary surplus were carried out to highlight this point. First, if GOP’s primary surplus is fixed at 1% of GDP during FY2022, FY2023 and FY2024, the debt stock to GDP ratio will be 77.8% in FY2024 as against 72.9%. Second, if primary surplus gradually increases by 0.3% of GDP from FY2022 and end up with 1.3% of GDP in FY2024, the debt to GDP ratio will be 78%. Third, if primary deficit continues with 1% of GDP from FY2021, GOP will end up with a debt stock figure of 85% of GDP in FY2024.