Pakistan Economy

June 14, 2023

REP-057

Pakistan Debt Restructuring – Part 3

Orderly Bilateral Debt Reprofiling

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Finance Minister again hinted at the possibility of debt reprofiling

News Articles

Pakistan seeks rescheduling of $27b bilateral debt: Dar

Dar says IMF's new emergency "food shock" borrowing window may also be a good fit for the country

Reuters October 15, 2022

Article by Tribune,
Pakistan seeks rescheduling of $27bn bilateral debt: Dar
Dated: Oct 15, 2022

Pakistan working on possible restructure of debt with bilateral lenders, finance minister says

By Gibran Naiyyar Peshimam and Ariba Shahid

June 10, 2023 4:12 PM GMT+5 · Updated 4 days ago

Article by Reuters,
Pakistan working on possible restructure of debt with bilateral lenders, finance minister says
Dated: Jun 10, 2023

Pakistan PM Says 'All Hell' to Break Loose Without Debt Deal

- Government signed 'very tough' agreement with the IMF, he says
- Nation ravaged by disaster, and political, economic turmoil

Article by Bloomberg
Pakistan PM Says 'All Hell' to Break Loose Without Debt Deal
Dated: Sep 23, 2022

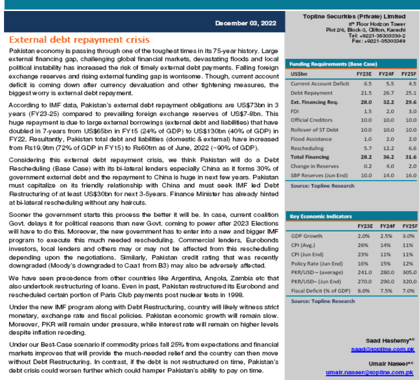
Pakistan debt relief requests won't include commercial creditors

Reuters

September 23, 2022 8:24 PM GMT+5 · Updated 9 months ago

Article by Reuters
Pakistan debt relief request won't include commercial creditors
Dated: Sep 23, 2022

Topline Previous Reports on Pakistan Debt Restructuring



December 03, 2022

External debt repayment crisis

Pakistan's Debt Restructuring
Dated: Dec 03, 2022

Pakistan Economy

Pakistan Debt Restructuring – Part 2
Effective Management of External Debt is Critical

Executive Summary

Pakistan Debt Restructuring Part II
Dated: Jan 24, 2023

- Pakistan's Finance Minister, Mr Dar in a recent press conference had said that Pakistan is working on External Debt reprofiling of its bilateral debt.
- After taking charge in Sep-2022, Mr Dar in Oct-2022 said Pakistan may seek rescheduling of some US$27bn worth of Non-Paris Club debt largely owed to China, but will not pursue haircuts as part of any restructuring. Since then there was no discussion on this topic.
- Before that in Sep-2022, Pakistan Prime Minister in an interview with Bloomberg TV said we have sought a moratorium on Pakistan's debt repayments from the Paris Club and others. As a result, Pakistan's Eurobonds prices fell by 5-10% in one day after his statement.
- Soon after that statement, Mr Miftah Ismail (Former Finance Minister) clarified on Sep 23, 2022 that "We are neither seeking, nor do we need, any relief from commercial banks or Eurobond creditors."
- Topline has been writing on Pakistan Debt Restructuring since Dec-2022 due to huge external debt repayments in next few years.
- In Dec 03, 2022, we issued a detail report captioned ***"Pakistan's Debt Restructuring - External debt repayment crisis*** where we highlighted Pakistan's external debt repayment obligations and the need to address them in a sustainable way. We had opined these external debt repayments are too high and should ideally be rescheduled and reduced to more sustainable levels.
- After that in Jan 24, 2023, we issued ***"Debt Restructuring Part II - Effective Management of External Debt is Critical"*** in which we recommended Pakistan should ideally try to go for pre-emptive debt restructuring by converting its short term external loans with long term with the help of friendly countries. This will be less painful and will help in speedy recovery.
- In that report we said that if the government does not opt for orderly and amicable restructuring and continues to rely on short term funding from friendly nations to manage the country's external accounts, the country could move towards a disorderly and coercive restructuring that will be very painful and may trigger a further credit rating downgrade.

Pakistan current IMF Program will end in June-2023

IMF Current Program Timeline	
Timeline	**Dates**
First Review	
Staff Level Agreement (SLA)	November 8, 2019
IMF Board Approval	December 19, 2019
Second, Third, Fourth and Fifth Reviews	
Staff Level Agreement (SLA)	February 27, 2020
IMF Board Approval	March 24, 2021
Sixth Review	
Staff Level Agreement (SLA)	November 21, 2021
IMF Board Approval	February 4, 2022
Seventh and Eight Reviews	
Staff Level Agreement (SLA)	July 13, 2022
IMF Board Approval	August 29, 2022

Source: IMF, Topline Research

- Finance Minister of Pakistan who has been saying that Pakistan will not default has recently said that they are considering to Reprofile/Restructure bilateral debt. This signals that situation is not fully under control on the debt repayment front.
- He said that they are working on extending external loan repayment without any haircut not giving any more details.
- He also mentioned that Paris Club Loans and Multilateral Loans will not be reprofiled. He did not specifically mentioned about Commercial loan and Eurobonds, but we understand that he doesn't want to touch these also.
- Interestingly, SBP Governor after the Finance Minister Statement said, he is not aware of Debt Reprofile/Restructure.
- Pak Eurobonds, local stock market and PKR did not show any major reaction after this recent statement, as we think current bond and stock prices have already incorporated to a larger extent a possibility of debt restructuring.
- This comes at a time when Pakistan IMF Program is about to end in Jun-2023 with third last tranche (9th review) still pending as certain IMF conditions are not met. Pakistan also blames geo-politics for this delay.
- To recall, 9th review of Pakistan US$7bn EFF program was initially scheduled in September 2022 but was delayed due to lack of imposition of policy actions including market driven exchange rate, energy tariff rationalization & increased tax measures, among others.
- As per media reports IMF needs credible assurance of US$6bn from different lenders out of which US$4bn support has been provided so far. Moreover budget and some issues related to currency market is also a concern for the IMF.
- Considering that IMF funding may not be coming soon, Pakistan may have think to speed up the process of debt reprofiling or/and immediate inflows from friendly countries.

China is a major contributor to Bilateral & Commercial debt

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Pakistan External Debt Composition March-2023

US$bn		% of Total
External Debt Total	**96.3**	**100%**
Multilateral Creditors	**44.6**	**46%**
IMF	7.5	*8%*
Bilateral Creditors	**37.5**	**39%**
Paris Club	8.8	*9%*
Non-Paris Club	28.8	30%
Bonds/Sukuk	**7.8**	***8%***
Commercial Creditors	**6.4**	***7%***

Source: SBP, Topline Research

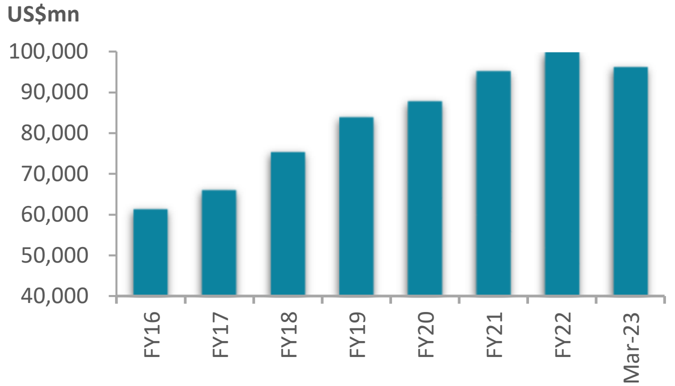
Estimated Monthly Public Debt Repayments net of Rollover in FY24

Source: Dawn News Paper

- Based on available information, Pakistan total external public debt is US$96bn (28% of GDP) as of March 2023. External debt and liabilities are at US$126bn.
- Multilateral debt (owed to International Financial Institutions) accounted for the bulk at 46% or US$45bn out of US$96bn.
- Bilateral debt is currently at US$38bn or 39% of which Paris Club is US$9bn and Non Paris Club is US$29bn.
- On the other hand, Commercial Debt has fallen close to US$6bn while Bonds and Sukuks are US$8bn constituting only 15% of total external debt.
- According to our estimates, China lending to Pakistan stand between US$25-30bn including bilateral loan and commercial loan through Chinese institutions.
- Similarly Saudi Arabia has provided Pakistan an estimated amount of US$5-10bn.
- In next 12 months Pakistan has to pay US$23bn according to SBP Governor. Out of that as per our estimate 30-40% is due to China and Saudi Arabia.
- Net amount payable after expected rollover is US$9-11bn in FY24. Rollover is again a risk in prevailing economic conditions.
- Thus China along with Saudi Arabia can help Pakistan come out of this crisis. There is an urgent need for Pakistan to engage with China and capitalize on its historical ties to get this less painful orderly debt reprofiling at reasonable terms and conditions.
- It has been reported that China seems unwilling to participate in debt restructuring unless the other lenders including World Bank and other regional development banks also agree to write down their own loans.
- However World Bank dismisses that demand, arguing that development bank financing already comes with low interest rates and does not add significantly to a country's debt burden.
- In Sri Lanka, China's delayed assurances to agree on a plan for Debt Restructuring was seen as the last hurdle in securing the IMF bailout.

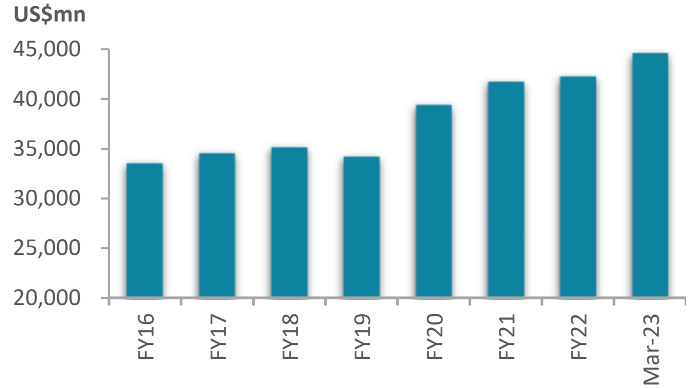
Pakistan External Debt in Graphs

Pakistan: Public External Debt Trend



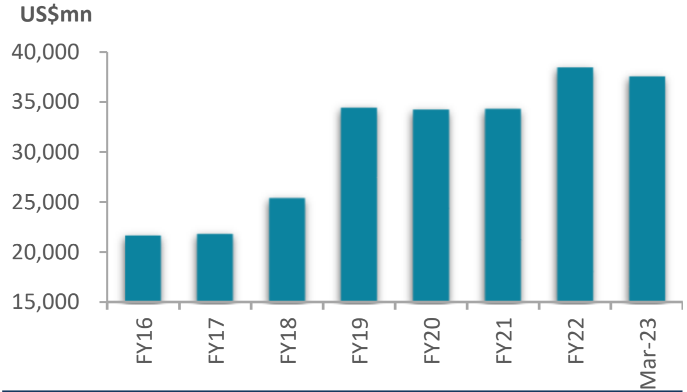
Source: SBP

Pakistan: Multilateral Debt Trend



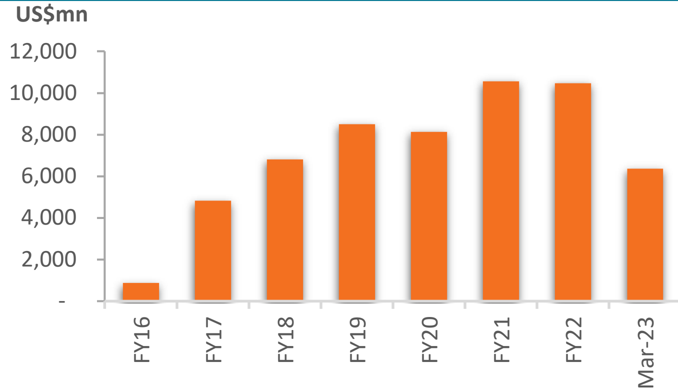
Source: SBP

Pakistan: Bilateral Debt Trend



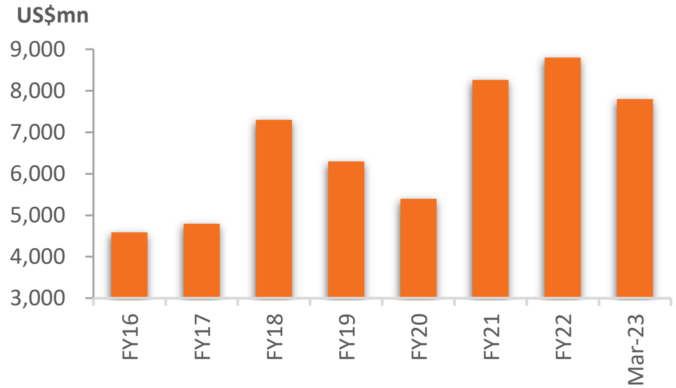
Source: SBP

Pakistan: External Commercial Loan Trend



Source: SBP

Pakistan: Euro/Sukuk Bonds Trend



Source: SBP

Timely and orderly Debt Restructuring needed

Angola – Rating Improved After Debt Restructuring in 2020

Moody's Rating	Outlook	Date
B3	positive	Oct 20 2022
B3	stable	Sep 13 2021
Caa1	stable	Sep 08 2020
B3	under review	Mar 31 2020
B3	stable	Apr 28 2018
B2	under review	Feb 07 2018
B2	stable	Oct 20 2017
B1	negative	Apr 29 2016
Ba2	negative watch	Mar 04 2016
Ba2	negative	Mar 04 2015
Ba2	stable	Aug 08 2014
Ba3	positive	Aug 22 2012

Source: Moody's

Sri-Lanka - Rating downgraded to Default in Economic Crisis of 2022

S&P		Fitch	
Ratings	Date	Ratings	Date
Selective Default	Apr 25 2022	Restricted Default	May 19 2022
CC	Apr 13 2022	C	Apr 13 2022
CCC	Jan 12 2022	CC	Dec 17 2021
CCC+	Aug 27 2021	CCC	Nov 27 2020
CCC+	Dec 11 2020	B-	Apr 24 2020
B-	May 20 2020	B	Dec 18 2019
B	Jan 14 2020	B	Dec 03 2018
B	Dec 04 2018	B+	Feb 09 2017
B+	Nov 20 2017	B+	Feb 29 2016
B+	Mar 10 2016		
B+	Feb 29 2012		

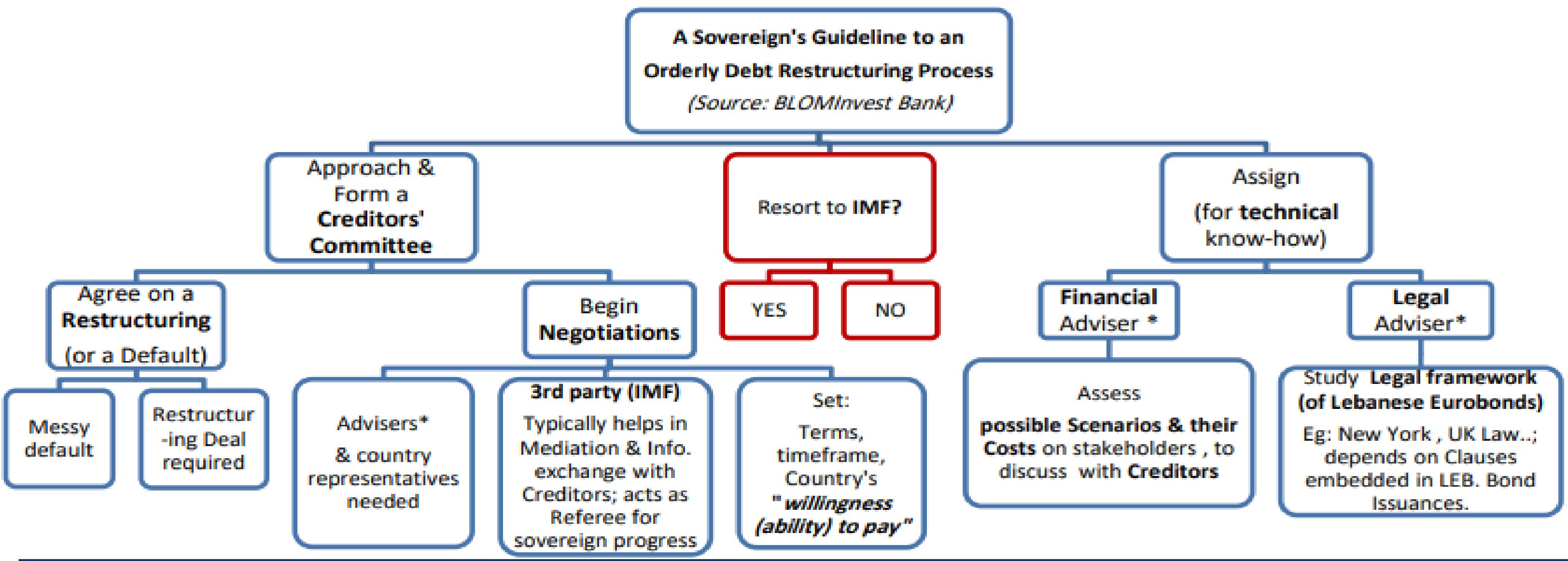
Source: S&P, Fitch

- Pakistan is currently facing a liquidity crisis and not a sovereign crisis, we think. This is because Pakistan overall external debt is not huge but reliance on short term foreign loans is creating issues with repayment.
- In our report ***Debt Restructuring Part II*** we also suggested that ideally Pakistan should go for an orderly preemptive Debt Restructuring. This will be less painful and will help in economic stabilization and faster than expected economic recovery.
- Pre-emptive restructuring is quicker to complete and secure higher creditor participation, according to experts. It provides faster access to international capital markets, as per the empirical evidence.
- We also believe that new IMF Program will most likely come with the condition of this debt reprofiling or debt restructuring. We have also seen IMF supporting Debt Restructuring both in case of Ghana and Sri Lanka.
- Based on our Research, Angola stands out having restructured their debt proactively and their macroeconomic indicators have improved after going through a brief period of distress.
- If Pakistan delays the negotiation process of Debt Restructuring or Reprofiling at a time when IMF review is getting pushed back, then the consequences will be very painful.
- Post-default restructuring usually aims to tackle a solvency crisis and is more painful. This entails larger haircuts while the country takes years to come back to the market due to bad reputation.
- As seen in few countries, restructuring post default results in hyperinflation, higher interest rates, sharp currency devaluation, food/fuel shortages, local debt restructuring etc.
- The debt restructuring events of Argentina, Ghana, Sri Lanka and Zambia can be classified as disorderly and post default. Their pre and post debt restructuring economic indicators remain challenging and all were classified by rating agencies under default.

Formal process of Debt Restructuring should start

- But the issue is who will initiate this formal process of debt reprofiling/restructuring in full spirit in Pakistan. The current coalition government term will be over in second week of August-2023. Then there will be an interim government for 2-3 months.
- And if Election are held on time in Oct/Nov then the new government will be taking charge in Nov/Dec 2023.
- There are slim chances that the present coalition government (PDM) might get its office term extended beyond August-2023. The government might invoke the Article 232 of the constitution under the garb of 'Emergency' in the country on the pretext of security concerns or/and financial crisis.
- Whosoever is in charge of Finance Ministry the delay in initiating this transaction is risky and increases a chance of disorderly default that has its far reaching consequences as mentioned earlier.
- Ideally Pakistan should start active work on this Debt Restructuring and if needed should hire legal experts and consultants.
- Sri Lanka hired leading financial and legal advisory firms Lazard and Clifford Chance LLP in May-2022 and IMF board approves US$3bn under the new Extended Fund Facility (EFF) exactly 9 months after that.
- In 1999 when Pakistan announced debt moratorium it hired experts to assist them in negotiations with different lenders.
- Pakistan cannot afford any further delay in negotiation with IMF for a new loan along with hiring experts for Debt Restructuring. Inaction has already cost the country and further delays may cause an abrupt default.

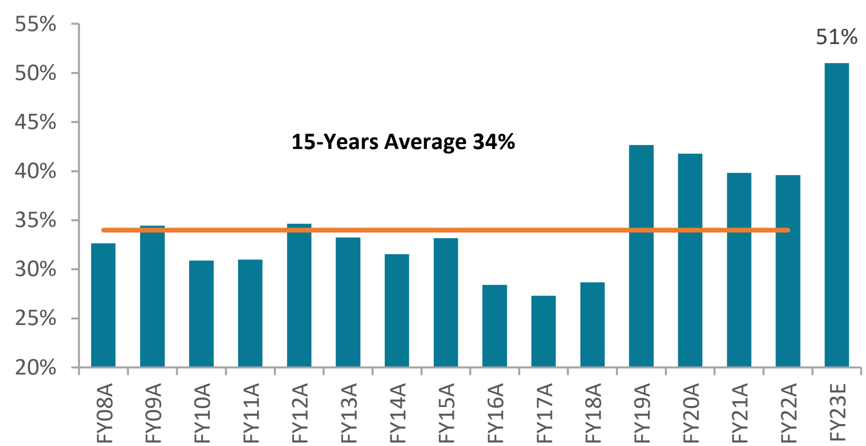
A Guideline to Orderly Debt Restructurings with Special Reference to Lebanon



Source: Blominvest Bank

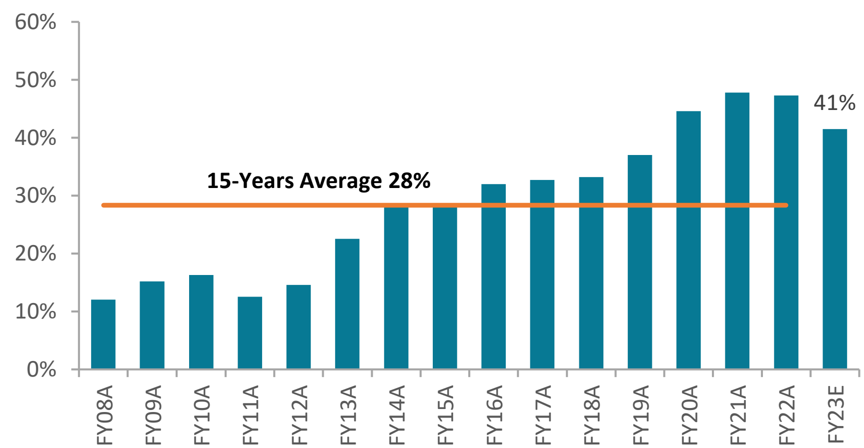
Domestic Debt Restructuring: Chances are low but cannot ruled out

Pakistan: Markup Expense to Total Revenue Trend



Source: MoF, Topline Research

Ghana: Markup Expense to Total Revenue Trend

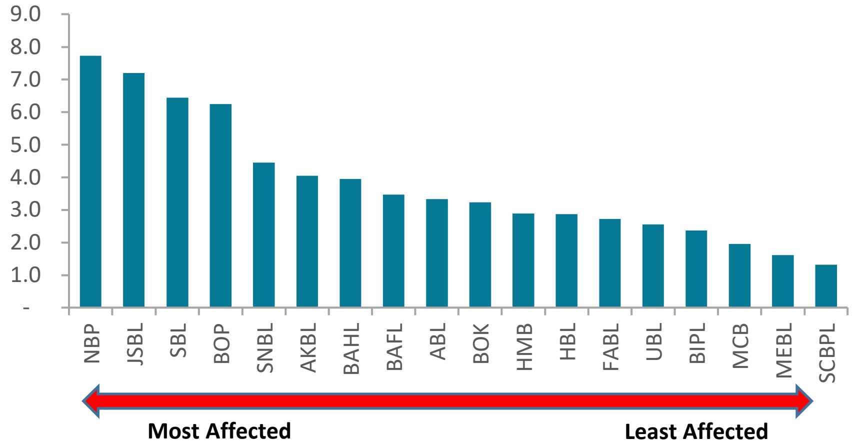


Source: IMF, Ghana's MOF, Topline Research

- Though Finance Minister has ruled out chances of domestic debt restructuring, but in case demanded by lenders this may happen.
- It all depends on how Pakistan capitalize on its relationship with China and other bilateral lenders. If negotiations are smooth then the local debt may not be touched.
- But from Ghana and Sri Lanka experience we see that external lender insist for equal treatment therefore local debt was also affected.
- Pakistan markup expense to total federal revenue is expected to reach a record 51% in FY23 vs average of 34% in last 15 years. In Ghana, same ratio is expected to reach 41% in FY23 vs 15 years average of 28% and in Sri Lanka it is expected to reach 67% in FY23 vs 45% in last 15 years.
- Pakistan's Domestic debt to GDP is 43% which is very much similar to Ghana of 46% and Sri Lanka of 50%.
- In Ghana, domestic debt restructuring has done through voluntary debt exchange of all domestic debt instruments other than T-bills. In total, 85% of the face value of bonds held by investors other than pension funds was exchanged which is equivalent to 28% of all outstanding domestic debt.
- Ghana's Government offered most bondholders a set of new bonds at fixed exchange proportions with a combined average maturity of 8.2 years and coupons of up to 10% (with part of the coupons capitalized rather than paid in cash in 2023 and 2024).
- At a 16-18% discount rate, the final terms imply an average NPV reduction of about 30% for these bondholders of Ghana, according to IMF. Individual bondholders were also offered an exchange into shorter term debt with higher coupons. As per IMF, local debt restructuring will provide a relief of almost GHS50bn (82% of interest expense) in 2023.

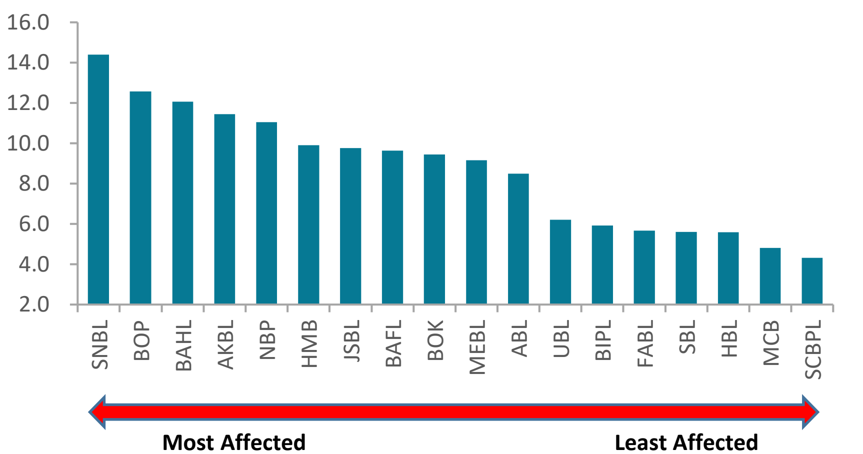
Domestic Debt Restructuring: Sri Lanka and Ghana experience

Investment Income to total earnings in 2023E



Source: Bank Accounts, Topline Research

Federal Securities to Total Equity 2023E



Source: Bank Accounts, Topline Research

- In Sri Lanka, second tranche of IMF under EFF program is also linked to debt treatment and the Debt Restructuring talks with local creditors. Government had initially planned to present debt plan in April 2023.
- After delays, Sri Lanka is now expected to complete workings on Debt Restructuring by July 2023 and is targeting to complete this exercise by September 2023 which is time for first review by IMF.
- In case IMF and other lenders insist on equal treatment then the Government may target to reduce its mark up payments on local debt along with other measures including an increase in tax rates on interest income.
- This could lead to a probable cut in yields on Government Securities to generate desired savings for the government and to create fiscal space.
- We believe, cut in investment yield will affect short term profitability and Balance Sheet of Banks. Earrings of Banks with high investment income to total earnings will be most affected while banks with lowest investment income to total earnings will be less affected.
- In terms of Capital Adequacy Ratio (CAR), few banks will not be able to meet minimum CAR requitements if there is a reduction in investment yield and thereby affecting the dividend paying ability of banks, as per our analysis.
- We believe that in case local Debt Restructuring happens then SBP will provide support in the form of (1) lower MDR to reduce impact on earnings and balance sheet, (2) moving from AFS & HFT to HTM category and (3) extension in meeting CAR and other capital related requirement.

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