COUNTRY RISK CATEGORY

7

OF 7

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Pakistan

COUNTRY ANALYST

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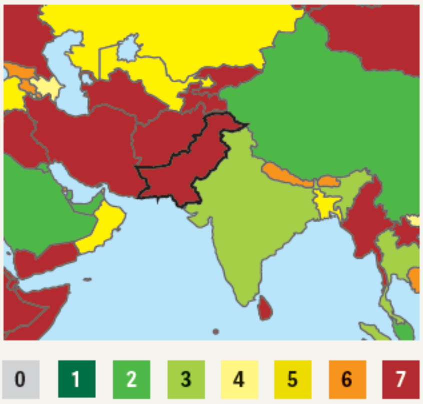
Basic facts (2021)

Population: 223 million

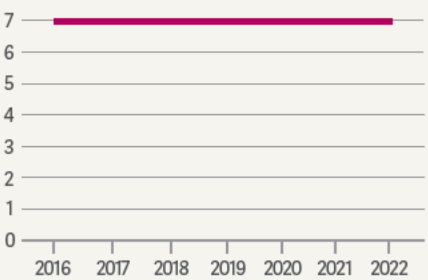
GDP, nominal: USD 348 billion

GDP/capita: USD 1 562



The country risk categories are arranged on a scale from 0 to 7. The lower the figure, the better the country's creditworthiness

Country classification history



Source: EKN

Strengths

+ Strategic interest from China, translates into investments and financing opportunities
+ Strong relations with multilateral and bilateral donors
+ Growth potential with a large economy and young population
+ Significant inflow of remittances.

Weaknesses

– Inherent risk of political instability, given social tensions and the geo-political situation

– Fragile economic stability due to weak public and external finances

– Challenging business environment and extensive corruption

– Exposure to climate change

Structural challenges hamper the growth potential

Factors such as a large economy with a GDP equivalent to USD 348 billion (2021) and the world's 5th largest population of some 225 million inhabitants, contribute to a measure of resilience and potential for growth. The economy is largely driven by household consumption (approx. 80% of GDP). The export sector and manufacturing industries are underdeveloped, accounting for a low 10% and 12% of GDP respectively. Robust remittance inflows (approx.. 9% of GDP), over half of which originate from the Gulf states, are the country's principal foreign exchange earner, stabilising consumption and financing part of the country's structural trade deficits.

As one of the poorer countries in Asia, Pakistan faces a number of structural challenges, not the least in being able to generate employment opportunities for a growing youth population. Geopolitical, religious and social tensions remain and imply a latent risk to political stability, despite three peaceful changes of power since the introduction of parliamentary democracy in 2010. Pakistan is a violence-stricken country with militant Islamism and armed conflict present in parts of the country. . The security situation is now complicated by the Taliban's seizure of power in Afghanistan, which contributes to increased activity by Pakistan's home-grown Taliban movement. The military and a dynastic political elite, whose vested special interests sometimes conflict with much-needed reforms, exert significant influence on politics. The situation undermines the ability to sustainably pursue a disciplined economic policy. Weak institutional settings and a difficult business climate are reflected in low government revenues, low levels of investment, and the fact that the banks' lending to the private sector remains limited while exposure vis-à-vis the central government is high. Since 2015, major investments are being made within the framework of the China-Pakistan Economic Corridor (CPEC), which has the potential to reduce infrastructural bottlenecks. The challenge is to ensure these debt-financed investments start generating economic returns in terms of growth and competitiveness, in order to be able to make the repayments that will start in the next few years. A related challenge is to reduce the country's macroeconomic vulnerabilities in terms of high levels of sovereign indebtedness and fragile external finances. Public debt amounts to over 75% of GDP and interest payments consume more than 35% of central government revenues. The risks are mitigated by the fact that two-thirds of the debt is domestic, while the external part is dominated by long-term bilateral and multilateral loans. However, current account deficits and debts falling due generate large external financing needs relative to low foreign exchange reserves, making it critical to secure external financing on an ongoing basis, not the least from the IMF, China and the Gulf states.

Domestic political tensions fuel uncertainty

Pakistan is again in a phase of rising macroeconomic uncertainty, as domestic political tensions converge with deteriorating external conditions. The economy weathered the 2020-2021 years of the pandemic relatively well, despite the pressures of growing poverty and rising unemployment. The country received

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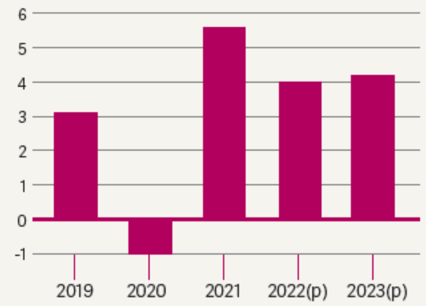
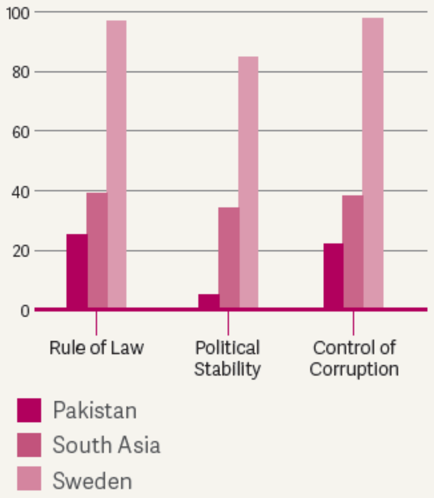
GDP growth (fixed prices, % per annum)



Source: IMF WEO, Macrobond

Business environment



Ranking from 0 (worst) to 100 (best)

Source: The World Bank, Macrobond

financial assistance from China, the Gulf States, multilaterals as well as through the Paris Club's temporary deferral of repayment. Meanwhile, the pace of reform has slowed. The IMF Programme (2019-2022) was paused and since its resumption, implementation has been uneven. Politically sensitive structural reforms lag behind. These include revenue-enhancing tax reforms and reforms in the debt-laden energy sector. In addition, the previous government's stimulus policies clashed with the IMF Programme's goal of stabilising the sovereign debt. IMF disbursements were thus paused and have been on hold since March 2022. The situation is further complicated by a change of regime that took place in April. The change of government was peaceful, taking place via a no-confidence vote, however it resulted in growing domestic political polarisation. Using populist rhetoric, protest rallies and calling for early elections (August 2023), the opposition is putting pressure on the fragile new coalition government. The political tensions increase the risk vis-à-vis the IMF Agreement and contribute to the country's loss of access to international capital markets. As a net commodity importer with substantial external financing needs, the country is simultaneously vulnerable to global rising raw material prices and financing costs, trends that have been exacerbated by the war in Ukraine. Increased import bills for energy and grain are adding to already high inflationary pressures and contributing to widening current account deficits. Lacking external financing, foreign exchange reserves have fallen sharply since the beginning of the year. The State Bank of Pakistan, the country's central bank, is acting by sharply raising the official interest rate, allowing the currency to weaken, and imposing advance deposit requirements for letters of credit for a range of imports, all with the focus on reducing reduce imports. If the pressure continues, further tightening of foreign exchange restrictions is to be expected.

In negotiations with the IMF to resume disbursements, the ruling coalition has been forced to take politically costly measures, such as starting to phase out the subsidies on fuel and electricity that the previous administration introduced during its final term. Negotiations include proposals to expand and lengthen the programme by one year to September 2023, which would be a positive development. Based on past episodes of Pakistan's predicament and given the country's strategic importance and long-standing relationships with multilateral and bilateral lenders, the baseline scenario is that the country narrowly avoids a full-blown balance of payments crisis and manages to get through the next few years with support from the IMF and bilateral allies. However, the political situation makes the situation difficult to forecast, and the country's ability to deal with large external debt payments and maturities in the coming years will depend on favourable circumstances and external support.

Business environment

Pakistan's business environment is assessed as weak while being on a cautiously positive trend. With a focus on increasing the country's low levels of investment, strengthening the competitiveness of the export industry, and generating new jobs, the government has made improving the business environment one of its priorities. The agenda includes reforms to increase access to finance for SMEs and streamlining the regulatory and administrative processes. Measures in this direction, including simplifying licence and permit applications, customs clearance procedures, etc., made Pakistan one of the top climbers in the World Bank's 2019-2020 Ease of Doing Business Index business climate rankings,

Pakistan

Swedish export to Pakistan

	MSEK
2021	2 376
2020	2 148
2019	3 647
2018	3 134
2017	2 129

Source: SCB

EKN:s exposure

	MSEK
Guarantees	3 939
Offers	955

ranked 108 out of 190 countries (147 in 2018). Challenges include a large inefficient state-owned enterprise sector and weak public institutions: In the World Bank's Worldwide Governance Indicators (WGI), the performance of the country's economic institutions remains almost 50% lower than the regional average .

EKN has limited experience with debt recovery in Pakistan. From EKN's credit risk perspective, key aspects of the business environment are related to the degree of predictability, stability and quality, both in terms of the rules and regulations affecting debtors' activities and the country's legal and institutional environment affecting creditors' position in terms of insolvency, collateral and guarantees, etc. According to the WGI, the quality of the regulatory environment is significantly weaker than the average for the region. For the credit environment, the WGI among other sources point to structural weaknesses that make recovery more difficult. At the same time, the legal framework is gradually being upgraded. Legislative provisions have been introduced for credit reporting bureaus (2015), for the licensing of restructuring companies that can acquire non-performing loans from banks and recover them (2016). In 2018, the Corporate Rehabilitation Act came into effect with the objective of establishing a court-led process for restructurings and rehabilitation of major companies. This enables debtors to continue with their business operations during the restructuring. Additionally, statutory and regulatory frameworks for collateral/security were updated and a centralized electronic collateral registry was established in 2020. However, it is likely to take some time for these reforms to take hold and have any significant impact on the credit environment. Challenges can be found in the implementation as well as in a lack of harmonisation of regulations and application between the country's provinces. In parallel, corruption remains at high levels, according to i.a. Transparency International's Corruption Perceptions Index (CPI). In 2021, the country's ranking deteriorated to 140 (out of 180 countries; it was 117 in 2018), significantly lower than the average ranking for emerging and developing countries in Asia (90).

In the corporate sector, among larger companies as well as among the private banks, family-owned conglomerates tend to dominate Access to financial information is relatively good for banks, larger companies, and publicly traded companies. These prepare financial reports in accordance with the IFRS international standard. Since 2015, smaller companies are also able to report according to IFRS. Deficiencies in the banking system's management of the risks related to money laundering and terrorist financing mean that since 2018 the country has been placed on the Financial Action Task Force (FATF) grey list for deficiencies in its counter-terror financing and anti-money laundering regimes. In order to reduce the risk of international banks cutting back on their relationships with the country's banks, with the negative consequences for international payments that would follow, Pakistan is following a remedial response action plan. In the latest FATF assessment from March 2022, the country remains on the list, but significant progress is noted (out of 27 points, the FATF deems 26 as mostly addressed) and the ambition from the Pakistani side is to reach the target in January of 2023.

Pakistan

EKN:s policy

EKN has placed Pakistan in country risk category 7 (out of 0 to 7) since 2011. Normal risk assessment applies to transactions with the Ministry of Finance, banks, and companies. This means that there are no predetermined limitations in the issuance of guarantees and that the transactions are assessed on their own merits without specific requirements or preconditions.

For public buyers there are requirements for a letter of credit, or a bank, or sovereign guarantee.

EKN:s commitment and experience

During the period 2017–2021, EKN issued guarantees of a total value of SEK 4.2 billion in 283 transactions for approx. 30 export companies. The flow is dominated by state-related counterparties and telecoms. SMEs account for 7% and just about half of the guarantee volume is for transactions with credit terms of less than one year. EKN's exposure amounts to SEK 4.9 billion. State-related counterparties dominate.

EKN's payment experience is good, with few losses due to claims in recent years and payment delays are less common. Of the guarantees issued in the period 2017-21, delays in payment occurred in 4%, which is explained partly by the large share of letter of credit guarantees. Excluding these, the proportion rises to 15%. On average, the delays in payment lasted 125 days. However, the statistics don't tell the whole story, as they are influenced by the coronavirus pandemic. Claims, as mentioned above are few, and over the past five years EKN has paid out only one claim. Debts owed by the Pakistani State are under a Paris Club Agreement and amount to approximately SEK 110 million. They relate to renegotiations with the country's external lenders that took place during 1999-2001. During the pandemic, Pakistan chose to take advantage of the possibility of the suspension and deferral of debt service payments under the G20 Debt Initiative (DSSI). The deferral of debt service payments under the Paris Club Agreement relates to amounts falling due during the period 2020-2021.