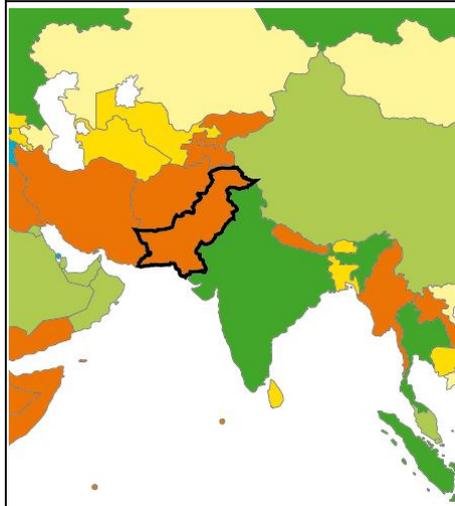


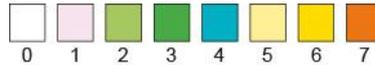
# Pakistan



## COUNTRY RISK CATEGORY

## 7/7

The country risk categories range from 0 to 7. The lower number the better the credit rating of the country.



## EKN'S OUTSTANDING GUARANTEES ON THE COUNTRY

**Short-term transactions:** SEK 658 million  
**Medium and long-term transactions:** SEK 9,426 million

## EKN'S POLICY

**Sovereign risks:** Restrictive risk assessment

**Other public risks:** Restrictive risk assessment

**Bank risks:** Restrictive risk assessment

**Corporate risks:** Restrictive risk assessment

See also "EKN'S POLICY" section

## DATE

**24/10/2013**

## Structural problems hindering development

Pakistan has long-standing difficulties in pursuing effective economic policies to boost growth and strengthen the balance of payments. Economic development is being hampered by factors such as poor infrastructure, inadequate power supply, corruption and violence. However, an agreement between Pakistan and the IMF has averted the most critical liquidity threat. The new government faces a major challenge in adhering to the recently agreed IMF programme and implementing the economic reforms that the country needs so much. However, history has shown that Pakistan has the knack of getting through difficult crises.

## STRENGTHS

- Pakistan is a key country in the region, as reflected in support from the United States
- Despite many crises, Pakistan has shown the ability to get out of difficult situations
- Strong and stable inflow of remittances

## WEAKNESSES

- Risk of very low international reserves triggering a payment crisis
- High public debt
- Unsettled political landscape and constant terror threat
- Weak democracy

## POLITICS

**Progress for democracy**

For the first time in the country's history, a government has completed its full term. Before the election in May 2013, the former government (dominated by the the Pakistan People's Party) was replaced by a non-political caretaker administration, as laid down in the Constitution. However, the election campaign became very violent. Sectarian violence increased particularly in Karachi and a campaign of violence against secular parties was carried out from Taliban quarters. The Pakistan Muslim League (PML-N) won a clear victory in the election. Nawaz Sharif was elected prime minister and was able to appoint a majority government.

At the top on the agenda is strengthening the economy and improving the country's security situation. A major first step in the summer of this year was an agreement between Pakistan and the IMF, whereby Pakistan has access to a total of USD 6.6 billion over a three year period if the programme is followed. The programme's reforms include increased tax revenue and reduced electricity subsidies. One of Pakistan's structural problems is that policies are controlled by special interests. Large agricultural and industrial owners occupy important political positions, which means that the necessary reforms cannot be pushed through.

The military is an important force in Pakistani politics and the government's relationship to it will determine whether and how reforms can be implemented. Last time the PML-N were in power, they were deposed in a coup in 1999. Most indications are that the military is content with a high level of influence and does not aspire to take over power. The PML-N's majority in the government also points against military intervention. The security situation in Pakistan is largely dependent on relationships with neighbouring countries and the United States. Foreign policy is dominated by the relationship with India and the conflict over Kashmir, while the relationship with Afghanistan also plays a major role. US drone attacks inside Pakistan and the raid on Osama bin Laden in 2011 have worsened relations with the United States. Sharif's government now has the opportunity for a fresh start in talks with Washington. Pakistan is dependent on financial support from the United States and with the withdrawal of international troops from Afghanistan in 2014, security issues will continue to be in focus. The current troubled economic and political situation will certainly continue to dominate in the foreseeable future without a marked improvement or deterioration. The new government will be forced to work hard on the new reform programmes.

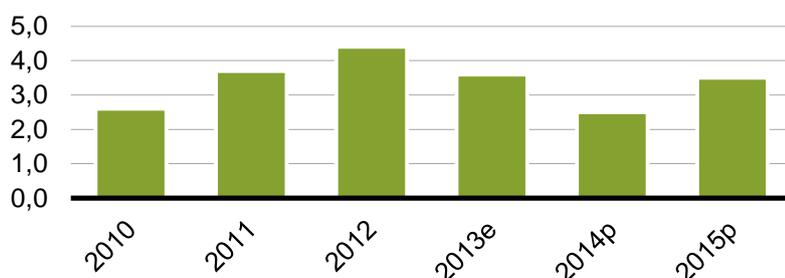
## ECONOMY

**Important reforms difficult to implement**

Pakistan has difficulties in pursuing an effective economic policy and managing the state's budget deficit. This results in low growth, high inflation and strained public finances. Vested interests, short-term priorities and poor governance are inhibiting factors. The lack of a long-term economic policy means that there are only small buffers for responding to natural disasters and high oil prices, for example. The agreement with the IMF is an important step in the right direction for Pakistan. This is likely to lead to more bilateral agreements on favourable loans and investments in the country. However, Pakistan does not have an impressive track record when it comes to completing IMF programmes. The most recent one

was abandoned prematurely and there is a large risk that the same will happen this time. The new government has the benefit of a majority which will enable it to push through major reforms. Reforms are needed in areas such as infrastructure, electrification and business environment, as well as reduced subsidies and an increase in the government revenue base.

#### GDP GROWTH (% PER YEAR)



*Structural bottlenecks in the economy are resulting in relatively weak and volatile growth. Data: IMF*

GDP growth has averaged around 3 per cent in recent years. However, this level is too low to significantly reduce the poverty and cater for the growing number of young people entering the labour market. In addition, the growth rate is volatile, which creates uncertainty. In the budget for 2014 (July 2013-June 2014), the country has its own growth forecast of over 4 per cent. However, it is the IMF's assessment that the country's structural problems, including the acute shortage of electricity, mean that growth will stay at just under 3 per cent in the next budget year.

Public finances are also very weak. Tax revenue is among the lowest in the world, corresponding to 10 per cent of GDP. The IMF estimates that only one per cent of the population pays income tax. About three quarters of the government's total revenue, goes to interest payments, defence spending and subsidies, which means that scope for investment is essentially non-existent. Pakistan's public debt has risen sharply since 2007 in nominal terms, although in relative terms it is stable at approx. 60 per cent of GDP. The continuous budget deficits are the main cause of the high debt. Pakistan's public debt to government revenue ratio is 500 per cent.

Overall, the new government is showing willingness to push through reforms in order to manage some of the structural obstacles in the economy. This is a painful task that will take time, and past experience has shown the difficulties of implementing substantial reforms. The process is likely to lead to popular discontent along the way and there is a risk that the reform programme agreed with the IMF will be cut short.

#### BALANCE OF PAYMENTS AND DEBT ISSUES

##### **Strong pressure on the external balance**

Although Pakistan's current account deficit is not large, the very low international reserves and weak capital inflows make financing difficult. The deficit can be kept down thanks to a strong inflow of remittances and bilateral support, primarily from the United States. The

remittances have proved resilient and they are showing an increasing trend. On the other hand, rising commodity prices are putting pressure on the current account balance. Pakistan is dependent on oil imports for energy supply. The bulk of the export revenues come from cotton products, mainly textiles.

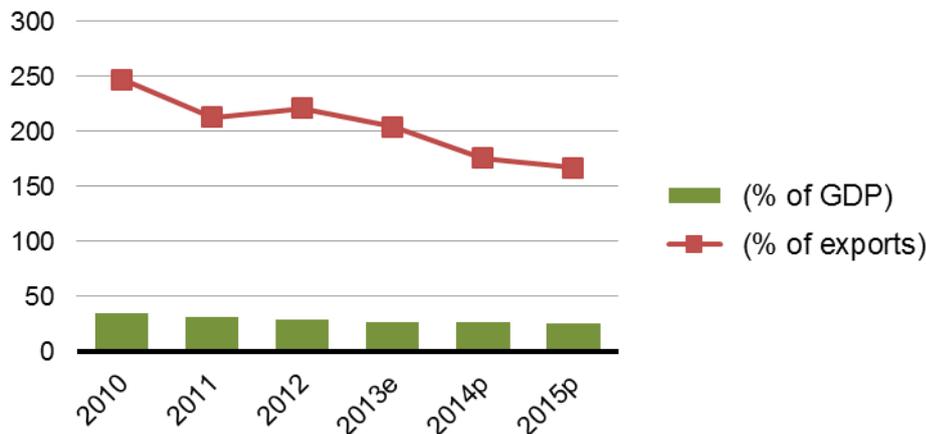
## CURRENT ACCOUNT BALANCE (% OF GDP)



The current account deficit is relatively small. Data: IMF

Pakistan's external debt is moderate at 25 per cent of GDP. However, this corresponds to 200 per cent of exports, which is high. However, as the debt consists largely of loans from multilateral or bilateral lenders, the debt situation is considered sustainable.

## EXTERNAL DEBT



Concessional loans mean that a high debt to exports ratio is still sustainable. Data: IMF

The country's international reserves have fallen by just over 40 per cent in the past year and now stand at approx. USD 6 billion, corresponding to just under 1.5 months of import requirements, which is a very low level. The planned reform programme is expected to increase the reserves to approx. USD 10 billion in the next few years. Conversely, if the current policies were to continue, the reserves would instead fall to half of the already low levels. The rapid decline in international reserves is due to reduced capital inflows into the country, while the repayment of debts to foreign countries has increased.

Overall, the plummeting international reserves represent the largest economic risk factor and could trigger a balance of payments crisis. With the IMF programme and the international support that is in place for Pakistan, the country is likely to make a slow recovery and bear up in the future. The main scenario is that a balance of payments crisis will be avoided.

## CURRENCY POLICY

### **Weaker currency**

The country uses a managed float exchange rate regime, which means that the central bank occasionally intervenes to influence the domestic currency. The rupee is fully convertible for import and export transactions.

The rupee has depreciated slightly against the US dollar over the past year but has been largely stable. This has been at the expense of the international reserves, which have been significantly eroded in the same period. The central bank is likely reduce its support purchases and allow the currency to weaken at a slightly faster pace than previously to allow the international reserves to recover.

## FINANCIAL SECTOR

### **High proportion of non-performing loans**

The banking system underwent a reform and privatisation phase in the 2000s which resulted in positive changes and improved standards in the sector. However, the trend has been reversed in recent years. The deterioration is due to the country's difficult economic situation, which makes the banks reluctant to lend to the private sector. The banks' very marked and growing concentration risk to the state (approx. 30 per cent of the sector's total assets) is also a contributing factor. The high average level of bad loans, approx. 15 per cent of the loan portfolio, is an indication of the link between the country's poor economy and corporate credit losses. The inability of state companies to fulfil their financial obligations is also affecting the level of non-performing loans. However, individual banks are relatively well capitalised, profitable and liquid. The five largest banks (one public, four private) account for half of the banking sector's assets. Many of the banks have ownership interests from the Gulf, and the vast majority of them are privately owned.

## BUSINESS ENVIRONMENT

### **Weak business environment with many obstacles**

The country's problems of corruption and lack of infrastructure and electricity supply are having an adverse effect on Pakistani companies, on their operations and the overall market conditions. For example, present electricity generation only corresponds to about 80 per cent of demand. Pakistan's institutional capacity to manage development projects is inadequate, while transparency in public procurement is often non-existent. The fact that Pakistan has liberal investment legislation, with low fees and scope for 100 per cent foreign ownership, does not outweigh the negative factors. Pakistan is ranked 107th out of 185 in the World Bank's Ease of Doing Business index for 2013, which is a decline of three places from 2012.

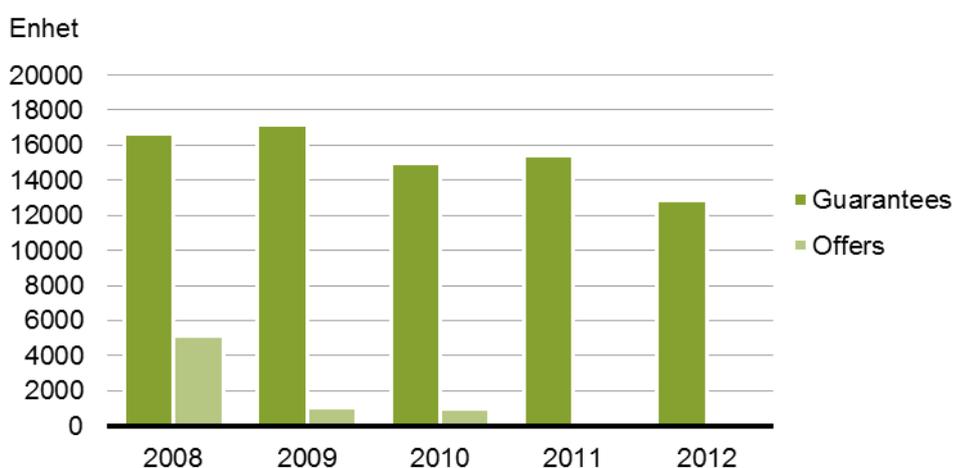
Listed companies use IFRS reporting standards and financial information from these companies is adequate in many cases. For smaller companies, availability of updated and audited information can be very limited. The public sector often has major problems which can also affect private companies that are dependent on a public customer. The civil law system is based on British law, but Islamic Sharia law also runs in parallel. There may be uncertainty about which system is to be used to deal with different issues.

## EKN'S EXPOSURE

### Large outstanding guarantees

EKN downgraded Pakistan in 2011 because of the country's negative development, both economically and politically. EKN has substantial exposure in the country, which comprises guarantees for exports to the Pakistani state and to a private buyer in the telecom sector. In addition, there is a small number of direct corporate risks and letter of credit guarantees. However, the latter represent very small amounts. The guarantee exposure has fallen since the beginning of the year and amounted to SEK 9.4 billion in October 2013.

### EKN'S EXPOSURE AT 31 DECEMBER, MSEK



*EKN has a large outstanding guarantee exposure to Pakistan. Data: EKN*

## PAYMENT EXPERIENCE

### Good experience

During the period 2008 to 2012, EKN issued 323 guarantees totalling SEK 5.7 billion. 80 per cent of these were letter of credit guarantees, i.e., risks relating to banks in Pakistan. EKN's experience has generally been good, and no claim settlements have occurred during that period.

EKN's claims amount to SEK 569 million and are renegotiated within the framework of the Paris Club. The claims relate to transactions that took place in the 1980s and 1990s. The agreement runs until 2024 and the payments are being made according to plan.

## EKN'S POLICY

**Unchanged policy**

EKN has placed Pakistan in country risk category 7 for both short and long-term guarantees – an assessment made in collaboration with other OECD countries. At present, some form of restrictiveness applies to all buyer categories. For public buyers, such as public utilities or line ministries, EKN requires a government guarantee from the central bank or finance ministry, or bank security in the form of a letter of credit or a guarantee.

For private buyers (companies and banks), the policy means that, in addition to assessing the risk on its own merits, EKN has a more restrictive approach from the start and wants to see that the transaction has a high level of transparency and that the debtor has sufficient buffers. The buffers are to be used to offset unanticipated events which are expected to arise more frequently in Pakistan than in countries with a more stable operating environment.

## OFFICIAL COUNTRY DATA AND CREDIT RATINGS

OFFICIAL COUNTRY DATA	CREDIT RATING	
<b>Area:</b> 796,100 km <sup>2</sup> (1.8 times Sweden)		
<b>Population:</b> 193 million (2013 est.)		
<b>Population growth:</b> 1.5 % (2013 est.)		
<b>GDP:</b> USD 231 billion, 2012 (Sweden USD 526 billion, 2012)		
<b>GDP/capita:</b> USD 1,260, 2012 (Sweden USD 56,210, 2012)		
	<b>Moody's:</b>	COUNTRY CEILING
	<b>S&amp;P:</b>	SOVEREIGN RATING
	<b>Fitch:</b>	
		B3
		Caa1
		B-
		B-
		n/a
		n/a

## COUNTRY ANALYST



EKN's country analyst for Pakistan:

Lovisa Bolander

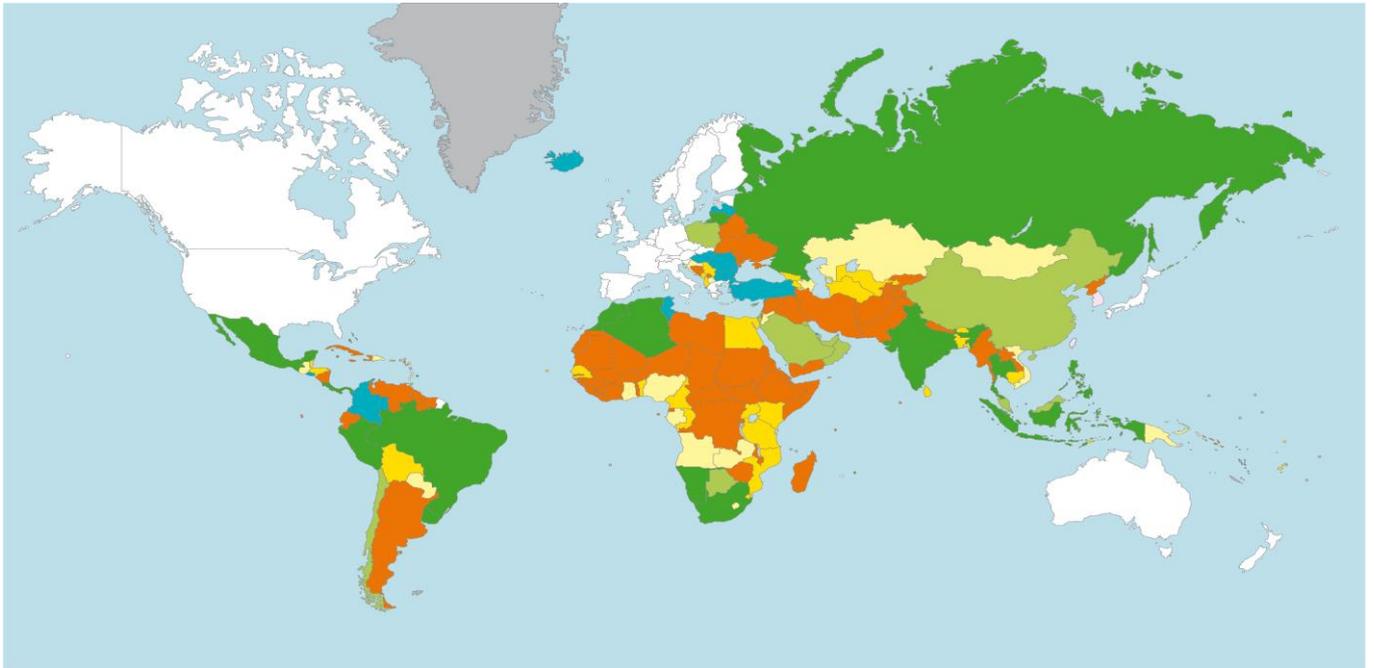
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**DISCLAIMER**

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## EKN'S VIEW OF THE WORLD



The country risk categories range from 0 to 7.  
The lower number the better the credit rating of the country.



### EKN – CREATING CONFIDENCE IN YOUR EXPORTS

EKN is a government agency that supports Swedish exports and the internationalisation of Swedish industry. This we do by offering exporting companies and banks guarantees for payment and financing, together with advice on business structure and risk management. Our services provide an extra level of confidence, increased competitiveness and more opportunities for successful export transactions.

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