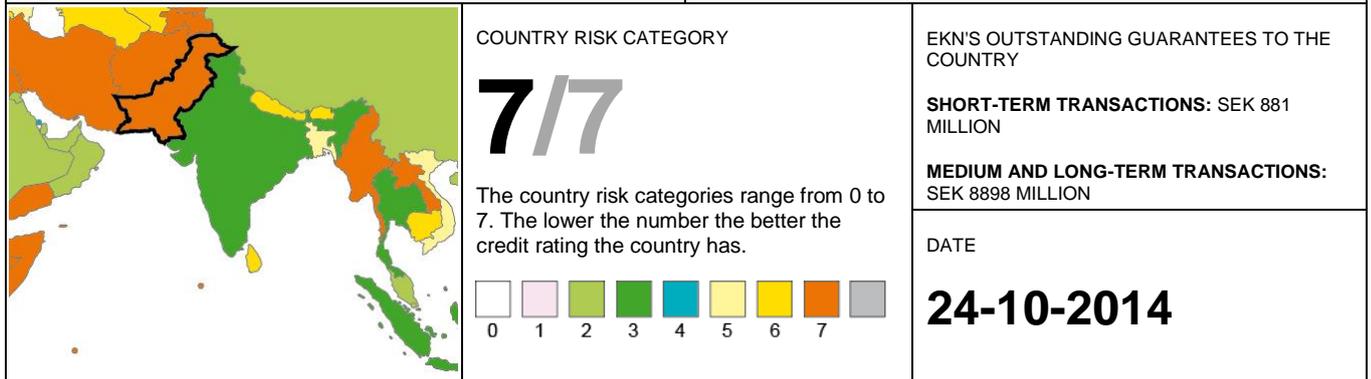


Pakistan



Fragile economy and political turbulence

Pakistan is politically unstable, and it was seen as progress when the previous government made it through its entire term of office. After the elections in 2013, the previous opposition took over with a clear majority. Hopes for a slightly more stable political phase have partially come true. During its first twelve months, the government has completed or initiated most of the structural measures agreed on in an agreement with the IMF. But implementation of the political reform agenda has been made difficult by protests that broke out in August this year. Pakistan is highly dependent on financing from multilateral banks and bilateral donors to maintain its ability to pay. Delayed payments from them would put the country in a difficult situation. When Pakistan was in similar situations previously, the situation was resolved via extraordinary bilateral loans or renegotiations with lenders. The risk of a balance of payments crisis in the country has increased.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Strategically important country in the region with support from the US and the Gulf states among others
- Ability to get through difficult economic situations
- Potentially large market with large and young population

Weaknesses

- Weak democracy and political instability
- Dependence on external financing with risks of delays
- Sizable macro-economic imbalances in the form of high inflation, large deficits and low growth

EKN'S POLICY

Restrictive policy

EKN has a restrictive risk assessment policy for debtors in Pakistan. This is justified by the difficult business climate and the country's lacking access to hard currency.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- A long-term stabilisation in both the political and the security situation
- A reduction in the vulnerability of the economy via a long-term and well-anchored financial policy

The policy may be made more restrictive in the event of

- The suspension or heavily delayed implementation of the IMF programme
- The escalation of political violence and protests

EKN'S EXPOSURE AND EXPERIENCE

A few large transactions

EKN's exposure in Pakistan is dominated by a few transactions. These transactions account for the great majority of EKN's exposure of nearly SEK 10.5 billion. Guarantees account for SEK 9.8 billion of the total exposure. The guarantees are mainly for export transactions to the Pakistani state and the telecom sector. EKN also has a large number of letter of credit guarantees in Pakistan. These guarantees have short credit terms and the amounts are often limited. EKN guaranteed an average of between 40 and 50 letters of credit per year in Pakistan from 2009 to 2013.

EKN has the capability to assess guarantees for transactions in local currency, but does not have any experience of that yet. The Pakistani rupee is convertible for trade in goods and services. However, the currency is not fully convertible.

COUNTRY ANALYST



EKN's country analyst for Pakistan:
Lovisa Bolander
Telephone: +46 (0)8-788 00 10
Email: lovisa.bolander@ekn.se

DISCLAIMER

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Weak democracy

Pakistan is an undeveloped democracy. It was seen as a sign of a certain degree of stability when the previous government made it through its entire term of office, for the first time in the country's history. The previous opposition took over with a clear majority after the elections in 2013. Hopes for a slightly more stable political phase have partially come true. During its first twelve months, the government has completed or initiated most of the structural measures agreed on in an agreement with the IMF. Previous IMF agreements have gone off track early, which led to sharp delays or a suspension of cooperation with the IMF. Thus far, cooperation with the IMF has worked better this time.

Unfortunately, the risk of Pakistan being unable to meet the targets in accordance with the schedule in the IMF agreement has increased since August as protesters spread in the capital. The protests are being led by two minor parties and have partially paralysed political efforts. In spite of limited popular support for both of these parties, the effects on the political efforts may turn out to be substantial. The military, which is seen as a strong force in Pakistan, has seemingly tried to stay out of the conflict, but is being accused of supporting the protests in order to force the prime minister to resign.

Pakistan is a strategically important country in the region. It is important both from a regional and international perspective that Pakistan not be a hotbed or sanctuary for extremism. The unstable situation in Afghanistan and the porous border between the two countries makes Pakistan a key player in the entire region's security developments.

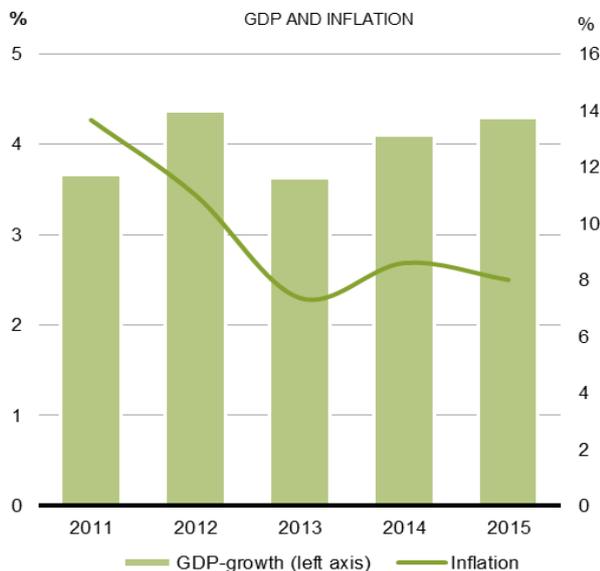
The political situation in the country will probably continue to be characterised by short-term thinking, tensions and violence going forward. It is probable that the military will hesitate to get openly and directly involved in politics, but will nonetheless be present and act in the background. Divisions between the three centres of power, the political parties, the supreme court and the military will remain, as well as those between the two dominant parties. This is because there is no unifying force to change the prevailing situation.

Risk of sharp economic effects if IMF programme is mismanaged

Pakistan's economy has shown certain signs of stabilisation over the past 12 months and has achieved slightly higher growth. Inflation has been limited and the budget deficit has been reduced. This stabilisation is the result of measures that have mainly been focused on consolidating the public finances, strengthening the country's international reserves and implementing structural reforms, with a particular focus on the energy sector. In the long term, these measures are expected to give the country better conditions for sustainable economic growth. At present, there is no scope for expansionary fiscal policies to stimulate growth, on account of a lack of financing. Growth is driven by private consumption, which in turn is being maintained by a steady inflow of remittances from Pakistanis abroad. The inflow of remittances is very large and accounts for over six per cent of GDP. The country's most important export goods are textiles and agriculture products, but a lack of electricity and infrastructure is reducing the country's competitiveness.

The key issue for the country in the coming year will be managing its payment obligations. Pakistan's external debt is relatively moderate in relation to GDP. However, it is equal to over 200 per cent of export earnings and the debt service ratio is currently nearly 25 per cent. More

than four-fifths of the national external debt is to public lenders and has a long repayment profile. The proportion of short-term debt is still low, but growing. The international reserves cover short-term debt due in the coming year by an acceptable margin, provided that



Source: IMF WEO April, Oct 2014

payments under the IMF programme are made according to plan.

In addition to loan financing, Pakistan is also planning to sell stakes in state-owned enterprises in the oil and gas sector and banks where the government is a minority owner in order to reduce the budget deficit. Other measures, such as increasing the tax rate on short capital inflows are also being taken to further improve the country's debt profile. The public debt in 2013 was equal to 63 per cent of GDP and interest expenses totalled an exceptional 41 per cent of public revenue.

The political protests can have major consequences for the country's economic development. The most urgent is the risk of protests diverting attention from the political efforts needed to meet the demands of the IMF for continued payments. Pakistan's dependence on external financing has resulted in an increase in the risk of payment default.

BUSINESS ENVIRONMENT

Business environment getting worse

Pakistan has a permissive attitude toward private entrepreneurship, with liberal investment legislation and low fees, and it allows 100% foreign ownership. Unfortunately, the business climate is made difficult in reality by several obstacles. Deficiencies in the form of high inflation, corruption, limited bank lending and in particular insufficient infrastructure and insufficient access to electricity have gradually deteriorated the business environment in Pakistan. This deterioration can be seen both in the World Bank doing business index (DBI) and the World Economic Forum Global Competiveness Index in the form of falling rankings. In addition to the deficiencies mentioned above, the country's institutions are weak and the judiciary is not independent.

The country's banking sector is considered to be relatively well-functioning, even though the growth trend is negative. Several of the banks are private and foreign-owned. The country's financial centre is Karachi, which is also where the stock exchange is located. Listed companies use IFRS as their accounting standard and financial information from these companies is often available to a sufficient extent. For small companies, access to updated, audited information can be very limited. Liquidity problems and payment delays in the public sector can affect private companies that are dependent on public customers.