Pakistan struggling to pay its debts to China

The State Bank of Pakistan, whose foreign reserves fell to $17 billion in October, is trying to avoid default

By FM SHAKIL DECEMBER 2, 2021

PESHAWAR – Chinese debts are squeezing Pakistan's pinched finances as external payments are set to balloon to US$14 billion at the end of this financial year. Nearly half is owed to Chinese commercial banks, largely for Belt and Road Initiative (BRI) related projects.

Observers say Islamabad needs to ask Chinese financial authorities to reschedule its debts to ease pressure on the State Bank of Pakistan – whose foreign reserves fell to US$17 billion in October – and avoid default.

The warning signs have been apparent for months. In April, the International Monetary Fund warned that policy slippage and mounting contingent liabilities were undermining Pakistan's public debt sustainability.

In May, Fitch Ratings said its "B-" rating for Pakistan reflected weak public finances, external finance vulnerabilities and low governance indicator scores.

The World Bank's Debt Report 2021, which analyzed the debts of South Asian countries, showed Pakistan lagging behind India and Bangladesh and the report said it was more comparable with debt-beleaguered Sri Lanka.

The report added among countries with a debt-to-GDP ratio exceeding 80%, Pakistan was the second-highest after Sri Lanka in terms of interest-to-revenue ratio. However, if the Pakistan net revenue, excluding the share of the provinces, is calculated, it ranks even higher than Sri Lanka.

The similarity between Sri Lanka and Pakistan's debt profile is ringing alarm bells. Some have drawn a comparison with Pakistan's Gwadar port agreement and the 2017 Sri Lanka port deal with the state-run Chinese company for a 99-year lease to pay off the Chinese debts.

So is Pakistan heading toward a disastrous default situation?

Pakistan never been in default

Farrukh Saleem, an Islamabad-based Pakistani political scientist, economist and financial analyst, told Asia Times that Pakistan had never gone into default on international debt repayments.

"Default category is always forced by the lending agencies," he said. "The institution that lends you money is legally entitled to declare you a defaulter. Usually, they do not declare a sovereign state a defaulter because by doing so they risk losing money.

"Instead of insolvency they always prefer to renegotiate the lending terms to reschedule or restructure the loans over an extended time."

The government reserves are already under stress for the repayment of multilateral lending of $2.6 billion, the Chinese government and commercial banks loans of $9.1 billion, the redemption of Eurobond/Sukuk of $1 billion and the IMF's $1 billion, which are falling due by the end of June next year.

Pakistan also owed $11.3 billion to the Paris Club, $33.1 billion to multilateral donors and $12 billion to international bonds such as Eurobond and Sukuk.

In addition to that, Pakistan also obtained safe deposits of $3 billion each from the United Arab Emirates and China. Another tranche of a $3 billion deposit is coming from the Kingdom of Saudi Arabia.

Pakistan’s Ministry of Finance informed the Senate Friday that during the past three years, Pakistan’s debts have increased by Rs16 trillion ($91 billion). The data released by the finance and planning ministries reveals that the total debts of the country in June 2018 were Rs25 trillion ($142 billion), which rose to Rs41 trillion ($233 billion) by August 2021.

Pakistan’s Senate was told Friday that internal debt increased from Rs16 trillion ($91 billion) to 26 trillion ($148 million) over this period. Similarly, external debts swelled from Rs8.5 trillion ($48.3 billion) to Rs14.5 trillion ($83 billion) in the same period. On these loans, the ministry said, the government paid Rs7.46 trillion ($42.4 billion) in interest.

“External debt is a component of the overall Growth External Financial Requirement (GEFR) of a country. At present, Pakistan’s GEFR is around $29 billion including external debt payment of $14 billion and an expected current account deficit worth $13 billion. We are in an alarming situation like never before. We are in chronic stagflation, GEFR touching $29 billion, IMF issue is lingering on, FATF is hanging on our head and we are breaking up with the US and European Union,” said Farrukh.

Sinking reserves

Being panicked by this situation, Islamabad explored banking channels to build the sinking reserves stock and deteriorating balance of payment position. The government raised $5 billion on Euro and Sukuk bonds during the current fiscal year and approached the Saudi government to pledge $4.5 billion worth of cash injection and oil on deferred payment.

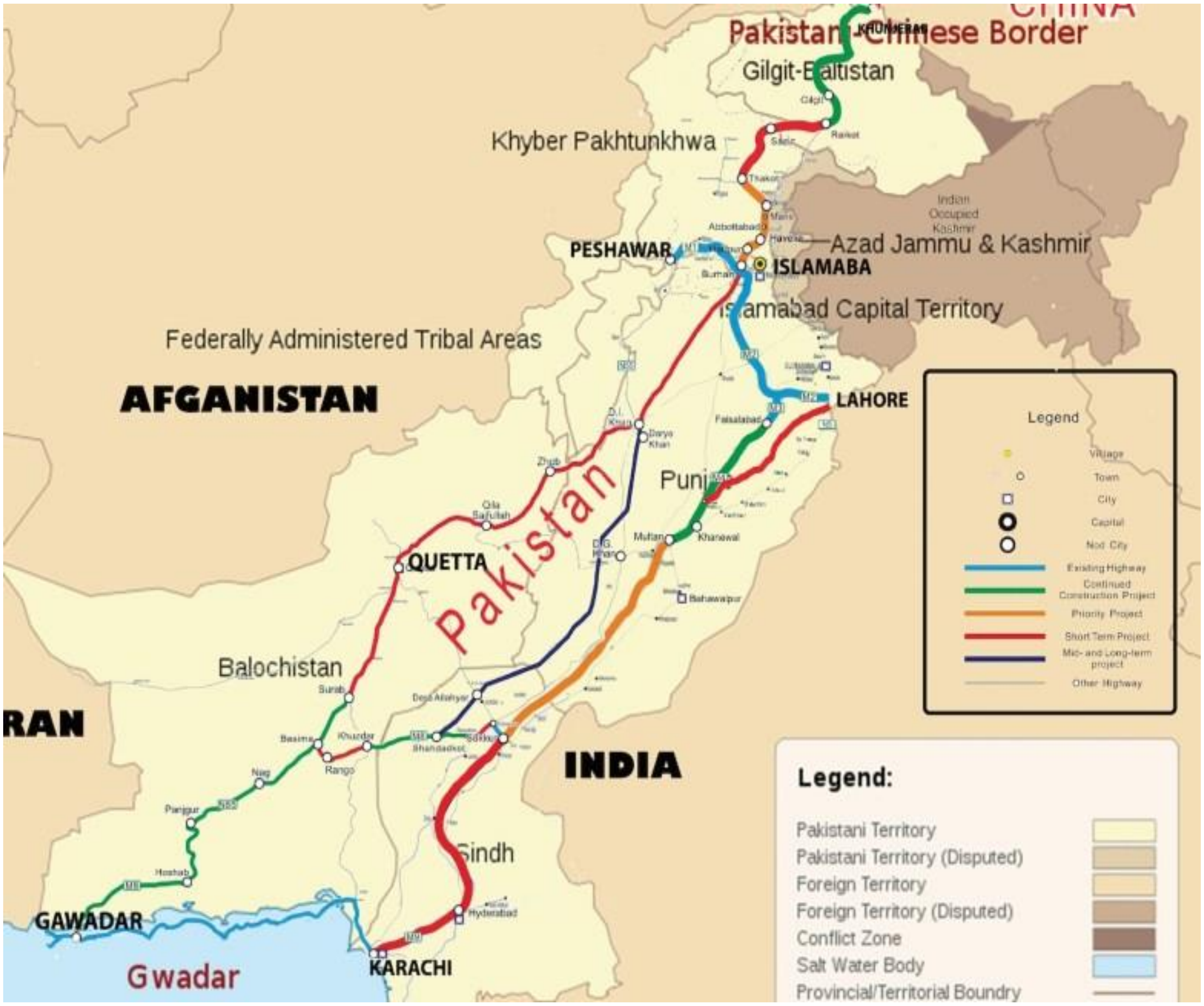
However, these measures neither could allay the pressure on the country’s current account portfolio nor could stop the currency depreciation that saw the Pakistani rupee dipping down to an all-time low against the US dollar.

Pakistan's Current Account, which had shown a gap of $2.5 billion in June this year, recorded a deficit of $3.4 billion in the July-September quarter.

Meanwhile, the SBP moved to shore up foreign exchange reserves and boost the cash-strapped economy by introducing new banking facilities – the Roshan Digital Account – to help procure foreign currency from non-resident Pakistanis. The new facility allows Pakistanis abroad to have access to banking services within Pakistan without physically visiting a consulate, embassy or bank branch.

The SBP has succeeded in procuring a chunk of more than $2.7 billion through the Roshan Digital Accounts (RDA) at a cost of about 7% on foreign exchange terms and 11% on rupee terms.

"A 7% return on the foreign currency deposit is too much. If you add up 10% currency depreciation, it shoots up to 17%, which is not at all feasible for the national economy," Farrukh said.



The China-Pakistan Economic Corridor aims to strengthen China's strategic and economic ties in South Asia and help Pakistan reduce its dependency on the US and its allies in the West. Image: Wikimedia Commons

China-Pakistan Economic Corridor

Pakistan's repayment problem is also reflected in the pace of the China-Pakistan Economic Corridor (CPEC), as Beijing slowed further investment given the difficulties faced by Chinese companies in getting their financial matters settled with Islamabad.

Chinese state insurer Sinosure had already blocked $13 billion worth of CPEC energy and infrastructure projects due to non-payment of capacity dues.

Sinosure's lethargy to underwrite the CPEC projects has delayed the much-touted 1,733-kilometer railway track linking Pakistan's seaport with the northwestern parts of the country and about half a dozen energy-related projects that should have been started generation by the end of June.

Special Assistant to the Prime Minister on CPEC Khalid Mansoor told journalists on Tuesday that the Chinese ambassador in Islamabad has been briefed on the Sinosure issue. He said the government had approached Chinese authorities for their intervention.

Mansoor hoped that strategically important projects like the ML-1 railway line and six energy projects including Gwadar, Karrot, Kohala and Azad Pattan, Thar and Thal-Nova would be prioritized.