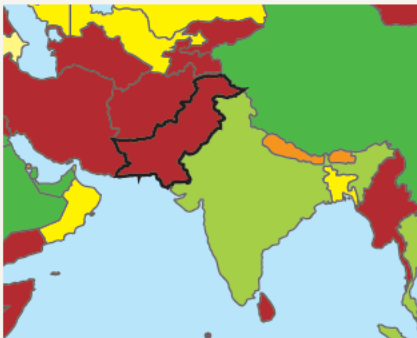


Basic facts (2022)

Population: 227 million

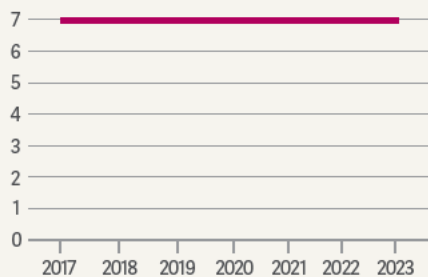
GDP, nominal: USD 376,5 billion

GDP/capita: USD 1 658



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, which has been translated into investments and financing opportunities
- + Good relations with bilateral donors
- + Growth potential with a large economy and young population
- + Relatively stable banking system
- + Significant inflow of remittances.

Weaknesses

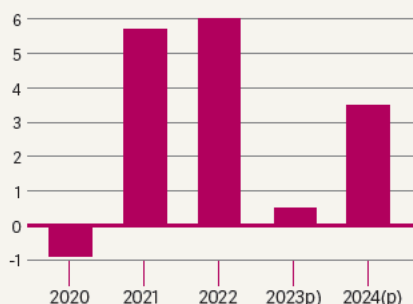
- Inherent risk of political instability, given social tensions, the geo-political situation and the military's influence
- Fragile economic stability due to weak public and external finances
- Challenging business environment and extensive corruption
- High exposure to climate change

Structural challenges hamper potential growth

A large economy with a GDP of USD 376 billion (2022) and the world's 5th largest population of 235 million creates some resilience and growth potential. The economy is driven by household consumption (about 80 per cent of GDP). The production side is dominated by the service sector (about 60 per cent of GDP) while manufacturing is underdeveloped (12 per cent of GDP). As a raw material importer with weak competitiveness, the country's imports of goods and services are twice as large as exports (about 10 per cent of GDP). Robust inflows of remittances from migrants (9 per cent of GDP), more than half of which originate from the Gulf States, stabilise consumption. Inflows are the main foreign exchange earner and finance most of the country's structural trade deficit.

Weak institutions, fragile public and external finances make the economy vulnerable to shocks. In addition, exposure to climate change is high, as reflected by the fact that the country is among the ten countries in the world most affected by recurrent extreme weather events in the last decade, resulting in significant material damage and human suffering. As one of the poorest countries in Asia, Pakistan faces structural challenges, not least creating jobs for a growing young population. Geopolitical, religious and social tensions carry a latent risk of political instability. With militant Islamism and armed conflict in parts of the country, Pakistan is afflicted by violence. The security situation is complicated by increased activity from a domestic Taliban movement after the Taliban's takeover in Afghanistan in 2021. Peaceful transfers of power have taken place on three occasions since parliamentary democracy was introduced in 2010, but the military exerts considerable influence over politics. The friction-filled interaction with civilian governments contributes to occasionally messy politics. The dominance of a dynastic political elite, whose vested interests at times are at odds with much-needed reforms, undermines the ability to sustain structural reforms and disciplined economic policies. This is reflected in weak public finances with structural deficits due to low tax revenues, subsidies in the agricultural and energy sectors and a large unprofitable state-owned enterprise sector. Over the last 10 years, the public debt ratio (debt to GDP) has been steadily increasing, a trend that worsened during the pandemic years. The debt ratio amounts to about 75 per cent of GDP, while the foreign share has risen to about 40 per cent. Over the next three years, interest expenses are expected to swallow more than 50 per cent of government revenue. The situation is also reflected in a difficult business climate that contributes to low levels of investment, as well as in the fact that the banks' lending to the private sector remains limited, while the exposure to the government has grown to high levels. Nevertheless, since 2015, the country's alliance with China has led to major investments in infrastructure under the China-Pakistan Economic Corridor (CPEC). They have the potential to reduce bottlenecks in transport, power generation, etc. However, the pandemic and the security situation have contributed to delays in CPEC projects. In order to make debt payments on the projects, the country needs to realize the returns from these largely debt-financed infrastructure investments in terms of growth dynamics and competitiveness. It is a challenge that seems increasingly difficult.

Real GDP growth (constant prices, % per annum)



Source: IMFWEQ, Macrobond

Business environment



Ranking from 0 (worst) to 100 (best)

Source: The World Bank, Macrobond

Swedish export to Pakistan

	MSEK
2022	2 221
2021	2 377
2020	2 148
2019	3 647
2018	3 134

Source: SCB

EKN:s exposure

	MSEK
Guarantees	3 462
Offers	756

Domestic political tensions coinciding with economic crisis

Pakistan is in a phase of heightened uncertainty as ever stronger domestic political polarisation coincides with a struggling economy. Since Imran Khan was ousted as prime minister through a no-confidence vote in spring 2022, the populist opposition leader has been waging an increasingly virulent campaign ahead of the autumn 2023 elections. With strong public opinion behind him, Khan is also challenging the military leadership and is therefore perceived as a threat to the status quo. A number of criminal charges are being brought against Khan, which could result in him being disqualified from standing in the elections. The risk of broader social unrest and increased repression is considered to have increased.

The country's fragile economy has suffered a series of shocks over the past year (higher commodity prices, rising global interest rates, loss of access to capital markets and a major flood disaster). The situation is pushing up inflation to double-digit levels and putting pressure on public finances and the balance of payments. Together with import restrictions, currency rationing and policy rate hikes, this is contributing to the economy slowing down with probably non-existent GDP growth in the current financial year FY23 (ending June 2023) and remaining around a low 2-3 per cent in FY24. At the same time, deadlocks in the IMF arrangement that expires in June 2023 mean that disbursements on IMF loans have been suspended since November 2022. In this situation, the official international reserves have fallen to critically low levels, insufficient to cover the country's external debt maturities in the coming year.

Pakistan has a history of wriggling out of tight situations. Given the country's strategic importance, China, the US and multilateral bodies are expected to have a strong interest in avoiding a deepening crisis. During the spring, foreign exchange reserves were also stabilised through new support loans from China and the Gulf States. However, the liquidity problems and the political power struggle that complicates the management of the economy, mean an increased vulnerability to the risk that the country will be forced to default on its public external debt. In the longer term, the lack of sustained reform progress to strengthen the country's public finances and external competitiveness means that there is still uncertainty about how the country will be able to meet significant external financing needs. A new IMF programme appears necessary but may not come about before the elections.

Business environment

Pakistan's business environment is considered weak. The challenges include a difficult security situation, an occasionally volatile macroeconomic environment with inflation and currency fluctuations, and interest rates. The country's propensity to repeatedly end up in a situation with a strained balance of payments contributes to a changing regulatory framework around foreign trade in the form of import restrictions, tariffs and periods of implicit currency rationing that make it more difficult and expensive for importers to obtain currency allocation for foreign payments. Structural problems in the energy sector, including tariff levels with insufficient cost recovery, lead to the recurrent accumulation of chains of unpaid debts in the economy and an uneven power supply. The predictability of the business environment is hampered by a lack of

harmonisation in regulations and enforcement across the country's provinces and territories, weak institutions and corruption. In the World Bank's Governance Indicators (WGI), the results for economic institutions are about 40 per cent lower than the average for emerging and developing countries in Asia. The results show modest improvements over the past five years. The country's ranking in Transparency International's Corruption Perceptions Index deteriorated to 140th out of 180 countries in 2021 (117th in 2018). The country remains at this position in 2022, which is significantly weaker than the average ranking in the region (90th).

In order to raise the country's low investment levels, strengthen competitiveness and create jobs, improvements in the business environment have been on the reform agenda for several years. The reform agenda, which has formed the basis for IMF cooperation since 2019, included reforms to increase access to finance for SMEs, streamlining regulations and administrative processes such as simplifying permit and license applications, customs procedures and taxation rules, as well as plans for state-owned enterprise reforms. However, the pandemic years followed by the 2022 flood disaster and turbulent domestic politics have taken the focus off the reform agenda, leading to modest progress in strengthening the business environment.

EKN has limited experience of debt recovery in Pakistan. From EKN's credit risk perspective, important aspects of the business environment are predictability and quality, partly in regulations that affect debtors' business operations, and partly in the country's legal and institutional environment, as these affect the position of creditors in terms of insolvency, collateral, etc. According to the WGI, the regulatory environment is significantly weaker than the average for the region. In the credit environment, the WGI, among others, points to structural weaknesses that make recovery difficult. At the same time, the legal framework is gradually being upgraded. Legislation has been introduced for credit reporting agencies (2015), for licensing so-called restructuring companies that can acquire distressed 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 large corporate reorganisations. This enables debtors to continue with their business operations during the restructuring. Additionally, statutory and regulatory frameworks for collateral were updated and a centralised electronic collateral registry was established in 2020. However, it will take time for these reforms to have a greater impact on an improved credit environment.

In the corporate sector, family-owned conglomerates tend to dominate among large corporations, as well as among private banks. 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 can also report according to IFRS. Deficiencies in banking supervision and the management of money laundering and terrorist financing risks contributed to the country being placed on the Financial Action Task Force's (FATF) so-called "grey list" between 2018 and 2022. To avoid international banks further reducing their relationships with the country's banks, with negative consequences for international payments, Pakistan completed an action plan that led to the FATF de-listing the country in October 2022.

EKN:s policy

EKN classifies Pakistan in country risk class 7 (on a scale of 0 to 7). Due to the negative risk development in the country, EKN currently does not cover payment risks for transactions with a credit period of more than 1 year. For short risk periods (<1 year), there is a requirement for a letter of credit as a payment instrument and increased premiums are applied.

EKN:s commitment and experience

Between 2018 and 2022, EKN issued guarantees in 248 transactions for some 30 exporting companies to a value of SEK 4 billion. The flow is dominated by state-related counterparties and telecoms. SMEs account for 6 per cent. Approximately 40 per cent of the guarantee volume relates to short-term transactions with credit periods of up to one year. EKN's exposure amounts to approximately SEK 4.2 billion. State-related counterparties dominate. EKN's payment experience is good, with few claims in recent years and payment delays are less common. Delays in payment occurred in 7 per cent of the guarantees issued in the period 2018-22, which is explained in part by the large proportion of letter of credit guarantees. On average, the delays in payment lasted 128 days, but the statistics are influenced by the coronavirus pandemic. Claims are few and EKN has only settled claims for one transaction in the past five years. Receivables from the state come under the Paris Club Agreement and amount to USD 94 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 to suspend and defer debt service payments under the G20 Debt Service Suspension Initiative (DSSI).

The deferment related to due dates under the Paris Club Agreement for the period 2020-2021.