



ETHIOPIA'S MEDIUM TERM DEBT MANAGEMENT STRATEGY

(2016-2020)

Debt Management Directorate of Ministry of Finance

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LIST OF ABBREVIATIONS

ADB - African Development Bank

ADF - African Development Fund

ATM - Average Time to Maturity

ATR - Average Time to Refixing

BADEA – Arab Bank for Economic Development in Africa

BoP - Balance of Payments

DBE – Development Bank of Ethiopia

DMD - Debt Management Directorate

DSA - Debt Sustainability Analysis

EEP – Ethiopian Electric Power

EEPCO - Ethiopian Electric Power Corporation

EEU - Ethiopian Electric Utility

EIB - European Investment Bank

EMTDS - Ethiopia’s Medium Term Debt Management Strategy

ETB - Ethiopian Birr

EAL - Ethiopian Air Lines

ERC – Ethiopian Railway Corporation

FX - Foreign Exchange

GDP - Gross Domestic Product

GTP - Growth and Transformation Plan

IDA - International Development Association

IFAD – International Fund for Agricultural Development

IMF - International Monetary Fund

MEEF - Macroeconomic Fiscal Framework

MTEF - Medium Term Expenditures Framework

NBE - National Bank of Ethiopia

NDF - Net Domestic Financing

OPEC Fund – OPEC Fund for International Development

PASDEP – The Plan for Accelerated and Sustained Development to End Poverty

SC - Sugar Corporation

SDR – Special Drawing Rights

SOE - State Owned Enterprises

USD – United States Dollars

FOREWORD

In Ethiopia there is a clear coordinating mechanism at the political and technical levels as well as legislation and implementation circulars defining the parameters for debt contraction, guarantees and servicing. The existence of a clear legal framework is an important enabling element for formulating a debt management strategy. In addition, the country's institutional arrangement for public debt management lies under the Ministry of Finance (MoF) with the Proclamation of Financial Administration of the Federal Government of Ethiopia, to enable the Ministry execute its mandate effectively and efficiently.

It is therefore important to closely monitor the burden of public debt both at the National level so as not to undermine economic growth. Similarly, it is important to note that ensuring the level of public debt to be consistent with the overall fiscal framework aimed at safeguarding macro-economic stability over the medium term. Accordingly, one of the methods to finance long and medium terms of development plans of the country is borrowing from both, external and domestic sources. These borrowing activities need to be guided by the internationally recognized framework for developing a debt management strategy while ensuring that the public debt remains within sustainable levels.

To this effect, this medium term debt management strategy (MTDS), designed by the Ministry of Finance (MoF) with the technical support of the International Monetary Fund (IMF) that aims to achieve a desired composition of the public sector debt portfolio that reflects a cost-risk analysis and captures the government's preferences with regard to the cost-risk trade-off. This second MTDS will also seek to assist Ethiopia in addressing the debt sustainability problem in the prevailing development agenda of the government. Of course, revision of this five years MTDS will be undertaken every year when need arises.

The Government last three (2016-2018) borrowing requirement and the level of public debt has been consistent with the designed five years MTDS and overall fiscal framework supporting macro-economic stability for sustainable growth over the medium term.

The purpose of the MTDS is to guide central government borrowing activities in the medium term while providing a path for sustainable level of debt over the medium term. The MTDS evaluates both costs and risks of various scenarios and recommends an optimal debt management strategy for implementation during the period. The Ministry of Finance will implement measures to simplify and disseminate information in the MTDS through easily accessible channels to ensure wider outreach and understanding by the general public.

The Government is considering this MTDS as a tool for evaluating and managing the risk involved with different debt compositions; facilitating coordination with fiscal and monetary management; and enhancing transparency. Moreover, the Government is committed to ensure the government's financing needs and payment obligations to be at the lowest possible cost consistent with a prudent degree of risk. Furthermore, the government is dedicated to follow up its implementation in order to maintain the transparency and accountability of public borrowing.

ACKNOWLEDGEMENT

Ethiopia's MTDS' work would not have been possible without the input and assistance of many individuals and organizations. We are deeply grateful to all those listed here.

Ministry of Finance owe a great debt of gratitude to IMF/World Bank Team for investing considerable time and effort in the cost and risk assessment process as well as producing a comprehensive mission report related to Ethiopia's MTDS. Without the mission support in terms of providing training on MTDS manual and Analytical Tool and inputs it was not possible to produce this strategy document.

We appreciate the Debt Management Directorate for taking the initiative to undertake the preparation of the second MTDS for Ethiopia. Thus, we wish to express our sincere gratitude to all Debt Management Directorate staff and other participants for their valuable contributions.

We are indebted to National Bank of Ethiopia (NBE), State Owned Enterprises (SOEs) officials, some MoF's directorates and individuals who made invaluable contributions in terms of their key insights, opinion and data necessary for the assessment made in this document. We are also indebted to our colleagues for the time and effort they put in participating in the workshop as well as for their presence in opening and closing ceremony of workshop. We believe that the support and input from them has made this strategy document a reality.

Last but not least many thanks to many of our colleagues whom we cannot all name but whose input during the MTDS opening and closing workshop remain vital to this output.

EXECUTIVE SUMMARY

The Federal Democratic Republic of Ethiopia Long Term Vision aspires to transform Ethiopia into a modern and prosperous society through provision of adequate infrastructure, development of agriculture, human resource and services sectors, enlargement of markets, strengthening of the private sector through industrialization. Implementation of the Ethiopia long term Vision will require substantial resources that will partly be garnered through domestic and international borrowing. To ensure that our debt remains sustainable, such borrowing has to be carried out through a properly formulated Medium Term Debt Strategy.

Accordingly, this MTDS has been prepared by the Ministry of Finance with the support of IMF and World Bank technical support and it illustrates government's cost and risk tradeoffs associated with different financing options and the risk exposure embedded in the current debt portfolio. The 2015/16-2019/20 MTDS provides a financing framework to meet the medium term fiscal financing requirement that would minimize debt servicing budgetary costs and the risks exposure to government while at the same time endeavoring to maintain debt sustainable of the country. It is a coherent framework which determines the appropriate financing mix of concessional and semi concessional debt necessary to finance planned expenditure, to be acquired in line with the GTP II objectives.

It is important to note that parallel to this central government debt strategy the Ministry has developed in collaboration with the IMF and World Bank technical support team has developed the comprehensive (SOEs and central government borrowing) MTDS for internal purposes aiming emplacing mechanism to monitor the borrowing process of SOEs so as to avoid any unforeseen debt burden problem including the occurrences of contingent liability that create burden on fiscal policy of the country.

The central government MTDS is primarily focused on determining the appropriate overall composition of the entire central government debt portfolio over the medium term, taking into account macroeconomic indicators and the market environment. In arriving at the preferred debt management strategy, the technical team considered combinations of various financing options and instruments relative to the existing financing structure and debt composition. Four financing strategies were formulated and tested through simulation against a variety of market shocks over a 5-year period.

The results obtained, especially on the cost of debt were compared with the baseline and with each other with a view to selecting a preferred one that is in line with the key debt management objectives of the Government. The process of selecting a preferred strategy was a challenging one because of the cost-risk trade-offs, as well as the many constraints associated with each of the strategies, including the size and availability of funding from the various sources, estimation of the annual funding requirements and the absence of well-structured and developed domestic financial market. The outcome of the analyses supports the identification of a robust strategy that is expected to reduce the cost of debt and exposure to interest rates changes and refinancing risk, while at the same time maintaining liquidity in Government's securities markets.

The preferred debt management strategy based on economic realities would require:

- An increase in external financing with a view to rebalancing the public debt portfolio in favor of long-term external financing in order to reduce the debt service cost and lengthen the maturity profile. To achieve a significant reduction in cost would require that the Government accesses relatively cheaper long-term external financing in such a way that it first maximizes the available funds from the concessional and semi-concessional sources, taking into account what may be readily available within a given period.
- Lengthening of the maturity profile of the domestic debt portfolio through reduction in the issuance of new short-dated (like treasury bills and borrowing

direct advance (overdraft) directly from National Bank of Ethiopia debt instruments or refinancing of maturing with external financing or both. Although the impact on cost of the introduction of new debt instruments into the domestic debt market is expected to be relatively high, the impact on maturity profile of total domestic debt could be significant, hence reducing the risk of bunching, roll-over risk, and the associated debt servicing costs.

Of course, the selected strategy is not without constraints including an increase in the foreign exchange risk, due to the rise in external debt relative to domestic debt and the need to maintain liquidity in the short end of the government domestic securities market.

Obviously, the borrowings will be used to fund priority infrastructure projects, which will boost output and put the economy on the path of sustainable growth and competitiveness and the loans are long-term which means that the economy would have been sufficiently diversified for increased export earnings for ease of debt service payments.

Adopting such an explicit and formal MTDS will enable the Government of Ethiopia to make informed decisions on the costs and risks associated with any alternative financing considerations. The MTDS will guide on the most appropriate financing option which will ensure that government of Ethiopia takes advantage of new financing opportunities without impairing our cost and risk thresholds in the GTP II.

The ministry is committed to annually review the MTDS in line with the medium term fiscal framework to provide an insight and clear guidance on the risk and cost tradeoffs that can be accommodated consistent with the long term debt management framework. Implementing the MTDS will help to avoid the consequences arising from unsustainable accumulation of public debt and build broad based support for responsible financial stewardship, and accountability.

I. EXISTING DEBT MANAGEMENT STRATEGY

The Federal Democratic Republic of Ethiopia (FDRE) debt management strategy was formulated in 2012 covering the period FY2012/13-2016/17. That strategy helped the country to maximize external concessional loans from multilateral and bilateral sources, and uses domestic financing to cover residual financing needs. The MTDS document was addressed the absence of a formal debt management strategy for decades based on a quantitative and qualitative analysis in the country. Similarly, although the strategy was not covered the State Owned Enterprises (SOEs) borrowing, to implement mega priority infrastructure projects from Non-concessional and domestic sources was restricted to SOEs.

It was obvious that the implementation of the debt management strategy during the 2012/13-2014/15 was in line with the published strategy. It means the three years (2012/13-2014/15) Debt management and borrowing process in Ethiopia was guided by the strategy.

After the completion of the first GTP there was a need to emplace the new MTDS that fit for the second five years GTP. Accordingly, in order to align the financing requirement for the second phase of GTP this strategy has been (for the period 2015/16-2019/20) designed and tabled for the period to be implemented.

This document was a crucial step forwarded for the government to implement a formal debt management strategy containing analysis of cost and risk tradeoffs of alternative strategies in order to avoid macroeconomic instability and debt hangover while accessing finances prudently to meet the development agenda of the country. The undertaking of the government in terms of emplacing borrowing strategy will support the government to plan based on projected availability of funding and adjust spending continuously through the years as financing actually becomes available.

1.1 Review of Public Debt Portfolio As At End of June 2015

Nearly four decades ago, Ethiopia's debt had peaked to unsustainable levels such that the economy did not have the capacity to meet its debt obligations. Fortunately, Ethiopia became among countries to qualify for debt relief under the Heavily Indebted Poor Country (HIPC) Initiatives in 2001 and subsequently under the Enhanced HIPC in 2004. In 2006/07, Ethiopia benefited from another form of debt relief under the Multilateral Debt Relief Initiative (MDRI). All these debt reliefs eased Ethiopia's debt service obligations and the country debt position has since remained sustainable.

Later on due to created fiscal spaces the government has borrowed substantial resources from concessional sources as well as provided consent and guarantees to SOEs to borrow from non-concessional sources to implement priority mega projects. These subsequent borrowing created to some extent in increments of debt volume of the country within short period of time.

Accordingly, the total debt stock (domestic and external) reached US\$ 34.056.00 million (Birr 705,391.00 million) at end June 2015. In the last more than one decade the volume of debt outstanding substantially increased at increasing rate due to increased borrowing from both external and domestic sources in order to implement infrastructure projects.

Obviously, out of the total public debt the external debt represented about 55% while the share of domestic debt was 45%. This shows a significant increase in the domestic debt portfolio, reflecting increased direct advances and treasury bills. It is pertinent to underscore the reasons for the upward trend in the domestic debt stock over the years. The following table and chart shows the public debt stock of the country by sources and borrowers.

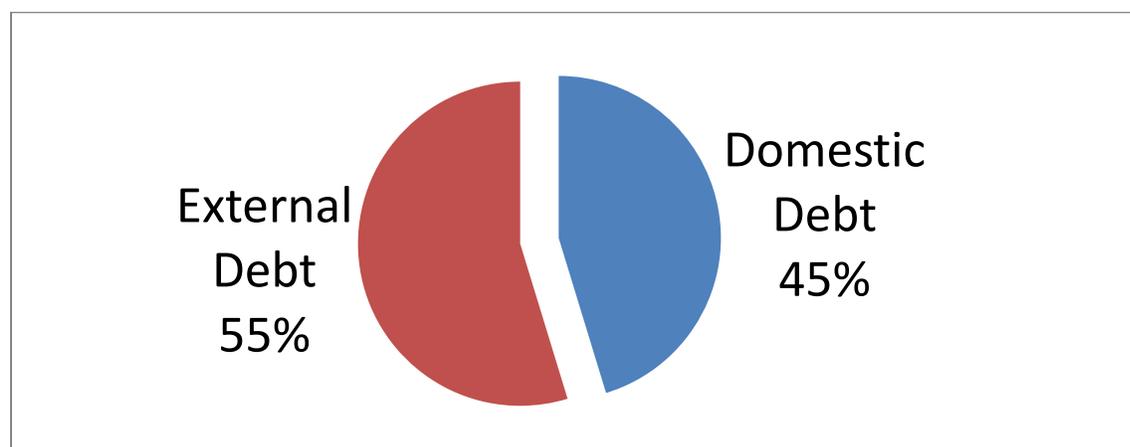
Table 2: Stock of Public Debt, as at end of 2014/15

End of June 2015	ETB Millions	US\$ Millions
External Central Government*	205,329.00	9,984.00
External SOEs Guaranteed	96,309.00	4,683.00
External SOEs Non- Guaranteed	86,633.00	3,969.00
Domestic Bonds	10,345.00	503.00
Domestic Treasury Bills	43,605.00	2,120.00
Domestic Direct Advance**	83,265.00	4,049.00
SOEs Domestic Bonds and Loans	179,905.00	8,748.00
Total Debt	705,391.00	34,056.00

Remarks:

- Most of the external debt stock owned by the central government is secured from concessional sources.
- As domestic debt market is not well developed the government may use Direct Advance as one of sources for its budget deficit financings.

Chart 1: Total Debt Portfolio by Source as at end of June 2015



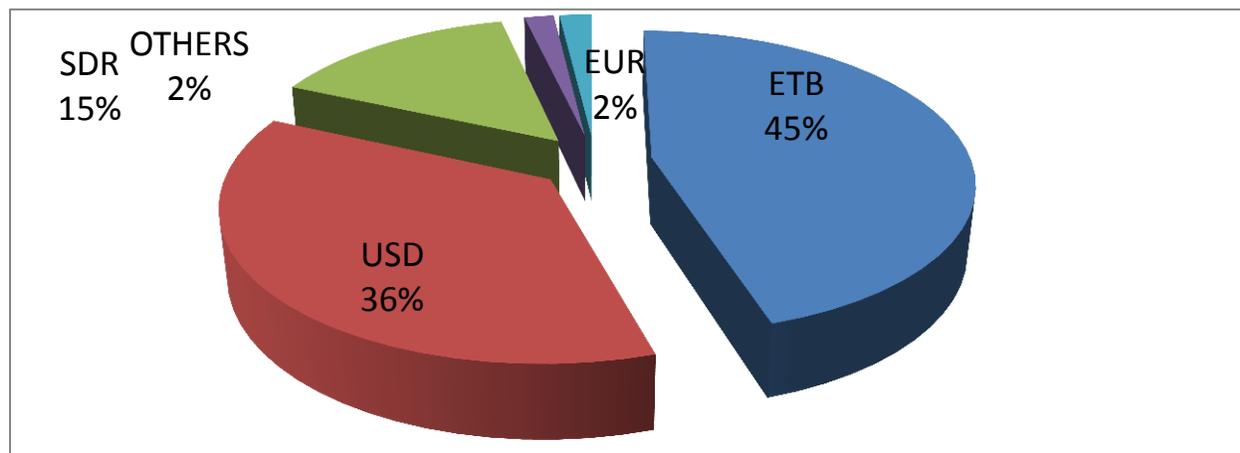
1.1.1 Financing Options from External Sources

As very well-known thanks to the HIPC and MDRI initiatives the debt stock of the country reduced to a level of USD 2,314.6 million in 2006/07 and the country was

within sustainable debt thresholds. Consequently both initiatives create fiscal spaces to borrow from concessional as well as limited volume from non-concessional sources to implement infrastructure projects.

Subsequently, it constantly increased and reached USD 18,636.23 million at the end of June 2015. The main reasons for this rise in external debt outstanding are mainly new disbursements by IDA, AfDF and IMF as well as non-concessional sources borrowings by the public enterprises, particularly by Ethiopian Electric Power (EEP), Ethiopian Railways Corporation (ERC), Sugar Corporation (SC), Ethio-Telecom (ETC) and Ethiopian Air Lines (EAL). The following chart presents currency composition of public debt as at end of June 2015.

Chart 2: Currency Composition of Public Debt Portfolio as at end of June 2015

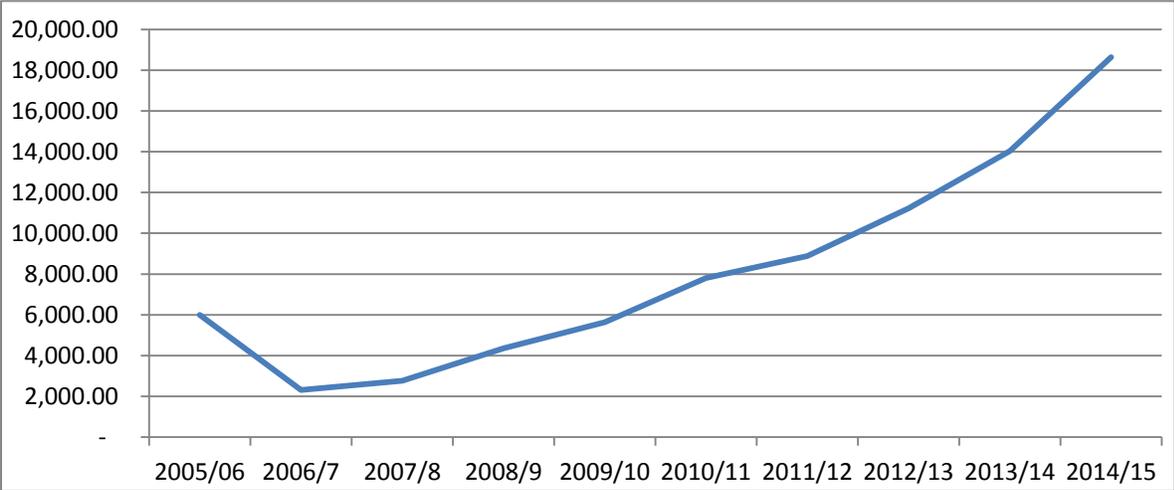


Remarks: As SDR is decomposed into its constituent currencies the portfolio of USD, JPY, Euro and GBP will be proportionally increased.

Out of the total external debt outstanding as at June 30, 2015, USD 12,448.96 million (68.8%) was owed to official creditors. This comprised multilateral (52.1%) and bilateral creditors (47.9%). The remaining 33.2% was owed to private creditors, which constitute commercial banks, Bond holders and suppliers and the proportion being 42%%, 16.0% and 42.%, respectively. The relative and absolute share of the private

creditors in 2014/15 is much higher than the previous years, as most of the ETC, EAL and EEP (former Ethiopian Electric Power Corporation) owed debt are suppliers credits.

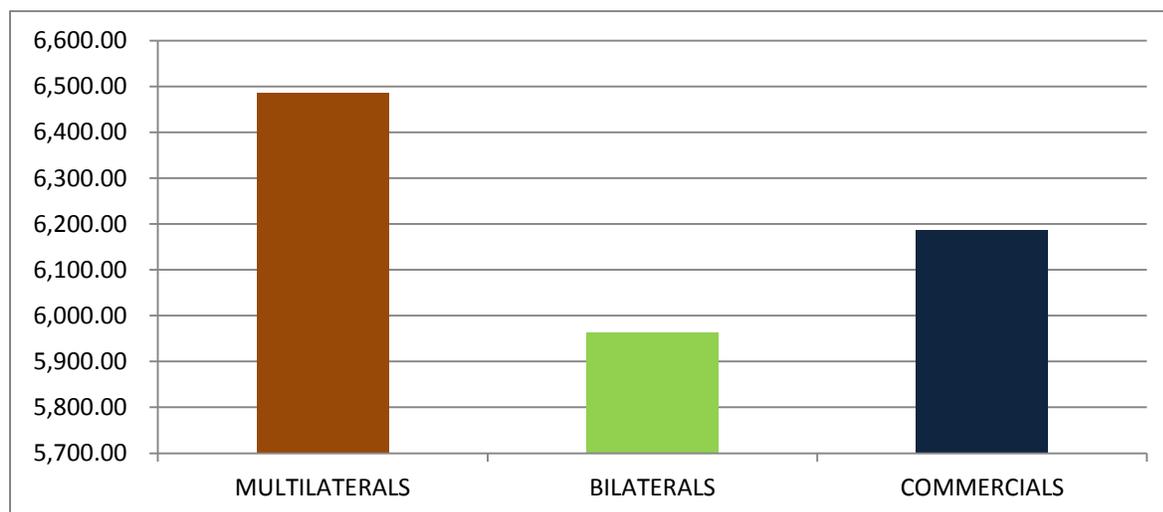
Chart 3: External Debt Movement 2005/06 – 2014/15



Source: Ministry of Finance

Similarly, in FY2014/15 it obtained 65% of total external credit from concessional multilateral sources, and 35% from concessional bilateral creditors. During the period International Development Association (IDA) accounted for 45% of total external credit followed by 14% from China and 13.5% from African Development Fund (AfDF).

Chart 4: External Debt Composition by Creditor Category as at end of June, 2015



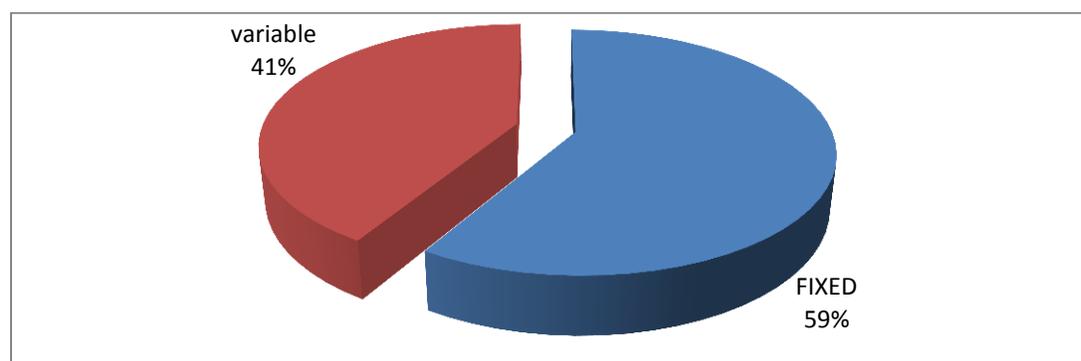
Source: Ministry of Finance

The share of the central government debt has decreased from more than 61.3% in 2011/12, to 52.5 % in 2014/15. It is evident that since 2008/09, the relative share of central government has significantly decreased due to new borrowings by public enterprises, particularly by EEP, ERC, EAL and ETC.

On the other hand, out of the total debt outstanding in 2014/15, nearly 67.5%, 26.3 %, and 2.9 % was denominated in US dollar, SDR and Euro, respectively, while the remaining 3.8% was denominated in other currencies including Chinese Yuan.

Similarly, in 2011/12 the proportion of the debt with the fixed interest rate was 66.6% and this reduced to 58.7% as at June 30, 2015. This is mainly due to the decrease in relative share of central government debt which was contracted on fixed interest rates.

Chart 6 External Debt Portfolio by Interest Type as at end June, 2015



1.1.2 Financing Trends from Domestic Sources

The volume of the debt as at end of June 2015 has reached to the level of Birr 317,120.00 million or equivalent to US\$15,154.00 million. The major instruments of government domestic borrowing were treasury bills, bonds and direct advance. Of course, in future when domestic debt markets develop direct advance has significantly increased over the last decade. Its share in the total domestic debt portfolio constantly increased and reached 60.7% in 2014/15. In the near future, as the domestic debt market develops its contribution to fill the financing gap is expected to increase and the dominance of the DA is expected to diminish.

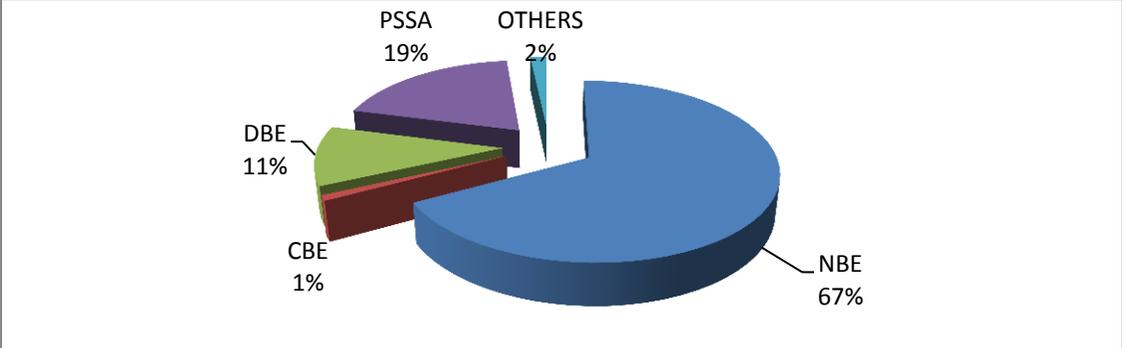
The outstanding balance for treasury bills, which was ETB 19.9 billion at the end of June 2011/12, increased sharply to ETB 43.6 billion in 2014/15. The share of 91 days treasury bills was the highest which accounted for 57.3 % in 2014/15.

Government Bonds, with longer term maturity (10 years and more), have been issued for special purposes rather than as a means of raising money to fill the budget gap. In 2011/12 the outstanding bond balance was Birr 12.1 billion, and decreased and reached Birr 10.3 billion at end 2014/15.

The major holders of government securities in Ethiopia are the National Bank of Ethiopia and the Commercial Bank of Ethiopia followed by government and private banks and insurance companies, Public Servants Social Security Agency and other public enterprises.

State Owned Enterprises (SOEs) have issued corporate bonds and borrowed long term loans from government banks to implement infrastructure mega projects. Some SOEs have access to borrow loans term loans directly from government banks for capital investments. The bonds and loans outstanding balance was Birr 77,761.0 million in 2011/12, and constantly increased and reached to ETB 179,905.00 million in 2014/15.

Chart 7: Government Domestic Debt by Holder Category as at end June, 2015



Remarks: NBE, CBE, DBE and PSSSA stand for National Bank of Ethiopia, Commercial Bank of Ethiopia, Development Bank of Ethiopia and Public Servants Social Security Agency respectively.

1.2 Ethiopia’s Cost and Risk Analysis of Public Debt Portfolio

As observed, the share of external and domestic debt as percent of total public debt was 55% and 45% respectively. Accordingly, it is important to assess the Cost and risks associated with the debt portfolio because such information enables decision makers to design forward looking strategies on the optimal debt structure in terms of maturity period, interest rate and exchange rate. In this regard market risk, operational risk and liquidity risk are the types of risks associated with Ethiopia’s public debt portfolio.

The weighted average interest rate for the external Public debt was 3.2% at June-FY2014/15, compared to 2.1% for Central Government External Debt. The weighted average interest rate for the domestic public and publicly guaranteed debt was 4.5% and a weighted average of 2.8% for Central Government Domestic Debt. The non-concessional debt by the SOEs increased the weighted average cost of the PPG debt portfolio was increased. As a result of the different weighted average interest rates of debt central government's interest payment obligations as percent of GDP was only 0.6%, while for interest payment including SOEs was 1.8% of GDP.

Out of the total, public debt 11.4% was maturing in one year and this is equivalent to 6.4% of GDP. Similarly, due to dominance of domestic debt 14% of the total central government portfolio was fall due within one year.

The central government share of external debt was characterized by very low exposure to rollover/refinancing risk while the domestic debt was characterized by high level of rollover risk due to short term direct advance and treasury bills.

It is important to note that since the main creditors of the domestic central government debt are the National Bank of Ethiopia, public banks, Public Servants Social Security Agency and Private Organization Social Security Agency refinancing risk is not a major concern as long as the public banks do not face sudden liquidity needs.

Given the debt management strategy of the country, Ethiopia is expected to contract concessional loans (from official multilateral and bilateral creditors) for central government and hence external debt obligations will be repaid over a long time horizon, spanning over 30 to 40 years. On the other hand, external debt contracted by SOEs on variable interest rate are gradually rising since 2015 and the interest payment by SOE's for their respective creditor is increasing from time to time and expected to rise on the upcoming years.

The average time to maturity of the total debt portfolio is about 8.9 years with the external and domestic debt portfolio displaying 11.3 years and 5.8 years, respectively. The domestic debt is associated with a substantial degree of refinancing risk due to the short term maturity of Treasury bills. The domestic debt portfolio of bond and treasury bills (combined) shows a lower maturity and may create risk to refinance the debt portfolio but if we see the Average Time to Maturing (ATM) of only the domestic bond it become much higher. Applying the above analysis the external debt will take a longer period of time before the debt is due for repayment on average. Comparing the ATM for the total public debt at 8.9 years the external debt portfolio has a lower exposure to refinancing risk.

This is explained by the structure of the external debt profile which is comprised of concessional loans. All in all, the average time to maturity for central government external debt is 12.6 years while that of state owned enterprises (SOEs) is about 6.9 years.

The external and domestic central government debt portfolio is made up of instruments that were contracted on fixed and low interest rates, with the exception of domestic debt particularly treasury bills which are susceptible to interest rate risk. This implies that the central government's share of external public debt is less susceptible to interest rate risk. It means adverse interest rate movements on the world market would not significantly affect Ethiopia's interest payment obligations. Although a significant proportion of the external loans are highly concessional and the interest rate is significantly below the market rates loans contracted by SOEs at market prices may increase risk exposure on the country.

Interest rate risk of the public debt is well captured by the proportion of debt that is subject to interest rate re-fixing within a specified period. For both external and domestic debt, changes in interest rates affect debt servicing costs. Hence, assessing

the proportion of debt to be re-fixed shows the extent to which the portfolio is vulnerable to higher funding costs as a result of higher market interest rates.

Analysis of Ethiopia's external public debt shows that the portfolio is subject to low interest rate risk because the majority of the loans are contracted in fixed interest rate. On the other hand, analysis of domestic debt particularly treasury bills show that the portfolio was subject to high interest rate risk due to the short-duration nature of the Treasury bills. A higher proportion of debt that is subjected to re-fixing within one year indicates high risk to adverse interest rate movements.

In contrast, in June 2015 the Average Time to Re-fixing (ATR) of Ethiopia's public debt was 7.9 years. Thus, it will take an average of 7.9 years to re-fix the interest rates of the portfolio. The ATR of the external debt stands at 9.5 years which imply that it will take, on average, 9.5 years to reset the interest rate of the external debt portfolio. This high value indicates lower interest risk associated with the external debt portfolio. It is noted that domestic debt is highly exposed to interest rate risk. This is confirmed by a low value of ATR which stands at 5.8 years. This implies that it will take only 5.8 years to re-fix the interest rate on domestic debt hence domestic debt has a high exposure to interest rate risk than external debt.

In the same way, there are three methods of quantifying exchange rate risk of the debt portfolio namely: the share of external debt in total debt, the currency composition of the debt portfolio and degree of currency mismatch between the debt service obligations and the composition of foreign exchange reserves for a given country. It is well noted that the country's external debt portfolio is exposed to exchange rate risks. Hence any significant depreciation of the Ethiopian Birr against the foreign currencies can substantially contribute to higher debt service payments in local currency terms. As a result, there could be higher debt service payments in the budget than forecasted.

The currency composition of total public debt exhibits minimal exchange rate risk emanating from currency mismatch since most of the external debt service obligations are in United States Dollars as the majority of our export or reserve is in USD ,and all domestic debt service obligations are in Ethiopian Birr. It means the currency composition of Ethiopia’s external debt does not constitute a significant source of external vulnerability except exposure to exchange rate fluctuation because the currency structure closely matches with foreign reserves/earnings.

1.2.1 Cost and Risk of the Central Government Debt Portfolio

The proportion of the existing central government external debt constituted 54% of total central government debt as at end of June 2015 and the dominance external debt continue. The large share of external debt and particularly concessional borrowing, in the debt portfolio lowered the overall cost and risk of the debt. That is why the overall debt portfolio carries an average interest rate of 2.1% per annum.

On the other front the central government debt portfolio entails significant exposure to exchange rate fluctuations as 59.7% is denominated in foreign currency. This represents potential risk given the historical trend of ETB depreciations against major foreign currencies. In addition, any adverse shocks in the terms of trade will aggravate the exposure to exchange rate risks.

Exposure to interest rate fluctuations appears to be not severe with the average time to re-fixing (ATR) of the overall central government portfolio being relatively long and exhibited at 12.6 years. The ATM of the overall portfolio for the existing debt is 12.6 years, it means the Central government debt portfolio exhibits that ATM equals to ATR.

The longer ATM (16.5 years) of the external debt portfolio emanates from the dominance of concessional financing. The ATM of 6.9 years for the domestic debt portfolio is partly due to the presence of long maturities of long term bonds. On average, the central government’s debt has relatively longer maturity. This shows that the country has been an IDA-only country for the past two decades.

The proportion of the portfolio to be refinanced within 12 months is not particularly large, standing at 14%. In addition, the refinancing risk of the repayment profile indicates that larger amount of repayment obligation in 2015 and 2024, which coincide with a rollover of treasury bills- and the bullet payment of the Euro bond in 2025. It means the nature of the repayment profile calls for efforts to smoothen and manage refinancing risk.

Overall analysis of the existing central government debt portfolio suggests that reduction of exchange rate exposure and smoothening of the repayment profile over the medium term of short term domestic debt constitute key drivers for the choice of MTDS.

**Table 2: Key Cost and Risk of Existing Central Government Debt, as at end
FY2014/15**

Risk Indicators		External Debt	Domestic Debt	Total Debt
Amount (In Million ETB)		205,329.00	137,215.00	342,544.00
Amount (In MUSD)		9,984.00	6,672.00	16,656.00
Nominal Debt as % GDP		15.7	10.6	26.3
PV as % GDP		9.8	10.6	20.4
Cost of Debt	Interest Payment as of GDP	03	0.3	0.6
	Weighted Average Interest Rate (%)	1.7	2.8	2.1
Refinancing Risks	ATM (Years)	16.5	6.9	12.6
	Debt Refixing in 1 Year (% of Total)	1.5	32.5	14.0
	Fixed Rate Debt (% of Total)	0.2	3.4	3.7
Interest Rate Risk	ATR (Years)	16.5	6.9	12.6
	Debt Refixing in 1 Years (% of Total)	1.5	32.5	14.0
	Fixed Rate Debt (% of Total)	100	100	100
FX Risk	FX Debt (% of Total Debt)			59.7
	ST FX Debt (% of Reserves)			4.4

II. RATIONALE FOR NEW MEDIUM TERM DEBT MANAGEMENT STRATEGY (2016-2020)

Financing the economic development program is essential for the realization of the objectives stated in the GTP II. During the five year GTP II period allocation of the development finance will aim to support the overriding objective of poverty reduction given the country's financial capacity with the maintenance of stable macroeconomic conditions. Obviously, one of the mechanisms to raise financing for the GTP II is borrowing from external as well as domestic sources.

In this connection, it is appropriate to design debt strategy to lead proper borrowing to fill the gap for the implementation of the second phase of GTP. Given this national and international circumstances the Government of Ethiopia has taken the right and timely decision to design this medium term debt management strategy and to follow and stick the future domestic as well as external borrowing to finance the developmental endeavors.

As the economy of the country is growing rapidly, it is the government's priority agenda to maintain this trajectory by taking appropriate actions including designing debt management strategy and implementing it to drive the course of borrowing and create enabling conditions for the debt strategy to play a key role in the economy in the process of gap filling. This strategy focuses only the central government borrowing plan. However, for the sake of averting any unforeseen risks and additional costs parallel to this strategy broad based and comprehensive debt strategy that contain the central government and SOEs borrowing has been developed for internal purposes to monitor and follows up the borrowing of the SOEs.

2.1 Objectives of the MTDS and Its Coverage

The Medium Term Debt Management Strategy 2015/16-2019/20 outlines Ethiopia's public debt management objectives to include the following:

- The efficient management of the country's public debt in terms of well-diversified and sustainable debt portfolio, supportive of government needs;
- Meeting Government's financing needs at minimal cost and with prudent degree of risk over the medium to long-term; and,
- Ensuring the growth and development of the country's domestic and external borrowing.

The Ministry of Finance including concerned Directorates, National Planning Commission (NPC) and National Bank of Ethiopia and other concerned bodies constitute a team to design this strategy.

A team of officials from the IMF, World Bank and WAIFEM were on the other hand to guide the Debt Management Directorate (DMD) and the stakeholders on the application of the Debt Management Strategy Analytical Tool.

The Strategy covers the country's external and domestic debts and financing needs. The Strategy is primarily concerned with how to optimally fund central government's primary balance (i.e., the difference between revenue and expenditure including principal payments and excluding debt service interest payment) by taking into account likely changes in macroeconomic and market variables, such as interest and exchange rates, inflation level, output and external reserves.

MTDS essentially guides the composition of borrowing instruments of the government debt to safeguard the debt sustainability status as well as continuously get access to domestic and external sources for long time. The time horizon of the MTDS analysis is five years, starting from fiscal year 2015/16 through 2019/20. This is in line with the country's second phase of Growth and Transformation plan.

2.2 Potential Financing Sources for MTDS Time Horizon

The sources of financing and instruments were expected to be used going forward. In addition, the DMD plans to introduce new products with a view to further diversifying

the investor-base, boost financial inclusion and national savings culture for increased gross capital formation, create more benchmarks and deepen the domestic government securities. The new debt instruments to be introduced, of course subject to market conditions. Similarly, the fiscal deficit decreases from 3.62% in 2016/17 to 1.95% in 2019/20.

2.2.1 Financing Options from External Sources

Ethiopia receives most of its external financing in the form of loan for the implementation of developmental projects. In the past 10 years disbursements for central government recorded an increasing trend, owing to improved macroeconomic environment and enhanced cooperation with development partners. The major development partners were the multilateral institutions constituting 67% of external financing of which IDA contributed 64% and bilateral donors accounting for the remaining 33%. The external sources will continue to finance a bigger proportion of budget deficit in the medium term given the relatively low level of development in the domestic financial market.

The Government, on the basis of the medium term financing assumptions, will continue to access concessional loans from both multilateral and bilateral sources to implement developmental programs and projects. Potential sources of external financing available for the planning period for the country can be categorized into multilateral and bilateral.

Generally, multilateral loans are concessional, for example IDA with low fixed interest rate (0.75 per cent), long maturity (38 years) and long grace period (6 years). Bilateral loans are usually concessional with fixed interest rate with average maturity of 20 years including grace period of 5 years. As concessional financing is insufficient and subject to unpredictability of disbursements, financial conditionality and tied to specific projects, the Government will consider limited semi-concessional financing for strategically viable and those who have good return projects during the MTDS period to repay without

difficulties. In line with the government's commitment to maintain debt sustainability, new borrowing will only be considered on concessional terms as evaluated by the MoF. New loans must have a grant element of at least 35 percent when calculated with an appropriate discount rate.

These loans are assumed to be denominated in foreign currencies including Special Drawing Right (SDR) United States Dollars (USD), EURO, Japanese Yen, Pound Sterling and others.

Semi-concessional loans are assumed to be contracted from official bilateral creditors. These loans have a maximum fixed interest rate of 2%, a maturity of 20 years including a 5-year grace period. In the absence of concessional financing, for strategic and an indispensable projects implementations, the Government will maintain semi-concessional financing in accordance with the international acceptable arrangement.

2.2.2 Financing Options from Domestic Sources

An active domestic debt market provides the government with an important avenue to secure additional financing for developmental endeavours, reduce dependence on foreign financing and currency risk. To that end, steps have been taken by the government to improve the primary market by introducing the 364-day treasury bills to elongate the tenor and diversifications of the investors. In this regard, in the future access to Direct Advance from the NBE will be diminishing and treasury bills and treasury bonds will be the major sources for financing the government gap before the end of MTDS period.

Naturally, the domestic debt market needs to develop continuously through introducing various security markets to finance the budget gap. These steps will encourage private investors to participate in the process. Subsequent actions in terms of sensitizing potential investors, creating conducive domestic market, improvement of auction

facilities and legal domestic debt market reform as required and other related measures will be taken in order to encourage private investors on investing in risk free government paper (treasury bills and treasury bonds).

For the time being, as domestic debt market and demand for the security is not well developed domestic borrowing will be undertaken through issuance of treasury bills and treasury bonds at the ratio of 80:20. This will ensure that the maturity structure of the portfolio is lengthened to move towards minimizing refinancing risk. In addition, treasury bonds expected to be issued at benchmark of 3 and 5 year tenors to build liquidity. This of course depends on the development of situation that allows the introduction of the other instruments.

Given the projected inflows, Private Organizations Social Security Agency (POSSA) could continue to absorb an average additional ETB 1 billion per year and the PSSSA could mobilize close to ETB 800 million per year. The inflows in short duration Treasury bills are expected to be strong by focusing on longer term of 364 days and depending on market development and demand to issue 2 and 5 years treasury bonds.

2.3 Baseline Macro-Economic Environment Assumptions

The primary balance has widened due to reduced revenues, while current account is also under pressure because the performance of external sector is not as expected.

The new strategy focuses on the utilization of all the borrowed amounts to fund the budget deficit of course not recurrent expenditure but for capital investment like funding identified infrastructure project implementations. Efforts are also being made to improve governance and efficiency in fiscal operations of the government so as to reduce wastages and leakages.

The Government, in its Macroeconomic and Fiscal Framework (MEFF), 2016-2020 envisages generating a real GDP growth rate of about of 11% in 2016 with a gradual

increase by 2020 while keeping the inflation level under control at slightly above 9 percent annually. The MEFF 2016-2020 and the 2016 Budget give room for fiscal expansion with conservative revenue estimates.

This would create funding gaps much of which would have to be covered through debt. The purpose of the Debt Management Strategy analyses was to explore how to optimally fund the gap (i.e., the difference between the revenue and expenditure estimates), thus created in view of the several funding sources and debts instruments available to the government.

The Ethiopian economy has been growing at high rates over the past decades and the government maintains the ambitious Growth and Transformation Plan, targeting an average real GDP growth rate of just over 9.2% until 2019/20.

The 2015/16-2019/20 MEFF projects a moderate primary deficit in the fiscal accounts. Ongoing discipline in recurrent spending and by strengthening revenue mobilization through broadening of the tax base and better compliance will help to reduce the primary deficit to about 1.95%-3% of GDP to a balance during the projection period.

On the external front, the current account is expected to remain in deficit over the time horizon. Despite declining trends in key commodity prices (especially coffee and gold), exports are expected to grow modestly supported by a rise in electricity exports to neighboring countries, increased domestic gold production, and a gradual recovery in global demand. Still, rapid growth in the import of capital goods driven by major public investment projects in the energy and transport sectors will continue to outstrip growth in exports.

Inflation is expected to stabilize at about 8 percent over the period, supported by lower food and global oil prices. Continued restraint on the monetary stance is expected to keep inflation within a single digit and help anchor inflation expectations. The exchange rate will also continue to be managed closely by the NBE in line with the policy of gradual depreciation. As a consequence, the real exchange rate is expected to stabilize,

with the nominal exchange rate depreciating by about 6 percent annually against the U.S. dollar. During the MTDS period to improve export performance by enabling of the product of the country to be competitive there is an expectation of devaluations of birr against USD by 16.5%.

2.3.1 Principal Risks to Baseline Macroeconomic Assumptions

The robustness of the analysis is based on the resilience of the macro fundamentals and typically the baseline assumptions for the economic growth, external and fiscal balance, and the monetary sector. The overall budget balance assumption is also anchored on a strong GDP growth, propelled by the strong fiscal stance which is enhanced by the revenue coming from tax sources.

Although the baseline medium-term macroeconomic projection assumes real GDP growth of over 11% for the full projection period, downside risks to baseline projections that may impede the implementation of the strategy including recurrent drought which mainly affects agricultural production, low capacity to mobilize tax revenue, decrease in volume of private transfer, inflation, political instability and exchange rate risks associated with the global financial environment. In view of the main macro postulations above, the following may post risk to the macroeconomic fundamentals.

- The enhanced economic growth not achieved resulting from delayed and unreliable rains and the offset of economy by a rise in grants and aid-in-kind to fund emergency measures,
- The current account deficit resulting to a prolonged shock to commodity exports prices a global growth exports putting pressure on exchange rate and inflation and dampening growth and a sudden stop to private transfer could require the government to contract additional external debt to finance the current account deficit,

- Not achieving the enhanced forecasted government revenue resulting from the inadequate capacity and other related problems including political instability to raise tax revenue collection rates with GDP growth and the contingent liabilities could also pose additional fiscal risk and,
- Failure to bring real interest rates to zero by reducing inflation which could hinder development of financial markets, limit domestic savings and reduce the demand for Government bonds.

Any one of the above risk could jeopardize growth and economic stability that will affect the implementation of the designed medium-term debt management strategy. In order to keep these risks in view, the Ministry of Finance is taking appropriate measures to monitor the total debt portfolio of the consolidated public sector so as to avoid the occurrence of the above mentioned risks.

2.4 Description of Baseline and Alternative Stress Scenarios

The baseline exchange rate projection assumes 6% depreciation per annum over the next five years. This is in line with the exchange rate projection used in the government's Macroeconomic Fiscal Framework for the period FY2015/16 through FY2019/20. The baseline domestic interest rate assumes on the average 3% for treasury bills, 5% for the three-year treasury bonds, and 7%-7.5% of the five-year Treasury bonds.

The robustness of the alternative debt management strategies was assessed under three scenarios based on interest and exchange rate shocks. The magnitude and direction of the shocks was informed by the historical performance of Ethiopian interest and currency exchange rates over the last ten years. It was assumed that shocks materialize in FY2017/18, and that all shocks are sustained through FY2019/20. The cost of all market-based borrowing increases in all years. For the purpose of this

analysis, three typical shocks stemming from exchange rate, short term interest rates and a combination of these are considered.

Scenario 1: In the past the Ethiopian Birr has been depreciated vis-à-vis USD. It is expected that 15% depreciation of the domestic currency against the USD in FY2017/18 over the baseline projection may materialize. As a result, the Ethiopian Birr is expected to depreciate by 21% vis-à-vis the USD which implies a total depreciation of 21% in 2017/18. The shock is assumed to be sustained throughout the projection period. The cost of borrowing at all tenors is assumed to remain the same as the baseline scenarios.

Scenario 2: This scenario assumes an upward parallel shift of the yield curve by 5% for all the domestic instruments. This shock is consistent with the macroeconomic target of raising real interest rates from the current level to zero.

Scenario 3: In this scenario, the Ethiopian Birr depreciates vis-à-vis USD, while all domestic interest rates increase by reasonable margin at all maturities. This reflects the likelihood that interest rates would likely react to an external shock that affects the exchange rate. A combined shock of 10% depreciation of the exchange rate relative to the 6% baseline depreciation projection (resulting in a total depreciation of 16% in FY2017/18) and a 5% increase of domestic debt yield curve are assumed in this scenario.

2.5 Description of Alternative Debt Management Strategies

To ensure a rigorous analysis, four medium term alternative financing strategies were designed to be assessed under this MTDS with the aim of attaining reasonable cost and prudent risks. The main differences in these strategies lie on the composition -of resources expected from domestic and external sources..

The first Strategy 1 is the status quo that maintains significant access to external concessional sources and borrowing through treasury Bills to cover the residual financing gap. The second, third and fourth strategies consider domestic market development and external sources with different proportions; the second strategy oriented to domestic financing, with the introduction of 3 years bond and the IDA blended external financing, third being largely oriented to Domestic source with the introduction of 3 and 5 years bonds and the fourth is the same as the third one but it introduce an IDA blended external borrowing.

The following four competitive debt management strategies were considered and their impact on cost and risk analyzed.

Strategy 1 (S1)

The status quo the strategy rely on maximizing external concessional financing continues to rely heavily on treasury bills from domestic source. Gross external financing is characterized by 82% multilateral concessional and 18% bilateral concessional loans. Gross domestic financing will be 100% in treasury bills. This strategy is relatively more external than the remaining three.

Strategy 2 (S2)

A strategy that introduces a 3-year bond in FY2018/19 and potential introduction of IDA blended financing. The issuance of 3 year bond with an initial percentage share of 20% and with an increment of 5% per year throughout the projection period. Out of the total External financing about 5% will be covered through IDA blended financing. The introduction of the three year note reduces the treasury bill issuance by so doing this strategy increases the ATM of domestic debt. Under strategy 2 Gross external financing characterize by 81.6% borrowing from multilateral concessional, with a 4.6% IDA Blended financing and 18.4% bilateral concessional. Gross domestic financing is initially 100% in treasury bills, but three-year bonds are gradually introduced with a 5%

increment per year, extending the maturities of the domestic debt. The introduction of three year bond reflects the core debt management objectives to extend maturities in the domestic market by introducing three year's treasury bonds. Strategy 2 is also more external than Strategy 3 and 4.

Strategy 3 (S3)

A strategy which further introduces a three year and five year Bonds in FY2018/19 in equal amounts, which initially amounted to 20% each and with a 5% increment every year for each instrument. The introduction of the three and the five year notes reduce the treasury bill issuance by 2020 and is in line with domestic debt market development of the government targeted as one of the objectives of this MTDS. This will extend the maturities of domestic debt and total Central Government Debt. The gross external borrowing characterized by 81.1% from multilateral concessional, with 18.9% bilateral concessional. Furthermore strategy 3 is more Domestic debt strategy than other 3 strategies.

Strategy 4 (S4) is A strategy similar to S3 with respect to introduction three year and five year's bond including additional IDA blend terms borrowing. The strategy introduces three and five year bonds in FY 2018/19, initially 20% of the total domestic financing for each instruments and it will increase by 5 % every year through 2019/20. The IDA blended will be about 5% of the external financing. The gross external borrowing is characterized by 81.1% from multilateral source and the remaining 18.9% from bilateral sources.

The gross borrowing requirements and their alternative financing strategies over the time horizon of the debt strategy are summarized in the figure below.

The Central Government nominal debt level is projected to be about 28.5% of GDP by end FY2019/20. The introduction of the new instruments 3 and 5 year notes, which

carry higher interest rates, plus the harder IDA term, explain the increase in debt level from 26.3 percent of GDP at end-FY2014/15 about 28.5% at end-FY2019/20.

The implementation of the four competitive borrowing strategies over the projection period changes both the stock and composition of the central government debt as well as the associated cost and risk in relative to those as at end-FY2014/15. The Table below presents the cost and risk indicators resulting from the portfolio transformation caused by the four alternative debt management strategies over FY2015/16 – FY2019/20.

All strategies help to reduce refinancing risk. The three strategies S2, S3 and S4 considered introducing 3 or/and 5 year term notes. The result has been to extend the average time of maturity of domestic debt to 2–3 years.

The share of foreign currency debt decrease for strategy 2, 3 and 4 from 59.7% of the total outstanding debt at end-FY2014/15, to 58.8%, 55% and 55% respectively at end-FY2019/20. But Exchange rate risk will increase to about 63% for strategy 1, as it is the most external oriented debt strategy.

2.6 Methodology for Outcomes of Strategies Analysis

The strategies have been simulated in the MTDS model under the assumptions discussed above. The different strategies considered in the MTDS would be evaluated using three ratios: interest/GDP, debt/GDP and PV of debt/GDP. The former ratio indicates the liquidity or the availability of resources to repay the debt while the latter two evaluate the degree of debt sustainability of each strategy. The Debt/GDP ratio is relevant in view of the strategic public debt-GDP ceiling of 56% of GDP and PV of Debt is relevant given the significant share of concessional and semi-concessional debt. The resultant values of these ratios under the stress test scenario will also be analyzed.

It should be noted that regardless of the strategy, the nominal debt to GDP ratio increase over the projection period for all strategies and this can be partly explained by the introduction of three year and five year bonds and the IDA blended borrowing.

Other additional measurements are also assumed in the analysis including average term to maturity (ATM) and Average Time to Refixing (ATR) which measure interest rate and rollover risks. The different strategies are also evaluated employing the redemption profile in order to look into the liquidity pressure on the budget. Overall, it is envisaged that the methodology applied and the cost-risk indicators considered will assist in obtaining the desired portfolio mix.

2.6.1 Analysis of the Four Selected Strategies

The direct exposure to exchange rate risk is limited due to the low share of debt denominated in foreign currencies and low interest rate at concessional terms that apply to most of external debt. Regarding domestic debt, the large amount of short-term securities in the portfolio implies a relatively higher exposure to an interest rate increase, and additional high refinancing risk.

With regard to the cost measured by nominal debt to GDP at the end of FY2019/20, S2, S3 and S4 display similar expected cost (at about 28.5%) while Strategy 1 is the strategy with the least cost at about 28.4%. Strategy 2, 3 and 4 displayed relatively higher debt to GDP ratio, due to the introduction of 3 years and 5 years domestic bonds and IDA hard term external borrowing. This suggests that domestic borrowing only with 100 % treasury bills, direct advances and external concessional borrowing is cheaper than the introduction of three and five year bonds with IDA blended external borrowing.

The strategy 1 with 100 treasury bills and direct advances from domestic source seems advantageous in the short-term from the cost perspective. But strategy 1 will not help the development of the domestic debt market as envisaged in the core debt management objectives.

On the other hand, strategy 2 with the introduction of 3 year bond and external borrowing with IDA blended, and strategy 3 with the introduction of both three year and five year bonds will be more costly as a result of the expected higher interest for this instruments. But these strategies will enhance domestic debt market. Strategy four has the highest nominal debt to GDP ratio as a result of both the introduction of 3 and 5 years bond and IDA blende borrowing assessing the cost and risk of the central government nominal debt to GDP ratio allows to quantify the contribution of each debt management strategy on vulnerability to debt sustainability. The debt management strategies that have a greater share in treasury bills and direct advances have the least cost and risk measured in terms of nominal debt to GDP. Of course, it is important ti note that there is not much difference in the ranking of cost-risk among the four Strategies.

While measuring the cost based on PV of debt to GDP at the end of 2019/20 S1, S2, S3 and S4 will have 21.1%, 21.9%, 22.3 and 22.5% respectively and S4 has the highest due to the introduction of 3 and 5 years bond. Whereas due to IDA blended borrowing S1 has relatively the least cost.

In terms of concessionality of debt, the IDA scale up facility terms has an important impact on the PV of debt to GDP. While Strategies 1 and 3 all have the same component of concessionality in the external financing, Strategy 2 and 4 have less concessional terms

On the other front, the outcome measured by interest payment to GDP at the end of FY2019/20, indicates that S1 has a lower expected cost and lower risk relative to S2,S3 and S4, that are more domestically oriented. S1 is one of the least cost strategies in terms of the interest/GDP and it produces a lower fiscal adjustment cost to maintain debt sustainability than the other strategies. Similarly, here it is important to note that in terms conducted analysis the difference among alternative strategies are not big that is 0.2%.

Overall, due to the positive outlook and the associated strong fiscal position, the debt indicators are generally encouraging under all the strategies. Further, though a clear ranking is observed, there is relatively little difference among the alternative strategies on the basis of their cost-risk indicators. The difference between the highest and lowest cost strategies is only 0.8% to 1.4% in terms of both interest/GDP and debt/GDP ratios.

On the other hand, in analyzing the strategies, other cost indicators such as the implied average interest rate, interest/revenue ratio and other risk indicators such as the Average Time to Maturity (ATM) and percentage of debt refixing within 12 months were considered to analyze the alternative four strategies in conjunction with the overall core objectives of debt management. In terms of refinancing risk Average time to maturity (ATM) for External Borrowing show an improvement while it is worsening for domestic debt as more of the domestic financing will be assumed to be in treasury bills. In this regard S1 will have a higher ATM followed by S2 and S3, S4 have the lowest ATM.

As far as Interest Rate Risk is concerned, Average Time to Refixing (ATR) shows the same trend as that of ATM since there is no variable interest borrowing by the central government.

2.6.2 Selection of Appropriate Strategy

Overall, maintaining the recorded debt sustainability, minimizing exchange rate exposure and smoothening the repayment profile over the medium term constitute key drivers for the choice of the best strategy. In this regard, out of the four assessed, on the basis of the outcome measured by interest payment to GDP and nominal debt to GDP ratio and other indicators, the two strategies of S1 and S2 are feasible strategies to implement in the MTDS period. The result of these two strategies suggest that domestic borrowing (given, the prevailing low interest rates) and external concessional borrowing have comparable cost and external semi-concessional borrowing is inferior to domestic borrowing, taking into account the exchange rate effect that offsets the lower

interest cost of semi-concessional debt.

Over the time horizon, given the changing circumstances and constraints expected, it may be imperative to select strategy 2. This strategy not only addresses the limited access to concessional borrowing but it is also helpful to meet the overall objectives of developing domestic debt market, increasing mobilization of domestic savings, reducing external dependence to fill the budget gap and reducing inflationary pressure in the economy during the MTDS period.

Indeed strategy 2 shifts the portfolio in this direction, with S2 being aggressive in increasing the domestic share of financing by maintaining gross domestic financing as a share of GDP at the current level of 1.5% of GDP and lengthening maturities by introducing Three-year bonds into the domestic financing mix. In addition, strategy 2 implies maintaining a reasonable stream of new issuance in the domestic market and is more in line with the core objective to extend maturities in the domestic market than S1. Certainly, these depend on the shift of demand and the level of progress of domestic debt market for treasury bonds.

Hence, out of the two strategies indicated above, on the basis of the objectives towards developing domestic debt market priority focus areas of the country and results of cost-risks assessments, the ideal to be selected as first choice is Strategy 2 over the time horizon given the changing circumstances and constraints expected during the period. However, the government will use both strategies interchangeably depending on the reality, availability of the resources, economic growth and global situations.

III. CONCLUSION and Way Forward

The key objective for the 2015 Medium Term Debt Strategy was to assess cost and risks of domestic and external borrowing while taking into consideration the debt sustainability. This analysis will guide the central government to develop financing plan by setting out among others the least cost combination of borrowing instruments with the prudent degree of risk taking into account macroeconomic indicators and the domestic debt market development.

The 2015 MTDS indicates that the total public debt is expected to rise substantially on the account of large infrastructure financing projected in the medium term fiscal framework. The PV Debt to GDP is projected to increase over the medium term. This is on the assumption that the current real growth projections over the medium term shall be sustained. This would nevertheless still be within the IMF debt convergence criterion that requires a PV of debt GDP of less than 56% at all times.

Similarly, the current cost and risk analysis of debt portfolio reveals that there is higher foreign exchange risks due to large foreign currency debt exposure and the current underdeveloped domestic borrowing market provide an opportunity to diversify sources of financing and further develop the domestic borrowing market.

The choice of debt strategy is guided by such objectives as maintaining debt sustainability, minimizing costs and risk exposure and viability of the strategies. In this regard, four alternative strategies were assessed using the MTDS Analytical Tool, based on debt management objectives of the government. The analysis indicates that strategy 1 and 2 that assume borrowing from concessional and semi-concessional sources while elongating domestic debt maturity seem more practical to implement than other strategies. It should be noted that both strategies could be implemented interchangeably based on the development of economic situation of the country.

Accordingly, taking into account that fact and the cost/risk tradeoffs, Strategy 1 (S1) is judged to be the most realistic strategy over the medium term. It means Strategy one was selected to be the first preferred strategy among the four alternative strategies. This strategy assumes a gradual reduction in the concessional envelope over the medium-term, replaced by semi-concessional borrowing. The strategy not only has relatively low risk and cost but also more feasible in implementation given the recent trends of reduced concessional borrowing while increasing reliance on non-concessional borrowing. Nonetheless, the preferred strategy is likely to pose a number of debt management risks as observed above of which one of it is exchange risks. Whereas strategy 2 may appear to dominate the alternative borrowing strategy if its constrained by the underdeveloped level of domestic debt market and limited availability of demand from the side of participants improved to meet the financial requirement for infrastructure development.

In conclusion, the assessment of the MEFF indicates high sensitiveness of the solvency indicators of Debt to GDP, PV Debt to GDP and GDP growth assumptions. Proactive actions as required are therefore necessary to ensure that the current public debt position is not worsened over the medium term. Therefore, attaining the programmed economic growth assumptions and the efficient use of borrowed funds are highly critical in maintaining the solvency indicators below the projected levels to create room for any future external borrowing and to ensure enplacing the long term debt sustainability in the country. The borrowing envisaged under the MTDS 2015 therefore, shall be undertaken with caution taking into account the above factors.

Going forward, an annual review of potential strategies shall be carried out to establish their feasibility and relative merits. Similarly, publication of the strategy is an important mechanism for enhancing accountability of debt management, as well as transparency of debt management operations in the country.