DEBT MANAGEMENT STRATEGY

24. Notwithstanding the rise in the public sector debt to GDP ratio in the wake of the pandemic, public sector debt remains sustainable due to its relatively low cost and risks. In fact, through active management, the cost of the debt portfolio in FY 2020-2021 is being maintained at the same level as in FY 2019-2020, while its profile and structure are being further improved, as evidenced by the following:

(a) the cost of debt is being reduced. Interest payments as a ratio to GDP is estimated at 2.8%, lower than the target of 3.5%;

(b) the affordability of public debt is being improved. The ratio of interest payments to recurrent revenue would drop to around 10% from 12.9% in FY 2019-2020, also below the benchmark of 10.5%.

(c) the average interest rate on Government debt would decline to 3.5% from 4.2% in FY 2019-2020;

(d) refinancing risk of Government debt is being reduced. The average maturity of Government debt is being increased from 4.9 years at end June 2020 to 5.8 years by end June 2021, above the set benchmark of 5 years;

(e) the amount due within one year is being reduced from 24.7% at end June 2020 to 21% by end June 2021; and

(f) interest rate risk is being brought down. The average time for fixing of interest is being increased from 4.2 years to 5.2 years and the percentage of debt falling due for re-fixing of interest lowered from 33.4% at end June 2020 to 29.3% by the end of June 2021.

25. In terms of composition, the share of external debt in total Government debt is expected to pick up to around 22.3% by end June 2021 compared to the benchmark of 20%. This would be mainly due to (i) concessional loans contracted from three development partners to mitigate the impact of the pandemic on the foreign exchange reserves situation of the country, and (ii) an increase in the holding of Government securities by non-residents amounting to around Rs 15 billion.

26. As regards the debt service ratio, it would pick up to around 8.1% during FY 2020-2021 mainly on account of a significant drop in exports as a result of the pandemic. However, it would still be below the international standard of 10%. In spite of increasing to 30.1% of GDP, foreign debt of the country has a cover in terms of international reserves of around 233% compared to the general rule of between 100-150%.

Medium Term Debt Management Targets/Benchmarks

27. Consistent with the Macroeconomic Framework, public sector debt is planned to be brought down to about 82% of GDP by end June 2024. The debt management strategy aims at setting out cost and risk control benchmarks/targets to further improve debt sustainability.

28. Interest payment on Government debt will be brought down to around 2.5% of GDP, below the set target of 3.5%. Furthermore, with the aim of increasing debt affordability, the benchmark for interest payment as a ratio of recurrent revenue will remain at 10.5%. However, it is planned to further bring down this ratio to around 10%. As regards the average interest rate on Government debt, it is expected to remain within 4%.

29. With a view to reducing foreign exchange rate risks, the share of foreign debt in the Government debt portfolio and public sector debt portfolio will be maintained at their present benchmarks of 20% and 25%, respectively.

30. The currency composition of Government foreign debt will be further diversified by increasing the share of other currencies. At the same time, to broadly reflect the currency composition of export proceeds of the country, the benchmark for the share of USD in public sector debt will be set at around 38% and that of EURO at 35% with other currencies constituting 27% of the portfolio.

31. In order to contain refinancing risks, the benchmark for the average time to maturity of Government debt will be raised to 5.5 years while the share of debt falling due for payment within one year will be contained at 22%. This is planned to be achieved by generally limiting new foreign borrowings to loans with long term maturities of 15 years and above and with concessional interest rates.

32. With regard to domestic debt, the share of short-, medium-, and long- term instruments will be maintained at 10%, 19%, and 42%, respectively while that of 5-year bonds will be raised to around 30%.

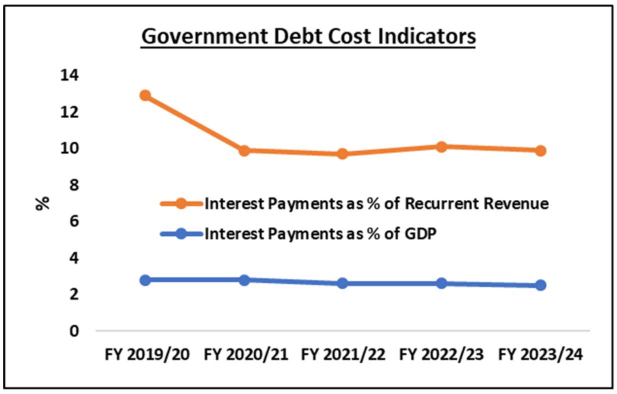
33. Interest rate risk will be mitigated by setting a benchmark of an average of 5 years and a share of 30% on the re-fixing of interest on Government debt portfolio. In this respect, the bulk of Government securities will be issued at fixed rates of interest.

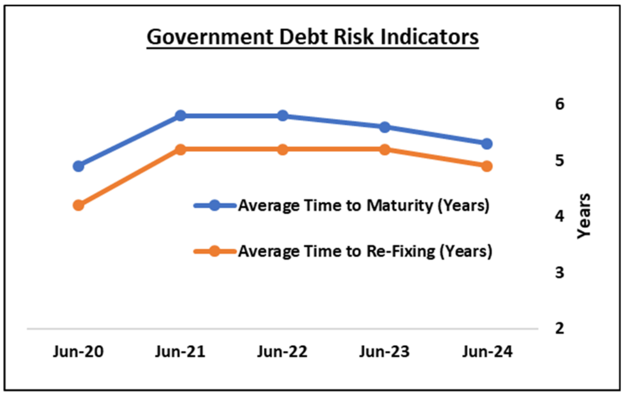
34. As regards foreign debt, the share of fixed interest rate loans will be set at 65% and that of variable rate loans at 33%, with the balance of 2% constituting interest-free loans. These benchmarks for public sector external debt will be 68%, 30% and 2%, respectively.

35. With the aim of further improving external debt sustainability, the benchmark for the ratio of national external debt to GDP will be reset at 25% while the target for debt service ratio will be maintained at 6% compared to the international standard of 10%. In the same vein, the benchmark for foreign exchange reserves cover for national debt will be raised to 250% from 225% at present.

36. In order to further encourage the development of the secondary market for Government securities, the bulk of financing of the Budget over the medium term will be from domestic sources. Thus, benchmark securities of higher amounts will be issued, thereby providing larger volumes for trading.

37. The overall aim of the strategy is to further enhance the sustainability of public sector debt by reducing cost over the medium term while maintaining risks at prudent levels as demonstrated in the charts below. It is set within the macroeconomic parameters of the Budget and represents the preferred option after internal analysis of alternative strategies.





Medium Term Cost and Risk Indicators

	End Jun-20 Actual	End Jun-21 Revised Estimates	End Jun-24 Estimates	Benchmarks/ Limits	Tolerance Level %
Government Debt					
As % of GDP (End of Period)	75.0	85.9	74.3	72.0	+/-5
Cost Indicators (Cash Basis) (Financial Year)					
Interest Payments as % of GDP	2.8	2.8	2.5	< or = 3.5	-
Interest Payments as % of Recurrent Revenue	12.9	9.9	9.9	10.5	+/-10
Average Interest on Debt (%)	4.2	3.5	3.4	4.0	+/-10
Composition (%) (End of Period)					
Foreign	12.7	22.3	17.3	20.0	+/-5
Domestic	87.3	77.7	82.7	80.0	+/-5
Currency Composition of External Debt (%)					
USD	12.8	5.9	11.0	12.0	+/-5
EURO	58.2	47.3	48.3	50.0	+/-5
YEN	1.5	13.8	15.9	15.0	+/-5
Others	27.5	33.0	24.8	23.0	+/-5
Refinancing Risks					
Average Time to Maturity (Years)					
Total Debt	4.9	5.8	5.3	5.5	+/-10
External Debt	6.5	8.8	7.6	7.5	+/-10
Domestic Debt	4.7	5.2	4.9	5.0	+/-10
Due Within 1 year (%)					
Total Debt	24.7	21.0	23.3	22.0	+/-10
External Debt	11.5	6.1	6.5	6.5	+/-10
Domestic Debt	26.3	24.2	26.3	25.0	+/-10
Interest Rate Risk					
Average Time to Re-Fixing (Years)					
Total Debt	4.2	5.2	4.9	5.0	+/-10
External Debt	2.1	6.3	5.8	5.6	+/-10
Domestic Debt	4.4	4.9	4.8	4.8	+/-10
Share with Re-fixing in 1 Year (%)					
Total Debt	33.4	29.3	29.9	30.0	+/-10
External Debt	65.4	38.3	35.8	38.0	+/-10
Domestic Debt	29.4	27.4	28.9	28.0	+/-10
Interest Rate Mix of External Debt (%)					
Fixed Interest Loans	33.9	65.8	64.3	65.0	+/-10
Variable Interest Rate Loans	63.3	32.7	34.4	33.0	+/-10
Interest Free Loans	2.8	1.5	1.3	2.0	+/-10
Public Sector Debt					
As % of GDP (Gross)	83.4	95.0	82.4	80.0	+/-5
As % of GDP (Net)	70.4	78.8	79.2	75.0	+/-5
Composition (%)					
Foreign	17.0	25.9	21.5	25.0	+/-5
Domestic	83.0	74.1	78.5	75.0	+/-5
Currency Composition of External Debt (%)					
USD	40.3	26.4	36.1	38.0	+/-5
EURO	40.1	37.3	35.2	35.0	+/-5
YEN	1.0	10.7	11.2	11.0	+/-5
Others	18.6	25.6	17.5	16.0	+/-5
Interest Rate Mix of External Debt (%)					
Fixed Interest Loans	41.5	66.0	67.6	68.0	+/-5
Variable Interest Rate Loans	56.7	32.8	31.4	30.0	+/-5
Interest Free Loans	1.8	1.2	1.0	2.0	+/-5
National External Debt [1]					
As % of GDP	19.7	30.1	22.0	25.0	+/-10
FX Reserves as % of External Debt	321.1	233.3	260.8	250.0	+/-10
Debt Service Ratio[2] (%) (Financial Year)	9.0	8.1	5.2	< or = 6	-

1 - Excludes Deposit Taking Institutions and Global Business.

2- Includes prepayment of Rs 6,437 million of external loans in FY 2019/20. Excluding these prepayments the debt service ratio would be 5.1%.