DEBT MANAGEMENT STRATEGY

34. The overarching objective of the Debt Management Strategy is to minimise the cost of the public sector debt portfolio while maintaining risks linked to the debt at a reasonable level. In this regard, the Strategy outlines the targeted composition of public sector debt in terms of domestic and foreign, the currency composition, maturity structure and interest rate mix. The Strategy also sets out appropriate benchmarks, after an assessment of the alternative financing strategies, that would deliver the optimum mix of debt instruments in view of their costs and risks. The focus is on further improving the sustainability of public sector debt.

35. On the cost side, notwithstanding the recent rise in interest rates both on the international and domestic markets, the Strategy aims at maintaining the ratio of interest payments on Government debt to GDP at its present level of 2.4%, that is, well below the limit set at 3.5%. Similarly, the ratio of interest payments to Government recurrent revenue will be maintained at its present level of around 10% compared to the benchmark of 10.5%.

36. On the risk side, with a view to containing exposure to foreign exchange risks, the share of Government foreign debt will be kept below 22% over the medium term. In fact, the share of foreign debt is projected to be around 21% as at end June 2026. Some 72% of the aggregate medium-term borrowing requirements of Government will be met from domestic sources and 28% from foreign sources. This represents a moderate exposure to foreign exchange risks according to international standards.

37. Moreover, Government's foreign financing requirements will be met mainly from long-term concessionary or semi-concessionary bilateral and multilateral sources. Simultaneously, the currency composition of Government debt will be reviewed to raise the share of USD from around 19% at present to 33% by end June 2026 while the share of the Euro will be brought down from about 43% to 39%. Foreign debt in other currencies will be reduced from 37% to 28%. As for public sector debt, the share of USD is planned to be maintained within 52%, with the Euro and other currencies constituting 28% and 20%, respectively.

38. To reduce rollover risks, the average time to maturity of Government debt will be increased from 5.8 years at present to 6 years over the medium term. The average time to maturity of Government domestic debt will be raised from 5.3 to 5.7 years as some Rs 15 billion of Government bonds, issued during the COVID-19 pandemic, will, at maturity, be replaced by longer term instruments. In addition, a higher amount of benchmark securities will be issued to deepen the domestic market for Government securities.

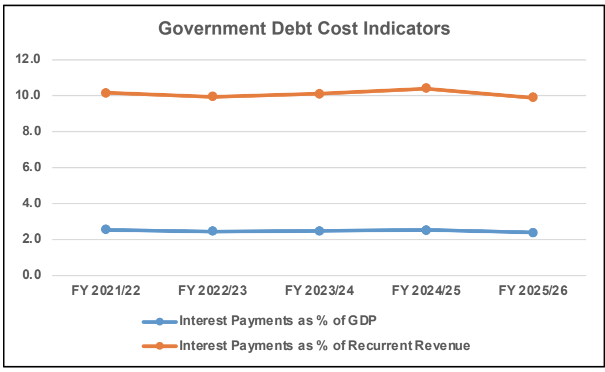
39. With a view to reducing interest rate risk of Government debt, the average time for re-fixing will be gradually raised from 5.1 years at present to 5.3 years by end June 2026. The objective is to reach the benchmark of 5.5 years. This is planned to be achieved by continuing to issue domestic securities at fixed interest rates.

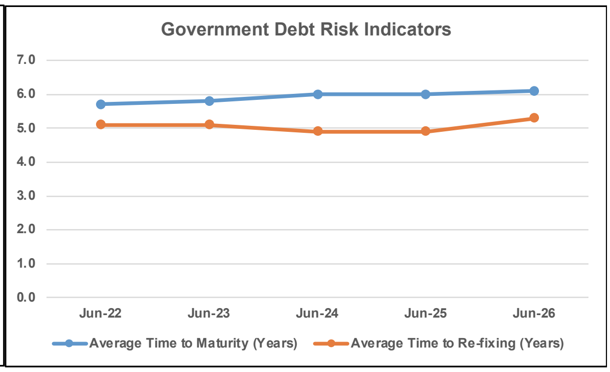
40. Moreover, in view of the high international interest rate environment, the interest rate mix of Government foreign debt will be slightly tilted towards variable interest rate. The share of variable interest rate loans will be increased from 54% at present to 60% as at end June 2026 and that of fixed interest rate loans reduced from 45% to 39%; the remaining being interest free loans. The situation will be closely monitored to adjust for changes in market conditions.

41. As regards the total external debt of the country, it is planned to be brought down to around 25% of GDP by end June 2026 from its present level of about 33%. This is envisaged to be achieved through a steady reduction of debt in each debt holder categories.

42. The debt service ratio, which picked up to 7% in FY 2022/23 due to repayment of an exceptional short-term bridging financing, is planned to be brought down to 3.6% in FY 2025/26, well below the benchmark of 6%. Furthermore, external debt servicing will be well shielded with a planned foreign exchange reserves to external debt cover of around 160%.

43. The overall objective of further enhancing public sector debt sustainability will be achieved through improvement in the indicators of liquidity and solvency. In particular, it will be attained through the lengthening of the average time to maturity and average time to re-fixing of Government debt while maintaining costs broadly at their current levels as shown in the charts below. The strategy will be operationalised by linking the annual issuance calendar with the financing plan in the Budget and through close monitoring of the cost and risk indicators.





Medium Term Cost and Risk Indicators

	End Jun-22 Actual	End Jun-23 Rev. Estimates	End Jun-26 Estimates	Benchmarks/ Limits	Tolerance Level %
Government Debt					
As % of GDP (End of Period)	75.9	68.7	56.7	57.0	+/-5
Cost Indicators (Financial Year)					
Interest Payments as % of GDP	2.5	2.4	2.4	< or = 3.5	-
Interest Payments as % of Recurrent Revenue	10.1	9.9	9.9	10.5	+/-10
Average Interest on Debt (%)	3.8	3.8	4.5	5.0	+/-10
Composition (%) (End of Period)					
Foreign	18.5	19.8	20.8	22.0	+/-5
Domestic	81.5	80.2	79.2	78.0	+/-5
Currency Composition of External Debt (%)					
USD	7.3	19.3	32.9	33.0	+/-5
EURO	50.0	43.4	39.1	39.0	+/-5
YEN	14.3	12.5	8.3	8.0	+/-5
Others	28.4	24.8	19.7	20.0	+/-5
Refinancing Risks					
Average Time to Maturity (Years)					
Total Debt	5.6	5.8	6.1	6.0	+/-10
External Debt	8.3	8.7	8.1	8.0	+/-10
Domestic Debt	5.1	5.3	5.7	5.5	+/-10
Due Within 1 year (%)					
Total Debt	19.1	18.5	18.3	20.0	+/-10
External Debt	7.0	4.7	4.9	5.0	+/-10
Domestic Debt	21.2	21.2	21.3	22.0	+/-10
Interest Rate Risk					
Average Time to Re-Fixing (Years)					
Total Debt	5.1	5.1	5.3	5.5	+/-10
External Debt	6.0	5.0	3.7	4.0	+/-10
Domestic Debt	5.0	5.1	5.6	5.5	+/-10
Share with Re-fixing in 1 Year (%)					
Total Debt	26.3	27.6	29.4	30.0	+/-10
External Debt	39.2	47.6	56.8	55.0	+/-10
Domestic Debt	24.1	23.7	23.3	24.0	+/-10
Interest Rate Mix of External Debt (%)					
Fixed Interest Loans	51.6	44.5	38.6	39.0	+/-10
Variable Interest Rate Loans	46.9	54.3	60.6	60.0	+/-10
Interest Free Loans	1.5	1.2	0.8	1.0	+/-10
Public Sector Debt					
As % of GDP (Gross)	86.1	79.0	64.2	65.0	+/-5
As % of GDP (Net)	73.9	70.3	60.2	60.0	+/-5
Composition (%)					
Foreign	22.7	23.7	25.7	27.0	+/-5
Domestic	77.3	76.3	74.3	73.0	+/-5
Currency Composition of External Debt (%)					
USD	33.4	41.4	51.9	52.0	+/-5
EURO	35.9	31.5	28.0	28.0	+/-5
YEN	10.3	9.1	6.0	6.0	+/-5
Others	20.4	18.0	14.1	14.0	+/-5
Interest Rate Mix of External Debt (%)					
Fixed Interest Loans	56.7	52.5	50.9	50.0	+/-5
Variable Interest Rate Loans	42.2	46.6	48.6	49.5	+/-5
Interest Free Loans	1.1	0.9	0.5	0.5	+/-5
National External Debt [1]					
As % of GDP	35.6	32.8	25.1	25.0	+/-10
FX Reserves as % of External Debt	188.0	153.8	158.8	160.0	+/-10
Debt Service Ratio (%) (Financial Year)[2]	3.6	7.0	3.6	< or = 6	-

1 - Excludes Deposit Taking Institutions and Global Business.

2 - Includes debt servicing of a short term loan of USD 250 million in FY 22/23. Excluding that servicing the debt service ratio would be 3.1% .