



REPUBLIC OF LEBANON
MINISTRY OF FINANCE

DEBT MANAGEMENT STRATEGY

2014-2016

Ministry of Finance
Public Debt Directorate
Strategic Planning & Risk Management Department

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Medium Term Debt Management Strategy 2014-2016

Introduction

A medium term debt management strategy outlines a plan for achieving the preferred composition of the public debt, in a tradeoff between cost and risk. The strategy is embedded in and developed within the Government's macro-fiscal framework and is updated annually.

Financing decisions not only affect the immediate interest cost for the government, but also the risks associated with potential higher cost of debt over the longer term. A medium term debt management strategy (MTDS) helps avoiding opportunistic and risky financing behavior and ensures transparency and predictability towards investors, thereby facilitating market access and ultimately lowering financing costs.

This report provides the strategy for the period 2014-2016. The proposal is based on an analysis of alternative debt management strategies, and explicitly takes into account the macro-economic framework, including the high debt level, as well as the constraints facing the debt manager in a situation with high annual foreign financing and limited absorptive capacity of the domestic market.

Debt management encompasses the main financial obligations over which the central government exercises control. For Lebanon, this applies to central government debt and publicly guaranteed debt on the loans of Electricité du Liban (EDL), which are currently being serviced by the Lebanese Treasury and are included in the published outstanding debt figures.

For the context of debt management strategy, medium-term fiscal projections are required, and primarily for the primary deficit, as well as medium-term projections of other macroeconomic variables such as GDP.

Upon positive advice from the High Debt Committee, the debt management strategy 2014-2016 is submitted to the Council of Ministers and is published.

Objective of debt management

In line with international best practices, the High Debt Committee formally adopted the following objective:

"The main objective of public debt management is to ensure that the government's financing needs and its payment obligations are met at all times, at the lowest possible cost over the medium to long run and consistent with a prudent, acceptable degree of risk."¹

An additional objective is the development of the primary and secondary domestic markets. In Lebanon, the domestic financing capacity has shown to be a potential bottleneck. In this context, proactive support of market development, among others through a transparent and predictable domestic issuance strategy, is essential.

As public debt management is highly interdependent with monetary policy, the essential coordination is institutionalized in the High Debt Committee. While the Ministry of Finance and the

¹ See also Public Debt Management Guidelines, World Bank and IMF, 2001.

Banque de Liban each have their own responsibilities, public debt management can be supportive of the transmission process of monetary policy, directed at the monetary base and short-term interest rates, by creating a yield curve of government bills and bonds.

Existing debt

The ratio of outstanding public debt to GDP in Lebanon is among the highest in the world. As of end December 2013, total public sector debt² was 138% of GDP. While the ratio has come down from its peak of 180% in 2006, this ratio has increased most recently from 132% end of 2012 to 138% end of 2013.

It is essential to summarize the large portfolio of government bills, bonds and loans in a few cost and risk indicators and steer policy on those indicators. The indicator values for the current debt portfolio, are listed in the table below. Some highlights:

- While more long domestic debt has been issued, the interest risk of the domestic debt is still considerable.
- The share of foreign debt has been coming down close to 40% of total, after hovering in 2007 against the agreed ceiling of 50%.
- The share of interest cost to government revenues has increased 2% in 2013 reaching 40%, which is considerably high, leaving thus less fiscal space for development expenditures

Table: Summary of cost and risk characteristics of the existing debt

Cost and Risk Indicators (end 2013)		Foreign debt*	Domestic debt*	Total debt
Amount (in millions of USD)		25,787.4	36,688.3	62,475.7
Nominal debt as % GDP		57.1	81.2	138.3
Cost of debt	Weighted Average interest rate (%)	5.9	6.7	6.4
	Interest as % of govt. revenues	17%	24%	40%
Refinancing risk	Average time to maturity (years)	5.6	3.5	4.3
	Debt maturing in 1yr (% of total)	8.9	20.4	15.7
Interest rate risk	Average time to refixing (years)	5.5	3.5	4.3
	Debt refixing in 1yr (% of total)	9.9	20.4	16.1
	Fixed rate debt (% of total)	98.8	96.3	97.3
FX risk	FX debt (% of total debt)			41.3

*The distinction between domestic and foreign debt is according to currency denomination.

The public debt would be significantly lower and stand at 116% of GDP for end-2013, if adjusted for around \$10.28 billion of idle cash balances, which constitute public sector deposits in both commercial banks and BDL. Currently, these deposits are not netted against debt.

² For the purpose of this document total Public sector debt is the Gross debt excluding accrued interest and other loans to public entities.

Analysis of alternative financing strategies

The main risk factors are the rollover risk of maturing debt and possible adverse interest rate movements³. These risks can be mitigated by financing strategies of extending maturities, more debt at fixed interest rates and more debt in Lebanese pounds. The lower risks must be weighed against the generally higher costs.

A wide range of financing strategies has been tested through simulation against a variety of market shocks over a three-year horizon. The impacts of these shocks on the cost of debt are compared to a baseline; this difference is used as the measure of risk and can be used to show the trade-off against the cost of a strategy. Beyond these risks, the debt manager faces many constraints, such as the size of the debt, the annual funding needs and the depth of the domestic market. Following the selection of acceptable trade-offs and taking the other constraints into account, the outcome of the analysis supports a choice among a few realistic strategies. In this reality, there is only limited scope for changing the composition and risk exposure of the debt in the short term.

Chosen strategy for 2014-2016

Given the above analysis, the selected medium term debt management strategy is based on:

- An increased reliance on foreign borrowing during 2014 -2016 to cover mainly for the redemptions plus the interest payments of FX currency debt. This would require an increase of the foreign currency borrowing ceiling enabling annual borrowing around 30% in foreign currencies, and with the remainder sourced in the domestic market.
- Furthermore, the gradual extension of maturities that has been achieved in the past years especially in the domestic market will need to be continued, aiming to lengthen the average time to maturity and average time to refixing of the debt portfolio beyond the current level of 4.3 years. Whilst the extension of maturities comes along with higher expected costs, it provides protection against the consequences of soaring interest rates in the future, a risk that Lebanon can hardly afford in the current circumstances.

A key consideration for the proposed strategy has been the estimated absorption capacity of financing in both domestic and foreign currency.

In the absence of an approved budget, the chosen strategy might require additional laws with quantified borrowing amounts for foreign currency borrowing. Quantification of targets for other risk parameters, maturities and specific instruments would stay an internal matter of the Minister of Finance, supported by the High Debt Committee. The actual performance against targets will be monitored and reported on a regular basis.

³ Macro-fiscal risks are considered to be a matter of fiscal policy and are considered in the debt sustainability analysis. The debt management strategy focuses on the composition of the debt.