REPUBLIC OF LEBANON
MINISTRY OF FINANCE

DEBT MANAGEMENT STRATEGY REPORT

2017-2021

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

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Medium Term Debt Management Strategy 2017-2021

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.

While the overall size of debt is a matter of fiscal policy, the debt management strategy is concerned with the composition of the debt portfolio. It is standard practice to summarize this large portfolio of government bills, bonds and loans in a few essential cost and risk indicators and steer policy on those indicators.

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, in this case five-year, 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 2017-2021. 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 and the large interest bill which consumes almost half of the budget revenues, as well as the market capacity constraints facing the debt manager. In addition, the analysis also takes into account the impact of each alternative on the level of FX reserves.

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.

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 Banque du 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.

Scope

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

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

Electricité du Liban (EDL), which are currently being serviced by the Lebanese Treasury and are included in the published outstanding debt figures.

Existing debt

The ratio of outstanding gross public debt[2] to GDP in Lebanon is among the highest in the world. While the ratio has come down from its peak of 180%[3] in 2006, this ratio has increased recently from 129% end of 2012 to 144% end of 2016[4]. If adjusted for around $9.46 billion of idle cash balances, which constitute public sector deposits in both commercial banks and BDL for 2016, the net public debt would be significantly lower and stand at 125% of GDP for end-2016[5].

Table 2:

Billions of LBP	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Gross total debt	**60,857**	**63,364**	**70,941**	**77,112**	**79,298**	**80,887**	**86,959**	**95,710**	**100,356**	**106,015**	**112,890**
Gross domestic debt	30,204	31,373	39,007	44,973	48,255	49,340	50,198	56,312	61,752	65,195	70,528
Gross Foreign debt	30,653	31,991	31,934	32,139	31,043	31,547	36,761	39,398	38,604	40,820	42,362
Accrued interest	1,119	1,140	1,459	1,459	1,350	1,195	1,189	1,321	1,454	1,432	1,556
Gross Debt excl. Accrued Int.	**59,738**	**62,224**	**69,482**	**75,653**	**77,948**	**79,692**	**85,770**	**94,389**	**98,902**	**104,583**	**111,334**
Gross Debt excl. Accrued Int./GDP	***180%***	***166%***	***158%***	***141%***	***135%***	***132%***	***129%***	***133%***	***132%***	***138%***	***144%***
Public sector deposits	4,444	4,527	8,326	10,522	11,419	10,984	12,916	15,495	13,965	13,227	14,268
Net domestic debt	25,760	26,846	30,681	34,451	36,836	38,356	37,282	40,817	47,787	51,968	56,260
Net total debt incl. Accrued Int.	**56,413**	**58,837**	**62,615**	**66,590**	**67,879**	**69,903**	**74,043**	**80,215**	**86,391**	**92,788**	**98,622**
Net total debt excl. Accrued Int.	**55,294**	**57,697**	**61,156**	**65,131**	**66,529**	**68,708**	**72,854**	**78,894**	**84,937**	**91,356**	**97,066**
Net debt / GDP	***166%***	***154%***	***139%***	***122%***	***115%***	***114%***	***110%***	***111%***	***114%***	***120%***	***125%***

As regards the composition of debt, which is the focus of debt management, the Ministry of Finance observes several indicators for cost and risk; see the table below. Most of these indicators are on track with the targets of the published strategy for 2014-2016.

It is worth highlighting some current characteristics of the debt portfolio:

- The share of interest cost to government revenues has increased from 38.5% in 2014 to a level of 48% by end 2016, leaving thus limited fiscal space for non-financial expenditures.
- Overall, while the risks related to such a very large debt are still unavoidably high, much risk improvement has been realized, allowing more attention to the high cost of the portfolio.

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[2] Throughout the document, Public debt means central government debt. In line with international practice, "debt" refers to the face value and excluding accrued interest.

[3] The change in the Debt-to-GDP figures from previous published reports is due to the revision of GDP made by the Central Administration of Statistics (CAS) and published in December 2014.

[4] Source GDP: 2006 – 2013 CAS / 2014 – 2015 - 2016 estimates using IMF Growth estimates.

[5] In the absence of a single treasury account and a comprehensive cash management strategy, these deposits are not netted against debt. This will need to get attention in the near future.

Table 2: Summary of cost and risk characteristics of the existing debt as end of 2016

Risk Indicators		External debt	Domestic debt	Total debt*
Amount (in millions of LBP)		41,824,348	69,212,837	111,037,185
Amount (in millions of USD)		27,744	45,912	73,657
Nominal debt as % GDP		53.6	88.8	142.4
PV as % of GDP		53.6	88.8	142.4
Cost of debt	Interest payment as % GDP	3.2	6.0	9.3
	Interest payment as % Revenue	17.2	30.8	48.0
	Weighted Av. IR (%)	6.0	6.8	6.5
Refinancing risk	ATM (years)	6.1	3.4	4.5
	Debt maturing in 1yr (% of total)	10.9	27.9	21.5
	Debt maturing in 1yr (% of GDP)	5.8	24.8	30.6
Interest rate risk	ATR (years)	6.0	3.4	4.4
	Debt re-fixing in 1yr (% of total)	12.3	27.9	22.0
	Fixed rate debt (% of total)	98.3	95.7	96.7
FX risk	FX debt (% of total debt)			37.7
	ST FX debt (% of reserves)			8.2

*The distinction between domestic and foreign debt is according to currency denomination.
*The Total debt differs from the figure in Table 1 due to the fact that T-bills are registered per purchase value

Analysis of alternative future financing strategies

The main risk factors are the refinancing or rollover risk of maturing debt and possible adverse interest and exchange rate movements.[6] These risks can be mitigated by extending maturities, more fixing of interest rates and more debt in Lebanese pounds. The lower risks have been weighed against the generally higher costs, especially as interest expenditure is already now absorbing half of all revenues.

A wide range of financing strategies has been tested through scenario analysis of a variety of market shocks over a multi-year horizon. The quantified impacts of these shocks on the cost of debt are a measure of risk in assessing the trade-off against the cost of a strategy. Debt management took into account a number of external constraints, such as the depth of the market. In reality, there is only limited scope for changing the composition and risk exposure of the debt in the short term. The scenario analysis provides a quantified basis for the (political) choice of acceptable trade-offs between costs and risks of alternative strategies.

The choice of strategy is made based on cost and risk characteristics of debt as end of 2021 after strategy implementation. A practical constraint in this choice has been the estimated market absorption capacity of issuance in both domestic and foreign currency.

Strategy for 2017-2021

The Minister of Finance decided on the following strategy for the coming years, which will be reviewed on an annual rolling basis. The chosen strategy will be widely communicated to the financial markets, as increasing transparency will enhance participation in new issuances and should lead to cost reduction over time. The actual performance against targets will be monitored and reported internally on a semiannual basis.

[6] 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.

The Ministry of Finance will pursue the following financing strategy:

- A level of FX borrowing in the medium term that takes into consideration, the level of outstanding foreign currency denominated debt, the Republic's amortization schedule and the assessed impact of this level of borrowing on the FX reserves. The remainder of the gross financing needs will be sourced in the domestic market.
- With the considerable burden of interest bill amounting to 48% in 2016, a prudent approach in the extension of maturities has been decided upon. As such, and while the extension of maturities comes along with higher expected costs providing protection against the consequences of soaring interest rates in the future, a modest target has been set in such a manner as not to add to the burden of the already considerable interest bill. This means that, in the absence of unforeseen developments, the Ministry of Finance continues its issuance of the same instruments as in 2016.