Debt Management and Sustainability: Strengthening Liability Management

Sri Lankan Perspective

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Colombo, Sri Lanka

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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

Overview

1. Evolution of Public Debt in Sri Lanka
2. Current Challenges
3. Key Debt Management Strategies

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1.1 Overview of Public Debt

- Liability of public debt stock has been increasing since the independence of Sri Lanka in 1948 mainly due to two reasons: persistent fiscal imbalances and depreciation of the domestic currency.
- During last 40 years, as a percentage of GDP, overall annual average budget deficit was recorded at 8.6%
- USD/LKR exchange rate depreciated to Rs. 155.25 as at 26 February 2018 compared to Rs. 8.83 recorded at end 1976. (Please note that the Current Exchange rate determination is market driven whereas in 1976, it was fixed.)

Chart 1
Overall Budget Surplus(+)/ Deficit(-) as a % of GDP
1950 - 2016

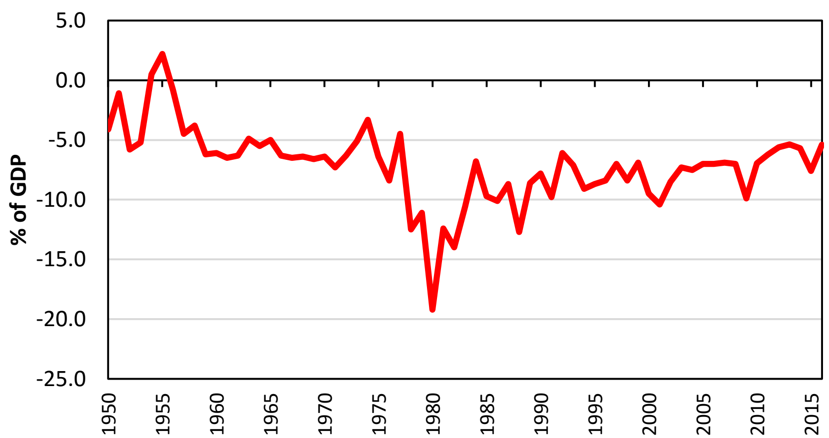
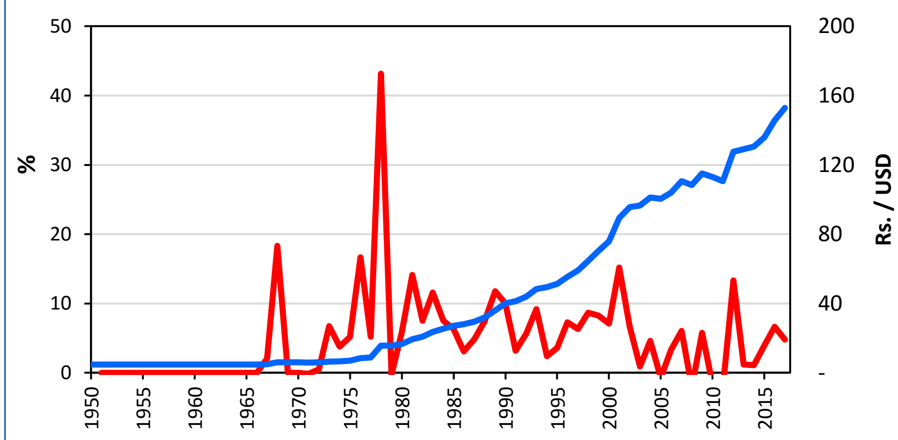
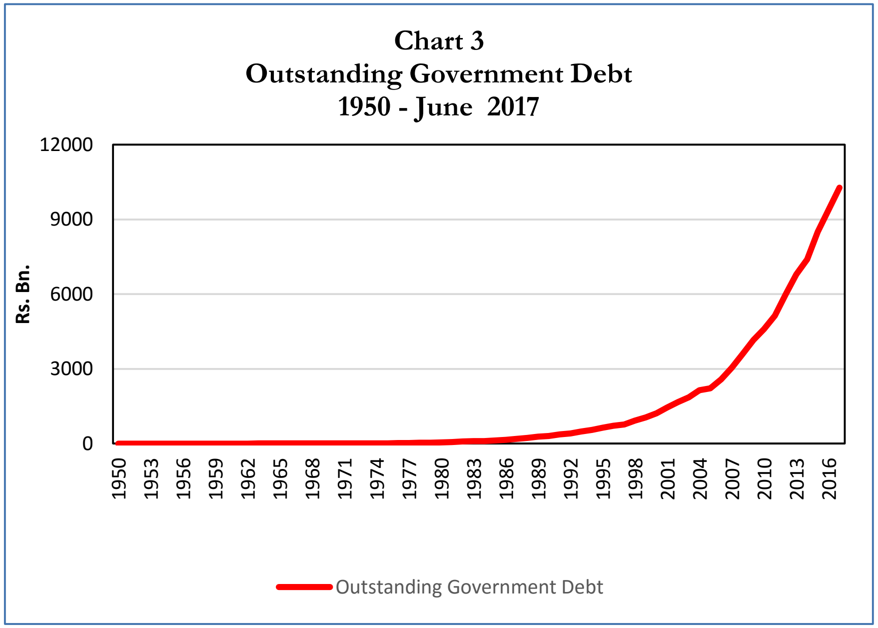


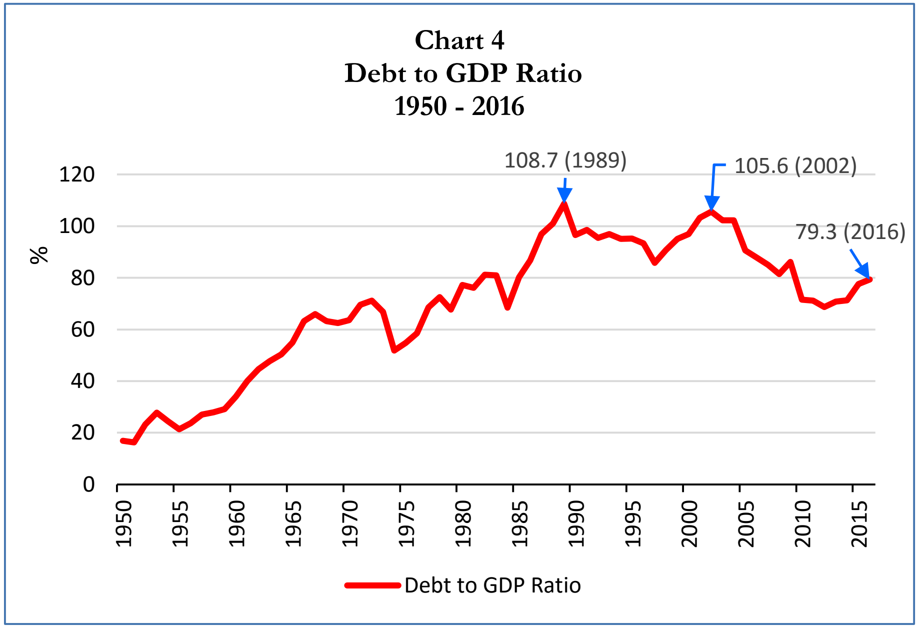
Chart 2
LKR Depreciation against USD
1950 - 2017/ Sep



1.1 Overview of Public Debt (Contd.)

- Debt to GDP ratio, which had a maximum of 108.7% in 1989 declined to stand at 79.3% at end 2016.
- As at end December 2017, the Total Debt Stock stood at Rs. 10,334 bn (US$ 67.6 bn)





1.2 Key Developments in Government Security Market during Last Three Decades

1992	Introduction of Primary Dealer (PD) system
1997	Commencement of the issuance of Treasury bonds (T-bonds)
1998	Introduction of an electronic bidding facility
2001	Issuance of Sri Lanka Development Bonds (SLDBs)
2003	Enactment of the Fiscal Management (Responsibility) Act
2004	Introduction of Scripless Securities Settlement System (SSSS), RTGS and CDS

1.2 Key Developments in Government Security Market during Last Three Decades (Contd.)

2006	Opening up the T-bond market to foreign investors (Limited access)
2008	Opening up of the T-bill market to foreign investors (Limited access)
2010	Introduction of participant managed Intraday Liquidity Facility to the LankaSettle and LankaSecure Systems
2016	Introduction of Bloomberg trading platform
2017	Introduction of new Primary issuance system for T-bonds
2018	Liability Management Bill (Presented to the Parliament)

1.3 Current Status of Public Debt

- **Domestic Debt**

  - 92% of domestic debt was raised through market based instruments.
  - As at end September 2017, Non Banking Sector accounted for 58% of the Domestic Debt

Chart 05
Composition of Domestic Debt by Instrument as at end December 2017

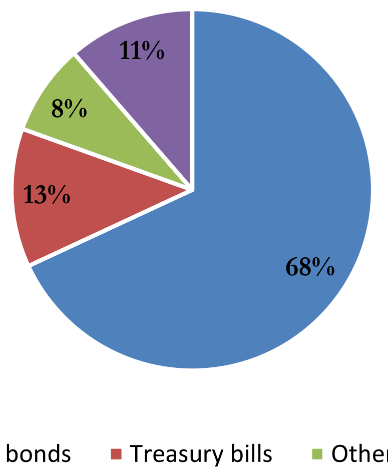
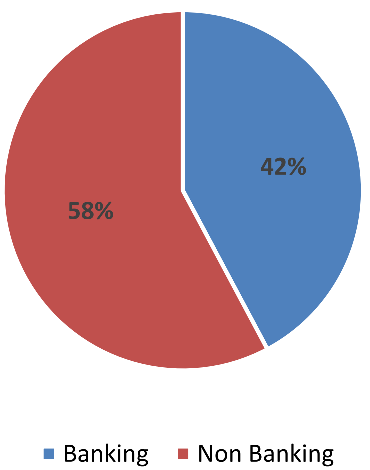


Chart 06
Ownership of Domestic Debt as at September 2017



1.3 Current Status of Public Debt (Contd.)

- **External Debt**

  - Concessional Debt (As per the IMF classification) accounted for 58% at end December 2017 in comparison to 83% in 2007.
  - Outstanding Commercial Debt accounted for 43% of the Total External Debt and high reliance of External Commercial Borrowing were reported during last 10 years.

Chart 07
Concessional and Non Concessional External Debt as at end 2017

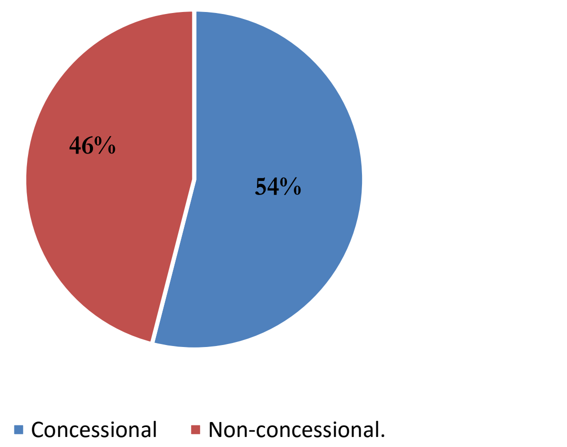
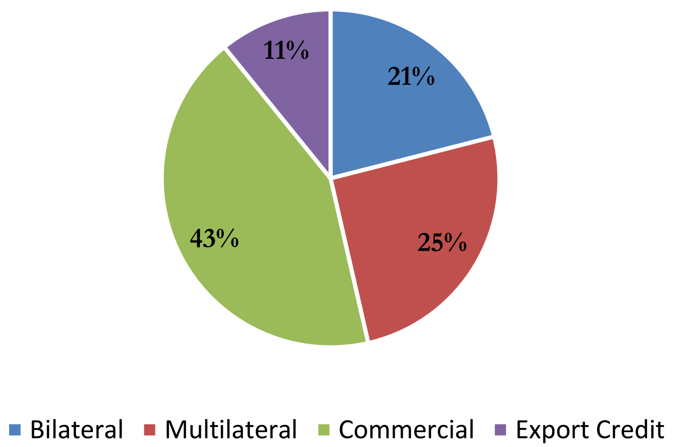


Chart 08
Composition of External Debt by Creditors as at end 2017



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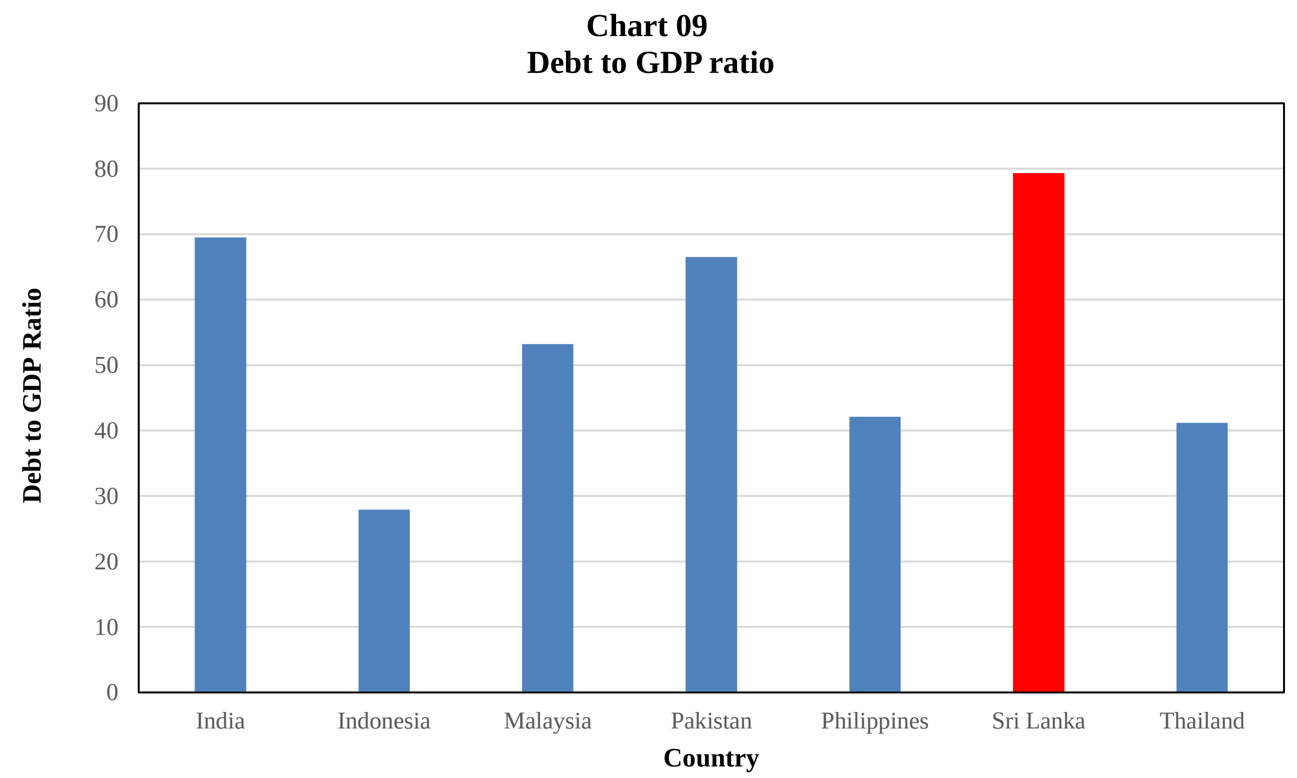
2. Current Challenges

- High debt to GDP ratio compared to peer rated economies
- High bunching of debt: Annual, monthly and daily
- Diminishing availability of external concessional funding
- Limited resource availability from domestic non-bank sources
- A relatively low Average Time to Maturity (ATM)
- High fragmentation of domestic T-bond market
- External commercial borrowing limited to the horizon of 10 years
- Government cash flow often deviate from original targets
- Limited flexibility in the Government budget
- Volatility in the international markets
- Limited scope to hedge future liabilities

2.1 High Debt to GDP Ratio

- Sri Lanka has a high debt to GDP ratio compared to peer countries.



Source: https://tradingeconomics.com

2.2 **Bunching Issue**

- High Refinance Risk due to annual, monthly and daily bunching both in domestic and foreign debt service payments during short to medium-term.
  - Domestic debt: Treasury bonds, Treasury bills and Sri Lanka Development Bonds (SLDBs, USD denominated)
  - Foreign debt: ISBs, other commercial and foreign loans
- **Bunching Issues: T-bonds**
  - Annual bunching 2018-2019
  - 6 days of debt service payments over USD 700 mn (Rs. 110 bn) during 2018

Chart 10
Servicing of T-bonds 2018 - 2026 (USD Mn)

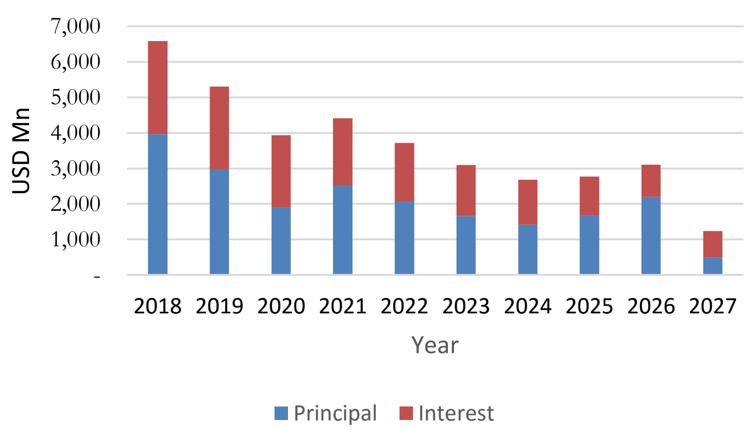
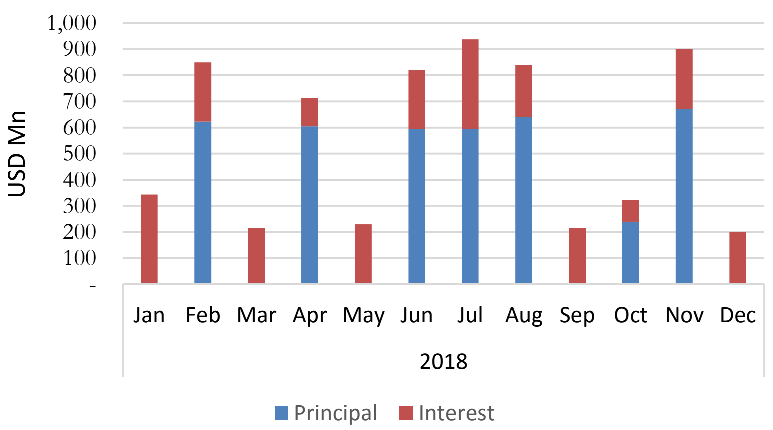
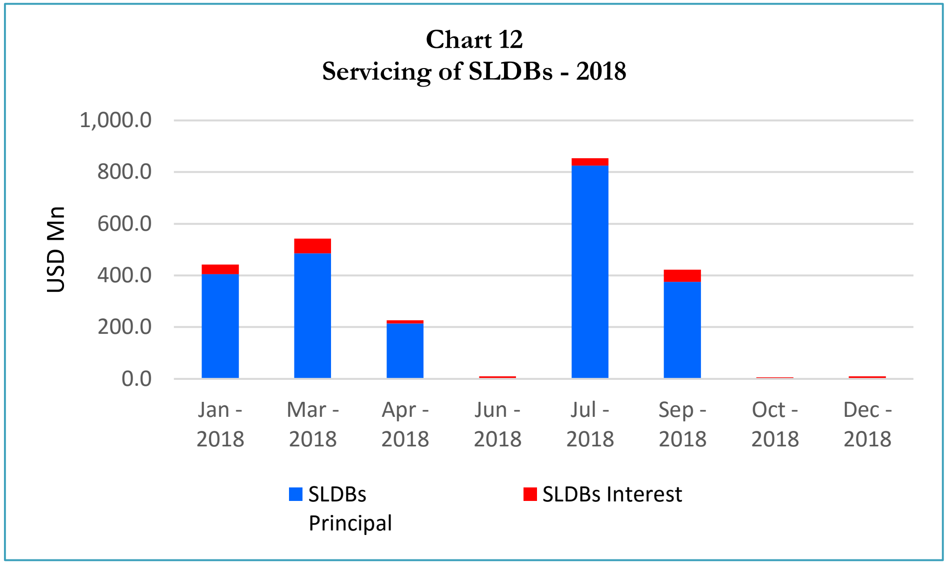


Chart 11
Servicing of T-bonds 2018 (USD Mn)

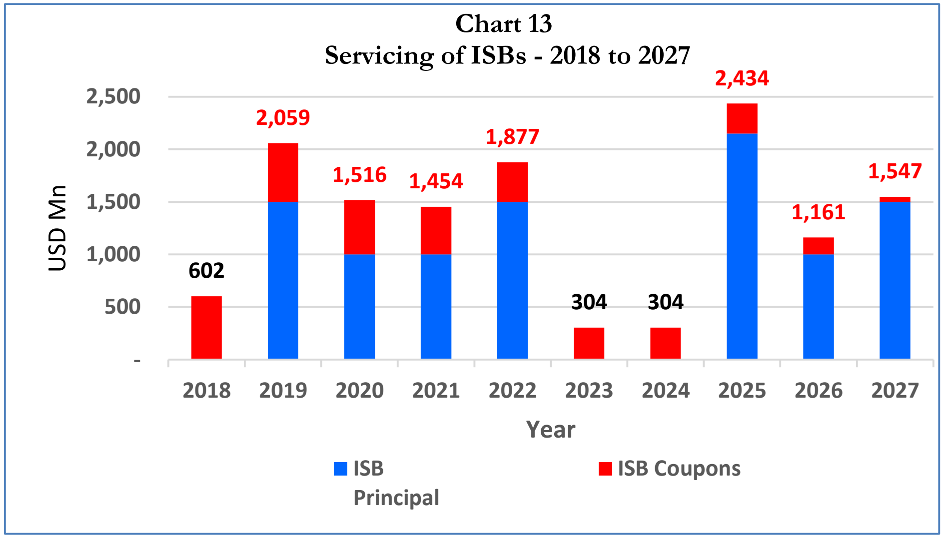


2.2 Bunching Issue

- **Bunching Issues: SLDBs**
- Annual bunching: USD 2,304 mn maturing in 2018
- During 2018,
  4 days of service payments over US$ 400 mn, with a peak of US$ 851 mn in July 2018.

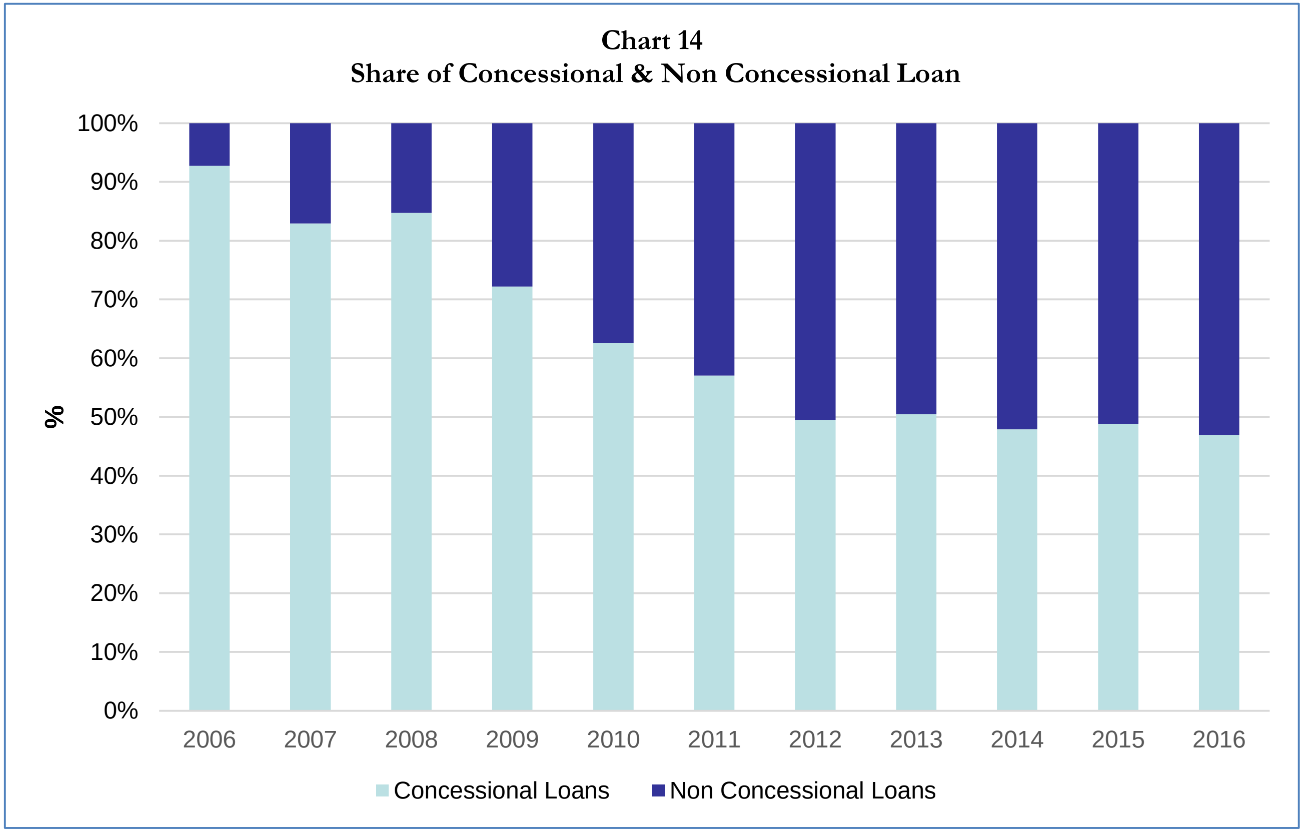


- **Bunching Issues: ISBs**
- Sri Lanka has issued 11 ISBs since 2007
- Last issue: USD 1,500mn in May 2017
- Maturities of USD 1,000 – 2,150 mn each year from 2019 to 2027 <u>except 2018, 2023 and 2024</u>
- Annual interest bill 2018: USD 600 mn (around Rs. 90 bn)



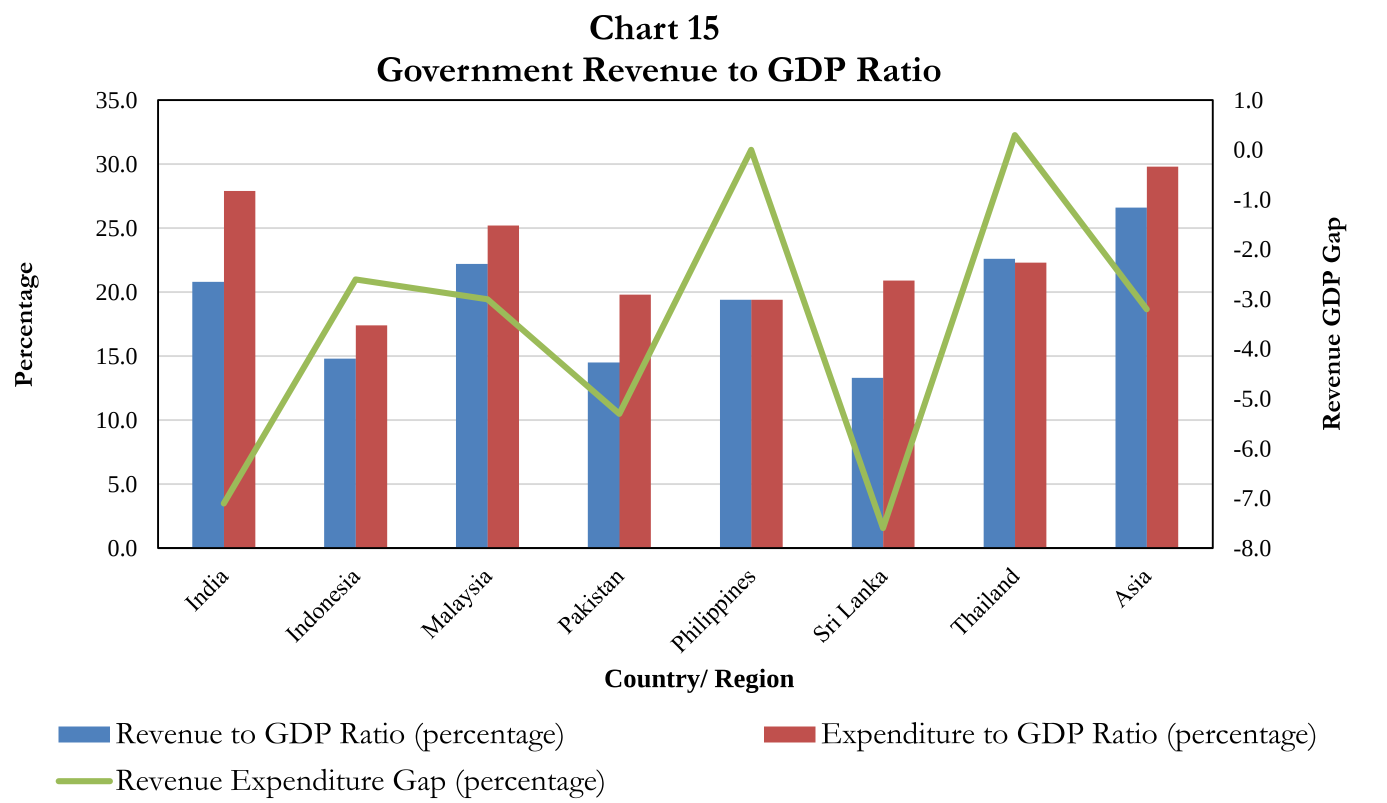
2.3 **Diminishing Availability of Concessional Funding**

- With the Country graduating to middle income status, availability of concessional loans have been diminishing



2.5 **Negative Revenue Expenditure Gap**

- Sri Lanka has a higher Negative Revenue Expenditure Gap compared to peer countries.



Source: Annual Report 2016,Central Bank of Sri Lanka

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3. Key Debt Management Strategies

GOSL has highlighted key debt management strategies in their Vision 2025, published in October, 2017, which focuses on 3 key areas;

- Revenue-based fiscal consolidation to reduce public debt in the medium term
- Rationalising Government expenditure
- Initiating liability management strategies

3.1 Revenue based Fiscal Consolidation

- The government is committed sturdily towards implementing revenue based fiscal consolidation measures, recognising the persistently low revenue mobilisation, which leads to high budget deficits, as the root cause of fiscal imbalances experienced during last several decades in Sri Lanka.

- Revenue based fiscal consolidation will expand the fiscal space and allow the government to accommodate mandatory recurrent expenditure while financing public investment programmes, without prejudice to the sustainability of the government's financial position.

- Moreover, enhanced revenue collection eases the need for increased foreign commercial borrowings, thereby easing the pressure on the exchange rate to depreciate.

3.2 Rationalising Government expenditure

- The government will strengthen the Fiscal Management Responsibility Act with mandatory binding targets for the fiscal deficit and overall government debt levels.

- Rationalise public expenditure while eliminating unproductive expenditure.

- Restructuring of SOEs.

3.3 Liability Management Exercises

- Reasons to engage in Liability Management Exercises, include:
  - Increase liquidity in government securities
  - Manage risks in debt portfolio
  - Decrease the cost of new funding
  - Stabilise markets during times of stress
  - Take advantage of market volatility

3.3 Liability Management Exercises (Cont.)

- Favorable Outcomes of Liability Management Exercises
- Liquidity Management Smoothening by reducing expected large bond maturities
  - Reduce par value amounts of maturing bonds
  - Purchase Target bonds
  - Swap investor into Destination bonds
  - Swaps always done to extend maturity

3.3 Liability Management Exercises (Cont.)

Favorable Outcomes of Liability Management Exercises

- Promote liquidity in new issue benchmark bonds
  - Buy back Target off-the-run bonds
  - Reopen benchmark bond as the Destination bond
  - Increase size of benchmark bond and reduce off-the-run illiquid bonds

3.4 Liability Management Strategy Initiatives in Sri Lanka

- The Active Liability Management (ALM) Bill was presented to the parliament. (during February 2018)
- The Act is expected to,
  - execute new liability management techniques
  - minimize rollover risk by altering the maturity profile of the outstanding debt stock
  - with the expectation to improve the underlying risk profile of the public debt stock, to manage the domestic and foreign public debt.
- The Act has given authority to maintain Buffer funds, both in local currency and foreign currency to ensure smooth operations.
- The Act will bring new market techniques such as reverse auctions, buy-back and switching arrangements.

3.4 Liability Management Strategy Initiatives in Sri Lanka (Cont.)

- Under the new Liability Management Policy, new medium term debt strategy is being developed covering the following:
  - Allocation of issuances – Types
    - T-bonds, T-bills, SLDBs and ISBs
  - Maturity
    - Short, Medium and Long term
  - Currency
    - Rupee, foreign currency
  - Interest rate
    - Fixed vs floating

3.4 Liability Management Strategy Initiatives in Sri Lanka (Cont.)

- Expected to contribute to proactively address part of the external refinancing requirements ahead of time (reduce rollover peaks) and extend the maturity duration beyond 2027 for ISBs.
- It will also enable the extension of the maturity structure of T-bonds and the smoothening of the coupon payments cycle.
- Lower the fragmentation of the T-bond market that helps improving the liquidity in the secondary market.

3.4 Liability Management Strategy Initiatives in Sri Lanka (Cont.)

- This exercise will help GOSL to diversify the investor base, reduce the cost of borrowing, mobilise funds based on prevailing market rates, extend the duration of the liability portfolio, reduce refinancing risk in near term and create a favourable price tension for any new issuances.

- The LMA will give flexibility for active debt management initiatives such as buy-backs, switching and pre-funding arrangements.

3.4 Liability Management Strategy Initiatives in Sri Lanka (Cont.)

- Government's action to reduce the budget deficit through the fiscal consolidation process and proceeds from divestment of non-strategic state assets which will be utilised strategically to manage liability of debt to lower the future borrowing requirement.
- Government's decision to earmark all proceeds of divestitures will play an important role in creating a buffer fund for more effective liability management.
- New issuance strategy under the effective liability management structure would address the fragmentation of domestic bond market thereby improving the secondary market operation.

3.5 In addition, the following measures are also expected to be implemented

- Improving cash flow management of the Central Treasury
- Strengthening the Primary Dealer System
- New Auction system for the Domestic Market (extending new auction system to T-bills market)
- Lengthening ATM for both Domestic and Foreign Debt Stock

Thank You