



REPUBLIC OF ZAMBIA

MEDIUM TERM DEBT STRATEGY (2017-2019)



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FOREWORD

The rapidly changing global economic environment has brought fiscal vulnerabilities to the fore. Many economies have experienced significant macroeconomic readjustments that have altered general perceptions and created a wave of uncertainty. On one hand, volatile exchange rates, subdued commodity prices and declining capital flows amidst increasing financing needs continue to be serious issues that emerging and developing countries are grappling with. On the other hand, financial globalisation has created opportunities for countries to explore and participate on the international financial market.

In the light of these developments, never before has the need to re-assess and re-position ourselves with regard to the management of our sovereign debt been so critical. We are faced with serious challenges of how to select an optimal mix among various financing options, with varying cost and risk characteristics, amidst a volatile environment, and most importantly, how to ensure debt sustainability in the long-run. Notably, the increase in direct or indirect contingent liabilities, coupled with an increase in various financing options which provide an enticing alternative financing source to traditional sources of financing has also created a new dimension to debt management. This scenario presents potential sources of fiscal risks for central governments.

As a country that has been through debt distress and that greatly benefited from debt relief under the HIPC Initiative, Zambia needs to rise above these challenges and ensure that debt is prudently secured and managed to ensure sustainability for the benefit of future generations.

It is imperative for debt management, therefore, to be nothing short of effective; clearly identifying, assessing and prioritising costs and risks, as well as consistently monitoring these risks in order to minimise the probability and/or the impact of their occurrence.

The Medium Term Debt Strategy (MTDS) 2017-2019, which has been developed using a rigorous quantitative assessment and evaluation of the cost and risks associated with Zambia's public debt portfolio, will serve as an important tool in guiding decision making with regard to prudent debt management. It is my sincere hope that all key stakeholders will rally behind Government in the successful implementation of the MTDS.



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1 INTRODUCTION

Zambia has over the years made tremendous economic progress with a Gross Domestic Product (GDP) growth rate averaging 5-6% in the last ten years. This growth in the economy has led to the reclassification of Zambia as a lower middle income country, which has redefined the financing landscape for Government. The reclassification of Zambia as a lower middle income country has limited the access to concessional external financing from traditional bilateral and multilateral creditors. This development has led to increased opportunities for Zambia to access financing from previously unavailable sources such as the international capital market at non-concessional terms¹. This is evidenced by the successful issuance of three Eurobonds in 2012, 2014 and 2015 amounting to US\$750.0 million, US\$1.0 billion and US\$1.25 billion, respectively. This increased access to various sources of financing has introduced new costs and risks to the debt portfolio which need to be prudently managed in order to ensure sustainability of public debt.

The Debt Management Strategy is a plan that the Government intends to implement over the medium term in order to achieve a desired composition of the government debt portfolio which captures Government's preferences with regard to the cost-risk trade-off. A medium term debt management strategy has a strong focus on managing the risk exposure embedded in the debt portfolio, specifically, potential variations in the cost of debt servicing and its impact on the budget and, in particular, identifying how cost and risk vary with the composition of the debt.

The Medium Term Debt Management (2017-2019) summarises the main outcomes of a robust quantitative analysis undertaken to operationalise Government's primary debt management objective i.e. ensuring the Government's financing needs and

¹ Concessional financing relates to financing at World Bank (IDA) comparable terms while non-concessional financing relates to financing at market terms.

payment obligations are met at the lowest possible cost, consistent with a prudent degree of risk. The strategy also captures the intention of Government to support the development of the domestic debt market.

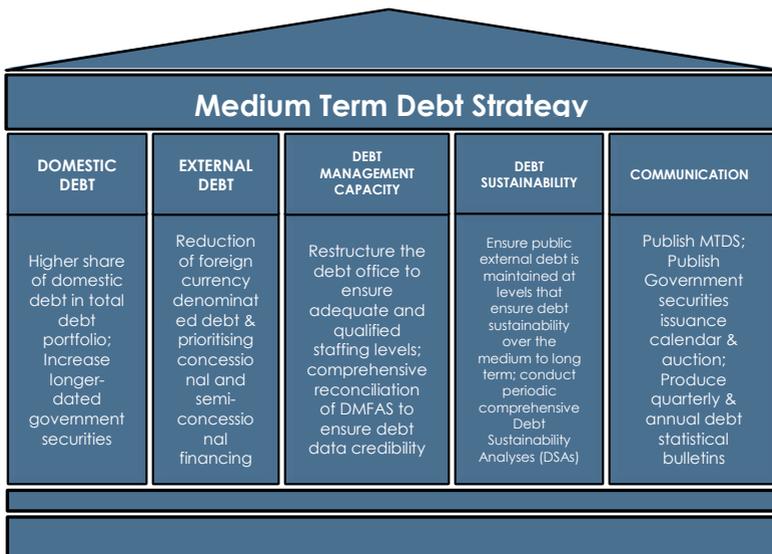
2 THE DEBT MANAGEMENT STRATEGY 2017- 2019

The strategy will focus on altering the structure of the debt portfolio, which in proportional terms currently stands at 45 per cent domestic debt and 55 per cent external debt, to achieve 60 per cent domestic debt and 40 per cent external debt during the implementation of the strategy.

The strategy will further maximise concessional external borrowing and address refinancing exposure in domestic debt by using more medium to longer tenor securities.

The Loans and Guarantees (Authorisation) Act Cap. 366 of the Laws of Zambia will serve as the legal mandate for the administration of the strategy.

The chart below summarises the main pillars of the strategy in the medium term.



2.1 DOMESTIC DEBT (GOVERNMENT SECURITIES)

The Government will continue to issue domestic debt for financing and capital market development. In this regard, the amount of financing from issuance of government securities, Bonds and Treasury bills, will be the sum total of net planned borrowing and debt repayments (interest and maturities). The financing or borrowing requirement will be advised by the fiscal policy and macroeconomic framework for the medium term. This in turn will provide the basis for the determination of auction amounts and also advise the government securities issuance calendar.

The Statutory Instrument (SI) on borrowing limits issued by Government from time to time will provide the guidance on domestic securities caps. Currently, the Loans and Guarantees (Maximum Amounts) Order, 2016 (Statutory Instrument No. 22 of 2016) caps the limit for Government Bonds at K40 billion and for Treasury Bills at K30 billion.

2.1.1 Domestic Debt Composition

The composition of Government Bonds and Treasury Bills will be 60 per cent to 40 per cent, respectively, during the medium term.

The composition of the Treasury Bills will include 91 day, 182 day, 273 day and 364 day treasury bills. The Bonds will include the 2 year, 3 year, 5 year, 7 year, 10 year and 15 year tenors. The Government will also develop benchmark series of Bonds in tenors and sizes that will be communicated to the market at the appropriate time. Other tenors and issues will be assessed for suitability and considered when there is need.

The proportions of the tenors in the auction amounts will be oriented to market conditions and with respect to a smooth redemption profile and tenor sizes that are large enough to ensure competitive pricing, especially in the secondary market.

The frequency of issuance in the medium term will be maintained i.e. fortnightly for Treasury Bills and once every two

months for Bonds. Market conditions will have an overarching basis on the implementation of the issuance plan and frequency.

2.1.2 Risk Management

Interest rate risk on coupon payments will be closely monitored and any large upward swings will entail Government undertaking measures to manage the interest cost exposure.

The investor base for Government securities is concentrated in a few big investors. The largest investors in Government securities are financial institutions (Banks mainly) and pension houses. This poses a risk to Government in mobilising adequate resources from the domestic market in the event of auction failures. To mitigate this risk, Government will embark on a national financial inclusion initiative to promote Government securities. This will involve undertaking targeted outreach programmes and using various methods to sensitise both local and foreign investors through investor relations exercises.

2.1.3 Redemption Profile

The Government will aim at lengthening maturities and ensuring the redemptions are evenly spread over time. Debt management will also be focused on maintaining the Average Time to Maturity (ATM) at a minimum of 3 years. When market conditions allow, efforts would be targeted at operations to align the average duration, including buyback, refinancing and other suitable mechanisms that could be considered.

2.1.4 Domestic Arrears

Other domestic debt arising from various government operations will be repaid over time through budget resources. The debt will be subject to reconciliation and audits before placement on government debt liabilities. The close monitoring of contingent liabilities will enhance early signalling of liabilities that may come on the Government debt portfolio. Any surplus on government securities issuance will also be channelled at retiring some of the debt created by domestic arrears.

2.2 EXTERNAL DEBT

The main thrust of the external debt strategy is reduction of foreign currency denominated debt in the long term and switching to domestic debt aimed at managing the exchange rate risk. The strategy will prioritise mobilising most funding from concessional and semi-concessional sources of financing.

Export credits and other commercial credits will be considered after assessment of their effect on debt sustainability and limited to projects with high economic return.

2.2.1 Risk Management

The main market risks embedded in the debt portfolio are exchange rate and interest rate risks. Government will manage these risks by building capacity in debt managers to use instruments such as derivatives to hedge the debt portfolio from adverse market developments.

The redemption profile for external loans will also be considered when contracting new loans to ensure smooth redemption profile by contracting varying maturities appropriately. The aim is to ensure the Average Time to Maturity of 10 years is maintained.

2.2.2 Eurobonds

The Government will maintain the option to access the international capital markets to ensure access to diverse investors as well as enhance Zambia's visibility in the international capital markets. This access will, however, be at a measured level and in line with the debt sustainability objective.

In order to deal with the refinancing risk posed by the maturing of the Eurobonds between 2022 and 2027, Government will proactively initiate mechanisms aimed at redeeming the Eurobond debt, including implementing the sinking fund.

2.2.3 Sovereign Guarantees

Analysis of contingent liabilities will be heightened and a database of eminent liabilities established.

All guarantees issued will be registered and the monitoring of government guarantees will be improved through enhanced recording of information on the Debt Management and Financial Analysis System (DMFAS). The timely information on the performance of the guaranteed loans will facilitate the taking of remedial measures in instances where guaranteed entities are not servicing the liabilities.

3 DEBT MANAGEMENT CAPACITY

The Debt Office will be restructured to ensure adequate and qualified staffing levels. The staff to be recruited will be trained in debt management skills in collaboration with capacity building institutions such as the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI), International Monetary Fund (IMF), United Nations Conference on Trade and Development (UNCTAD) and the World Bank.

In order to ensure debt data credibility, the Debt Management and Financial Analysis System (DMFAS), housed in the debt management office, will undergo comprehensive data reconciliation in 2017 to ensure debt data credibility. Thereafter, periodic reconciliation will be scheduled to ensure an up to date database.

4 DEBT SUSTAINABILITY

Government will ensure that public external debt is maintained at levels that ensure debt sustainability over the medium to long term. The internationally accepted thresholds/ratios, e.g. Public Debt to GDP, Public External Debt to GDP, External Debt Service to Revenue, which are proportionate with Zambia's status as a middle income country will highlight debt target levels. Periodic comprehensive Debt Sustainability Analyses (DSAs) will be conducted to confirm Zambia's debt situation and inform threats to debt sustainability.

5 COMMUNICATION

Government will publish the Medium Term Debt Strategy (MTDS) for the information of market participants (investors) and stakeholders on the objectives of debt management pursued by the Government. A government securities issuance calendar and an auction announcement will also be published for information purposes through press releases and the website. The auction results would also be published after each auction. Quarterly debt statistical bulletin and annual debt report shall be produced to inform stakeholders on Zambia's debt situation. The Annual Economic Report will also contain information on public debt. The following websites will publish information on Government debt:

- a) www.mof.gov.zm; and
- b) www.boz.zm.

6 CONCLUSION AND WAY FORWARD

To complement the effective implementation of the strategy, the following will be pursued:

- a) A strengthened legal framework and institutional arrangement for debt management to reinforce the delegated authority of the Minister of Finance as duly authorised official to commit Government to liabilities and Ministry of Finance's centrality in debt contraction and debt management processes².
- b) The restructuring of the Ministry of Finance, in particular the Investment and Debt Management department, to ensure adequate and qualified staffing levels to implement the strategy.

It is expected that the principles laid out in this strategy will be fully implemented. It is noted that debt sustainability will depend on stable macroeconomic performance and prudent fiscal

² The Loans and Guarantees (Authorisation) Act has been revised to strengthen Parliament's oversight and approval of new borrowings.

policy. The implementation of this MTDS will be executed cautiously with attention paid to the risks that may derail the thrust of the strategy and remedial actions undertaken to ensure public debt does not have adverse effects on macroeconomic stability. The strategy will be reviewed periodically.

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