SIERRA LEONE MEDIUM-TERM DEBT STRATEGY 2021-2025

Government of Sierra Leone

MINISTRY OF FINANCE

PUBLIC DEBT MANAGEMENT DIVISION

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Contents

FOREWORD

The Ministry of Finance updated the Medium-Term Debt Strategy (MTDS) 2021-2025 in June 2021 in accordance with Section 6 of the Public Debt Management Act 2011, which requires the formulation of a debt management strategy that considers: (a) the macroeconomic framework; (b) future borrowing requirements of Government; (c) market conditions; and (d) other factors as may be relevant for the development of the strategy. The Medium-Term Debt Strategy (MTDS) outlines the strategic options for minimising the cost and risks of the existing public debt portfolio and recommends the most compelling strategy for achieving the MTDS targets to Cabinet.

The last MTDS was conducted in 2017 and needed to be updated to include verified domestic arrears in the Arrears Clearance Strategy and Principles (2020-2025). This MTDS exercise was conducted virtually, for the first time, on account of COVID-19, with support from the World Bank (WB), International Monetary Fund (IMF) and the West African Institute for Financial and Economic Management (WAIFEM). The above institutions provided technical support to the National MTDS Team consisting of representatives from the Ministry of Finance (Public Debt Management Division, Fiscal Risk Division, and Multilateral Project Division, Research and Delivery Division), Bank of Sierra Leone, University of Sierra Leone, Civil Society Organizations (CSOs) and the Press.

Government is advised to adopt Strategy 3 (S3) which reduces short-term domestic debt and uses more of highly concessional external debt to implement the National Development Plan (NDP) 2019-2023. The central objective of the MTDS is to reduce the exchange rate and rollover risks in the existing debt portfolio and achieve a lower cost and risk of the debt stock by the end of 2025. The adopted strategy is expected to improve the debt sustainability rating under the LICs debt sustainability framework. The impact of the recommended strategy (S3) on debt sustainability would be realized if it is pursued together with the necessary fiscal adjustments.

Unlike the previous MTDS, quantitative targets were not set. We have set specific targets on the key MTDS indicators that will be monitored during the implementation period and provided clear policy guidelines to help with mitigating measure that will be taken in the event of shocks.

Cabinet had approved the update and publication of the Medium-Term Debt Strategy 2021-2025. The publication of this document is a clear demonstration that Government is fully committed to public debt transparency and sound debt management which would not have been possible without the support of development partners, the private sector, civil society, the university of Sierra Leone, staff of the Ministry of Finance, Bank of Sierra Leone and other stakeholders including the Press.

Dennis K. Vandi
Minister of Finance

ACKNOWLEDGEMENT

Publication of the Sierra Leone Medium-Term Debt Strategy 2021-2025 gives a clear foresight to the public on the Government debt management strategy which is to reduce domestic debt and increase highly concessional external borrowing within the borrowing limit. It also underscores the commitment of Government to deepen debt transparency and management. The last MTDS was updated in 2017 but it did not cover a significant portion of domestic debt—domestic suppliers arrears, which accounted for about 8.7 percent of GDP in 2018. The update of the Sierra Leone Medium Term Debt Strategy (2021-2025) would not have been possible without the contribution of World Bank, International Monetary Fund and the National MTDS Team made up of the Ministry of Finance (PDMD, FRD, AGD, DRD, MPD), Bank of Sierra Leone (BSL), the National Revenue Authority (NRA), Statistics Sierra Leone (SSL), University of Sierra Leone, Civil Society Organizations and the Press.

We also wish to thank the Minister of Finance, Hon. Deputy Ministers of Finance I and II, the Principal Deputy Financial Secretary, the Chief Economist, the Director and Staff of the Public Debt Management Division, the Director and Staff of the Macro Fiscal Policy Division, Director and Staff of Fiscal Risk and Oversight of State Owned Enterprise; Director and staff of the Research and Delivery Division, Director and Staff of Legal Affairs Division, Director and Staff of Internal Audit Division, the Accountant General and Staff, and our external auditors—Audit Service Sierra Leone for their invaluable support in ensuring the provision of valuable data, audit and analysis for the update of the MTDS 2021-2025.

Sahr L. Jusu
Financial Secretary

EXECUTIVE SUMMARY

The Government of Sierra Leone in collaboration with the World Bank, International Monetary Fund (IMF) and the West African Institute for Financial and Economic Management virtually conducted the third Medium Term Debt Strategy (MTDS) Workshop from 25th May to 2nd June 2021. An update of the Sierra Leone Medium-Term Debt Strategy 2021-2025 underscores the commitment of Government to deepen debt transparency and management. The last MTDS was updated in 2017 but it did not cover a significant portion of domestic debt—domestic suppliers arrears, which accounted for about 8.7 percent of GDP in 2018.

This MTDS update covers a five-year projection period from 2021 to 2025 and included the stock of verified arrears audited by the Audit Service Sierra Leone as at Pre-April 2018 and the Arrears Clearance Strategy and Principles 2020-2025. It also includes the most up-to-date macroeconomic framework agreed with the International Monetary Fund under the Extended Credit Facility. It follows the previous MTDS document developed in Sierra Leone which covered 2013 to 2017 and the subsequent document covering 2018 to 2021- both strategy documents were not published because of data gaps. This MTDS (2021 to 2025) has been approved by Cabinet for publication following the endorsement of the Bank of Sierra Leone.

For the purpose of the MTDS, the total public debt stock of Sierra Leone (excluding IMF-credits) at end-2020 amounted to Le27.34 trillion (US$2.67 billion) of which external and domestic debt accounted for Le18.87 trillion (US$1.84 billion) and Le8.47 trillion (US$827.27) respectively. IMF-credits were excluded from the MTDS debt stock because the loan was provided to the Bank of Sierra Leone and not directly to Government budget. When IMF credits are on-lend by the Bank of Sierra Leone to Government budget, they are counted under the domestic debt of the MTDS. The stock of public debt increased significantly from Le16.00 trillion (US$2.01 billion) at end-2017 to Le27.34 trillion (US$2.67 billion) at end-2020. The stock of public debt (excluding IMF) amounted to 30.5 percent of GDP in 2012 and increased to 55.2 percent of GDP in 2017, and further increased to 66.1 percent of GDP end-2020. The growth was as a result of new domestic borrowing to implement the national budget and net external disbursement to implement donor financed projects across sectors nationwide. The exceptional disbursement of about US$142 million in 2020 by the IMF under the Rapid Credit Facility (RCF) which was on-lent by the Bank of Sierra Leone to the fiscal in order to minimize the impact of Covid-19 on the economy and recognition of verified arrears of 8.7 percent of GDP at Pre-April 2018 were significant drivers of public debt increase in 2020.

The MTDS 2021-2025 recommended Strategy 3 (S3) for adoption by Cabinet to reduce domestic debt and increase highly concessional external loans. Strategy 3 will strike the right balance between cost and risk, and most importantly support development of the domestic debt market. The choice of S3 will also reduce interest payment burden on Government, elongate the domestic yield curve and introduce medium-term marketable bonds to reduce the refinancing risks while Government prioritize concessional external borrowing to improve upon the debt distress rating from high risk to moderate risk of debt distress rating or better under the World Bank/IMF LICs debt sustainability framework. The recommended strategy is supported by ongoing reforms and incremental measures that have been proposed for implementation by Government with support from development partners. On the domestic front, Government should deepen market surveillance and interaction with relevant players to ensure development of the domestic debt market, whilst containing rollover and refinancing risk. On the external front, Government should prioritize contracting of grants and highly concessional loans to support the Medium-Term National Development Plan 2019-2023.

Implementation of the MTDS will be monitored by the Expanded Cash and Debt Management Committee. The Expanded Cash and Debt Management Committee (ECDMC) will monitor the MTDS target semi-annually and serve as the anchor for using the right composition of financing consistent with the targets set in the MTDS. In addition, the debt management processes will continue to be subjected to annual scrutiny by the Audit Service Sierra Leone and the Internal Audit Department of the Ministry of Finance. Government is committed to undertake a Debt Management Performance Assessment (DeMPA) with support from the World Bank.

In the event of shocks, it is recommended that Government should first rationalize spending and implement appropriate fiscal adjustment to contain the shock without compromising the targets set in the MTDS as specified in table 4.2.6. Shocks may trigger a revision of the MTDS target in collaboration with stakeholders and cost and risk of adjusting the debt composition during shocks will be assessed.

ACRONYMS

AfDB	–	African Development Bank
AGD	-	Accountant General's Department
ATM	–	Average Time to Maturity
ATR	–	Average Time to Re-fixing
ACNC	--	Arrears Clearance Negotiations Committee
BADEA	–	Arab Bank for Economic Development in Africa
BSL	–	Bank of Sierra Leone
CPIA	–	Country Policy and Institutional Assessment
CM	-	Commonwealth Meridian
CS-DRMS	–	Commonwealth Secretariat Debt Recording and Management System
CUB	–	Committed Undisbursed Balance
DAD	-	Development Assistance Database
DBR	–	Domestic Budget Revenue
DeMPA	–	Debt Management Performance Assessment
DOD	–	Disbursed Outstanding Debt
DRD	—	Directorate of Research and Delivery Department
EBID	–	ECOWAS Bank for Investment and Development
ECF	-	Extended Credit Facility
EEC	–	European Economic Community
EIB	–	European Investment Bank
FRD	—	Fiscal Risk & State-Owned Enterprise Management Division
GoSL	–	Government of Sierra Leone
ICM	-	International Capital Markets
ICT	–	Information and Communication Technology
IFMIS	–	Integrated Financial Management Information System
IMF	–	International Monetary Fund
MDA's	–	Ministries Departments and Agencies
MDRI	–	Multilateral Debt Relief Initiative
MoPED	–	Ministry of Planning and Economic Development
MoF	-	Ministry of Finance
MPD	—	Multilateral Project Division
MPR	—	Monetary Policy Rate
MTDS	-	Medium Term Debt Strategy
NASSIT	-	National Social Security and Insurance Trust
NDP	-	National Development Plan (2019-2023)

NRA	–	National Revenue Authority
PDMA	—	Public Debt Management Act
PDMD	–	Public Debt Management Division
PPP	—	Public Private Partnership
SOEs	–	State Owned Enterprises
SSSS	-	Script-less Securities and Settlement Systems
WB	–	World Bank
WAIFEM	-	West African Institute for Financial and Economic Management
RTGS	–	Real Time Gross Settlement
T-Bills	–	Treasury Bills
T-Bonds	-	Treasury Bonds

SECTION 1: OVERVIEW

1.0 Background

The Government of Sierra Leone in collaboration with the World Bank, International Monetary Fund (IMF) and the West African Institute for Financial and Economic Management virtually conducted the third Medium Term Debt Strategy (MTDS) Workshop from 25th May to 2nd June 2021. The Workshop brought together officials of the National Medium Term Debt Strategy and Debt Sustainability Analysis (DSA) Teams drawn from the Ministry of Finance (MoF), Accountant General's Department (AGD), Ministry of Planning and Economic Development (MoPED), the Bank of Sierra Leone (BSL), Statistics Sierra Leone (SSL), the University of Sierra Leone, Civil Society Organizations and the Press. The Public Debt Management Division (PDMD), Ministry of Finance coordinated the exercise while the World Bank, International Monetary Fund and the WAIFEM provided technical support.

Section 6(1) of the Public Debt Management Act 2011 (PDMA) provided for the formulation of an annual Public Debt Management Strategy by the Minister of Finance and should be approved by Cabinet. The PDMA further provides that the Medium-Term Debt Management Strategy, in its formulation, should consider: a) the macroeconomic framework; (b) future borrowing requirements of Government; (c) market conditions; and (d) such other factors as may be relevant for the development of the strategy.

The Medium-Term Debt Strategy (MTDS) incorporates proposed guidelines or specified targets for acceptable risks in the debt portfolio, as well as planned measures to promote development of the domestic debt market. The strategy document is anchored on two objectives: (i) meeting the government financing needs at minimal cost consistent with prudent degree of risks and also (ii) the development of the domestic debt management.

The MTDS covers a five-year projection period from 2021 to 2025. It follows the first MTDS document developed in Sierra Leone which covered 2013 to 2017 and the subsequent document covering 2018 to 2021- both strategy documents were not published because it omitted about 8.7 percent of GDP in domestic arrears which has been verified by the Audit Service Sierra Leone. This MTDS (2021 to 2025) has been approved by Cabinet for publication following the endorsement of the Bank of Sierra Leone.

In preparing the strategy, the team utilised the analytical tool of the World Bank (WB) and International Monetary Fund (IMF) Medium Term Debt Management Strategy framework. A Medium-Term Debt Strategy is a plan to guide government financing approach, taking into consideration the cost and risks implications on the debt portfolio. The following eight steps were followed in producing the strategy: (i) setting the objectives and scope of the MTDS; (ii) reviewing the existing debt management strategy and the cost-risk characteristics of the existing debt portfolio; (iii) identifying the potential sources of financing; (iv) reviewing the macroeconomic framework and medium-term projections and risks; (v) identifying structural factors; (vi) analyzing the cost and risks of alternative debt management strategies; (vii) reviewing alternative strategies with policy makers and market participants; and (viii) producing a debt management strategy document for approval, publication and dissemination.

1.1 Objective and Scope

The central objective of the MTDS is to reduce the exchange rate and rollover risks in the existing debt portfolio and achieve a lower cost and risk of the debt stock by the end of 2025. The general objectives of managing public debt in Sierra Leone, as reflected in Section 5 of the Public Debt Management Act 2011, are to (i) ensure that Government financing needs and its payment obligations are met at the lowest possible cost over the medium to long term, with a prudent degree of risk; and (ii) to promote development of the domestic debt market.

The scope of the stock of public debt for this MTDS covers central government external and domestic debt, including debt guaranteed by the Government of Sierra Leone and debt borrowed by the Central Government but on-lent to other government agencies. External debt for the MTDS includes public and publicly guaranteed external debt owed to multilateral, bilateral and commercial creditors. IMF loan obligations rest on the balance sheet of the central bank and represents external borrowing for balance of payment support and therefore excluded from the MTDS analysis. Domestic debt includes the recently verified arrears under the Arrears Clearance Strategy and Principles (2021-2025). The amortizations schedule in the Arrears Clearance Strategy and Principles (2021-2025) were included in the MTDS.

The repayment of IMF loans, except when on exceptional circumstances on-lent to the Government by the Bank of Sierra Leone for budgetary support purposes, is the responsibility of the Bank of Sierra Leone. External commercial debt comprised of the stock of accumulated unpaid obligations for goods and services supplied and works performed prior to and during the civil war (23rd March 1991 to 18th January 2002) is included in the analysis, according to expected payment schedule. External commercial debt is part of the external debt stock in the MTDS.

Domestic debt included in the MTDS analysis reflects the stock of marketable and non-marketable securities held by the Bank of Sierra Leone, commercial banks, other financial institutions including NASSIT and the general public. It should be noted that the stock of treasury bills is included at discounted costs and not at nominal or face value in the MTDS, to enable the separation of principal and interest payment within the analysis. Treasury bills are reported on nominal value basis by the Public Debt Management Division in line with historical practices.

Unlike in previous cases, this MTDS included the analysis of the stock of verified domestic arrears in line with the proposed settlement approach in the Domestic Suppliers and Contractors' Arrears

Clearance Strategy and Principles (2020-2025) approved by Cabinet. The stock of verified domestic and contractors' arrears stood at US$184 million by end of 2020.

1.2. Policy and Budget Environment

Public debt management is guided by the Public Debt Management Act 2011 (PDMA 2011) and supported by the Public Financial Management Act 2016, Section 118 of the 1991 Constitution of Sierra Leone and the Bank of Sierra Leone Act 2019. Debt management policy is largely informed by agreed financing targets under the economic programme arrangements with the IMF and the prevailing MTDS. There is an Expanded Cash Management and Debt Committee which monitors and approves Government cashflow forecasts in view of the annual Budget Approved by Parliament and monitors domestic and external debt levels. Members of the Expanded Cash Management Committee are drawn from the Ministry of Finance, National Revenue Authority, Accountant General's Department, Bank of Sierra Leone, Petroleum Directorate, National Minerals Agency and other Ministries, Departments and Agencies (MDAs).

SECTION 2: EXISTING PUBLIC DEBT PORTFOLIO

2.0. Description of debt levels and trends, including drivers

The total public debt stock of Sierra Leone (excluding IMF-credits) as at end-December 2020 amounted to Le27.34 trillion (US$2.67 billion) of which external and domestic debt accounted for Le18.87 trillion (US$1,844 million) and Le8.47 trillion (US$824 million) respectively. See Table 1a below. The stock of public debt increased significantly from Le16.00 trillion (US$2.01 billion) end-2017 to Le27.34 trillion (US$2.67 billion) as of December 2020. As a percent of GDP the public debt stock increased from 30.5 percent in 2012, to 55.2 percent in 2017, and further increased to 66.1 percent of GDP end-2020. The calculation of debt over GDP for 2017 MTDS did not include the stock of domestic and external arrears because it was not audited by Audit Service Sierra Leone. The growth was mainly as a result of net external disbursement to implement donor financed projects across sectors nationwide and the inclusion of the audited arrears. The exceptional disbursement of about US$142 million in 2020 by the IMF under the Rapid Credit Facility (RCF) which was on-lent by the Bank of Sierra Leone to the fiscal (as domestic borrowing) in order to minimize the impact of Covid-19 on the economy was also another significant driver of public debt increase in 2020.

2.1. Composition of Public Debt by Creditor, Currency, Interest Type

The stock of domestic debt accounted for 31 percent of the total public debt portfolio as at end 2020. The domestic stock comprises treasury bills and medium to long term treasury bonds and further classified into marketable and non-marketable securities. The treasury bills constitute about 20.2 percent of total public debt and 65.4 percent of total domestic debt, and domestic Suppliers Arrears constitute 6.9 percent of total debt and 22.3 percent of total domestic debt.

The MTDS exercise classified external debt as follows: Multilateral, Bilateral, Commercial-External Arrears and Domestic Foreign Currency Debts. The stock of external debt accounted for 69 percent of the total public debt stock. External debt slightly decreased from 72 percent end 2017 to 69 percent end 2020. Multilateral debt accounted for 51.6 percent of total public debt and 74.8 percent of the external debt portfolio, Bilateral debt accounted for 8.5 percent of total public debt (12.3 percent of external debt portfolio), Commercial-External Arrears accounted for 6.9 percent of total public debt (9.9 percent of external debt portfolio) and domestic debts denominated in foreign currency which were issued in the domestic market to settle contractors/suppliers' arrears with 2, 3 and 5 years maturity periods and unpaid verified domestic arrears accounted for 2.0 percent of total public debt (2.9 percent of external debt portfolio).

The baseline public debt data by creditor category and by instrument as at end-2020 is shown in Table 1a. Whilst the evolution debt since the last MTDS to the current is shown in Table 1b.

Table 1a: MDTS Public Debt Stock by Creditor Category and by Instrument by end of 2020 (in Million USD)		
	FY 2020	**Percent of Total**
Total External Debt	**1,844**	**69.1%**
Multilateral	1,443	54.1%
Bilateral	228	8.5%
Commercial Debt	173	6.5%
Total Domestic Debt	**824**	**30.9%**
T Bills/1	540	20.2%
2-Yr Bond	32	1.2%
3-Yr Bond	30	1.1%
5-Yr Bond	38	1.4%
Arrears	184	6.9%
Total Debt Stock	**2,668**	**100.0%**

Source: Ministry of Finance

1/ For the MTDS analysis, the stock excludes IMF debt (of US$508.54 as at end-December 2020) which is the obligation of the Bank of Sierra Leone and Treasury Bills are included at discounted value basis.

The external debt portfolio in the 2020 public debt stock is made up of the following currencies: United States Dollars, Euro Chinese Yuan, Saudi Riyal, Great Britain Pounds, Japanese Yen, Kuwaiti Dinar and Arab Emirates Dirham. The largest portion of external debt portfolio is denominated in United States Dollar accounting for 55 percent of the total external debt portfolio. The second largest is denominated in Euro, 23 percent, and the total remaining currencies amounted to 22 percent. The external debt portfolio is still dominated by high share of United States (US) Dollar denominated debt of 55 percent followed by the Euro and Chinese Yuan of 23 percent and 8 percent respectively. The share of external debt by currency has remained largely unchanged since 2017.

For the definition of stylized instruments used in the MTDS simulations, the choice was to aggregate all the external debt instruments into few representative instruments denominated only in US Dollars. The implicit assumption is that the national currency will fluctuate against other foreign currencies as it will also fluctuate against US Dollars during the strategy period.

The interest type of the entire external debt portfolio is fixed and a large proportion of the external debt portfolio is a combination of highly concessional, semi-concessional and concessional.

Table 1b. Composition of central government debt in FY2017 and in FY2020, In SLL million

Total central government debt	FY2017	In percent	FY2020	In percent
Total Domestic Debt	**4,524,536**	**28%**	**8,465,877**	**31%**
Treasury Bills	3,782,797	24%	5,534,292	20.2%
2-year T-Bond	47,502	0.3%	333,414	1.2%
3-year T-Bond	143,814	0.9%	314,723	1.2%
5-year T-Bond	367,990	2.3%	367,990	1.3%
10-year T-Bond	48,750	0.3%	26,250	0.1%
Suppliers Arrears	13,653	0.1%	1,889,208	6.9%
Ways and Means Advances[1]	120,030	0.8%	-	-
Total External Debt (SLL)	**11,477,795**	**72%**	**18,873,849**	**69%**
Multilateral	8,638,700	54%	14,118,564	51.6%
Bilateral	1,352,026	8%	2,329,184	8.5%
Commercial/External Arrears	1,487,069	9%	1,874,176	6.9%
FX domestic debt[2]	-	-	554,924	2.0%
Total Debt	**16,002,331**	**100%**	**27,342,726**	**100%**

Source: Ministry of Finance

2.3. Costs and Risks on the Existing Debt Portfolio as at end 2020

The MTDS assessed costs and risks inherent in the public debt portfolio by end of 2020, being the base period for the MTDS. The MTDS identified the critical costs and risks to be managed during the MTDS period of 2021 to 2025.

The structure and composition of public debt at end-2020 was partly influenced by agreed debt policy under on-going and past Extended Credit Facility (ECF) Programme arrangement as well as the previous debt management strategies. Government treasury securities (T-bills and T-bonds) have been used to finance the annual Government budget while external debt has been used to mainly finance development projects at concessional terms.

The high share of foreign currency debt in the overall debt portfolio at end-2020 poses exchange rate risks while the short-term nature of domestic debt poses rollover and refinancing risks. Interest rate risk is low as the overall portfolio is in fixed interest rate terms.

2.4. Implied Cost of the Public Debt Portfolio

The Weighted Average Interest (WAI) or implied interest rate of the overall debt portfolio as of end 2020 was 4.8 percent compared to the previous MTDS level of 5.8 percent at end-2017,

[1] These are temporary advances (overdrafts) extended by BSL to the government. This tool has been used on continuing basis up to the annual statutory limit (SLL 251 billion for 2021, equivalent to 5% of the previous year's domestic revenue (excluding privatization receipts)). For the current MTDS exercise it has not been considered on the existing debt portfolio given its small relevance and for simplicity.

[2] On the MTDS exercise domestic and external debt are defined based on currency exposure. Therefore, government securities issued on the domestic market but denominated in foreign currency are considered external debt.

indicating some improvement. This relatively low interest rate environment was driven by the concessional nature of external debt of an average interest rate of 0.7 percent compared to 13.8 percent for domestic debt. Impliedly, the cost burden of domestic debt was 2.8 percent of GDP at end-2020 compared to 0.4 percent of GDP for external debt, reinforcing how less expensive external debt has been.

Table 2. Cost and Risk Indicators of the Public Debt Portfolio in 2020

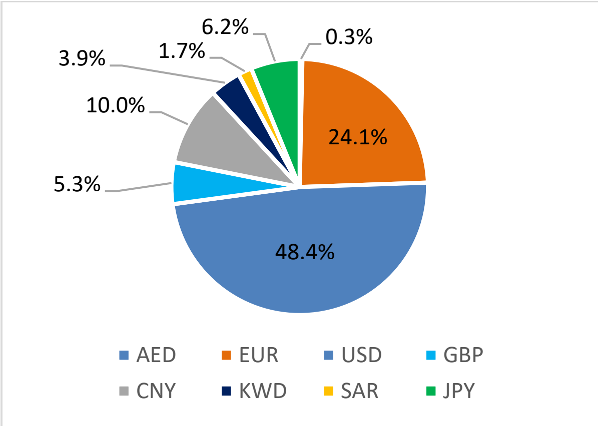
Risk Indicators		External debt	Domestic debt	Total debt
Amount (in millions of SLL)		18,876,849	8,465,877	27,342,726
Amount (in millions of USD)		1,844	827	2,672
Nominal debt as percent of GDP		45.7	20.5	66.1
PV as percent of GDP[1]		33.0	20.5	53.5
Cost of debt[2]	Interest payment as percent of GDP[3]	0.4	2.8	3.2
	Weighted Av. IR (percent)	0.8	13.8	4.8
Refinancing risk[2]	ATM (years)	11.4	1.7	9.3
	Debt maturing in 1yr (percent of total)	5.1	73.7	19.8
	Debt maturing in 1yr (percent of GDP)	3.8	15.1	18.9
Interest rate risk[2]	ATR (years)	11.4	1.7	9.3
	Debt refixing in 1yr (percent of total)	5.1	73.7	19.8
	Fixed rate debt incl T-bills (percent of total)	100.0	100.0	100.0
	T-bills (percent of total)	0.0	65.4	14.0
FX risk	FX debt (percent of total debt)			69.0
	ST FX debt (percent of reserves)			19.7

2.5 Exchange Rate Risk

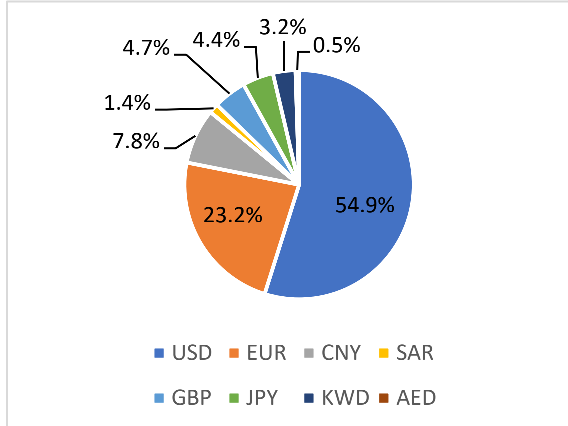
There is still a prevalence of high foreign currency risks in the overall debt portfolio despite the significant improvement, as foreign currency debt accounted for 69.0 percent at the end of 2020 compared to 75.8 percent at the end of 2017. Despite its cheap nature, external debt accumulation should be monitored to effectively manage exchange rate risks. The level of Gross Foreign Exchange Reserve and the depreciation of the Leone against major loan currencies are important elements that feeds in the assessment of risks in the external debt portfolio which should feed into Government's decision on new external borrowing.

Figure 1: Public External Debt: Currency Composition, in percent of total external debt (as of end-December 2017 and 2020)

End-December 2017



End-December 2020

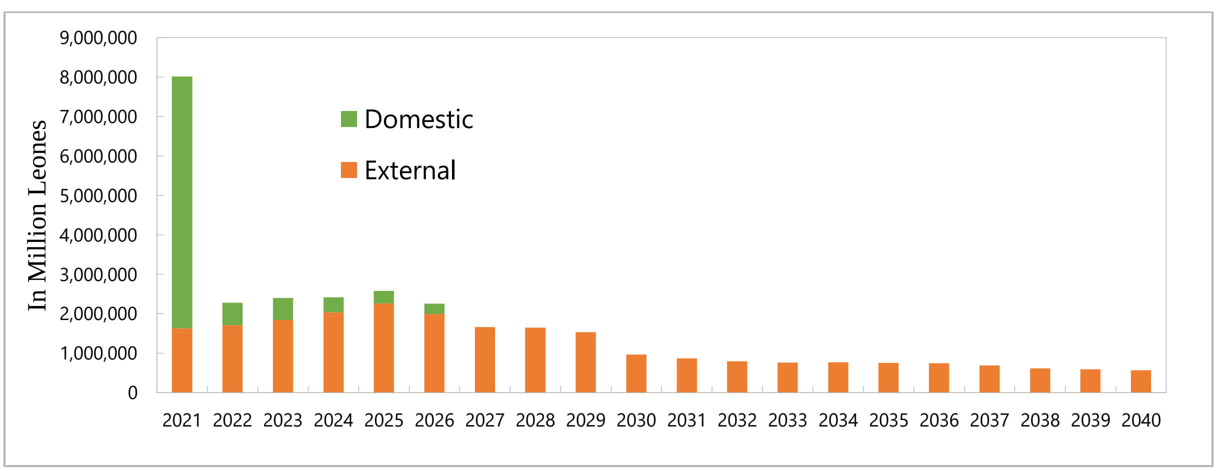


Source: Ministry of Finance

2.6. Rollover /Refinancing Risk

Rollover risk is moderate in the public debt portfolio, despite of the short-term nature of domestic debt. The Average Time to Maturity (ATM) of the total debt portfolio end of 2020 was 9.3 years. External and domestic debt ATM was 11.4 years and 1.7 year respectively. ATM for the external debt portfolio is high due to longer maturity profile typical of concessional debt. Refinancing risks is high in the domestic debt portfolio as 73.7 percent of domestic debt would mature in less than a year, while 5.1 percent only for external debt. The inclusion of the verified stock of domestic suppliers' arrears in the remaining maturity profile of up to 5 years has lessen the prominent of refinancing risk in the domestic debt portfolio. Figure 2 shows the maturity profile of the debt portfolio with domestic debt concentrated in year 1 (2021) and external debt distributed over 40 years although with relatively large maturities between 2021 to 2026.

Figure 2:-
Redemption Profile of the Debt Portfolio end of 2020



2.7. Interest Rate Risk

Interest rate risk is assessed to be low as the entire portfolio is comprised of fixed interest rate instruments. The total portfolio to be re-fixed within 1 year is 19.8 percent, indicating some improvement when compared to 24.7 percent in 2017. However, interest rate risk is high in the domestic debt portfolio with 73.7 percent of domestic debt is to be re-fixed within one year compared to 5.1 percent for external debt.

In summary, there is high exchange rate risk exposure in the overall debt portfolio. Given that exchange rate risks emanate from external debt, managing such risks should be calculated against the low cost and low rollover risks associated with external debt. Refinancing and interest rate risks are significant in the domestic debt portfolio. The frequent rollover of domestic debt also triggers interest rate risks.

SECTION 3: ENVIRONMENT FOR DEBT MANAGEMENT

3.0. Market environment

The domestic debt market is underdeveloped with limited number of instruments being traded, and low secondary market activity. Market participants are few and the banking sector is the largest buyers of Government securities. The market is dominated by short-term T-Bills accounting for 63.8 percent of domestic debt end of 2020, although falling from 84.6 percent end of 2017, indicating inclusion of Arrears Clearance Strategy and Principles (2020-2025) in the domestic debt stock. The debt portfolio also includes 2 and 3-Year treasury bonds issued to refinance maturing bills and in lieu of settlement of domestic suppliers' arrears. Non-marketable bonds are denominated in foreign currency and were issued to the non-bank (mainly to infrastructure contractors) before the Arrears Clearance Strategy. Table 3 shows domestic debt by instrument end of 2017 and 2020.

Table 3. Domestic Debt by Instrument 2017 and 2020 (in millions of Leones)

Central Government Domestic Debt	FY2017	In percent	FY2020	In percent
Treasury Bills	3,782,797	83.6%	5,534,292	63.8%
2-year T-Bond	47,502	1.0%	333,414	3.8%
3-year T-Bond	143,814	3.2%	314,723	3.6%
5-year T-Bond	367,990	8.1%	367,990	4.2%
10-year T-Bond	48,750	1.1%	26,250	0.3%
Suppliers Arrears	13,653	0.3%	1,889,208	21.8%
Ways and Means Advances[3]	120,030	2.7%	213,568.64	2.5%
Total Debt	**4,524,536**	100.0%	**8,679,446**	100.0%

Source: Ministry of Finance

Treasury bills auction is done on weekly basis - informed by quarterly auction calendar - and results are published on weekly basis. Although primary market dealership arrangement has remained dormant due to mainly liquidity challenges it is under review to ensure its effective implementation.

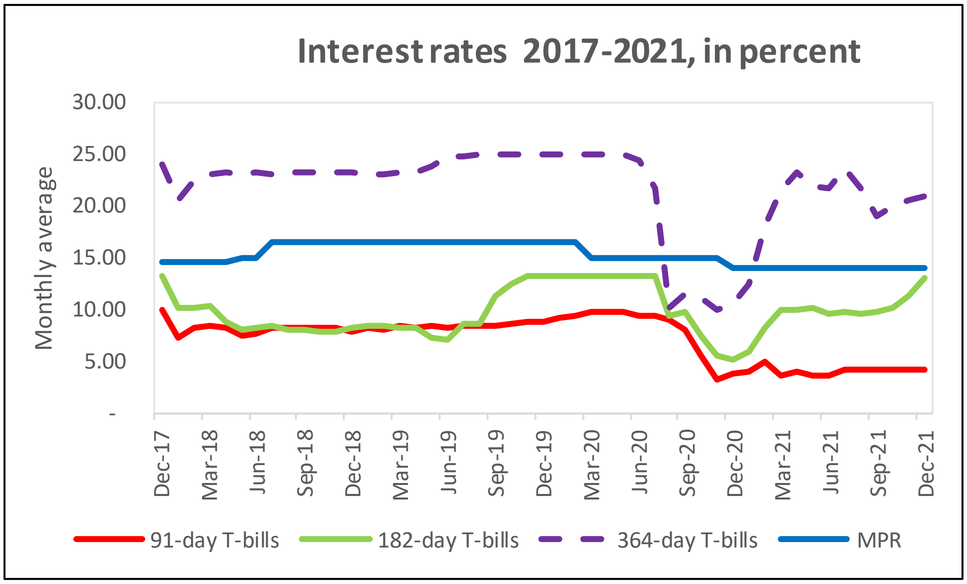
3.1. Domestic Interest Rates

The yield on the 364-day T-bills, which accounts for over 90 percent of the T-bills portfolio, declined from 25.06 percent in February 2020 to 10.02 percent in August 2020 due to increased liquidity supported by huge Covid-19 related disbursement. The 364-day T-bills rates averaged 18.72 percent in 2020 compared to 10.8 percent and 8.01 percent for 182 -day T-bills and 91-day

[3] Ways and Means Advances are short-term overdraft facilities extended to the Government by the Central Bank of Sierra Leone which is capped at 5 percent of the previous domestic revenue in the Bank of Sierra Leone Act 2019.

T-bills respectively. The 91-day and 182-day rates have been below the MPR throughout 2020 while the 364-day T-bills rate dipped below the MPR for some period in the 2nd half of 2020. The average interest rates on 364-day T-bills, 182-day T-Bills and 91-days T-bills are 24.93 percent, 14.0 percent and 11.0 percent respectively.

Figure 3:-
Sierra Leone Short Term Domestic Interest Rates



SECTION 4: DESCRIPTION OF MEDIUM-TERM DEBT STRATEGIES

4.0 Debt Strategies and Assumptions

Government has adopted strategy 3 (S3) which builds on the baseline and assumes that Government will follow the agreed borrowing limits with the IMF under the latest Extended Credit Facility programme. It assumes prioritizing and maximizing external concessional borrowing as best as possible, keeping borrowing from multilateral and bilateral as in past trends. It assumes a decline in domestic borrowing with a greater share of longer tenures. The rationale of this strategy is to increase the ATM of domestic debt and reduce interest rate costs (Sustainable External Financing and Domestic Market Development).

4.1 Baseline Macroeconomic Assumptions

The baseline macroeconomic assumptions at the time of the strategy calibration, are outlined in the Table below:

Table 4: - Baseline Macroeconomic assumptions

No.		Metric	2020	2021	2022	2023	2024	2025
1	Budgeted Revenue and Grants	In billions of Leones	7,803	7,890	8,595	9,276	9,534	10,011
2	Domestic Revenue	In billions of Leones	5,501	6,237	6,928	7,596	7,873	8,661
3	Grants	In billions of Leones	2,303	1,653	1,667	1,680	1,660	1,684
4	Budgeted Primary Expenditure	In billions of Leones	8,884	9,059	9,522	10,670	11,398	12,218
5	Total Expenditures including budgeted interest payments	In billions of Leones	10,093	10,336	10,931	12,151	12,917	13,743
6	Budgeted interest payments	In billions of Leones	1,209	1,278	1,410	1,481	1,518	1,526
7	International reserves (USD million)	In USD millions	677	695	640	551	511	531
8	Nominal GDP	In billions of Leones	40,028	44,978	49,245	53,866	59,236	62,894
9	Real GDP	In billions of Leones	10,013	10,425	10,840	11,355	11,973	12,427
10	Real GDP growth	In Percent	3.2	4.1	4.0	4.7	5.4	3.8
11	Programme	In billions of Leones	1,724	1,085	1,091	1,096	1,096	1,107
12	Projects	In billions of Leones	597	568	576	584	564	578
13	Rev/GDP	In percent of GDP	13.7	13.9	14.1	14.1	13.3	13.8
14	Overall Deficit	In billions of Leones	(2,290)	(2,446)	(2,336)	(2,874)	(3,383)	(3,733)
15	Overall Deficit/GDP	In percent of GDP	(5.7)	(5.4)	(4.7)	(5.3)	(5.7)	(5.9)

4.1.2 Limitation of the Debt Strategies, Assumptions and Forecasts

The limitations of the MTDS strategies, assumptions and forecasts are outlined below:

1) The global economy remains uncertain especially under the COVID-19 environment and the recent international supply chain disruptions have the tendency to affect the realism of the macroeconomic framework that underpins the assumptions in the above strategies. This limitation can be resolved by regular update of the MTDS annually.

2) Liquidity conditions in the domestic financial market is unstable and the domestic debt market is shallow. Majority of the commercial banks usually do not invest in medium to long term bonds. Most of their investment portfolios are locked in the short end of the market which limits the possibility of elongating the yield curve. Limited secondary market activities also pose a challenge to deepening of the domestic debt market. This limitation can be moderated by a robust communication strategy and sensitization of the market on the instruments to be issued.
3) Overreliance on external concessional financing despite shift in Global financial architecture towards market-based financing instruments for developing as well as LICs. This could be moderated by enhancing domestic revenue generation and public financial management.
4) Prudential requirements limits the ability of commercial banks to count their medium term investment as part of liquid assets. Hence, limiting their ability to lock funds in long-term investment in order to meet their prudential requirements. This limitation can be managed by reviewing outdated laws and guidelines in line with regional peers.
5) Exceptional fiscal pressures such as spending on electoral processes may lead to higher deficits which could in turn affect the borrowing targets under the MTDS. If fiscal pressures are not contained, it may lead to higher than planned borrowing and affect the baseline borrowing path. This limitation can be moderated by effective planning of electoral spending and seeking external financing (prioritizing grants) to support electoral processes.

4.2.0. Identifying Potential Sources of Financing

Government financing in the MTDS will come from the usual traditional sources of external and domestic creditors. On the external front, Government will continue to seek concessional financing from both bilateral and multilateral creditors through standard loans and grants. Government will also attempt to access the international capital markets, contingent on improved macroeconomic conditions in the medium-term. Government will also explore innovative financing options such as PPPs and Climate-based financing to complement traditional external sources. On the domestic front, Government will continue to issue T-bills as the main source of domestic financing. To deepen the domestic market, Government will explore competitive issuance of medium-term bonds.

There is the possibility of higher domestic revenues if the assumptions about resumption of iron ore mining holds for both the Marampa and the Tonkolili mines. These two have the potential to increase domestic revenues from iron ore exports especially in 2022 and the medium-term.

Unlocking these revenue sources would create the space for higher external borrowing as the debt distress rating will improve and pave the way for the raising of funds from the international capital market.

4.3.0. Cost and Risk of Alternative Strategies

4.3.1. Refinancing Risk

Refinancing risk is assessed to be high for domestic debt across all strategies given the short-term nature of the stock of domestic debt unlike external debt with longer maturities. The Average Time to Maturity (ATM), which defines on average how long a debt portfolio will mature, is the longest under S3 (9.0 years) and lowest under S1 (6.9 years) for the total portfolio. Debt maturing within one year is the highest under Strategy 1(40%), with the lowest refinancing risk of 18.7%, driven by the 10-year Euro bond in the ICM in Strategy 4. On the external debt front, all Strategies have ATM above 10 years with the less refinancing risks associated with S3 (12 years). S1, S2, S3 showed departure from the baseline (S1) as longer tenor debts instruments are introduced in these strategies unlike S1, which is dominated by treasury bills.

4.3.2. Exchange Rate Risk

Exchange rate risk has implications for managing reserves and cost of managing external or foreign currency debt. S3 and S4 put share of foreign currency debt to total debt at 71.7 percent and 73.4 percent respectively, indicating high foreign currency risks compared to 56.9 percent and 56.5 percent in the baseline (S1) and S2 respectively. This is as a result of introducing more foreign currency debt in S3 and S4 unlike in S1 and S2. Short-term foreign currency debt account for 25.5 percent of reserves across all strategies, indicating capacity by Government to support external debt service falling due within a year.

4.3.3. Interest Rate Risk

Interest rate risk is low on the overall debt portfolio given that the entire debt portfolio is in fixed interest rate terms. However, debt to be re-fixed within one year to be rolled over, would be subjected to the prevailing interest rate in the market, which is 40% over the total portfolio in S1 which is considered high compared to the lowest of 18.7 percent under S4. This is supported by T-bills as a percentage of total which is 33.5 percent under S1 and 11.8 percent each under S3 and S4. Average Time to Re-fixing (ATR) which is similar to ATM as the entire portfolio is in fixed instrument, is most favourable under S3 (9 years) than the other Strategies.

Table 5:- Cost and Risk Indicators end of 2025

Risk Indicators		2020	As at end 2025			
		Current	S1	S2	S3	S4
Nominal debt as percent of GDP		66.1	64.3	64.7	63.0	64.9
Present value debt as percent of GDP		53.5	53.4	53.9	49.1	54.0
Interest payment as percent of GDP		3.2	4.6	4.8	3.4	3.9
Implied interest rate (percent)		4.8	7.5	8.2	5.6	6.7
Refinancing risk	Debt maturing in 1yr (percent of total)	19.8	40.0	28.6	19.4	18.7
	Debt maturing in 1yr (% of GDP)	18.9	25.7	18.5	12.3	12.2
	ATM External Portfolio (years)	11.4	11.5	11.5	12.0	10.3
	ATM Domestic Portfolio (years)	1.8	0.8	1.29	1.34	1.3
	ATM Total Portfolio (years)	9.3	6.9	7.1	9.0	7.9
Interest rate risk	ATR (years)	9.3	6.9	7.1	9.0	7.9
	Debt refixing in 1yr (percent of total)	19.8	40.0	28.6	19.4	18.7
	Fixed rate debt incl T-bills (percent of total)	100.0	100.0	100.0	100.0	100.0
	T-bills (percent of total)	14.0	33.5	19.4	11.8	11.8
FX risk	FX debt as % of total	69.0	56.9	56.5	71.7	73.4
	ST FX debt as % of reserves	19.7	25.5	25.5	25.5	25.5

4.3.4. Other Cost Measures and Debt Indicators

Other costs measures and debt indicators such as interest payment to GDP, interest payment to budget revenue, PV of debt to GDP are used to assess the cost impact of alternative strategies. PV of debt to GDP, which assesses the solvency capacity of Government, is lowest in S3 (49.1 percent) due to larger share of external concessional borrowing in the debt stock. PV of debt to GDP in S1 and S2 are 53.5 percent and 53.4 percent respectively, compared to the highest, S4 (54.0 percent), as S4 accommodates the issuance of expensive Euro Bond.

Interest payment as a percentage to GDP is lowest in S3 which accommodates more cheap external borrowing followed by S4. S2, which aligns with domestic market developments by introducing 2 to 5 years marketable bonds, is costlier compared to the others. Government could absorb this cost in the interest of deepening the domestic debt market and reducing refinancing risks. Similarly, S2 is the highest in terms of interest cost to revenue followed by S1.

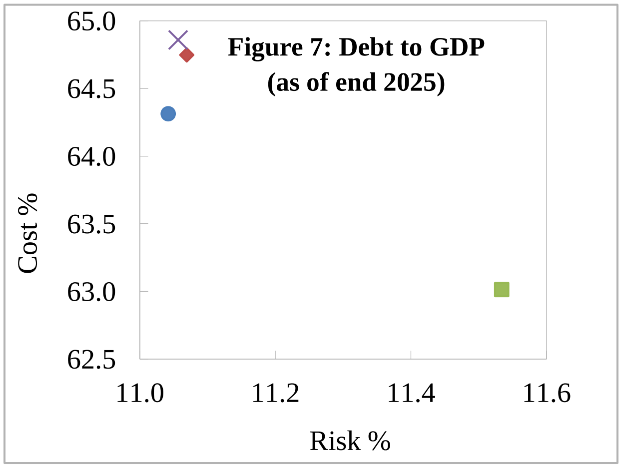


Figure 7: Debt to GDP (as of end 2025)

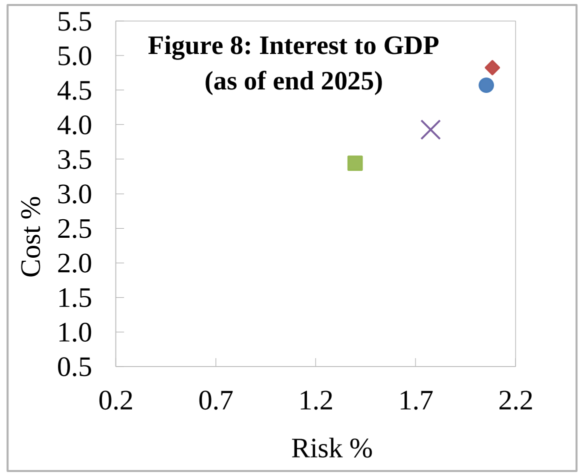


Figure 8: Interest to GDP (as of end 2025)

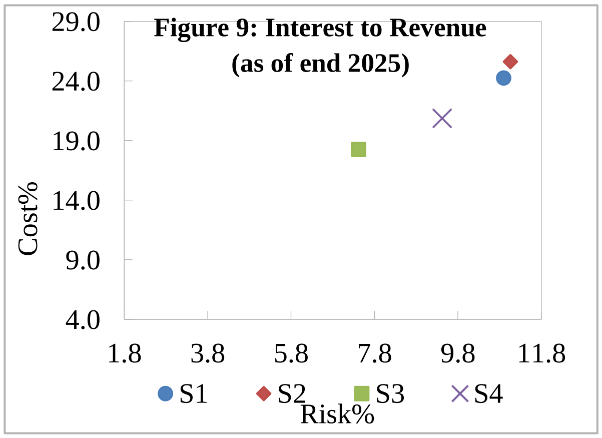


Figure 9: Interest to Revenue (as of end 2025)

4.3.5. The Preferred Public Debt Management Strategy

Considering the significant exposure of the existing public debt portfolio to exchange rate and rollover risks, high debt to GDP ratio (of 66.1 percent), coupled with the high domestic interest cost, strategy 3 (S3) is recommended to reduce the total debt to GDP over the medium term. Despite the higher interest cost of Strategy 3 relative to the baseline, strategy 3 has a lower cost of domestic debt in the Government budget and facilitate speedy return to long-term debt sustainability. Strategy 3 strikes the balance between reducing the cost and risk of the existing public debt portfolio, by lowering the quantum of domestic debt (including redemption of the foreign exchange component of domestic debt issued to non-bank for clearance of arrears). It will also increase the share of highly concessional debt in the debt portfolio which produces a lower cost of debt relative to the other strategies. Whilst the quantum of domestic debt is projected to decline in the financing of the National Development Plan (NDP) (2019-2023), Strategy 3 recommends issuance of more competitive medium-term bonds instead of the usual Treasury bills (364-day T-bills, 182-day T-bills and 91-day T-bills under the baseline). This will come with a slightly higher cost in order to lengthen the maturity profile of the domestic debt stock. Hence, it is recommended that majority of the minimal domestic debt that will be contracted under Strategy 3 should be in the form of competitive medium-term marketable bond to reduce the refinancing risks. Government is also advised to prioritize concessional external borrowing to facilitate improvement in the debt distress rating from high to moderate risk of debt distress or better under the World Bank/IMF LICs debt sustainability framework.

4.2.6. Medium Term Cost and Risks Target

The medium-term cost and risks targets of the MTDS are derived from the preferred strategy and some of the targets are more ambitious with the aim of achieving a reduced cost and risk of the debt portfolio over the medium-term. It is anticipated that achievement of the MTDS targets would indirectly support the linkage between progress on the MTDS to improvement in the debt sustainability indicators.

Table 6:- Medium-Term Cost and Risk Targets 2021-2025

Goal	Indicator	Baseline	Target /1
Reduce debt burden	Present value of debt to GDP	53.5%	49.1%
Manage FX risk	FX debt (as % of MTDS debt)	69%	≤ 70%
Domestic Market Development	Domestic Debt (as % of MTDS debt)	31%	≥ 30%
Manage refinancing risk	Overall ATM (years)	9.3	≥ 10
	Debts Maturing in 1 year (as % of GDP)	18.9%	≤ 12.3%
Manage interest rate risk	Fixed rate debt (% of MTDS debt)	100%	100%
	T-bills (% of total debt)	14.0%	11.8%

1/. The targets set in the MTDS are not completely under the control of PDMD and some are ambitious relative to strategy 3.

SECTION 5: CONCLUSIONS

5.0. Recommended Public Debt Management Strategy

The MTDS 2021-2025 recommended Strategy 3 (S3) for adoption by Cabinet because pursuing the baseline approach for debt management would worsen the debt burden. Whilst Strategy 3 increases the cost of the debt in the short-run, it lowers the present value of debt to GDP over the medium term and therefore the most superior strategy on several cost and risk dimensions relative to the other three strategies. Strategy 3 will strike the right balance between cost and risk, and most importantly support development of the domestic debt market (reduce the foreign exchange component in the existing domestic debt portfolio issued to clear arrears). The choice of S3 will introduce competitive medium-term marketable bonds to reduce the refinancing risks while Government prioritises concessional external borrowing to facilitate improvement in the debt distress rating from high risk to moderate risk of debt distress rating or better under the World Bank/IMF LICs debt sustainability framework.

The recommended strategy is supported by ongoing reforms and incremental measures that have been proposed for implementation by Government with support from development partners. On the domestic front, Government should deepen market surveillance and interaction with relevant players to ensure development of the domestic debt market, whilst containing refinancing risk. On the external front, Government should prioritize contracting of grants and highly concessional facilitates to support the Medium-Term National Development Plan 2019-2023.

5.1. Debt Management Reforms

In order to achieve the above set of targets under the Medium-Term Debt Strategy 2021-2025, Government is committed to implement institutional and policy reforms in debt management in short-term, the medium term and long-term. At the institutional level, Government is committed to transition from the Commonwealth-Secretariat Debt Recording and Management System (CS-DRMS) to the Commonwealth Secretariat Meridian in the short-term. Government is also committed to integrate the Meridian with existing and potential PFM and banking platforms across various institutions involved in debt management whilst managing operation risks of the transition to Meridian. This will involve integrating the CS-MDMS with other applications and databases such as FreeBalance (Integrated Financial Management Information Systems (IFMIS)) at the Accountant General’s Department, Script-less Securities and Settlement Systems (SSSS) and T-24 Domestic Debt systems at the Bank of Sierra Leone, Development Assistance Database (DAD) at the Ministry of Planning and Economic Development. When implemented, the Commonwealth Meridian will also serve as an audit trail which can be accessed by the Audit Service Sierra Leone and Internal Audit Department of the Ministry of Finance to perform audit functions.

Government is also committed to advance debt transparency by ensuring that adequate information is provided on the state of public debt on regularly basis and published on the website of the Ministry of Finance.

Government is implementing reforms in the domestic debt management through support from the West African Monetary Institution/West African Monetary Agency to develop the domestic debt management. Progress under this ongoing reform will support the achievement of the objectives set out in the Medium Term Debt Strategy.

5.2. Monitoring of Progress and Evaluation of the Public Debt Management Strategy

Public debt cost and risk would be monitored by the Expanded Cash and Debt Management Committee. As outlined in section 3.2 above, an Expanded Cash and Debt Management Committee monitors and approves Government cash flow forecasts in line with the annual Budget approved by Parliament. The committee also monitors domestic and external debt levels. The Cash and Debt Management Committee will continue to provide the anchor for monitoring of public debt and support the implementation of reforms. The debt management processes will continue to be subjected to annual scrutiny by the Audit Service Sierra Leone and the Internal Audit Department of the Ministry of Finance. Progress towards achieving the targets in the MTDS will be measured at regular intervals and supported by performance audit to be conducted by the Audit Service Sierra Leone and the annual audit reviews by the Internal Audit Department of the Ministry of Finance. Government will also undertake a Debt Management Performance Assessment (DeMPA) during the MTDS period to help identify areas for improvement.

5.3. Risk mitigating measures if conditions change.

Implementation of the MTDS is not devoid of external shocks persistence of the CoVID-19 pandemic, decline in international metal prices (iron ore, Rutile) and other minerals, spikes in international oil prices and the recent international supply chain disruptions. These shocks usually lead to increase fiscal pressures and higher deficit financing needs. The above shocks can also affect the external sector, leading to higher balance of payment deficit and depreciation pressure on the local currency relative to other foreign currencies.

On the external front, Government should allow the currency to depreciate to serve as a partial automatic adjustor to the shock whilst monetary policy would be designed to lean against the second round impact of the exchange rate depreciation and its pass-through to inflation.

It is recommended that Government should seek exceptional assistance from development partners during shocks, implement fiscal adjustment whilst allowing the local currency to depreciate to prevent the Gross International Reserve levels from falling below 3.5 months of import cover.