REPUBLIC OF GHANA

MINISTRY OF FINANCE

**MEDIUM-TERM DEBT MANAGEMENT STRATEGY
2016-2018**

APPROVED BY:

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MINISTER FOR FINANCE**

Accra, March 2016

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The Medium Term Debt Management Strategy 2016-2018 is also available at the Ministry of Finance Website at: http://www.mofep.gov.gh

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FOREWORD

His Excellency the President John Dramani Mahama has reiterated his commitment to ensuring macroeconomic stability and a shared growth for all Ghanaians in the medium term. To operationalize this broad policy objective, a number of economic instruments and strategies are to be adopted for the period. One of these strategies is our Medium Term Debt Managament Strategy (MTDS). The MTDS is a useful public debt management tool that recognizes the cost and risk trade-offs in setting sustainable borrowing limits and ensuring that debt is serviced under a wide range of shocks without risk of default.

Ghana's 2016 MTDS has been carefully drafted by taking into consideration the medium term macroeconomic fiscal framework, which among others covers enhanced revenue projections and tionalized expenditures. Going forward, we will ensure that we integrate this process effectively in our budget cycle, and the entire public finanacial management reforms. Being the fourth annual publication, the 2016 MTDS has been prepared to guide financing of the budget deficit, as indicated in the 2016 Budget Statement and Economic Policy of Government. It is for this important reason that this strategy does not only address the appropriate mix between domestic and external debt, but also defines the terms and conditions for new borrowing within the global economic environment.

Government is committed and will continue to take remarkable steps towards improving public debt management in Ghana. It is in the light of this that we are reviewing the 1970 Loans Act as part of our review of the public financial management laws. The new public debt law is expected to include a wide range of financial instruments, including financial derivatives.

Finally, permit me to state that Government is committed to achieving better development outcomes through improved transparency and accountability in public financial management. I see the publication of this Medium Term Debt Management Strategy report as meeting this commitment. It is my wish that this strategy paper is seen as a critical tool for informed policy decisions by all stakeholders, reducing the debt burden and other fiscal vulnerabilities and also serve to deepen relations with existing and potential investors.

Hon. Seth E. Terkper
Minister for Finance

ACKNOWLEDGEMENT

The MTDS tool seeks to analyse the cost and risk of alternative borrowing strategies. This Medium Term Debt Management Strategy (MTDS) as prepared by the Ministry of Finance outlines Government's plan to guide debt management operations over the medium term, 2016-2018.

As you will find in this strategy document, the preparation and implementation of a MTDS is a technical exercise which requires highly skilled human resource capacity to undertake. I wish to at this point acknowledge all who contributed in diverse ways in bringing this document into reality.

It is refreshing to note that the preparation of the 2016 MTDS document was spearheaded by staff of the Debt Management Division of this Ministry with the support of Hon. Seth E. Terkper, Minister for Finance, his Deputy Ministers and Special Advisors.

The Ministry also recognises the contribution of officers from the Bank of Ghana, Controller and Accountant General's Department, and officers from the Economic Research and Forecasting, Real Sector, Financial Sector, Public Investment, Budget and the External Resource Mobilization (Bilateral and Multilateral) divisions of the MOF. The Ministry appreciates the contribution of Eriko Togo, Financial Sector Specialist (IMF), Samuel Danquah Arkhurst, (Director, Debt Management Division), Dr. Zakaria Issahaku (Head, Risk Management Unit), Ralph J.A. Ayiku (Head, Accounting and Settlement Unit), Yaa Asantewa Asante (Head, Public Expenditure Monitoring Unit), Emmanuel Edumadze Mensah (Tax Policy Unit), David Obuamah (Head, Public Debt and Investments, CAGD) Doris A. Dzidzornu, Henry Kyeremeh, Kwaku Forkuo (BOG) and all staff of the Debt Management Division.

Major (Rtd.) M. S. Tara
Chief Director
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SECTION 1: INTRODUCTION

1. Given the limited resource available to meet the development aspirations of a country, Governments usually resort to debt financing from domestic and external sources in order to undertake development projects and programmes. Debt can be an impetus for economic growth if borrowing proceeds are used judiciously in driving infrastructural development required for sustained economic progress.

2. High levels of public debt may stifle economic growth if there is no strategy in place to contain heavy debt service burden. Having prudent debt management strategy therefore, ensures that right choices among several financing options are made while keeping in view cost and risk trade-offs.

3. In the case of Ghana, the 1992 Constitution of the Republic of Ghana, the Loans Act 1970 (Act 335), the Financial Administration Act 2003 (Act 654), the Financial Administration Regulations 2004 (LI 1802), the Public Procurement Act and the Bank of Ghana Act 2002 (Act 612) clearly provide the mandate of debt management in the country.

4. In this regard, the Government of Ghana has developed its Medium-Term Debt Management Strategy (MTDS, 2016-2018)[1] to ensure that the financing requirements are met at the lowest possible cost with prudent degree of risk while ensuring development of the domestic debt market.

Objectives and scope

5. The government's debt management objectives are to ensure that :

   - Financing needs of Government are met on a timely basis;
   - Borrowing costs to Government are as low as possible over the medium term, consistent with a prudent degree of risk; and
   - Development of the Ghanaian debt market is promoted.

6. The above stated objectives are in line with National Medium Term Development Policy Framework (Ghana Shared Growth and Development Agenda II-GSGDA).

[1] The Medium-Term Debt Management Strategy is a plan that Government intends to implement over the medium-term in order to achieve a desired composition of the Government debt composition, which captures the Government's preferences with regards to the cost-risk trade-off.

7. The time horizon of the analysis is the medium term, spanning three years from 2016 through 2018. The scope of the MTDS 2016-2018 analysis is all central government debt with direct repayment obligation.

8. This strategy was prepared by the public sector stakeholders in debt management and has benefited from contribution from other external stakeholders.

9. This strategy is structured as follows: Following this introductory section, Section 2 outlines the recent macroeconomic developments and Section 3 presents succinctly the cost and risk of the Debt Portfolio; Section 4 describes the borrowing strategy over the medium term; current debt management policies which are on-going and would support the strategy are presented in Section 5; and the conclusion is in Section 6.

SECTION 2: RECENT MACROECONOMIC DEVELOPMENTS

Growth

10. The Ghana Statistical Service estimates indicate preliminary real GDP growth for 2015 at 4.1 percent. This is higher than the earlier forecast of 3.5 percent. Within the sectors, for the first time in five years, non-oil sub-sector is expected to drive the growth of the Industry Sector mainly as a result of level of production from the Jubilee Field and increased output from the Construction and Water and Sewerage subsectors, among others. Growth is expected to increase in the medium term on the back of oil and non-oil sector growth.

Inflation

11. Inflation rose from 17.0 percent in 2014 to 17.7 percent at the end of 2015 largely on account of exchange rate depreciation which did hit the non-food inflation.

Fiscal Performance

12. Provisional information indicates that the budget deficit recorded 7.2 percent against a target of 7.3 percent. The medium term forecast is 5.3 percent. 3.7 percent and 3.0 percent for the 2016, 2017 and 2018 respectively.

13. The budget deficit is financed by mobilizing resources from domestic and external sources.

Pricing assumptions

14. Future interest rates are projected based on the observed treasury rates in 2015 and U.S. Treasury forward rates.
15. The expected interest rates for USD denominated borrowing by Ghana is derived by adding a credit spread of 7 percent to the U.S. Treasury rate to closely match the observed price of outstanding Eurobonds. The credit spread represents the premium Ghana is expected to pay by virtue of having a higher credit risk than the United States.
16. The expected interest rates on Cedi denominated borrowing is the sum of expected interest rates on USD denominated borrowing plus expected inflation differential between Ghana and the United States. Future GHS yield curve is projected to be downward sloping reflecting reduced inflation expectations.

SECTION 3: DEBT PORTFOLIO REVIEW

17. The Government of Ghana has developed its MTDS to ensure that the financing requirements are met at the lowest possible cost with prudent degree of risk and to develop the domestic debt market. The MTDS primarily focuses on determining the appropriate composition of the debt portfolio, taking into account the macro-fiscal framework and the market environment in the most cost efficient way.

18. The MTDS analysis reveals a weighted average interest rate of the total debt portfolio of 10.8%. This is driven by Ghana's transitioning to lower middle income, depreciation of domestic currency in 2015 and relatively high inflation expectation. It is expected that, as the second round effect of the deregulated price adjustment in crude oil and utilities passes through the economy, inflation expectations would reduce. With the fiscal consolidation policy highly supported by the Home grown Policies and the IMF, macroeconomic stability would be restored.

19. The debt portfolio tends to have a high refinancing, interest and exchange rate risks. The refinancing risk is revealed by the fact that about 23.6 percent of the entire debt portfolio matures within a year, which represents about 17.1 percent of GDP. More particularly, about 48.6 percent of domestic debt matures within a year, representing 14.8 percent of GDP. The Average time to Maturity (ATM) of the entire debt portfolio is about Nine (9) years, with domestic debt facing ATM of approximately a year.

20. A significant proportion of the debt portfolio is subject to regular interest rate resetting (re-fixing), which poses a risk in terms of budgeting for interest payments. About 33.8 percent of the entire debt portfolio faces different interest rates on due dates, with Average Time to Re-fixing (ATR) of about Nine (9) years.

21. Fluctuation in exchange rates also poses a risk in managing the debt portfolio. About 57.7 percent of the debt portfolio is external, 65% of which is denominated in United States Dollars (USD).

SECTION 4: FINANCING STRATEGY

22. The chosen strategy is in line with the debt management objectives of borrowing at minimum cost, maintaining prudent degree of risk while helping to develop the domestic capital market. The strategy relies on both external and domestic sources to finance government's activities. The strategy, thus, supports the use of debt instruments with longer maturity profile as part of measures to deepen the domestic capital market. The strategy proposes issuance of a Dollar-linked domestic bond as a way of protecting returns on debt instruments held by non-residents. Government also envisages issuing inflation-linked bonds in 2017 targeted at pension funds and insurance companies. Inflation-linked bonds are meant to protect the purchasing power of domestic investments. Government also intends to use part of the Eurobond proceeds to restructure domestic debt.
23. The chosen strategy has some inherent market risks. However, there are planned benchmarks to help monitor such risks, as follows:

Foreign Currency Risk Benchmark

24. In external debt portfolio, a strategic benchmark of 65 percent +/-5 percent exposure to the US Dollar is pursued. This is premised on the fact that a significant proportion of Ghana's international reserves and export receipts are denominated in US Dollars.

Interest Rate Risk Benchmark

25. The current structure of interest rate reveals eminent interest rate risk for the debt portfolio. Over the medium term, the share of the floating rate debt in total external debt is expected to be in the range 20-25 percent. The share of the entire debt portfolio facing interest rate resetting in a year is not expected to be more than 35 percent.

Re-financing Risk Benchmark

26. The management of refinancing risk is pursued to avoid bunching of debt service obligations and rollover risk, which may lead to excessive increase in the debt service cost. With this strategy, bullet repayment structure and accumulation of debt servicing in one period will be smoothened to ensure that it is aligned with flows on revenue structure to avoid liquidity crisis and high re-financing cost. The share of debt maturing in one year is expected to be within the range of 20-25 percent. The Average Time to Maturity (ATM) of the debt portfolio is expected to be not less than 6.5 years.

SECTION 5: DEBT MANAGEMENT POLICIES

27. As part of the above stated strategy, and in support of Government's commitment to maintain sustainable debt levels, the implementation of critical debt management policies which were outlined in the 2016 Budget Statement and Economic Policy have already commenced. These are:

Concessional loans and grants

28. Government is committed in channelling concessional loans and grants to financing social infrastructure and non-concessional financing to self-financing capital projects.

Implementation of the 'Golden Rule'

29. The Government intends to finance capital expenditure with long-term debt whilst using short term bills for liquidity management.

Implementation of the On Lending and Escrow Arrangement

30. Government has a policy to on-lend proceeds of financing agreements, any related counterpart funding and other relevant financing costs to State Owned Enterprises (SOEs) and Metropolitan Municipals and District Assemblies (MMDAs). To ensure recovery of on-lent loans for commercially viable projects undertaken by SOEs, government has introduced an on-lending and escrow account initiative to minimize the impact of loans on the public debt portfolio.

31. By this arrangement, SOEs are required to open escrow accounts with any universal commercial bank approved by the Ministry of Finance where proceeds from the projects shall be transferred into. SOEs are required to open an account each in the appropriate currencies for all on-lent facilities.

Sinking Fund

32. A Sinking Fund Account has been set up with funds from excess over the cap of the Stabilization Fund. The objective of establishing the Fund is to manage the orderly redemption of Eurobonds and other debt instruments.

33. The fund will form the basis for spreading debt service over the tenor of the debt facilities in order to minimise the roll over risk.

Ghana Infrastructure and Investment Fund (GIIF)

34. The GIIF was established by the Ghana Infrastructure and Investment Fund Act 2014 (Act 877). The fund is to mobilize, manage, coordinate and provide financial resources for investment in infrastructure projects. The establishment of the Fund will also enable self-financing projects to be taken off the government's debt stock and managed as commercial projects.

Interest Rate Hedging

35. Ghana has a sizeable stock of external debt with floating interest rate. The volatility of LIBOR and other reference interest rates could affect debt service costs. The consequential impact on Ghana's debt servicing could be worrisome.
36. To mitigate this risk, government will hedge the interest rates through swap arrangements to allow for enhanced predictability of debt service.

Limit on Sovereign Guarantees

37. Government will continue to encourage SOEs and SPVs to borrow on the strength of their own balance sheet. This approach does not only ensure the efficient running of these SOEs but also removes the need for Government to backstop SOE payment default in purely commercial agreements.
38. The guarantees are usually not backed by specific budget provision and pose significant fiscal risks. In the medium term, Government intends to ring-fence some receivables of SOEs for debt repayments including utility payments, besides making explicit budgetary allocations as part of the budget of the parent MDAs to pay for the debt.
39. Furthermore, Government is moving away from the provision of Sovereign Guarantees to a project financing approach. It is in the light of this that Government is leveraging its IDA resources to provide underlying security to critical projects through Partial Risk Guarantees (PRGs).
40. Government, as part of its debt management strategy, intends to use this approach for qualifying projects on a competitive and secure basis, with the aim of reducing the State's financial exposure in purely commercial projects.

Capital Market Development

41. Government stated in the 2015 Budget Statement and Economic Policy its intention to use the book building approach in allocating issuance on the domestic capital market similar to the approach used for the Eurobond on the international capital market.
42. This approach is to promote a more active engagement between government and its Book runner, on one hand and large institutional investors such as pension funds, insurance companies and mutual funds, on the other hand.
43. Government has also put in place measures to enhance secondary trading of all fixed income securities. The Ghana Fixed Income Market (GFIM) Governing Committee has been established to promote the secondary trading of fixed income securities for greater efficiency, better price discovery, increased liquidity and greater transparency. The Ministry of Finance is a member of GFIM.

SECTION 6: CONCLUSION

44. With the coming into force of the MTDS for the period 2016-2018, the approved MTDS for the period 2015-17 has been annulled.