ETHIOPIA'S MEDIUM TERM DEBT MANAGEMENT STRATEGY (2013-2017)

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Contents

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LIST OF ABBREVIATIONS

ADB - African Development Bank

ADF - African Development Fund

ATM - Average Time to Maturity

ATR - Average Time to Refixing

BADEA – Arab Bank for Economic Development in Africa

BoP - Balance of Payments

DBE – Development Bank of Ethiopia

DMD - Debt Management Directorate

DSA - Debt Sustainability Analysis

EIB - European Investment Bank

EEPCO - Ethiopian Electric Power Corporation

EMTDS - Ethiopia's Medium Term Debt Management Strategy

ETB - Ethiopian Birr

EAL - Ethiopian Air Lines

FX - Foreign Exchange

GDP - Gross Domestic Product
GTP - Growth and Transformation Plan

IDA - International Development Association

IFAD – International Fund for Agricultural Development

IMF - International Monetary Fund

MEEF - Macroeconomic Fiscal Framework

MTEF - Medium Term Expenditures Framework

NBE - National Bank of Ethiopia

NDF - Net Domestic Financing

OPEC Fund – OPEC Fund for International Development

PASDEP – The Plan for Accelerated and Sustained Development to End Poverty

SDR – Special Drawing Rights

SOE - State Owned Enterprises

USD – United States Dollars

FOREWORD

The Growth and Transformation Plan (GTP) is Ethiopia's five years ongoing developmental plans with the aim to record fast, sustainable and broad based economic growth while preserving macroeconomic stability so as to attain the Millennium Development Goals (MDGs). This ongoing developmental plan needs huge resources. Accordingly, one of the sources to finance GTP is borrowing from both, external and domestic sources. These borrowing activities need to be guided by the internationally recognized framework for developing a debt management strategy while ensuring that the public debt remains within sustainable levels.

In Ethiopia there is a clear coordinating mechanism at the political and technical levels as well as legislation and implementation circulars defining the parameters for debt contraction, guarantees and servicing. The existence of a clear legal framework is an important enabling element for formulating a debt management strategy.

To this effect, this medium term debt management strategy (MTDS), designed by the Ministry of Finance and Economic Development (MoFED) with the technical support of the International Monetary Fund (IMF) and World Bank Team provides a framework for developing an effective public sector debt management strategy that aims to achieve a desired composition of the public sector debt portfolio that reflects a cost-risk analysis and captures the government's preferences with regard to the cost-risk trade-off. Undertaking cost and risk analysis in debt management is helpful to meet the country's long term objectives of financing development initiatives and to ensure regular and predictable management of the overall debt portfolio.

The Government is considering this MTDS as a tool for evaluating and managing the risk involved with different debt compositions; facilitating coordination with fiscal and monetary management; and enhancing transparency. In addition, the Government is very much happy by this action of designing of MTDS that ensures the government's financing needs and payment obligations are met at the lowest possible cost consistent with a prudent degree of risk.

The 2013-2017 MTDS outlines the Government's preferred strategy to guide debt management operations beginning from 2012/13 Fiscal Year. Designing an MTDS strategy includes a comprehensive assessment of potential new financing options from external concessional sources as well as possible market based domestic sources inflows, focusing on how best to mobilize the highest quality financing to support national development priorities and ensure debt sustainability. In addition, the MTDS seeks to balance the cost and risk of both the existing public

debt portfolio and the alternative borrowing mix, going forward. The strategy incorporates initiatives to develop a vibrant domestic debt market development.

The implementation of this MTDS will enable, as public debt management is under the mandate of Ministry of Finance and Economic Development, to deliver in ensuring prudent borrowing by both the Central Government and State Owned Enterprise as well as tracking contingent liabilities that will arise with the implementation of devolved governance structures. In this respect, measures are being taken to simplify and raise awareness among all the key players in the process of developing the debt management strategy to ensure it is well understood by them.

Moreover, the government is committed to follow up and implement this strategy in order to maintain the transparency and accountability of public borrowing. And also ensure that the level of public debt is consistent with the overall fiscal framework aimed at ensuring macro-economic stability over the medium term. The MTDS will also seek to assist Ethiopia in maintaining the current debt sustainability and economic growth estimated in the prevailing development agenda of the government.

In the same manner, as part of the reforms, strengthening capacity has been an overriding priority for the country. Accordingly, MoFED has been exerting the maximum effort to establish a core technical team with adequate skill and capacity to design international standard debt management strategy and other related assessments so that the debt is managed prudently to reduce the risk of vulnerability to debt sustainability in the country.

ACKNOWLEDGEMENT

Ethiopia's MTDS' work would not have been possible without the input and assistance of many individuals and organizations. We are deeply grateful to all those listed here.

MoFED appreciates the Debt Management Directorate for taking the initiative to undertake the preparation of the first MTDS for Ethiopia. Thus, we wish to express our sincere gratitude to all Debt Management Directorate staff and other participants for their valuable contributions.

We owe a great debt of gratitude to IMF/World Bank Team for investing considerable time and effort in the cost and risk assessment process as well as producing a comprehensive mission report related to Ethiopia's MTDS. Without the mission support in terms of providing training on MTDS manual and Analytical Tool and input it was not possible to produce this strategy document.

We are indebted to National Bank of Ethiopia (NBE) and some MoFED's directorates and individuals who made invaluable contributions in terms of their key insights, opinion and data necessary for the assessment made in this document. We are also indebted to our colleagues for the time and effort they put in participating in the workshop as well as for their presence in opening and closing ceremony of workshop. We believe that the support and input from them has made this strategy document a reality.

Last but not least many thanks to many of our colleagues whom we cannot all name but whose input during the MTDS opening and closing workshop remain vital to this output.

EXECUTIVE SUMMARY

The Ethiopian economy is experiencing a radical and in-depth change in the structure marked by an ever increasing globalization. During the past nine years Ethiopia achieved remarkable economic and social progress. The economy grew by 11% on average, which is ranked among the highest not only in Sub-Saharan African countries but also in the world. This strong performance puts Ethiopia among the group of Sub-Sahara African countries on track to meet most of the Millennium Development Goal targets.

Despite these gains, more effort is required to further reduce poverty, and achieve economic transformation. The Growth and Transformation Plan, launched late in 2010, is the Government of Ethiopia's response to these challenges. It is borne out of the Government's Vision not only to eradicate poverty but also to propel Ethiopia into middle income country status by 2025.

In this regard financing is one important element to sustain continuous economic development. In this regard, the country has been trying to increase its domestic revenue by taking appropriate fiscal measures and introducing various mechanisms. The other sources of financing are loans from external and domestic sources taking into account debt sustainability, macroeconomic stability and cost and risks considerations. In addition, the principle of borrowing shall be managed in such a manner as to prevent any negative impacts on the general economy, such as creating instability in monetary policy or balance of payments.

In the past, over the decade of the 1990's Ethiopia had developed serious external debt problems which overextended its servicing capacity. As a result, its creditworthiness has been generally reduced thus limiting its access to certain categories of financing from internationally recognized creditors as well as brought negative impact on its image. Currently, Ethiopia is a low risk country in terms of external debt. But given its financing requirement to execute its GTP, it needs to have a strategy to ensure debt sustainability.

In view of this, it is the right time to develop a Medium Term Debt Management Strategy that will serve as a basic guiding document for the government to follow in the process of mobilizing resources from domestic and external sources as well as to consider as solid foundation and linked with the overall development goals and objectives of the country. The recent continuous and persistent global financial turbulence has also provided impetus to formulate and implement a more credible and robust strategy in the area of debt management.

Thus, this MTDS which is the first of its kind for the country is prepared by MoFED based on technical assistance provided by a joint IMF and World Bank team during October 09-19, 2012. The new MTDS covers a period of 5 years starting 2012/13 and ends in 2016/17. It builds on the existing implicit Debt Management Strategy that is currently practiced. The implicit strategy focuses on elements relating to: ensuring debt sustainability, maximizing debt relief, more preference to fixed foreign long term, mostly with 35% grant element for external borrowings, accessing of limited non-concessional borrowings for some SOE, and rolling of maturing domestic debt.

In line with international best practices in debt management, broad based policy direction in the form of Medium-Term Debt Management Strategy have been articulated, aimed at giving MoFED a new strategic focus to manage external and domestic debt with the aim of maintaining the current sustainable level of debt. The new strategic focus is committed to ensure that all governmental institutions subscribe to the principles of prudent and sustainable borrowing, and effective utilization of resources. The debt management strategy also seeks to create a deep and vibrant domestic debt market that is supportive of private sector development.

On external debt management, the new policy direction under the Medium-Term Debt Management Strategy will be on mobilizing additional financing such as concessional and semi-concessional loans targeted at accelerating growth and poverty reduction, as well as meeting the MDGs related targets with maintaining the existing recorded debt sustainability of the country.

On the side of internal debt, the new domestic debt management strategy will focus on the development and deepening of the domestic debt market, as well as the introduction of secondary markets with the objective of providing low cost funding for the Government. The debt management strategy will also integrate cash management with domestic debt management operations and deepen the security market so that the private sector can play a crucial role in development by accessing long-term funds.

In the process of developing this MTDS four alternative debt management strategies are examined to illustrate the impact of the alternative mix of external and domestic financing sources, as well as alternative mix of short term and longer term domestic debt on the Ethiopian's Public debt portfolio in the future. The four strategies envisage different annual net issuance of domestic borrowing.

This medium term debt management strategy considered as a starting point to assess the risk exposure associated with the existing debt portfolio. Analysis of

the cost and risk tradeoffs from alternative debt management strategies were carried out under baseline assumptions for the macro economic and market environment. All strategies were tested under three shock scenarios; these are exchange rate shock with a deprecation of the birr by additional 15% on baseline, interest rate shock of 3% on domestic debt on baseline and a combined shock of a 10% exchange rate shock and a 3% domestic interest rate. It is aimed to try and take corrective actions through strategy implementation. The financing assumptions were based on past trends in commitments and information available on the multilateral and bilateral recourses envelope for Ethiopia over the next few years.

To determine the appropriate debt management strategy, the performance of alternative strategies was evaluated in terms of their impact on costs and risks. The cost of each strategy was assessed under a baseline scenario for key macroeconomic and market variables, and under various risk scenarios. For the choice of strategy and associated future borrowing decisions to be robust, the risk scenarios are appropriately identified and reflect a sound understanding of the macro framework.

In this direction, out of the assessed four strategies the first strategy assumes maximization of external concessional debt while financing the residual needs through domestic treasury bills. The second strategy anchors the net domestic financing to 1.5% of GDP at the beginning of the period, and which gradually reduces to 1.2% of GDP by the end of the time horizon. Domestic maturities are extended, from only treasury bills in the first year, towards gradually issuing two year and five year Treasury Bonds over time and the residual needs are financed by external concessional loans.

The third strategy examined increases in external financing relative to the first strategy, and resorts to bilateral semi-concessional borrowing, while the residual is financed through domestic debt, gradually extending domestic maturities as in Strategy 2. The fourth and last strategy examined increases in the domestic financing relative to the second strategy and maintains the net domestic financing to 1.5% of GDP, and extends the domestic debt maturities, as in Strategy 2 and 3.

Overall, a strategy that addresses the high exchange rate risks while maximizing concessional external debt and develops the domestic debt market, provides the most attractive alternative for the government. In this regards, out of the four assessed, on the basis of the outcome measured by interest payment to GDP and nominal debt to GDP ratio and other indicators, the two strategies of S1 and S2 are feasible strategies to implement in the MTDS period. The result of these two strategies suggest that domestic borrowing and external concessional borrowing

have comparable cost advantages and external semi-concessional borrowing is inferior to domestic borrowing, taking into account the exchange rate effect that offsets the lower interest cost of semi-concessional debt.

Nowadays, the Government intends to continue prioritizing external financing on concessional terms for the MTDS period. Consequently, in the process of assessment to select the best strategy attention has been given to the concessional external financing that the Government prefers while maintaining a limited window for SOEs to borrow with government guarantee and non-guarantee on commercial terms to minimize costs and refinancing risks. Financing on non-concessional terms will be highly restricted to projects with high expected risk-adjusted rates of return including critical infrastructure that would otherwise not be undertaken due to lack of concessional financing.

Hence, out of the two strategies indicated above, on the basis of the objectives of the strategy, priority focus areas of the country and results of cost-risks analysis, the ideal to be selected as first choice is Strategy 1 and as fallbacks move towards Strategy 2 over the time horizon given the changing circumstances and constraints expected during the period.

As sustainability of the public debt depends on the assumption of continued robust GDP growth, moderate public sector primary deficits, continued access to external concessional loans, and low domestic real interest rates, the selection of strategy 1 as the first choice should not be overemphasized. Taking into account both cost and risk considerations and the feasibility of implementing the strategy over the medium term, the 2013 MTDS proposes Strategy S1 as the optimal strategy. In addition, strategy 1 is the more robust and seems to lessen the debt and macroeconomic instability in the country as well as intends to maximize high concessional borrowing with high short-term domestic debt to finance deficit.

Over the time horizon given the changing circumstances and constraints expected, it may be imperative to move toward the second choice of strategy 2. This strategy not only addresses the limited access to concessional borrowing but it is also helpful to meet the overall objectives of developing domestic debt market, increasing mobilization of domestic savings, reducing external dependence and reducing inflationary pressure in the economy during the MTDS period.

Finally, this New Strategic Focus and corresponding Medium Term Debt Management Strategy framework were articulated as a response to numerous challenges facing debt management and in response to the changes in the country's debt structure. In addition, the strategy which has set out more practical steps for implementation in four areas promoting Government leadership,

improving predictability of external resources flows in the government budget, harmonization and alignment to national priorities and national systems and improving domestic capacity for coordination and management of domestic and external resources.

I. INTRODUCTION

Ethiopia had, since December 1993 with the support of IMF, adopted a debt management strategy with the objectives to reduce debt service and stock and to ease debt overhang difficulties at that time of economic transformation. The Ministry of Finance and Economic Development has regularly designed debt analysis and strategies internally for the purposes of checking the concessionality of new loan and debt relief needs. Accordingly, the emergences of Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief Initiative (MDRI) gave opportunities to significantly reduce the debt stock and the country's debt position has become sustainable and the capacity of debt servicing is strengthened. In view of that the Government intends to usher in an era of long-term debt sustainability a prerequisite for lasting poverty reduction.

Now, there have been major changes in the country's circumstances in terms of reduced debt burdens, enhanced access to financing from non OECD partners and potential access to international finance. This enhanced capacity of the country to mobilize substantial amount of external and domestic resources for development endeavors need to be used wisely. Although Ethiopia's debt portfolio does not appear to be significant compared to the debt magnitude of other countries, the need to prepare and implement a debt management strategy for Ethiopia could not be overemphasized and will also be aligned with international best practice.

In the same way, the recent continuous and persistent global financial turbulences call for formulating a more reliable and robust debt management strategy within the framework of the country's development goals.

Under this situation it has become imperative to have in place a comprehensive debt management strategy aimed at maintaining the current recorded track of debt sustainability and debt servicing capacity of the country as well as improvements of the country's debt management capacity including selection of and negotiation of future loans and allocation of external finances for strategic development projects and programs. The proposed debt management strategy provides a policy framework and a working document for the government and enhances effective and efficient mobilization of resources from domestic and external sources in the process of filling the financing gap.

In addition, the proposed debt Management strategy enables government to plan and negotiate the best available borrowing options to fund economic development, growth and poverty reduction, keep debt servicing costs and risks as low and sustainable as possible in the short and long term-term, and assess potential risks arising from non-concessional loans.

Consequently, the Ministry of Finance and Economic Development in collaboration with the International Monetary Fund and the World Bank conducted a workshop to develop a medium term debt management strategy in Addis Ababa, Ethiopia on October 9th -19/2012. The objective of the workshop was to build capacity on the MTDS Analytical Tool for 25 officials and experts of MoFED and National Bank of Ethiopia which brought together participants from key stakeholder government institutions to develop the MTDS for the country for the period of 2012/13-2016/17.

It seeks to provide additional insight to the discussion regarding debt volume and sources of financing as one element of an overall approach to improve the effectiveness of contracting loans from various sources. Various methodologies used for assessing public debt in terms of availability of future concessional funds as important factors of fiscal sustainability.

In the process the first action carried out was revisiting the previously designed debt management strategy according to the financing needs vis-a-vis debt sustainability issues in the post MDRI era. Given this background, assessment have been undertaken by looking into the approaches to current debt management and future commitments in order to ensure that the country will not face any debt burden problem and at the same time generate finance to fill the financing gap for the implementations of the ongoing Growth and Transformation Plan.

The remainder of this document is organized as follows. Section I provides the introduction of the MTDS. Section II provides an overview of the existing debt strategy of the country as well as reviewing of the existing public debt portfolio. Section III focuses on the rational for the new MTDS and other related issues. Section IV presents the implementation and monitoring mechanism. Section V presents the conclusion by summarizing the main findings and discusses the way forward. Last but not least the last section VI contains appendices on selected data.

II. EXISTING DEBT MANAGEMENT STRATEGY

Ethiopia has, since reaching the Heavily Indebted Poor Country completion point in 2004 and benefiting from Multilateral Debt Reduction Initiative in 2006, pursued a cautious approach to accumulating new external debt. Debt management in Ethiopia is guided by the 1993 qualitative strategy developed with the support of the IMF and an implicit debt management strategy for the country embedded in the Debt Sustainability Analysis as well as medium term developmental plans of the country including the ongoing GTP.

Currently, although there is no formal debt management strategy based on a robust quantitative analysis of cost and risk trade-offs, external loans are contracted with grant element of not less than 35%. Borrowing on less than 35% is only envisaged for SOEs to implement strategic projects which have economic significance for economic growth and poverty reduction endeavors in the country. The implicit borrowing strategy of the country has been intended to maximize external concessional loans from multilateral and bilateral sources with a minimum grant element of 35 percent, limit semi-concessional borrowing only to finance investments by the SOEs in the priority sectors, and use domestic borrowing to cover residual financing needs.

The current practice is to make plans based on projected availability of funding and adjust spending continuously through the years as financing actually becomes available. This MTDS document is to address the absence of a formal debt management strategy based on a quantitative and qualitative analysis in the country. This document is a crucial step forward for the government to implement a formal debt management strategy containing analysis of cost and risk tradeoffs of alternative strategies in order to avoid macroeconomic instability and debt hangover while accessing finances prudently to meet the development agenda of the country.

2.1 Review of Existing Public Debt Portfolio

After the external debt stock level is reduced significantly and reached US$2.31 billion, equivalent to 24.6% of GDP in 2006/07, principally as a result of debt forgiveness under the HIPC and MDRI initiatives it constantly increased thereafter and reached US$ 8.87 at the end of June 2012. The total debt stock (domestic and external) reached US$ 13,251.60 (Birr 237.3 billion) at end June 2012. This was the result of increased disbursement from new external loans. Out of the existing public debt the external debt represented about 67% while the share of domestic debt was 33%. This shows a significant increase in the domestic debt

portfolio, reflecting relatively improved market activities and participations. It is pertinent to underscore the reasons for the upward trend in the domestic debt stock over the years.

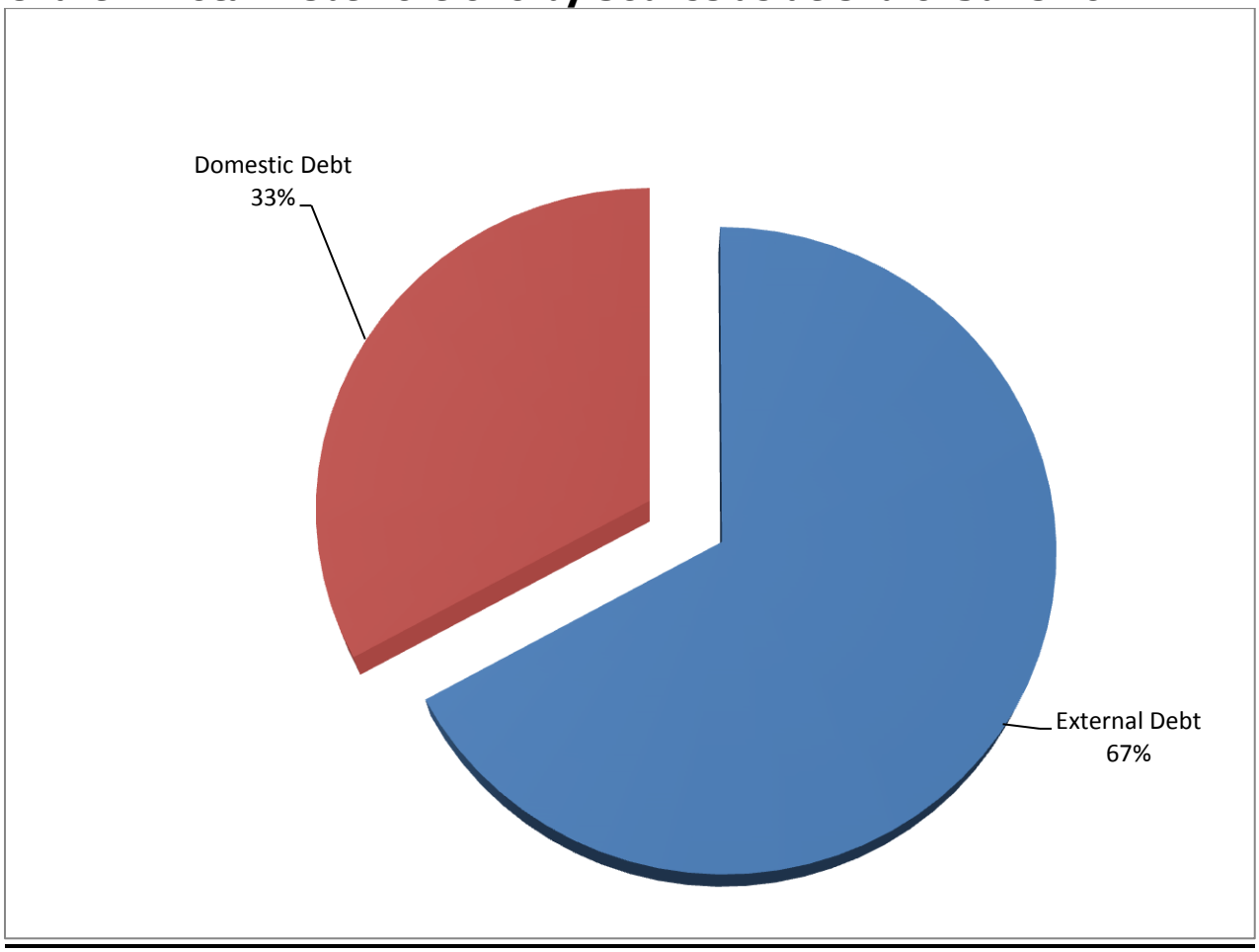
Table 2: Stock of Public Debt, as at end of 2011/12

2011/12	ETB Millions	US$ Millions	% of GDP
External Central Government*	97,461	5,442	13.8
External. Guaranteed	22,868	1,277	3.2
External Non- Guaranteed	38,578	2,154	5.5
Domestic Bonds	12,124	677	1.7
Domestic Treasury Bills	19,859	1,109	2.8
Domestic Direct Advance**	46,265	2,584	6.6
Total Debt	237,155	13,243	33.6

Remarks: * Most of the external debt stock owned by the central government is secured from concessional windows.

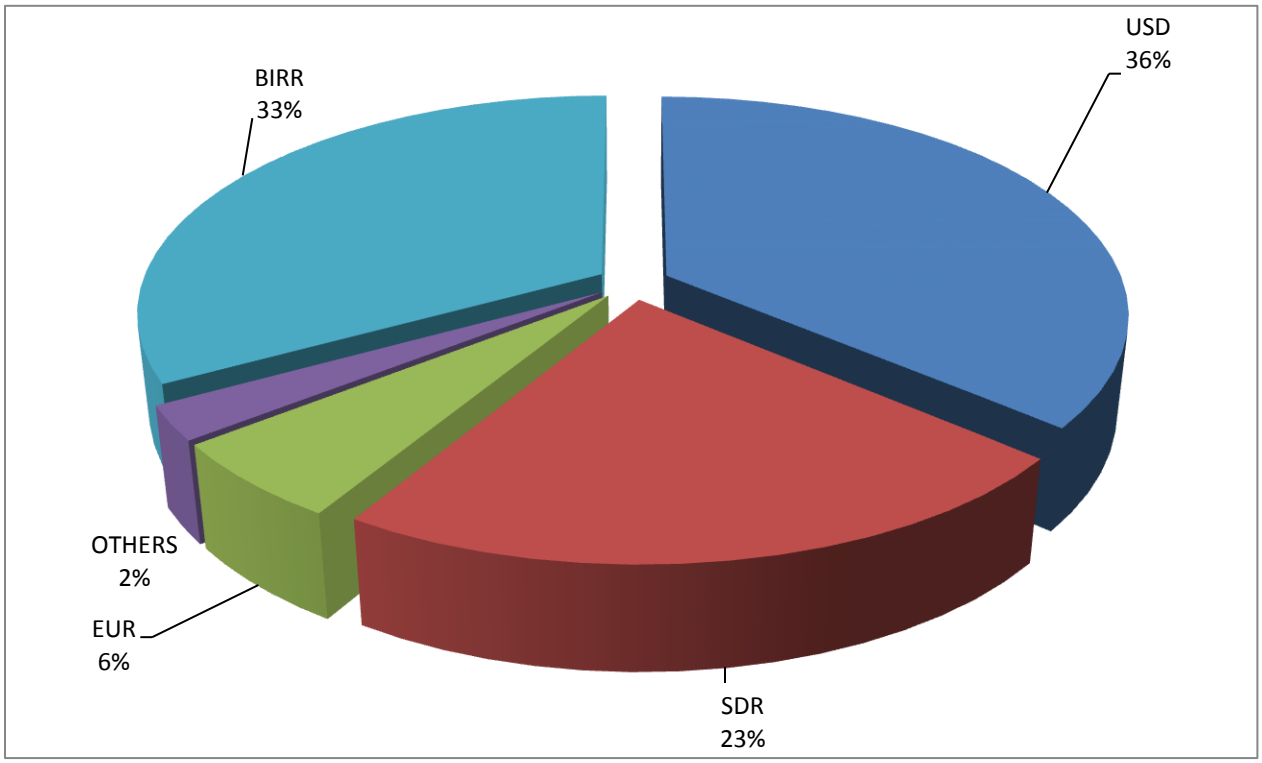
** As domestic debt market is not well developed the government is used Direct Advance as one of sources for its budget deficit financing in the past several years.

Chart 1: Total Debt Portfolio by Source as at end of June 2012



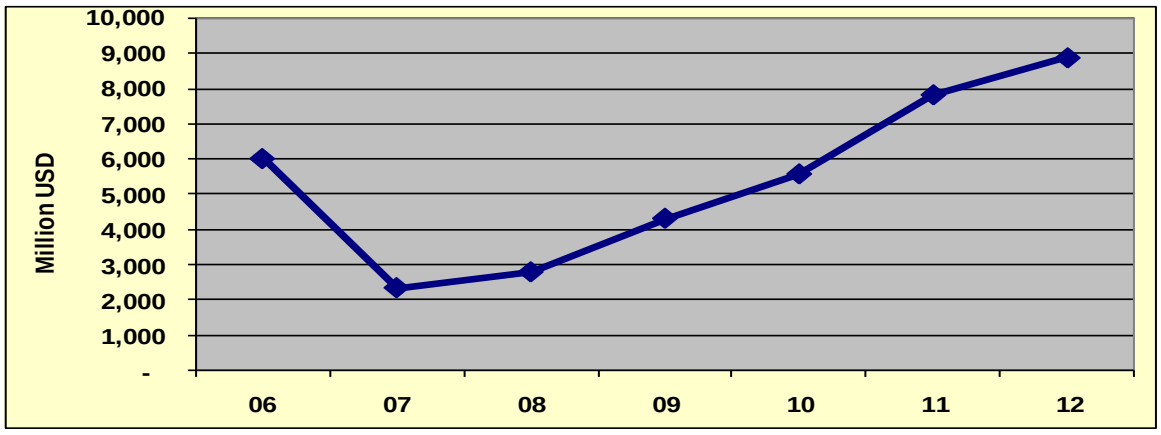
Source: Ministry of Finance and Economic Development

Chart 2: Currency Composition of Public Debt Portfolio



Remarks: As SDR is decomposed into its constituent currencies the portfolio of USD, JPY, Euro and GBP will be proportionally increased.

Chart 3: External Debt Movement 2005/06 – 2011/12



Source: Ministry of Finance and Economic Development

2.1.1 External Debt Relief and Financing Options from External Sources

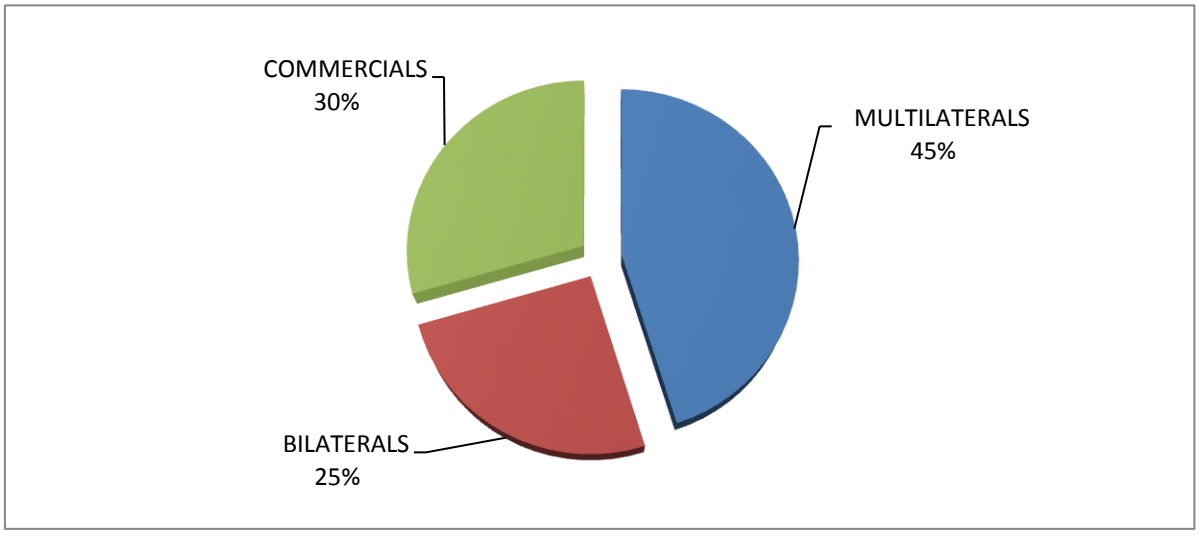
The total debt relief (including flow and stock write-off) was about USD 4,521.2 million over the period of 2005/06-2011/12. The largest relief was obtained during the fiscal year of 2006/07, which was about USD 4,090.4 million. This was mainly due to HIPC and MDRI stock relief from IDA, IMF and AfDF, making up 98.3% of the total relief. The highest stock relief was obtained from IDA and AfDF/ADB, USD 3,039.80 million and USD 837.00 million, respectively. In 2005/06, IMF has also cancelled about USD 164.8 million under HIPC and MDRI program. Thanks to these two initiatives, the debt stock reduced to a level of USD 2,314.6 million in 2006/07 and the country was within sustainable debt thresholds.

Then after, it constantly increased and reached USD 8,873.6 million at the end of June 2012.[1] The main reasons for this rise in external debt outstanding are mainly new disbursements by IDA, AfDF and IMF as well as non-concessional sources borrowings by the public enterprises, particularly by Ethiopian Electric Power Corporation (EEPCO), Ethio-Telecom (ETC) and Ethiopian Air Lines (EAL).

Out of the total external debt outstanding as at June 30, 2012, USD 6,255.9 million (70.5%) was owed to official creditors. This comprised multilateral (64.1 %) and bilateral creditors (35.9%). The rest 29.5% was owed to private creditors, which constitute commercial banks and suppliers; the proportion being 46.4 % and 53.6%, respectively. The relative and absolute share of the private creditors in 2011/12 is much higher than the previous years, as most of the ETC, EAL and EEPCO owed debt are suppliers credits.

[1] After obtaining debt relief and achieving the target of debt sustainability the volume of concessional loans secured from multilateral and bilateral development partners has been rising for the purposes of implementing infrastructure projects (capital intensive) including roads and power generation that require huge foreign currencies resources, for poverty reduction and economic developments activities. In the meantime SOEs accessing limited non-concessional loans to implement strategic projects.

Chart 4: External Debt Composition by Creditor Category as at end of June, 2012



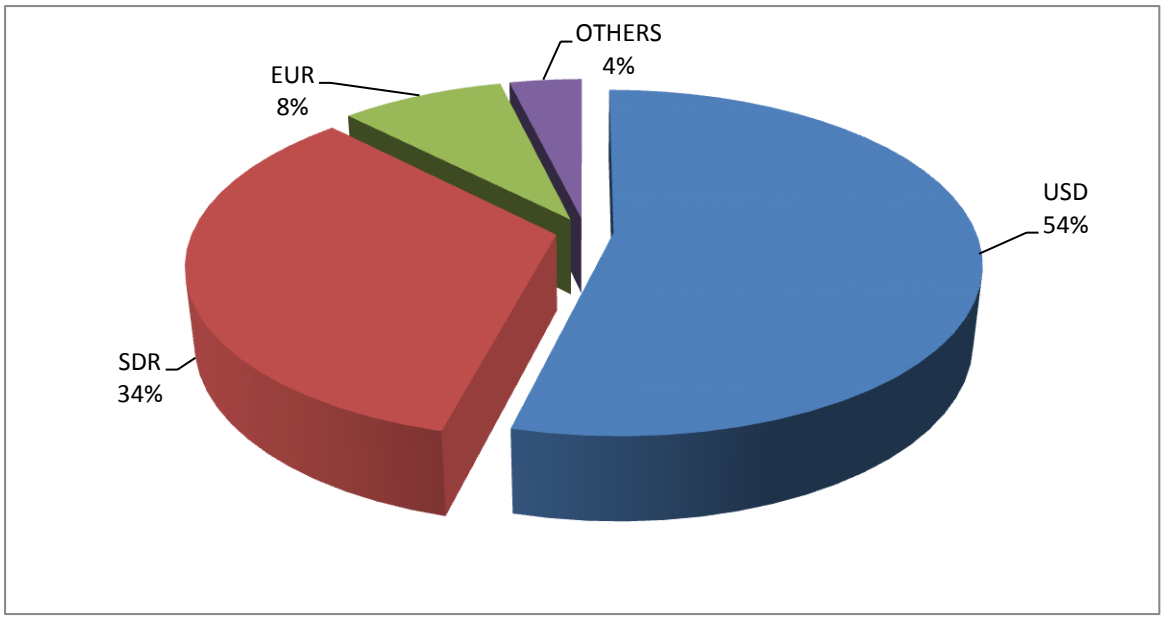
Source: Ministry of Finance and Economic Development

The share of the central government debt has decreased from more than 94.3% in 2005/06, to 61.3% in 2011/12. Since 2008/09, the relative share of central government has significantly decreased due to new borrowings by public enterprises, particularly by EEPCO, EAL and ETC.

On the other hand, out of the total debt outstanding in 2011/12, nearly 54.0%, 33.7%, and 8.6% was denominated in US dollar, SDR and Euro, respectively, while the rest 3.7% was denominated in other currencies including Japanese Yen. [2]

[2] As SDR is decomposed into its constituent currencies the debt portfolio of USD, JPY, EURO and GBP will be proportionally increased.

Chart 5 External Debt Portfolio by Currency Composition as at end June, 2012

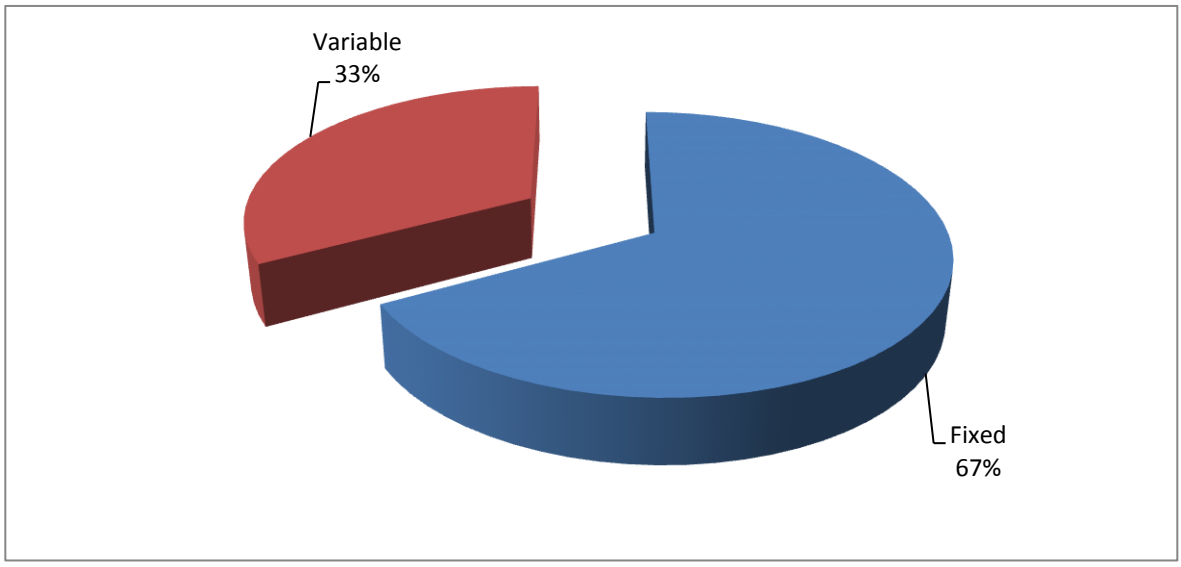


Remarks: As SDR is decomposed into its constituent currencies the volume of USD, JPY, Euro and GBP will be proportionally increased.

Source: Ministry of Finance and Economic Development

Similarly, out of the external debt outstanding as at June 30, 2012, 66.3 % was contracted on fixed interest rate terms while the rest 33.7% was contracted on variable interest rates by Ethiopian Air Lines, EEPCO and ETC. The proportion of the debt with fixed interest rates was 95 %, in 2005/06. However, the share of fixed rate has declined to 66.3 %. This is mainly due to the decrease in relative share of central government debt which was contracted on fixed interest rates.

Chart 6 External Debt Portfolio by Interest Type as at end June, 2012



Source: Ministry of Finance and Economic Development

2.1.2 Financing Options from Domestic Sources

The major instruments of government domestic borrowing are treasury bills, bonds and Direct Advance (DA).[3] As domestic debt market is not well developed Direct Advance has significantly increased over the last decade. Its share in the total domestic debt portfolio constantly increased and reached 59.1% in 2011/12 from its level of 40.1% in 2005/06. In the near future, as the domestic debt market develops its contribution to fill the financing gap is expected to increase and the dominance of the DA is expected to diminish.

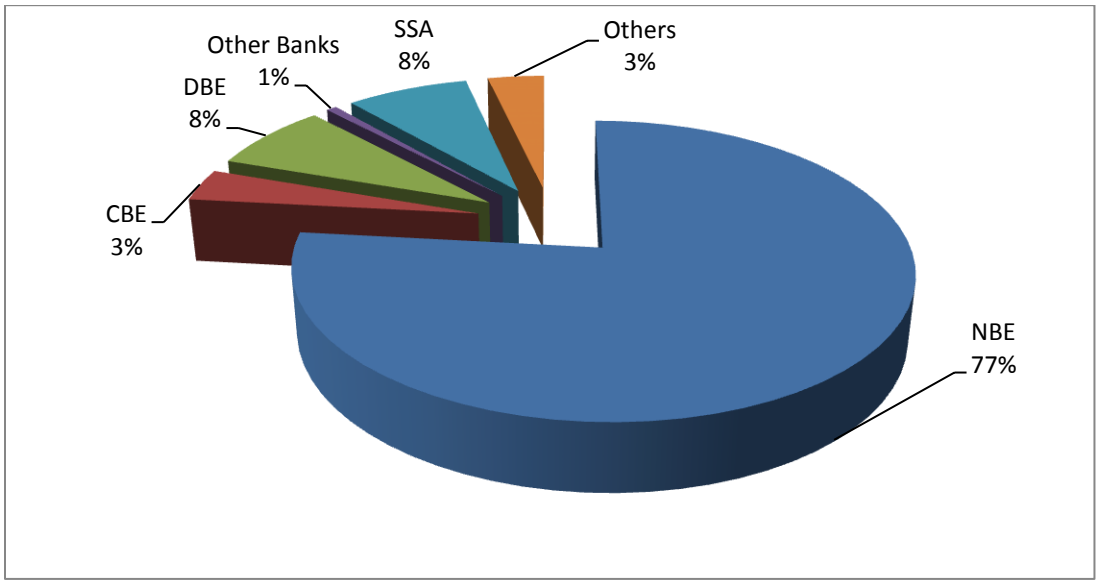
The outstanding balance for treasury bills, which was ETB 12.3 billion at the end of June 2005/06, exhibited a declining trend over the subsequent years and reached ETB 7.8 billion in 2008/09, before it increased sharply to ETB 19.9 billion in 2011/12. The share of 91 days treasury bills was the highest which accounted for 40% on average.

[3] As domestic debt market is not well developed if demands for treasury bills are not adequate because of various reasons the government has been using Direct Advance for its budget gap financing in the past.

Government Bonds, with longer term maturity (10 years and more), have been issued for special purposes rather than as a means of raising money to fill the budget gap. In 2005/06 the outstanding bond balance was Birr 12.4 billion, and remains about the same at Birr 12.1 billion at end 2011/12.[4]

The major holders of government securities in Ethiopia are the National Bank of Ethiopia and the Commercial Bank of Ethiopia followed by government and private banks and insurance companies, Public Servants Social Security Agency and other public enterprises.

Chart 7: Domestic Debt by Holder Category as at end June, 2012



Remarks: NBE, CBE, DBE and PSSSA stand for National Bank of Ethiopia, Commercial Bank of Ethiopia, Development Bank of Ethiopia and Public Servants Social Security Agency respectively.

Source: Ministry of Finance and Economic Development

[4] Bonds issued under the name of special purposes in order to reschedule government's short term domestic debt to longer term and transferring SOEs' domestic debt to government at the time of privatization.

2.2 Ethiopia's Risk Analysis of Existing Public Debt Portfolio

It is important to assess the risks associated with the debt portfolio because such information enables decision makers to design forward looking strategies on the optimal debt structure in terms of maturity, interest rate and exchange rate. Market risk, operational risk and liquidity risk are the types of risks associated with Ethiopia's public debt portfolio. In this analysis, exposure of the debt portfolio to risk is captured using the following risk indicators: refinancing risk, interest rate risk and exchange rate risk.

In 2012/13, the redemption of Ethiopia's public debt (excluding direct advance) was 15.1% percent of the total public debt. Of the 15.1% of the total debt falling due within 2012/13, external debt accounts for only 4.1% and domestic debt accounts for the remaining 11.0%. The central government share of external debt is characterized by very low exposure to rollover/refinancing risk. High debt service payments are expected between 2015 and 2020. This is on account of the large repayments to private creditors by SOEs which are falling during this period.

Given the debt management strategy of the country, Ethiopia is expected to contract concessional loans (from official multilateral and bilateral creditors) for central government and hence external debt obligations will be repaid over a long time, spanning over 40 years. On the other hand, the current weighted average interest rate of the external debt contracted by SOEs on variable interest rate of 1.8% LIBOR and EURIBOR rates are relatively lower than expected due to the current worldwide financial crisis.

The domestic debt falling due in 2012/13 is USD 1,128.5 million representing 64% of the total outstanding domestic debt. This is explained by the short term nature of domestic debt which is mostly in the form of treasury bills that mature in less than or equal to one year and get rolled over on maturity. Hence, the domestic debt portfolio is highly exposed to refinancing risk.

The average time to maturity of the total debt portfolio is about 11.2 years with the external and domestic debt portfolio displaying 12.6 years and 4.2 years, respectively (please see table 2). The domestic debt portfolio of bond and treasury bills (combined) shows a lower maturity and may create risk to refinance the debt portfolio but if we see the ATM of only the bond it increases to 10.3 years. Applying the above analysis the external debt will take a longer period of time before the debt is due for repayment on average. Comparing the ATM for the total public debt at 11.2 years the external debt portfolio has a lower

exposure to refinancing risk. This is explained by the structure of the external debt profile which is comprised of concessional loans. All in all, the average time to maturity for central government external debt is 18.0 years while that of state owned enterprises (SOEs) is about 4.7 years.

In case of the domestic debt, the Average Time to Maturity of domestic debt is (Bonds and Treasury Bills) is 4.2 years. This means on average it takes 4.2 years before the debt is due for repayment or roll over. The domestic debt is associated with a substantial degree of refinancing risk due to the short term maturity of Treasury bills.

The external and domestic central government debt portfolio is made up of instruments that were contracted on fixed and low interest rates, with the exception of domestic debt particularly treasury bills which are susceptible to interest rate risk. This implies that the central government's share of external public debt is less susceptible to interest rate risk. It means adverse interest rate movements on the world market would not significantly affect Ethiopia's interest payment obligations. Because a significant proportion of the external loans are highly concessional, with contractual interest rates for these loans set at significantly below the market rates.

Interest rate risk of the public debt is well captured by the proportion of debt that is subject to interest rate re-fixing within a specified period. For both external and domestic debt, changes in interest rates affect debt servicing costs. Hence, assessing the proportion of debt to be re-fixed shows the extent to which the portfolio is vulnerable to higher funding costs as a result of higher market interest rates.

Analysis of Ethiopia's external public debt shows that the portfolio is subject to low interest rate risk because huge portion of the loans contracted is in fixed interest rate. On the other hand, analysis of domestic debt particularly Treasury bill shows that the portfolio is subject to high interest rate risk. This is as a result of the short-duration nature of the Treasury bill. By the end of June 2012 Treasury bill amounting to USD1.1 billion is expected to be rolled over. This implies that 25.0% of the domestic debt portfolio is subject to changes in domestic interest rates. A higher proportion of debt that is subjected to re-fixing within one year indicates high risk to adverse interest rate movements. Excluding domestic debt, interest risk associated with Ethiopia's external debt is extremely low since the existing debt is not subject to interest rate changes due to fixed interest rates.

On the other hand, in June 2012 the Average Time to Re-fixing (ATR) of Ethiopia's public debt was 9.9 years. Thus, it will take an average of 9.9 years to

re-fix the interest rates of the portfolio. The ATR of the external debt stands at 11.1 years which imply that it will take, on average, 11.1 years to reset the interest rate of the external debt portfolio. This high value indicates lower interest risk associated with the external debt portfolio. In contrast, domestic debt is highly exposed to interest rate risk. This is confirmed by a low value of ATR which stands at 4.2 years. This ATR implies that it will take only 4.2 years to re-fix the interest rate on domestic debt hence domestic debt has a high exposure to interest rate risk.

In the same way, there are three methods of quantifying exchange rate risk of the debt portfolio namely: the share of external debt in total debt, the currency composition of the debt portfolio and degree of currency mismatch between the debt service obligations and the composition of foreign exchange reserves for a given country. Accordingly, the share of external and domestic debt as percent of total public debt is 67.0% and 33.0% respectively. This shows a significant change in the composition of public debt due to the devaluation of Ethiopian Birr in 2010/11. In June 2010, the share of foreign debt was 55.9% while domestic debt accounted for 44.1% respectively. The external debt portfolio is exposed to exchange rate risks owing to adoption of free floating rate. Hence any significant depreciation of the Ethiopian Birr against the foreign currencies can substantially contribute to higher debt service payments in local currency terms. As a result, there could be higher debt service payments in the budget than forecasted.

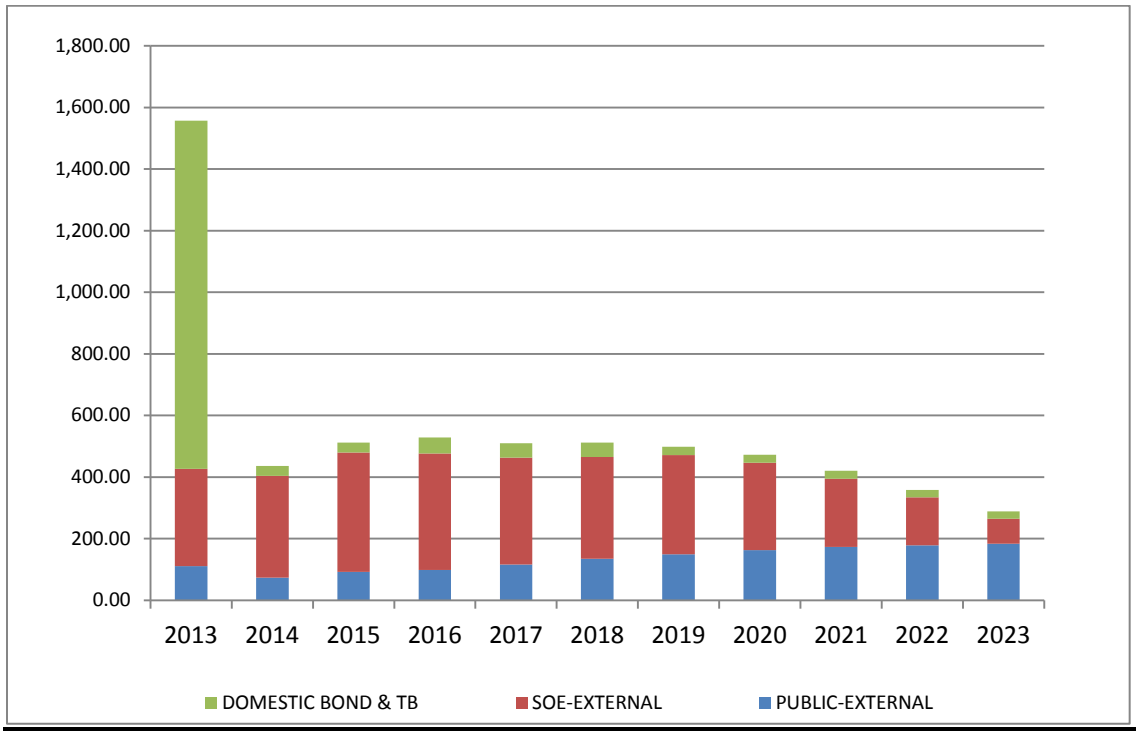
The currency composition of total public debt exhibits minimal exchange rate risk emanating from currency mismatch since most of the external debt service obligations are in United States Dollars and all domestic debt service obligations are in Ethiopian Birr. It means the currency composition of Ethiopia's external debt does not constitute a significant source of external vulnerability (except exposure to exchange rate fluctuation) since the currency structure closely matches with foreign reserves/earnings.

Table 2: Cost and Risk of Existing Public Debt, As at end FY2011/12

Risk Indicators		External Debt	Domestic Debt	Total Debt
Amount (in millions of US$)		8,873.60	4,369.50	13,243.10
Amount (in millions of ETB)		158,906.65	78,247.64	237,154.24
Nominal Debt as % GDP		21.8	10.7	32.5
PV as % of GDP		14.0	10.7	18.1
Cost of Debt	Weighted Average Interest Rate (%)	1.1	2.6	1.8
Refinancing Risk	ATM (years)	12.6	4.2	11.2
	Debt Maturing in 1 year (% of total)	6.7	64.3	11.9
Interest Rate Risk	ATR (years)	11.1	4.2	9.9
	Debt Refixing in 1 year (% of total)	36	64.2	41
	Floating Rate Debt (% of total)	34	25.1	31
Exchange Rate Risk	FX Debt (% of total debt)			67

Source: Ministry of Finance and Economic Development

Chart 8: Public Debt Redemption Profile in Million USD

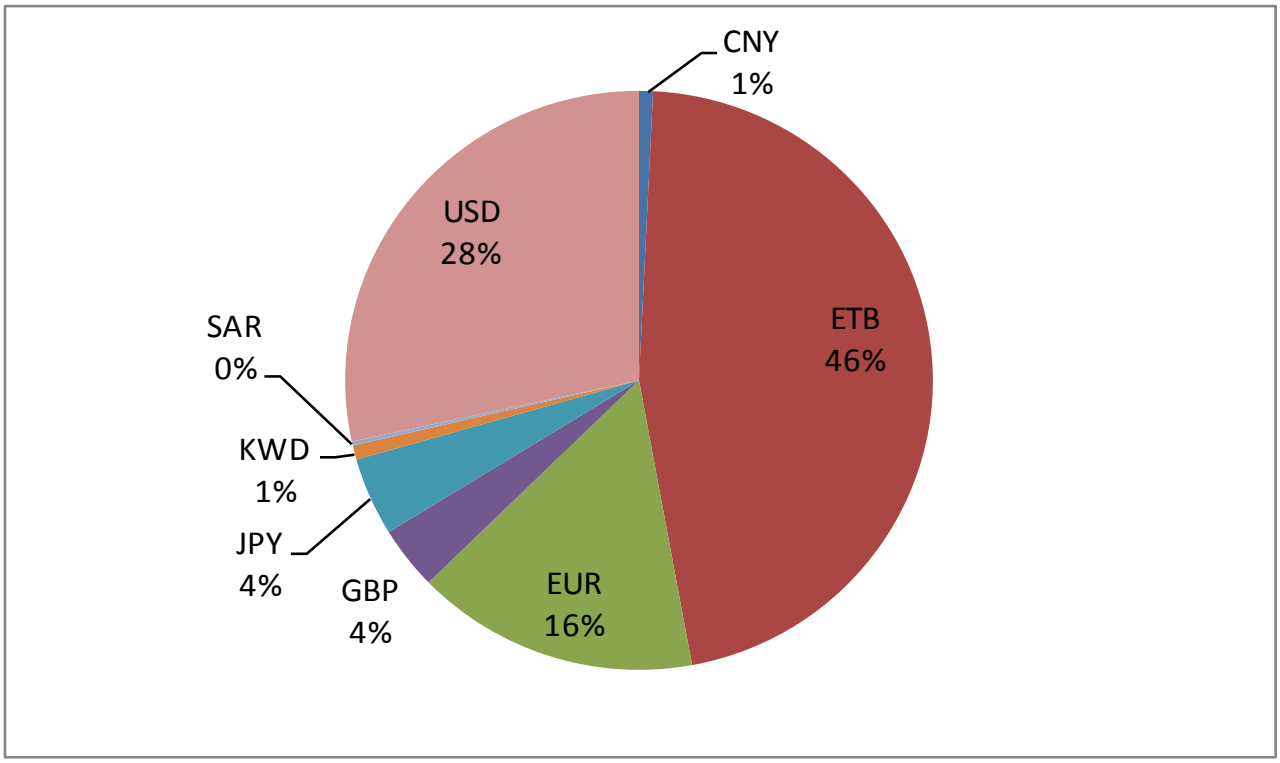


2.2.1 Cost and Risk of the Existing Central Government Debt Portfolio

The proportion of the existing central government external debt constituted 54% of total central government debt as at end of June 2012 as a result of underdeveloped domestic market. The large share of external debt and particularly concessional borrowing, in the debt portfolio lowered the overall cost and risk of the debt. That is why the overall debt portfolio carries an average interest rate of 1.8% per annum.

The existing central government debt portfolio entails significant exposure to exchange rate fluctuations as 54% is denominated in foreign currency. This represents potential risk given the historical trend of ETB depreciation against major foreign currencies. In addition, any adverse shocks in the terms of trade will aggravate the exposure to exchange rate risks.

Chart 9: Currency Composition of the Federal Government Debt, as at end June 2012



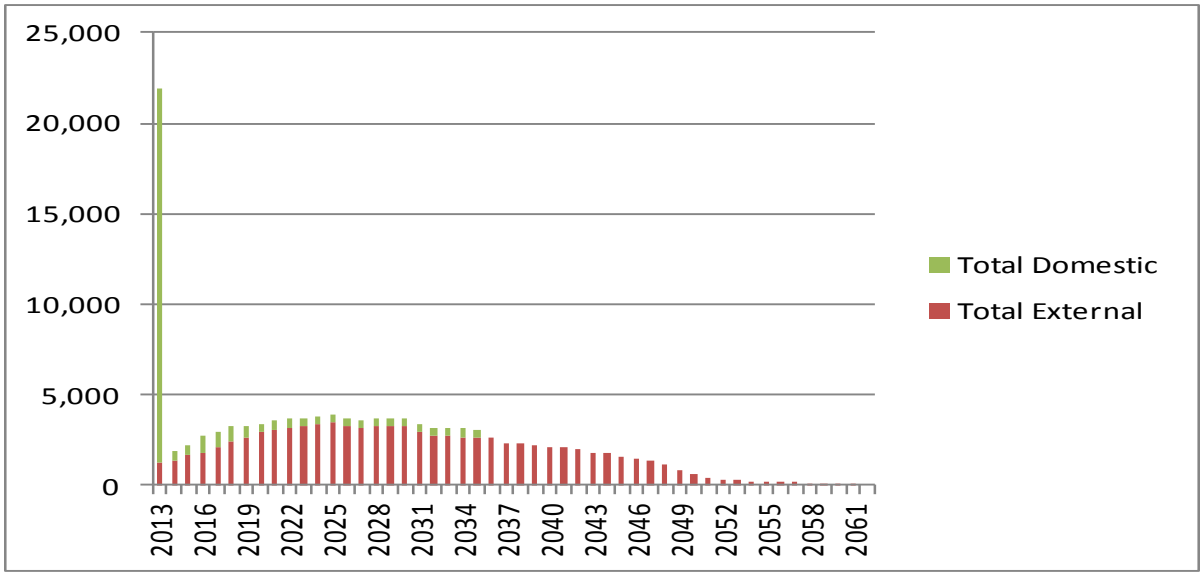
Exposure to interest rate fluctuations appears to be not severe with the average time to re-fixing (ATR) of the overall portfolio being relatively long at 14.4 years. This reflects no amount of floating rate instruments in the portfolio.

The Average Time to Maturity (ATM) of the overall portfolio for the existing debt is 14.4 years. The long ATM (18 years) of the external debt portfolio emanates from the dominance of concessional financing. The ATM of 4.2 years for the domestic debt portfolio is partly due to the presence of long maturities of long term bonds. On average, the central government's debt has relatively longer maturity. This shows that the country has been a borrower from IDA-only for the past two decades.

The proportion of the portfolio to be refinanced within the next 12 months is not particularly large, standing at 17.7%, although for domestic debt, the proportion was 64.0% reflecting a high rollover risk in FY2012/13. In addition to the refinancing risk in the next 2 years, the repayment profile also indicates larger amount of repayment obligation in 2013 and 2023, which coincide with

redemption of Direct Advance. The nature of the repayment profile calls for efforts to smoothen and manage refinancing risk.

Chart 10: Redemption Profile of the Federal Government Debt, as at end June 2012



Remarks: The chart excludes DA from the NBE

Source: Ministry of Finance and Economic Development

Overall analysis of the existing central government debt portfolio suggests that reduction of exchange rate exposure and smoothening of the repayment profile over the medium term constitute key drivers for the choice of MTDS.

Table 3: Cost and Risk of Existing Central Government Debt, as at end FY2011/12

Risk Indicators		External debt*	Domestic debt	Total debt
Amount (in millions of US$)*		5,069.9	4,369.5	9,439.4
Amount (in millions of ETB)		90,790.2	78,247.8	169,038.0
Nominal debt as % GDP		12.9	11.1	24.0
PV as % of GDP		8.2	10.8	19.0
Cost of debt	Weighted Average Interest Rate (%)	1.1	2.6	1.8
Refinancing Risk	ATM (years)	18.0	4.2	14.4
	Debt maturing in 1 year (% of total)	1.4	64.0	17.7
	Debt maturing in 1 year (% of GDP)	0.2	3.4	3.6
Interest Rate Risk**	ATR (years)	18.0	4.2	14.4
	Debt Refixing in 1 year (% of total)	1.4	64.0	17.7
	Fixed rate debt (% of total)	100.0	100.0	100.0
Exchange Rate Risk	FX debt (% of total debt)			53.7

Source: Ministry of Finance and Economic Development

*Excludes arrears to bilateral creditors amounting to US$371.8 million that qualify for HIPC debt relief that are under negotiations.

**Excluding DA from the NBE, as there is no formal maturity date that is established.

III. RATIONALE FOR NEW MEDIUM TERM DEBT MANAGEMENT STRATEGY (2013-2017)

The past several years saw sustainable, fast and broad based economic growth and export revenue flows has significantly improved the image of the country. It is expected that the ongoing endeavor to transform the economy from agriculture to industrial led growth will raise the profile of the country into a middle income rank. In this regard potentially Ethiopia is likely to attain a middle income status in the medium term horizon. This favorable situation of the country needs to be maintained for long.

Financing the economic development program is essential for the realization of the objectives stated in the GTP. During the five year GTP period allocation of the development finance will aim to support the overriding objective of poverty reduction given the country's financial capacity with the maintenance of stable macroeconomic conditions. Of course, one of the mechanisms to raise financing for the GTP is borrowing from external as well as domestic sources.

In this direction, the opportunities of debt relief secured from multilateral, bilateral and commercial creditors through the two initiatives of HIPC and MDRI not only led the country to become debt sustainable beginning from 2004/05 but also created fiscal space for the country to borrow additional resources for the economic development endeavor which also contributed to the recorded economic growth.

In this regard, although the appetite for additional investment is enormous it is appropriate to use wisely the situation without bringing any difficulties in terms of debt hangover and macro instability in the country. Similarly, the current debt volume of the country demands a shift in the composition of debt towards medium to long term domestic debt over the medium term to minimize both cost and risk in the debt portfolio. The relevant considerations that influence the debt volume contracted from both domestic and external sources need to reduce exchange rate and refinancing exposure while containing the cost of debt. Moreover, the current country and international situations demand a well-designed and robust MTDS that is properly implemented to manage unforeseen macroeconomic risks as well as debt hangover.

To sustain the existing good situation, in terms of recorded debt sustainability and economic growth over the last almost 10 years without difficulties, there is a need to closely monitor the existing favorable situations and if it is necessary to take various appropriate actions to tackle any difficulties. In this regard, one of the crucial actions is to develop appropriate MTDS and implement properly. Of

course developing effective medium-term debt management strategies requires the understanding of a number of important policy inter linkages concerted efforts and coordination among the concerned authorities. Ideally, the medium-term debt management strategy should be embedded in an overall framework that includes debt sustainability analysis, considerations of the wider economic framework, a cost-risk analysis of the various financing strategies available, an annual borrowing plan to operationalize the strategy in the immediate budgetary period and domestic market development plans.

Given this national and international circumstances the Government of Ethiopia has taken the right and timely decision to design this medium term debt management strategy and to follow and stick the future domestic as well as external borrowing to finance the developmental endeavors.

As the economy of the country is growing rapidly, it is the government's priority agenda to maintain this trajectory by taking appropriate actions including designing debt management strategy and implementing it to drive the course of borrowing and create enabling conditions for the debt strategy to play a key role in the economy in the process of gap filling. This strategy, because of data limitation, time constraints and the process is a new phenomenon for the country, and it focuses only the central government borrowing plan. During the update of this strategy all public sector debt including Owned Enterprises will be incorporated to make the strategy broad based and comprehensive.

3.1 Objectives of The MTDS and Its Coverage

MTDS essentially guides the borrowing pattern of the government to safeguard the debt sustainability status as well as continuously get access to domestic and external sources for long time. The time horizon of the MTDS analysis is five years, starting from fiscal year 2012/13 through 2016/17. This is in line with the country's Macroeconomic Fiscal Framework (MEEF) and Medium-Term Expenditure Framework (MTEF).

The primary objective of this MTDS is to diversify alternatives and possibilities to ensure the Ethiopian Government's financing needs are met to accomplish the GTP within sustainable debt levels, and by minimizing costs and risks of the existing and future portfolio. The secondary objective of the new MTDS is to enhance the Domestic Debt Market, by enhancing and developing efficient local primary and secondary debt markets for government securities, gradually minimizing dependence on foreign sources and increasing transparency in the

country. These actions solidify more trust on the fiscal and monetary policies of the country and build a case for negotiation to mobilize optimal level of financing flows.

It is well understood that broad based debt management strategy which is consistent with the public sector borrowing policy will not only ensure the overall risk exposure of the public sector debt is contained but is also coordinated and managed in a better manner. In that regard, conducting a MTDS analysis of the broader public sector and developing Guidelines for Public Sector Debt Management including SOEs debt will be crucial for the government in near future.

As far as the coverage is concerned, for the time being the MTDS analysis covered public external and domestic debt excluding guarantees/non-guarantee (contingent liabilities) because of time limitations, this strategy is focused only on the central government borrowing pattern.

As developing an MTDS is a new phenomenon this action is considered as the first step for the country to manage the debt volume and borrowing process in the country so as to avoid any unforeseen debt hangover and macroeconomic instability. During the update of this strategy MoFED intends to prepare the broad based debt strategy and extend the scope by incorporating guarantee and non-guarantee loans contracted by SOEs.

3.2 Potential Financing Sources for MTDS Time Horizon

According to the MTEF (2012/13-2016/17) the primary deficit, which excludes estimate of interest expenditure, is expected to increase to 2.8% in the first two years of the planning period and decreases to 2.4% in 2014/15, 1.7% in 2015/16 and 1.5% in 20016/17. Similarly, the fiscal deficit decreases from 3.2% in 2012/13 to 1.8 in 2016/17.

The requirement in percent of GDP decreases from 5.7% in 2012/13 to 1.9% in 2016/17 mainly associated with the increase in public revenue throughout the MTDS period. External financing is determined by the residual after Net Domestic Financing not more than 1.5% of GDP. Towards this, availability of concessional sources and semi-concessional loans is limited to USD 1,171 million for the financial year 2012/2013 and USD 1.2 billion per year for the financial year 2013/14 to 2016/17.

3.2.1 Financing Options from External Sources

Ethiopia receives most of its external financing in the form of loan for the implementation of developmental projects. In the past 10 years disbursements for central government recorded an increasing trend, owing to improved macroeconomic environment and enhanced cooperation with development partners. The major development partners were the multilateral institutions constituting 67% of external financing of which IDA contributed 64% and bilateral donors accounting for the remaining 33%. The external sources will continue to finance a bigger proportion of budget deficit in the medium term given the relatively low level of development in the domestic financial market.

The Government, on the basis of the medium term financing assumptions, will continue to access concessional loans from both multilateral and bilateral sources to implement developmental programs and projects. Potential sources of external financing available for the planning period for the country can be categorized into multilateral and bilateral.

Generally, multilateral loans are concessional, for example IDA has low fixed rate (0.75 per cent), long maturity (40 years) and long grace period (10 years). Bilateral loans are usually concessional or semi-concessional with both fixed interest rate with average maturity of 20 years including grace period of 5 years. As concessional financing is insufficient and subject to unpredictability of disbursements, financial conditionality and tied to specific projects, the Government will consider limited semi-concessional financing for strategic projects during the MTDS period. In line with the government's commitment to maintain debt sustainability, new borrowing will only be considered on concessional terms as evaluated by the MoFED. New loans must have a grant element of at least 35 percent when calculated with an appropriate discount rate.

These loans are assumed to be denominated in foreign currencies including Special Drawing Right (SDR) United States Dollars (USD), EURO, Japanese Yen, Pound Sterling and others.

Semi-concessional loans are assumed to be contracted from official bilateral creditors. These loans have a maximum fixed interest rate of 3%, a maturity of 20 years including a 5-year grace period. In the absence of concessional financing, for strategic and indispensable projects implementations, the Government will maintain semi-concessional financing in accordance with the international acceptable arrangement.

On the other hand, for the time being the potential to issue an international bond is not feasible because no recovery has been seen in international securities markets.

Table 4: Future Financing Opportunities from External Sources (Financial Terms of the Main Creditors and Creditors Types)

Creditor	Category	Repayment Structure	Cost	Principal Risk Exposure	Estimated Amount Available (US$)
IDA	Concessional	10 year grace; 40 year maturity	Fixed 0.75%	Exchange rate	US$3,686 million over the next five years.
AfDF	Concessional	10 year grace; 50 year maturity	Fixed 0.75%	Exchange rate	US$1,122 million over the next five years.
IFAD	Concessional	10 year grace; 40 year maturity	Fixed 0.75%	Exchange rate	Depends on country allocation.
OPEC Fund, BADEA, EIB	Concessional	5 year grace; 20 year maturity	Fixed 1%– 2.75%	Exchange rate	Depends on country allocation.
Bilateral	Concessional	Average 5 year grace; Average 25 year maturity	Fixed, Average 2.5%	Exchange rate Political Risk	US$1,006 million over the next five years.
Bilateral	Semi-Concessional	Average 4 year grace; Average 17 year maturity	Fixed, Average 3.0%	FOREX Political Risk	

3.2.2 Financing Options from Domestic Sources

An active domestic debt market provides the government with an important avenue to secure additional financing for developmental endeavours, reduce dependence on foreign financing and currency risk. Accordingly, steps have been taken by the government to improve the primary market by introducing the 364-day treasury bills to elongate the tenor and diversifications of the investors. In this regard, in the future access to Direct Advance from the NBE will be diminishing and treasury bills and treasury bonds will be the major sources for financing the government gap during the MTDS period.

The domestic debt market needs to develop continuously through introducing various security markets to finance the budget gap. These steps will encourage private investors to participate in the process. Subsequent actions in terms of sensitizing potential investors, creating conducive domestic market, improvement of auction facilities and legal domestic debt market reform as required and other related measures will be taken in order to encourage private investors on investing in risk free government paper (treasury bills and treasury bonds).

For the time being, as domestic debt market and demand for the security is not well developed domestic borrowing will be undertaken through issuance of treasury bills and treasury bonds at the ratio of 80:20. This will ensure that the maturity structure of the existing portfolio is lengthened to move towards minimizing refinancing risk. In addition, treasury bonds will be issued around at benchmark of 2 and 5 year tenors to build liquidity.

For FY2012/13, MEFF projects the government's net domestic financing (NDF) at ETB 13.0-15.0 billion (1.5% of GDP), implying an increase of ETB 3.5 billion compared to FY2011/12. Central government financing from domestic sources during FY2012/13 is expected to fulfill the net domestic financing of ETB 13-15 billion. As inflation is coming under control, the treasury bills would be an important source for meeting the government's borrowing needs through domestic financing in FY2012/13 and beyond.

Given the projected inflows, Private Organizations Social Security Agency (POSSA) could continue to absorb an average additional ETB 1 billion per year and the PSSSA could mobilize close to ETB 800 million per year. This coupled with the continued demand from banks and in line with GDP growth, ETB 13-15 billion in treasury bills for FY2012/13 can be absorbed by the domestic investor base. In general, central government financing from domestic sources during FY2012/13 is

expected to fulfill the net domestic financing of ETB 13-15 billion. The inflows in short duration Treasury bills are expected to be strong by focusing on longer term of 364 days and depending on market development and demand to issue 2 and 5 years treasury bonds.

Table 5: Future Financing Opportunities from Domestic Sources

Domestic	Maturity	Interest rate	Amounts available
T bills *	28 days	2.25%	Birr 13-15 Billion
	91 days	1.5%	
	182 days	1.43%	
	364 days	3%	

Remarks: * The Government may, in case if the demand for treasury bills is not sufficient as expected because of various reasons and when the ongoing target to arrest inflation rate to single digit is achieved, obliged to use DA to fill the budget financing gap during the MTDS period.

3.3 Macro-Economic Assumptions

The Ethiopian economy has been growing at high rates over the past nine years and the Government maintains the ambitious Growth and Transformation Plan, targeting an average real GDP growth rate of just over 11% until 2014/15.

It is assumed that the main macro variables, as indicated in the GTP, shows that the national economy intends to attain sustainable and equitable growth over the five-year planning horizon. During the last nine years real GDP has displayed an average growth rate of 11%. It reached a peak of 11.4% in year 2011/12, mainly attributed to the growth of agriculture and industry sectors, which registered an increase over the set targets assumed during the Plan for Accelerated and Sustained Development to End Poverty (PASDEP) as well as the first year of the GTP.

In the forthcoming years (applicable to the MTDS), real Gross Domestic Product (GDP) is expected to increase by 11.1% per annum, a bit higher than the growth achieved in 2010/11. Modest increase 11.3% and 11.4%, is expected in 2013/14 and 2015/16 respectively. This is more or less equivalent to the achievement made during the year 2011/12.

Inflation in the last couple of years exhibited double digits, except in year 2009/10 that displays 2.8%. The inflation rate was about 18.1% in 2010/11 and 33.7% in 2011/12. In the medium term (within the debt strategy period), it is assumed that the inflation rate will remain around 6%.

Table 6: Macroeconomic Projections FY 2012/13-2016/17

Indicator (% GDP)	Pre-Actual 2011/12	Projections 2012/13	2013/14	2014/15	2015/16	2016/17
Real GDP Growth (%)	11.4	11.1	11.3	11.2	11.4	10.5
Inflation (%)	33.7	6.0	6.0	6.0	6.0	6.0
Exchange Rate, Birr to USD, (% change)	5.0	5.0	5.0	5.0	5.0	5.0
Trade Balance (% GDP)	-15.9	-15.5	-15.1	-14.2	-14.0	-14.1
Current Account Balance (% GDP)	-6.9	-7.3	-6.6	-6.5	-6.2	-6.5
Primary Fiscal Balance (%GDP)	-0.9	-2.4	-2.3	-2.0	-1.4	-1.3
Net Financing (% GDP)	-1.2	-2.9	-2.7	-2.5	-1.9	-1.6
In millions of ETB						
Revenues (including grants)		138,675	167,300	200,383	240,369	263,429
Primary expenditures		159,132	190,201	223,793	259,565	283,291
Primary balance		-20,457	-22,901	-23,410	-19,196	-19,862
GDP		843,962	990,812	1,154,295	1,339,982	1,553,219

Source: MOFED

Export of goods and services, as percent of GDP, is projected to attain a maximum of 22.5% at the end of the GTP period, with an average increase of 8% per year. This target is believed to be achieved through growth promotion and diversification of exports. The growth in import, on the other hand, depicts a slight increase as greater focus is given to initiating import substitution industries. It is projected to increase by only 1.2% compared to the increase in export. As a result, the deficit in balance of goods and services, will display a declining trend, decreasing from 16.8% in 2011/12 to 13.1% in 2014/15. It exhibits a sharp decline of 7.9% per annum mainly associated to an increase in exports.

Public sector revenue, including grants, was about 17.3% of GDP in 2009/10 and 16.7% in 2010/12. Its percentage, however, is expected to increase to 20% throughout the period. The primary deficit, which excludes estimate of interest expenditure, is expected to decrease from 2.7% in 2013/14 to 1.5% in year 2016/17.

Public sector revenue, including grants, was about 16.4% of GDP in 2011/12 and is estimated to attain the same level in 2012/13. Its percentage, however, is expected to increase to almost 17% throughout the period with a peak of 18% in year 2015/16. Grants, on the other hand, will gradually decrease from 2.0% in 2011/12 to 1.4% in 2016/17. Primary expenditure decreases to about 18.2% of the GDP in the end period of the planning horizon after attaining 19.4% between the years of 2014/15 and 2015/16.

3.3.1 Principal Risks to Baseline Macroeconomic Assumptions

The robustness of the analysis is based on the resilience of the macro fundamentals and typically the baseline assumptions for the economic growth, external and fiscal balance, and the monetary sector. The overall budget balance assumption is also anchored on a strong GDP growth, propelled by the strong fiscal stance which is enhanced by the revenue coming from tax sources.

Although the baseline medium-term macroeconomic projection assumes real GDP growth of over 11.0% for the full projection period, downside risks to baseline projections that may impede the implementation of the strategy including recurrent drought which mainly affects agricultural production, low capacity to mobilize tax revenue, decrease in volume of private transfer, inflation, and exchange rate risks associated with the global financial environment. In view of the main macro postulations above, the following may post risk to the macroeconomic fundamentals.

- The enhanced economic growth not achieved resulting from delayed and unreliable rains and the offset of economy by a rise in grants and aid-in-kind to fund emergency measures,

- The current account deficit resulting to a prolonged shock to commodity exports prices a global growth exports putting pressure on exchange rate and inflation and dampening growth and a sudden stop to private transfer could require the government to contract additional external debt to finance the current account deficit,

- Not achieving the enhanced forecasted government revenue resulting from the inadequate capacity and other related problems to raise tax revenue collection rates with GDP growth and the contingent liabilities could also pose additional fiscal risk and,

- Failure to bring real interest rates to zero[5] by reducing inflation which could hinder development of financial markets, limit domestic savings and reduce the demand for Government bonds.

Any one of the above risk could jeopardize growth and economic stability and as a result will affect the implementation of the designed medium-term debt management strategy. In order to keep these risks in view, the Ministry of Finance and Economic Development is taking appropriate measures to monitor the total debt portfolio of the consolidated public sector so as to avoid the occurrence of the above mentioned risks.

3.4 Description of Baseline and Alternative Stress Scenarios

The baseline exchange rate projection assumes 5% depreciation per annum over the next five years. This is in line with the exchange rate projection used in the government's medium-term MEFF for the period FY2012/13 through FY2016/17. The baseline domestic interest rate assumes 3% for treasury bills, 3.75% for the two-year treasury bonds, and 6% of the five-year Treasury bonds.

The robustness of the alternative debt management strategies was assessed under three scenarios based on interest and exchange rate shocks. The magnitude and direction of the shocks was informed by the historical performance of Ethiopian interest and currency exchange rates over the last ten years. It was

[5] As the government focused to reduce inflation by taking appropriate action during the period as a result the interest rate became at lower levels.

assumed that shocks materialize in FY2013/14, and that all shocks are sustained through FY2016/17. The cost of all market-based borrowing increases in all years. For the purpose of this analysis, three typical shocks stemming from exchange rate, short term interest rates and a combination of these are considered.

Scenario 1: In the past the Ethiopian Birr has been depreciated vis-à-vis USD. It is expected that 15% depreciation of the domestic currency against the USD in FY2013/14 over the baseline projection may materialize. As a result, the Ethiopian Birr is expected to depreciate by 20% vis-à-vis the USD which implies a total depreciation of 20% in 2013/14. The shock is assumed to be sustained throughout the projection period. The cost of borrowing at all tenors is assumed to remain the same as the baseline scenarios.

Scenario 2: This scenario assumes an upward parallel shift of the yield curve by 3% for all the domestic instruments. This shock is consistent with the macroeconomic target of raising real interest rates from the current level to zero, given the inflation target of 6%.

Scenario 3: In this scenario, the Ethiopian Birr depreciates vis-à-vis USD, while all domestic interest rates increase by reasonable margin at all maturities. This reflects the likelihood that interest rates would likely react to an external shock that affects the exchange rate. A combined shock of 10% depreciation of the exchange rate relative to the 5% baseline depreciation projection (resulting in a total depreciation of 15% in FY2013/14) and a 3% increase of domestic debt yield curve are assumed in this scenario.

3.5 Description of Alternative Debt Management Strategies

To ensure a rigorous analysis, four medium term alternative financing strategies were designed to be assessed under this MTDS with the aim of attaining reasonable cost and risks**.** The main differences in these strategies lie on the magnitude of resources expected from domestic and external sources. It means the selected four strategies are external (S1 and S3) and domestic (S2 and S4) oriented.

The first strategy S1 is consistent with the debt sustainability analysis for 2011/12 fiscal year prepared by MoFED for maintaining significant access to concessional sources of the current status quo. The second, third and fourth strategies consider domestic and external sources with different proportions; the second strategy oriented to domestic financing, third being largely oriented to external

sources and the fourth taking domestic financing particularly treasury bills and long term treasury bonds into account.

The latter three strategies effectively consider the implications of substituting alternative sources of financing in view of the eminent constrains of obtaining concessional financing in the medium term. The 2013 considered strategy will be on basis of actual for the first half of the year and projected for the other half of the year. The following four stylized debt management strategies are considered and their impact on cost and risk analyzed.

Strategy 1 (S1) (maximizing concessional financing) follows closely the funding mix envisaged in the latest Debt Sustainability Analysis prepared by MoFED and is anchored by its projected gross external financing of around US$1.0–1.2 billion per year in FY2012/13–2016/17. Gross external financing is characterized by 87% multilateral concessional and 13% bilateral concessional loans in FY2012/13, increasing the share of bilateral loans to 20% in FY2013/14 and FY2014/15. Gross domestic financing will be 100% in treasury bills. It represents a balanced currency split, with an optimistic assumption regarding the availability of concessional debt.

Strategy 2 (S2) which is consistent with the budget and MEFF (limited Multilateral and Bilateral Financing) follows closely the borrowing strategy implied by the current budget, and is anchored by the NDF projections in the MTEF of around ETB 13–15 billion (1.5% of GDP in the initial period, falling to 1.3% of GDP in FY2016/17). Gross external financing maintains the same proportion as in S1. Gross domestic financing is initially 100% in treasury bills, but two-year and five-year bonds are gradually introduced with a 5% increment per year, extending the maturities of the domestic debt. It maintains the balanced currency split, but envisages a more constrained availability of concessional sources, with domestic being substituted. The domestic debt split reflects the core debt management objectives to extend maturities in the domestic market and introduces two and five year's treasury bonds.

Strategy 3 (S3) which focuses on external semi-concessional financing has the greatest share of external borrowing, taking net domestic financing to zero. The increase in external borrowing is financed through bilateral semi-concessional loans. External borrowing will range between US$1.4–1.6 billion per year over the five-year horizon. Composition of gross domestic financing is the same as in S2. This strategy envisages the substitution of more domestic debt to compensate for the shortfall in concessional borrowing.

Strategy 4 (S4) is, aggressive in domestic borrowing (in amount and maturities), similar to S2, but increases the quantity of domestic borrowing by maintaining the NDF to GDP trajectory at the current level (1.5% of GDP), and the composition of gross external and domestic financing is the same as in S2. It means this strategy envisages a more aggressive switch to domestic debt.

Table 7: Key Characteristics of the Alternative Debt Strategies (2013-2017 Average)

Strategy	Key Characteristics	NDF (%GDP)	Gross Domestic Verses External Financing	Net Domestic Verses External Financing	Domestic mix	External mix	Feasibility
1	External Concessional Loan Oriented (Consistent with DSA)	0.7%	65% vs 35%	26% vs 74%	T-bill 100%	Concessional 100%	High
2	Domestic Debt Market Oriented (Consistent with MEFF)	1.3%	77% vs 23%	52% vs 48%	T-bill 80%; T-bond 20%	Concessional 100%	High
3	Most external borrowing	0%	39% vs 61%	0% vs 100%	T-bill 80%; T-bond 20%	Concessional 85%; Semi-concessional 15%	High
4	Most domestic borrowing	1.5%	81% vs 19%	58% vs 42%	T-bill 80%; T-bond 20%	Concessional 100%	Medium

3.6 Methodology for Outcomes of Strategies Analysis

The strategies have been simulated in the MTDS model under the assumptions discussed above. The different strategies considered in the MTDS would be evaluated using three ratios: interest/GDP, debt/GDP and NPV of debt/GDP. The former ratio indicates the availability of resources to repay the debt while the latter two evaluate the degree of debt sustainability of each strategy. The Debt/GDP ratio is relevant in view of the strategic debt-GDP ceiling of 60% of GDP and NPV of Debt is relevant given the significant share of concessional and semi-concessional debt. The resultant values of these ratios under the stress test scenario will also be analyzed.

It should be noted that regardless of the strategy, the nominal debt to GDP ratio declines over the projection period as a result of fast and broad based GDP growth relative to the growth rate of debt and decreasing of primary deficit as a percent of GDP over the time horizon (from 2.4 to 1.3%). This brings to the fore the fact that the main drivers of debt levels are primary balance and the rate of growth of real GDP.

Other additional measurements are also assumed in the analysis including average term to maturity (ATM) and Average Time to Refixing (ATR) which measure interest rate and rollover risks. The different strategies are also evaluated employing the redemption profile in order to look into the liquidity pressure on the budget. Overall, it is envisaged that the methodology applied and the cost-risk indicators considered will assist in obtaining the desired portfolio mix.

3.6.1 Analysis of the Four Selected Strategies

With regard to the outcome measured by nominal debt to GDP at the end of FY2016/17, S1, S2 and S4 display similar expected cost (at about 22.8%) while Strategy 2 is the strategy with the least risk. This suggests that domestic borrowing is as cheap as external concessional borrowing. The domestic financing is advantageous in the short-term from the cost and risk perspective. Again, strategy 1 will not help the development of the domestic debt market as envisaged in the core debt management objectives. Strategy 1 is the priority area and the first choice of the government in accessing concessional borrowing, with the existence of the increasing constrains in accessing concessional and other official sector facilities. Although the domestic debt market is not well developed strategy 2 should be the second option for the government to implement by improving the domestic issuance calendar and broadening the investor base and making it more attractive to domestic investors. Of course, since the domestic debt portfolio is made up of mainly short average maturity, strategy 2 is

vulnerable to interest rate shocks. S3, which relies more on external bilateral semi-concessional debt, is the least attractive financing option.

On the other front, the outcome measured by interest payment to GDP at the end of FY2016/17, indicates that S1 and S3, which are more externally oriented, have lower expected cost and lower risk relative to S2 and S4, which are more domestically oriented. S1 is one of the least cost strategies in terms of the interest/GDP and it produces a lower fiscal adjustment cost to maintain debt sustainability than the other strategies.

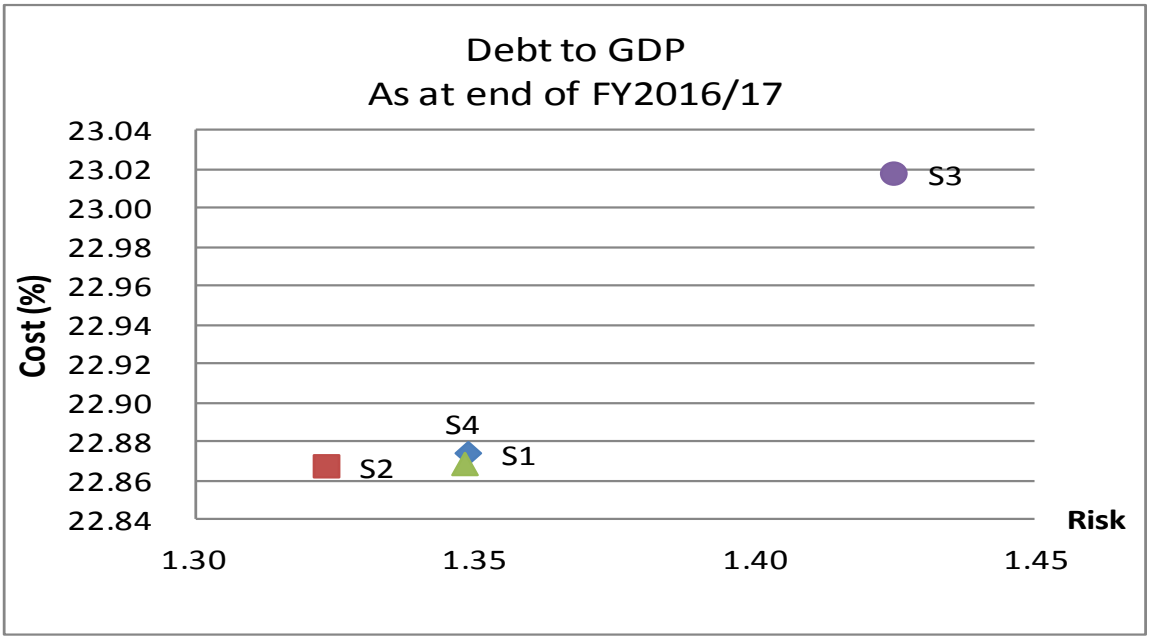
Accessing external loans more aggressively by tapping bilateral semi-concessional sources S3 will increase the exchange rate risk to the portfolio. The benefit of S3 is that refinancing risk of the total debt portfolio is greatly reduced compared to S1 due to less borrowing from domestic sources.

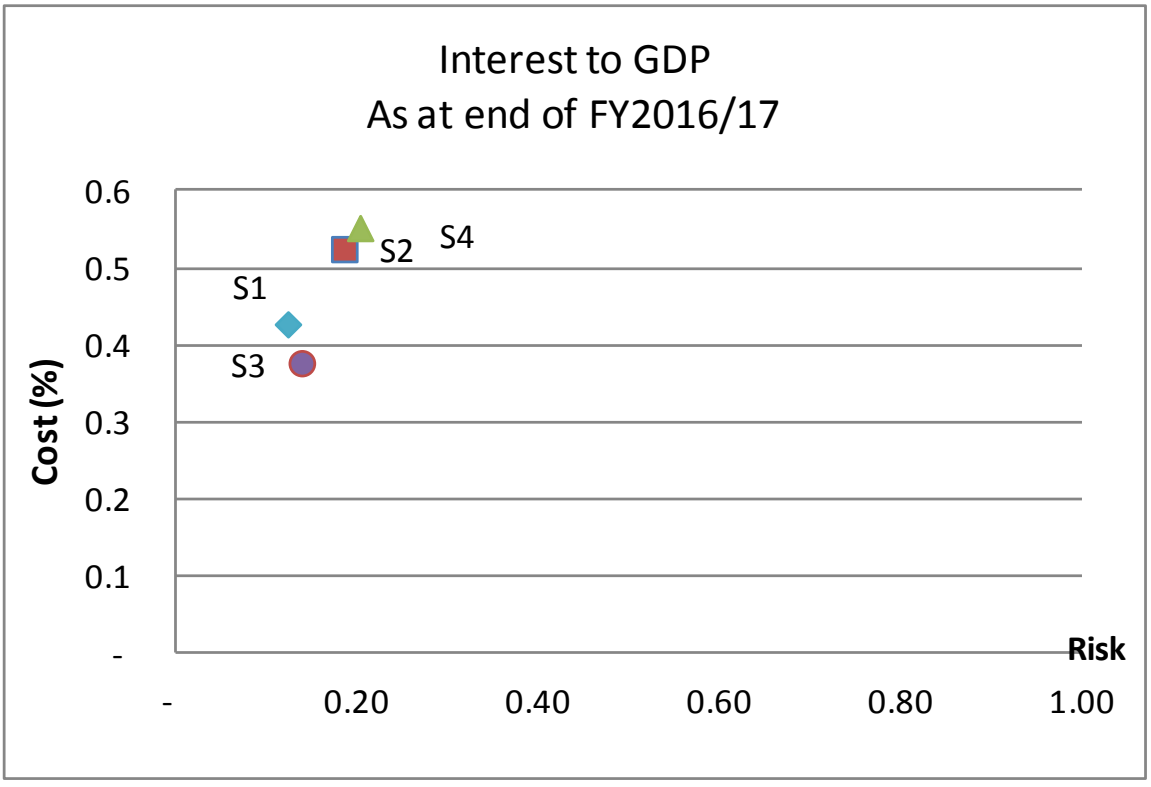
Overall, due to the positive outlook and the associated strong fiscal position, the debt indicators are generally encouraging under all the strategies. Further, though a clear ranking is observed, there is relatively little difference between the alternative strategies on the basis of these cost-risk indicators. The difference between the highest and lowest cost strategies is only around 0.5% in terms of both interest/GDP and debt/GDP.

Table 8: Summary of Cost Risk Indicators

Debt/GDP (%)	S1	S2	S3	S4
Baseline Scenario	22.874	22.867	23.018	22.869
Impact of Stress Scenario:				
Exchange Rate Shock	24.223	24.134	24.442	24.140
Domestic Interest Rate Shock	23.210	23.344	23.202	23.367
Combinations of Both Shocks	24.111	24.191	24.152	24.216
Interest/GDP (%)				
Baseline Scenario:	0.428	0.526	0.377	0.553
Impact of Stress Scenario				
Exchange Rate Shock	0.443	0.541	0.394	0.569
Domestic Interest Rate Shock	0.539	0.699	0.428	0.743
Combination Both Shocks	0.550	0.710	0.439	0.755

Chart 11: Cost Risk Trade Off





On the other hand, in analyzing the strategies, other cost indicators such as the implied average interest rate, interest/revenue ratio and other risk indicators such as the Average Time to Maturity (ATM) and percentage of debt refixing within 12 months were considered to analyze the alternative four strategies in conjunction with the overall core objectives of debt management. In terms of refinancing risk Average time to maturity (ATM) for External Borowing show an improvement while it is worsening for domestic debt as more of the domestic finanacing will be assumed to be in treasury bills. In this regard S3 will have a hihger ATM followed by S1 and S1 also shows an improvement from the current 2012 figure.

As far as Interest Rate Risk is concerned, Avarage Time to Refixing (ATR) shows an improvement over 2012 for Strategies 1 and 3, where the relative share of external is much higher than the other two strategies, while it is deterorating for S2 and S4. It is possible to note that the debt refixing in one year in all cases is worsening over time. Under Strategy 3 the proportion of debt expected to refix in one year is less than the others followed by S1.

Table 9: Other Key Cost Indicators

Risk Indicators		2012	As at end FY2017			
		Current	S1	S2	S3	S4
Nominal debt (millions of US$)		9,439	15,545	15,540	15,643	15,541
Nominal Debt (millions of Local Currency)		169,038	374,494	375,733	375,137	376,135
Nominal Debt as % of GDP		24.0	22.9	22.9	23.0	22.9
PV Debt as % of GDP		19.0	16.7	17.8	16.9	18.2
Interest Payment to GDP (%)			0.428	0.526	0.377	0.553
Implied Interest Rate (%)		1.8	2.1	2.6	1.9	2.7
Refinancing Risk	ATM External Portfolio (years)	18.0	20.2	19.4	17.8	19.0
	ATM Domestic Portfolio (years)	4.2	1.9	2.1	3.5	2.1
	ATM Total Portfolio (years)	14.4	16.0	13.5	16.4	12.4
	Debt Maturing in 1 year (% total)	17.7	17.6	21.4	6.3	24.4
	Debt Maturing in 1 year (%GDP)	3.1	4.3	5.2	1.5	5.9
Interest Rate Risk	ATR (years)	14.4	16.0	13.5	15.3	12.4
	Debt Refixing in 1 year (% total)	17.7	18.6	22.6	17.7	25.8
	Fixed Rate Debt (% total)	100.0	100.0	100.0	100	100.0
FX risk	FX debt as % total	53.7	67.1	57.1	78.1	53.1

Table 10: Annual Net Borrowing By Strategy

External In MUSD	2013	2014	2015	2016	2017
Strategy 1	1,100	1,158	1,130	1,058	917
Strategy 2	724	898	839	704	648
Strategy 3	1,416	1,575	1,568	1,302	1,287
Strategy 4	743	839	770	449	387
Domestic In Million Birr					
Strategy 1	5,955	8,314	9,287	5,790	9,262
Strategy 2	13,022	13,701	15,837	14,440	16,961
Strategy 3	-	-	-	-	-
Strategy 4	12,639	14,862	17,314	20,085	23,298

3.6.2 Selection of Appropriate Strategy

Overall, maintaining the recorded debt sustainability, minimizing exchange rate exposure and smoothening of the repayment profile over the medium term constitute key drivers for the choice of the best strategy. In this regard, out of the four assessed, on the basis of the outcome measured by interest payment to GDP and nominal debt to GDP ratio and other indicators, the two strategies of S1 and S2 are feasible strategies to implement in the MTDS period. The result of these two strategies suggest that domestic borrowing (given, the prevailing low interest rates) and external concessional borrowing have comparable cost and external semi-concessional borrowing is inferior to domestic borrowing, taking into account the exchange rate effect that offsets the lower interest cost of semi-concessional debt.

Hence, out of the two strategies indicated above, on the basis of the objectives of the strategy, priority focus areas of the country and results of cost-risks assessments, the ideal to be selected as first choice is Strategy 1 and as fallbacks move toward the Strategy 2 over the time horizon given the changing circumstances and constraints expected during the period.

The selection of strategy 1, as sustainability of the public debt depends on the assumption of continued robust GDP growth, moderate public sector primary deficits, continued access to external concessional loans, and low domestic real interest rates, as the first choice should not be overemphasized. In addition, strategy 1 is robust and seems to lessen the debt and macroeconomic instability in the country as well as intends to maximize highly concessional borrowing with high short-term domestic debt to finance deficit.

On the other hand, since strategy 1 presumed with constrained access to concessional borrowing, it may be more realistic in its outlook, which is the most competing strategy with S2. Accordingly, over the time horizon, given the changing circumstances and constraints expected, it may be imperative to move toward the second choice of strategy 2. This strategy not only addresses the limited access to concessional borrowing but it is also helpful to meet the overall objectives of developing domestic debt market, increasing mobilization of domestic savings, reducing external dependence to fill the budget gap and reducing inflationary pressure in the economy during the MTDS period.

Indeed strategy 2 shifts the portfolio in this direction, with S2 being aggressive in increasing the domestic share of financing by maintaining gross domestic financing as a share of GDP at the current level of 1.5% of GDP and lengthening maturities by introducing two-year and five-year bonds into the domestic

financing mix. In addition, strategy 2 implies maintaining a reasonable stream of new issuance in the domestic market and is more in line with the core objective to extend maturities in the domestic market than S1. Certainly, these depend on the shift of demand and the level of progress of domestic debt market for treasury bonds.

In general, on the basis of the availability of highly concessional loans and low level of development of the domestic debt market, S1 is the most preferred strategy for the country. However, given the changing circumstances and constraints expected during the period, the selected strategy 1 as priority moves to S2 to address the constraints in securing resources from concessional widows in the meantime achieve the overall objectives of the MTDS in developing domestic debt markets which considered as strategic step for the government to harmless budget gap filling as well as increasing saving volume in the country and reducing dependence in foreign resources to fill budget gap.

IV. Implementing the MTDS by Developing the Associated Annual Borrowing Plan and Establishing Monitoring Mechanism

The borrowing composition assumed in the MTDS analysis provides the basis for determining the annual borrowing plan to accompany the selected strategy to meet the financing requirement for the fiscal year. For effective implementation of the MTDS, there is a need to develop vibrant risk management tools and monitoring mechanism.

There is also the need for active investor-relations and market consultation to get up to date information on the market. This will help determine a prior the investor appetite for the various instruments before it is done. The domestic borrowing plan would be translated into a potential auction calendar for treasury bills and bonds. The auction calendar is derived by determining the required number of auctions and the typical size of an auction. The planning of the calendar also takes into account government cash position and budget outturns in the fiscal year. The plan also envisages that the long dated instruments will be used for specific projects.

In this regard, external borrowing plan anticipates two utilization options; project and budget support (program) and is based on commitments. Budget support loans are mainly under the concessional loans under the Multi-Donor Financing of Protection of Basic Services arrangements.

Since the MTDS is anchored on a macro framework it is important to establish monitoring mechanism to control the effective and efficient implementation of the strategy. This needs constant monitoring and review of performance and progress made on the MTDS implementation. The quarterly public debt public report and the annual review will be used for this purpose. The quarterly report will include a backward looking review of performance of the previous quarter, which will reveal possible risks and recommend measures to mitigate in the subsequent quarter.

Moreover, there will be regular monitoring of macro performance. Developments in the macroeconomic situations to a large extent drive the domestic market conditions and especially form investors' perception of risk for government papers/instruments as well as concessional borrowing from external sources.

On the other side, though the MTDS is for medium term strategy, it is necessary to annually update the strategy document so that in the process it is possible to review the implementation, improve and incorporate the missing item in the MTDS as well as to help developing an effective, efficient and broad based

strategy for the country. In addition, if there are significant and sustained deviations in the outturns relative to the targets and assumptions in the MTDS, the strategy will be reviewed and revised accordingly.

As legal and institutional frameworks exist in a good manner the monitoring activities need to be undertaken by MoFED through the Debt Management Directorate. Formulating appropriate and vibrant borrowing planning and in placing monitoring mechanism to closely monitor its implementations ensure contemporary debt management practices in Ethiopia.

Finally, on the basis of the existing governing laws related to debt management strategy appropriate guidelines must be set and closely monitor its implementation. In addition, it is envisaged that the annual revision of the MTDS would be a crucial activity of MoFED to maintain debt sustainability as well as macroeconomic stability so as to maintain the sustainability of the recorded economic growth for long time.

V. CONCLUSION

Out of the assessed four strategies the first strategy assumes maximization of external concessional debt while financing the residual needs through domestic treasury bills. The second strategy anchors the net domestic financing to 1.5% of GDP at the beginning of the period, and which gradually reduces to 1.2% of GDP by the end of the time horizon. Domestic maturities are extended, from only treasury bills in the first year, towards gradually issuing two year and five year treasury Bonds over time and the residual needs are financed by external concessional loans.

The third strategy examined increases in external financing relative to the first strategy, and resorts to bilateral semi-concessional borrowing, while the residual is financed through domestic debt, gradually extending domestic maturities as in Strategy 2. The fourth and last strategy examined increases in the domestic financing relative to the second strategy and maintains the net domestic financing to 1.5% of GDP, and extends the domestic debt maturities, as in Strategy 2 and 3.

Overall, out of the four assessed, on the basis of the outcome measured by interest payment to GDP and nominal debt to GDP ratio and other indicators, the two strategies of S1 and S2 are feasible strategies to implement in the MTDS period. The result of these two strategies suggest that domestic borrowing and external concessional borrowing have comparable cost, and that external semi-concessional borrowing is inferior to domestic borrowing, taking into account the exchange rate effect that offsets the lower interest cost of semi-concessional debt.

Hence, out of the two strategies indicated above, on the basis of the objectives of the strategy, priority focus areas of the country and results of cost-risks assessments, the ideal to be selected as first choice is Strategy 1 and as fallbacks move toward the Strategy 2 over the time horizon given the changing circumstances and constraints expected during the period.

The selection of strategy 1 as, as sustainability of the public debt depends on the assumption of continued robust GDP growth, moderate public sector primary deficits, continued access to external concessional loans, and low domestic real interest rates, the first choice should not be overemphasized. In addition, strategy 1 is the robust and seems to lessen the debt and macroeconomic instability in the country as well as intends to maximize high concessional borrowing with high short-term domestic debt to finance deficit.

Over the time horizon given the changing circumstances and constraints expected, it may be imperative to move toward the second choice of strategy 2. This strategy not only addresses the limited access to concessional borrowing but it is also helpful to meet the overall objectives of developing domestic debt market, increasing mobilization of domestic savings, reducing external dependence and reducing inflationary pressure in the economy during the MTDS period.

Ethiopia believes that a better and effective MTDS framework is one that primarily promotes and upholds sustainable development in the country. The MTDS is a robust framework for prudent debt management. In this regard debt management strategy analysis enables governments to plan and negotiate the best available new borrowing and financing options to fund economic development, growth and poverty reduction, keep debt costs and risks as low and sustainable as possible in the short and long-term, negotiate maximum debt relief from creditors where this is needed, assess potential risks arising from private sector debt and contingent liabilities.

MTDS provides a systematic approach to decision making on the appropriate composition of external and domestic borrowing to finance the budget in the financial year 2012/13, taking into account both cost and risk. The cost-risk trade-off of the MTDS has been evaluated within the medium term context considering the macro-economic, and global and domestic market environment and related vulnerabilities, and recommends a shift in the composition of debt towards medium term domestic debt over the medium term.

In addition, this medium term debt strategy complements the Debt Sustainability Analysis outcomes which are concerned with long-term sustainability of debt. This strategy has set out more practical steps for implementation in four areas of promoting Government leadership, improving predictability of external resources flows in the government budget, harmonization and alignment to national priorities and national systems and improving domestic capacity for coordination and management of domestic and external resources.

The Ministry of Finance and Economic Development is formally presenting the Medium Term Debt Strategy as part of the MEFF and Budget. This initiative will be implemented and entrenched in legislation going forward with the aim of enhancing the transparency of the borrowing process of the country.

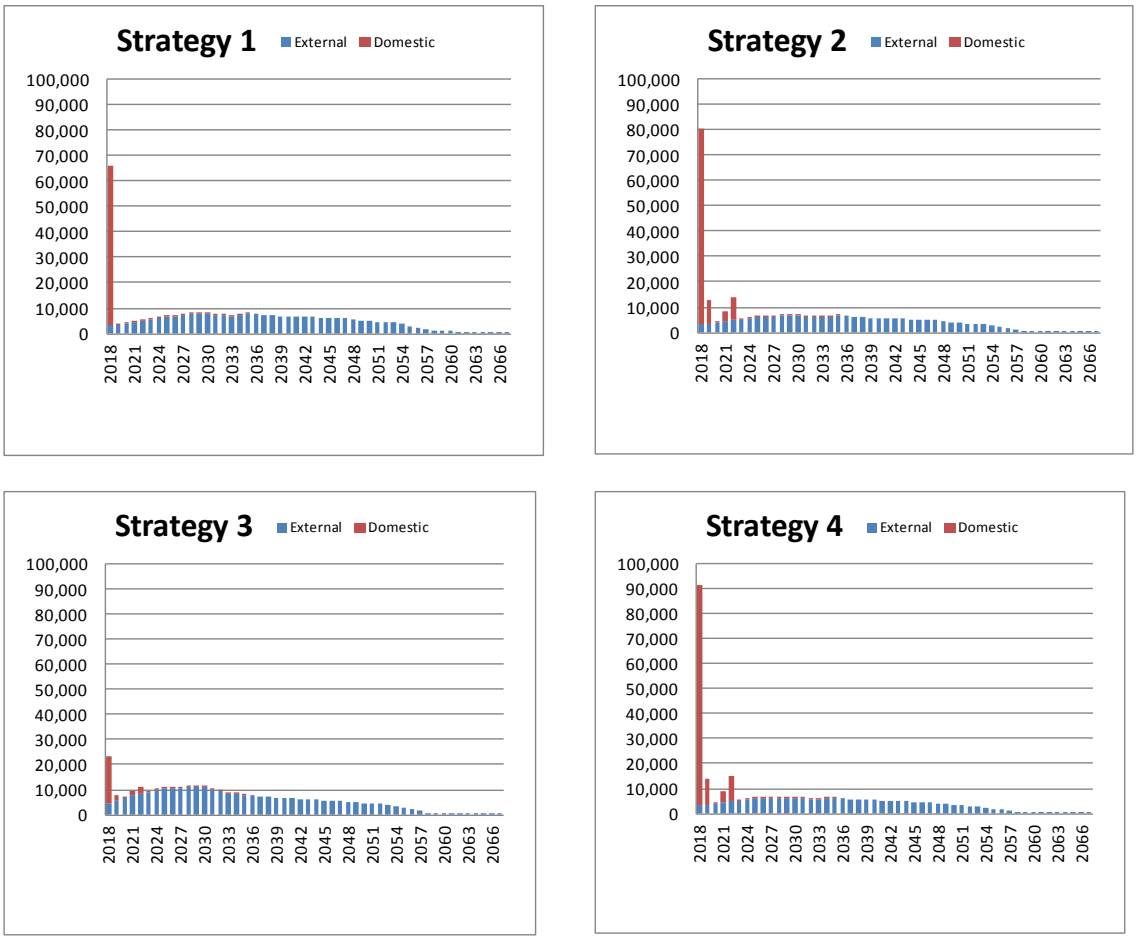
5.1 Way Forward

The results and findings of the 2012/13 MTDS recommend as follows:

- In line with HIPC and MDRI framework the government needs to follow and adhere to this MTDS by wisely using the fiscal space created as a result of MDRI, carefully determining the quality and volume of new borrowing, which is compatible with external debt and fiscal sustainability.
- The government should also continue negotiation for debt relief with the bilateral and commercial creditors, which are reluctant to participate in the HIPC Initiative, and to seek assistance from the Bretton Woods Institutions in this process where appropriate.
- Government should endeavor to strengthen expertise in costing the essential needs for longer term planning and must, as a matter of priority, build capacity in developing debt management strategy and management so as to closely monitor the debt of the largest public enterprises, assess potential contingent liabilities and undertake a well-defined debt management performance assessment exercise.
- As the recent continuous and persistent global financial turbulences call for formulating a more reliable and robust debt management strategy and revising every fiscal year within the framework of development direction in the area of debt management by undertaking assessment of risks to avert any unforeseen events. Thus, this developed debt management strategy needs to be used as a guiding document for the future borrowing.
- Government agencies and stakeholders in fiscal and monetary policy management would need to strengthen collaboration and information sharing among them and need to follow the borrowing plan articulated in Ethiopia's Medium Term Debt management Strategy document in order to improve the efficacy of Government policies, stabilize and strengthen the operating macroeconomic environment for more robust growth in debt accumulations.
- It is a crucial and important step to upgrade this MTDS every fiscal year and properly implement it.
- It is worth noting that monitoring the overall consolidated public and publicly guaranteed external debt is needed to avoid a building up of vulnerabilities as well as avoiding debt distress risks.
- The next update of the MTDS will contain total public debt, including guaranteed and non-guaranteed domestic and external debt contracted by State Owned Enterprises to make the strategy broad based and comprehensive.

VI. ANNEXICES

Chart 12: Redemption Profiles of Central Government under Alternative Debt Management Strategies, as at end FY2016/17



*Excluding Direct Advances from the National Bank of Ethiopia.

The redemption profile for strategies 1and 3 are almost similar but Strategy 3 has a smooth redemptions profile compared to the others as the strategy is most externally oriented with less treasury bills .

Table 11: Total Gross Financing in Millions of US$, by Debt Instrument and by Strategy

S/No	Instrument	Strategy 1				
		2013	2014	2015	2016	2017
	Gross financing	2.6	3.0	3.4	3.5	3.8
I	Gross external	1.2	1.2	1.2	1.2	1.0
1.1	Multilateral_1	0.8	0.7	0.7	0.7	0.7
1.2	Multilateral_2	0.2	0.3	0.3	0.2	0.1
1,3	Bilateral_1	0.2	0.2	0.3	0.2	0.2
1.4	Bilateral_2	-	-	-	-	-
II	Gross domestic	1.4	1.8	2.2	2.4	2.7
2.1	T- Bills	1.4	1.8	2.2	2.4	2.7
2.2	2 years T-Bond	-	-	-	-	-
2.3	5 years T-Bond	-	-	-	-	-

S/No	Instrument	Strategy 2				
		2013	2014	2015	2016	2017
	Gross financing	2.6	3.4	3.9	4.2	4.5
I	Gross external	0.8	1.0	0.9	0.8	0.8
1.1	Multilateral_1	0.6	0.5	0.5	0.5	0.5
1.2	Multilateral_2	0.1	0.2	0.2	0.2	0.1
1,3	Bilateral_1	0.1	0.2	0.2	0.1	0.1
1.4	Bilateral_2	-	-	-	-	-
II	Gross domestic	1.8	2.4	3.0	3.4	3.8
2.1	T- Bills	1.8	2.3	2.7	2.9	3.0
2.2	2 years T-Bond	-	0.1	0.3	0.3	0.4
2.3	5 years T-Bond	-	-	-	0.2	0.4

S/No	Instrument	Strategy 3				
		2013	2014	2015	2016	2017
	Gross financing	2.6	2.7	2.7	2.3	2.3
I	Gross external	1.5	1.6	1.7	1.4	1.4
1.1	Multilateral_1	0.8	0.7	0.7	0.7	0.7
1.2	Multilateral_2	0.2	0.2	0.2	0.2	0.1
1,3	Bilateral_1	0.2	0.3	0.3	0.3	0.2
1.4	Bilateral_2	0.3	0.4	0.4	0.2	0.4
II	Gross domestic	1.1	1.1	1.0	0.9	0.9
2.1	T- Bills	1.1	1.0	0.9	0.8	0.7
2.2	2 years T-Bond	-	0.1	0.1	0.1	0.1
2.3	5 years T-Bond	-	-	-	0.0	0.1

S/No	Instrument	Strategy 4				
		2013	2014	2015	2016	2017
	Gross financing	2.6	3.4	4.0	4.3	4.9
I	Gross external	0.8	0.9	0.9	0.5	0.5
1.1	Multilateral_1	0.6	0.5	0.5	0.4	0.4
1.2	Multilateral_2	0.1	0.2	0.2	0.1	0.1
1,3	Bilateral_1	0.1	0.2	0.2	0.1	0.1
1.4	Bilateral_2	-	-	-	-	-
II	Gross domestic	1.8	2.5	3.1	3.7	4.4
2.1	T- Bills	1.8	2.3	2.8	3.2	3.5
2.2	2 years T-Bond	-	0.1	0.3	0.4	0.4
2.3	5 years T-Bond	-	-	-	0.2	0.4

Table 12: Total Gross Financing in Billions of ETB, by Debt Instrument and by Strategy

S/No	Instrument	Strategy 1				
		2013	2014	2015	2016	2017
	Gross financing	48	60	71	77	86
I	Gross external	22	24	25	25	24
1.1	Multilateral_1	15	14	15	16	17
1.2	Multilateral_2	4	6	5	5	3
1,3	Bilateral_1	3	5	5	4	4
1.4	Bilateral_2	0	0	0	0	0
II	Gross domestic	26	35	45	52	62
2.1	T- Bills	26	35	45	52	62
2.2	2 years T-Bond	0	0	0	0	0
2.3	5 years T-Bond	0	0	0	0	0

S/No	Instrument	Strategy 2				
		2013	2014	2015	2016	2017
	Gross financing	48	67	81	91	104
I	Gross external	15	19	19	17	17
1.1	Multilateral_1	10	11	11	11	12
1.2	Multilateral_2	3	5	4	4	2
1,3	Bilateral_1	2	4	4	3	3
1.4	Bilateral_2	0	0	0	0	0
II	Gross domestic	34	48	62	73	86
2.1	T- Bills	34	45	56	62	69
2.2	2 years T-Bond	0	2	6	7	9
2.3	5 years T-Bond	0	0	0	4	9

S/No	Instrument	Strategy 3				
		2013	2014	2015	2016	2017
	Gross financing	48	54	55	51	53
I	Gross external	28	33	34	30	33
1.1	Multilateral_1	14	13	14	15	16
1,2	Multilateral_2	3	5	4	4	2
1.3	Bilateral_1	4	7	7	6	6
1.4	Bilateral_2	6	8	9	5	9
II	Gross domestic	20	21	21	21	20
2.1	T- Bills	20	20	19	17	16
2.2	2 years T-Bond	0	1	2	2	2
2.3	5 years T-Bond	0	0	0	1	2

S/No	Instrument	Strategy 4				
		2013	2014	2015	2016	2017
	Gross financing	48	67	82	93	111
I	Gross external	15	18	18	12	11
1.1	Multilateral_1	11	10	10	8	8
1,2	Multilateral_2	3	4	4	2	1
1.3	Bilateral_1	2	4	4	2	2
1.4	Bilateral_2	0	0	0	0	0
II	Gross domestic	33	49	64	81	100
2.1	T- Bills	33	46	58	69	80
2.2	2 years T-Bond	0	2	6	8	10
2.3	5 years T-Bond	0	0	0	4	10