



Medium-Term Debt Management Strategy (MTDS)

Ministry of Finance

The purpose of this document is to identify the optimal medium term debt management strategy for the Fiscal Years (FY) 2015-16 through 2017-18 based on the Government of Egypt's objectives and targets for debt management.

Contents

Acronyms.....	2
Definitions.....	3
INTRODUCTION	4
Guidelines	5
OBJECTIVES AND SCOPE FOR THE MTDS	5
CHARACTERISTICS OF THE EXISTING DEBT PORTFOLIO.....	6
Outstanding Debt	6
Existing Debt Management Strategy	7
Sources of Financing.....	11
Domestic Sources of Funding.....	11
External Sources of Funding.....	11
Baseline Macroeconomic Assumptions and Key Risk Factors	11
Baseline Macroeconomic Assumptions	11
Key Risk Factors	12
Shock Scenarios	13
Alternative Financing Strategies.....	13
Cost-Risk Analysis of Alternative Debt Management Strategies.....	14
Concluding remark and the way forward.....	14
Implementation Issues	15

Acronyms

ATM	Average Time to Maturity (years)
ATR	Average Time to Re-Fixing (years)
AT	Analytical Tool
CBE	Central Bank of Egypt
DMU	Debt Management Unit
EGP	Egyptian Pound
EMTN	Euro Medium Term Note Program for the Eurobonds issuances on the foreign markets.
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GoE	Government of Egypt
GMTN	Global Medium Term Note Program for the Eurobonds issuances on the foreign markets.
IMF	International Monetary Fund
MoF	Ministry of Finance
MTDS	Medium Term Debt Strategy
PV	Present Value
QE	Quantitative Easing

DEFINITIONS

Average Time to Maturity (ATM)	An indicator used to assess refinancing risk based on the current average time to maturity of debt outstanding.
Average Time to Re-fixing (ATR)	An indicator used to assess refinancing risk based on the portion of debt exposed to a change in the interest rate, including debt issued at a variable interest rate and debt less than one year.
REOPENING	The reopening of existing government securities serves to build up benchmark bonds and thereby to increase the liquidity in the secondary market and to develop the domestic debt market.
Present Value (PV)	The current worth of a future sum of money or stream of cash inflows to the MoF after the issuance of discounted instruments, which include T-Bills and Zero Coupon Bonds and give a specified rate of return.
YIELD CURVE	A line that plots the structure of interest rates, at a set point in time, of government securities with different maturities, ranging from 3 month T-Bills to 10 year T-Bonds. It enables investors at a quick glance to compare the yields offered by short, medium and long term bonds.
CLASSIFICATION OF DEBT BY RESIDENCY	The concept of residence here refers to the engagement of investors in economic activity. Government securities held by domestic investors, whether issued domestically or externally, are considered domestic debt. Government securities held by foreign investors, whether issued domestically or externally, are considered external debt. This classification does not comply with the standards of the World Bank and IMF.
CLASSIFICATION OF DEBT BY CURRENCY	Debt denominated in domestic currency is considered domestic debt whether issued domestically or externally, and debt denominated in foreign currency is considered external debt whether issued domestically or externally. This classification complies with the standards of the World Bank and IMF.

INTRODUCTION

- The Government of Egypt (GoE)'s borrowing activities are governed by the annual budget law approved by the Parliament. The drafting of the yearly budget is done according to provisions of law no. 53/1973 as amended by law no. 87/2005 and law no. 109/2008. According to Article no. 127 of the Egyptian Constitution issued in January 2014, the budget law includes articles that grant authority to the Ministry of Finance (MoF) to issue treasury bills and bonds to meet the government's borrowing requirements.
- The Medium Term Debt Management Strategy (MTDS) is the plan that the MoF intends to implement over a three-year time frame in order to achieve a desired composition of the debt portfolio, reflecting the government's preferences with regard to the cost-risk tradeoff. To operationalize this plan, the Minister of Finance has issued Ministerial Decree no. 515 for the year 2015 mandating the composition of a working group to review debt management policies and to approve the MTDS document prior its publication.
- The purpose of this document is to identify the optimal debt strategy based on the government's key objectives and targets for debt management. The announcement of the MTDS document complies with the international sound practices as defined in the World Bank and International Monetary Fund (IMF) guidelines for debt strategy design.
- The MTDS is designed to have a strong focus on managing the risk exposure embedded in the debt portfolio. It is essentially a toolkit that provides useful information enabling decision-makers to quantify the potential risks to the budget arising from alternative debt management strategies and economic shocks.
- The Debt Management Unit (DMU) within the MoF is responsible for carrying out the MTDS and will update this strategy document on an annual basis.
- The MTDS analysis consists of eight steps:
 1. Clarifying the objectives and scope of the MTDS;
 2. Clarifying the current debt management strategy and reviewing the cost-risk characteristics of existing debt to determine the need for change;
 3. Reviewing potential funding sources for future borrowing strategies;
 4. Reviewing the macroeconomic and market environment and medium-term forecasts on an annual basis;
 5. Identifying risk factors to which the economy is exposed and which the debt management strategy should take into account;
 6. Defining and analyzing the cost-risk performance of alternative debt management strategies;
 7. Reviewing the preferred strategy with policy makers and market participants;
 8. Producing a debt management strategy document for approval by the Minister of Finance and subsequent public dissemination.

Guidelines

- For the purpose of the MTDS analysis, the scope of debt shown in this report includes only domestic tradable and external tradable debt.
- The classifications used for domestic and external conform to those in use by the IMF and the World Bank, as follows:
 1. Domestic Debt includes only T-Bills and T-Bonds issued in the domestic market and denominated in EGP;
 2. External Debt includes T-Bills and T-bonds issued in the domestic market and denominated in US\$ and Euro € as well as the international issuances of Eurobonds.

OBJECTIVES AND SCOPE FOR THE MTDS

- The objectives of debt management are specified in the Medium Term Debt Management Strategy (MTDS) rather than in a debt management law.
- The MTDS of the three year period spanning Fiscal Years (FY) 2015/16 – 2017/18 states that the objective of debt management is to ensure that the treasury funding requirements and payment obligations are met at a relatively low cost over the plan's term, consistent with a prudent degree of risk. Furthermore, the strategy aims to support the development of the domestic securities market.

CHARACTERISTICS OF THE EXISTING DEBT PORTFOLIO

Outstanding Debt

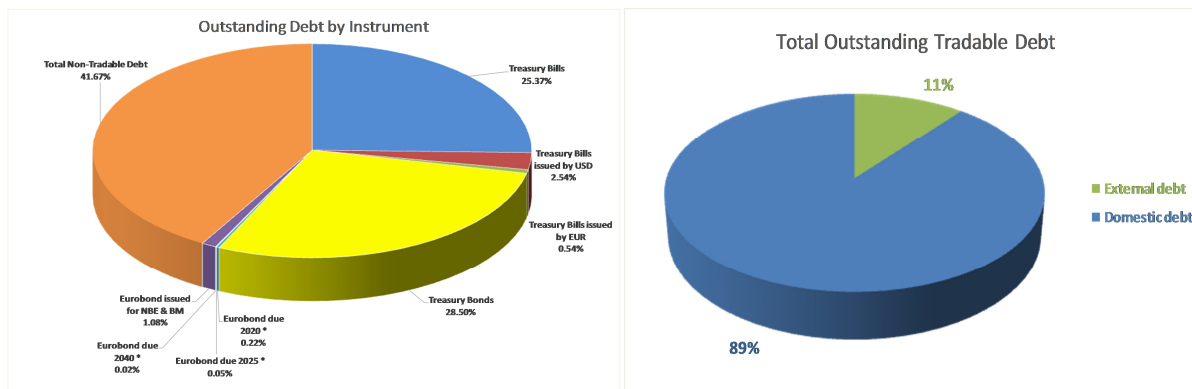
- Total domestic debt (both tradable and non-tradable) reached EGP 2.09 trillion at the end of June 2015, or 86 percent of GDP. Of this, domestic tradable debt was EGP 1.13 trillion, equivalent to 54 percent of the total domestic debt (please refer to Table 1 below).
- Domestic tradable debt is comprised of Treasury bonds and Treasury bills, both denominated in EGP. The former constituted 54 percent of domestic tradable debt (28.6 percent of the total domestic debt), while the latter made up 46 percent (25.4 percent). Treasury bonds have been gaining share in recent years, leading to a gradual improvement in the Average Time to Maturity (ATM) of the overall domestic tradable debt portfolio.
- External debt consists of three sub-categories: medium and long term public and publicly guaranteed debt; medium and long term private sector non-guaranteed debt; and short term debt.
- Gross External debt recorded US\$ 48.1 billion at the end of June 2015, compared to US\$ 46.1 billion at the end of June 2014. External debt recorded 15 percent of GDP as end of June 2015, a relatively low figure when compared to the average of peer countries (for example, the Middle East and North Africa countries recorded an average debt amounting to 27 percent of GDP during the year 2013).
- Of the total gross external debt, government external debt was US\$ 25.7 billion (equivalent to 53.5 percent), having declined by 11.4 percent from US\$ 29 billion (63.1 percent of total external debt) at the end of June 2014.
- The government's external tradable debt reached US\$ 17.4 billion at the end of June 2015.

Table 1: Total Domestic Debt as at June 30, 2015

Total Domestic Debt As at June 30, 2015		
Domestic Debt		
In Million EGP		
Total Tradable Debt	1,221,804.72	58.3%
Total Non-Tradable Debt	872,995.78	41.7%
Total Domestic Debt	2,094,800.50	

- The bulk of the government's outstanding tradable debt is domestic debt. Debt denominated in domestic currency represents 89 percent of the total tradable debt, with the remaining 11 percent consisting of external debt and debt denominated in foreign currency (including US\$ T-Bills, US\$ T-Bonds and Euro T-Bills issued in the domestic market).

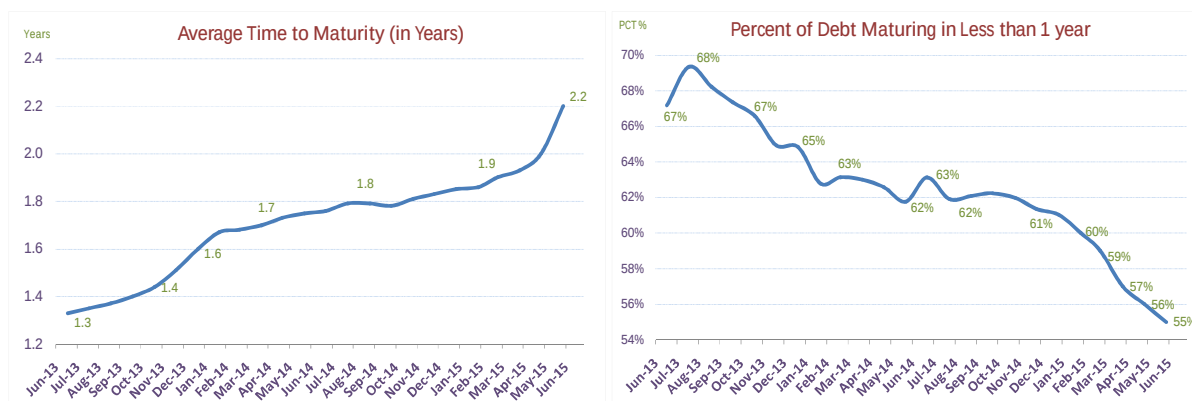
Figure 1: Outstanding Debt by Instrument (Left) and by Type (Right) as end of June 2015



* / External debt outstanding includes T-Bills and T-Bonds denominated in foreign currency (US\$ and Euro) that are issued in the domestic market.

- Average Time to Maturity (ATM) reached 2.2 years for domestic tradable debt by the end of June 2015.
- The percentage of domestic debt with maturity less than one year reached 55% of total domestic tradable debt; with respect to external debt, 56% of total external tradable debt at the end of June 2015.

Figure 2: Evolution of ATM and the percentage of debt less than one year of Domestic tradable Debt

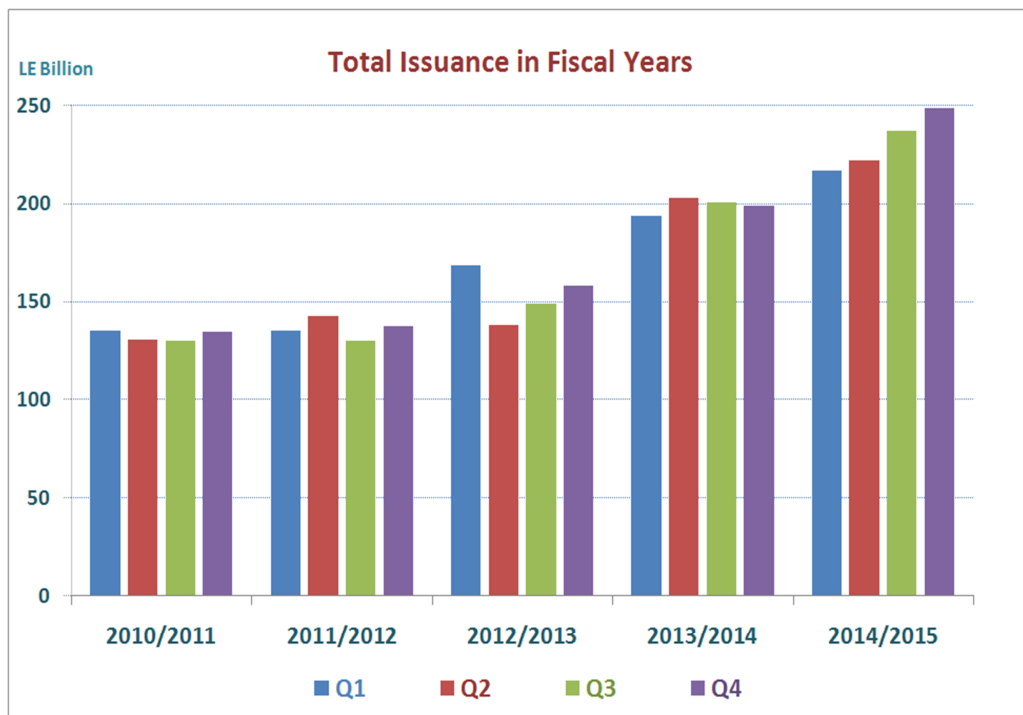


Existing Debt Management Strategy

- The mission of the Debt Management Unit (DMU) is to carry out the government's debt management strategy and procure treasury funding requirements at the lowest long-term cost relative to the general level of interest rates, consistent with the government's fiscal and monetary policy framework. The Ministry of Finance follows a market-oriented funding strategy based on projected requirements, determining frequency, volume, timing and maturities.

- Supporting market development is also an important objective for debt management strategy, which the MoF is addressing by:
 - Focusing on a limited number of benchmark maturities, namely, 3, 5, 7 and 10 years;
 - Increasing the number of re-openings for each security in order to raise the target amount outstanding to approximately EGP 12-15 billion per T-bond life time; this strategy increases the liquidity in the supply side, which will in turn enhance activity in the secondary market; and
 - Organizing the issuance schedule to avoid the crowding out of securities through alternating the issuance week for 3 and 7 year T-bonds along with 5 and 10 year T-bonds. A similar approach is followed for T-bills by issuing 3 and 9 month bills on one day, while 6 and 12 month bills are issued on a different day.
- During FY 2014/15, the MoF (through the operations of the DMU) issued government securities amounting to EGP1,097 billion (846 EGP billion T-Bills, 239 EGP billion T-Bonds, and 11 EGP billion representing the equivalent of the Eurobond issued in June 2015). These issuances were equivalent to 86 percent out of LE 1,278 billion in total financing needs.

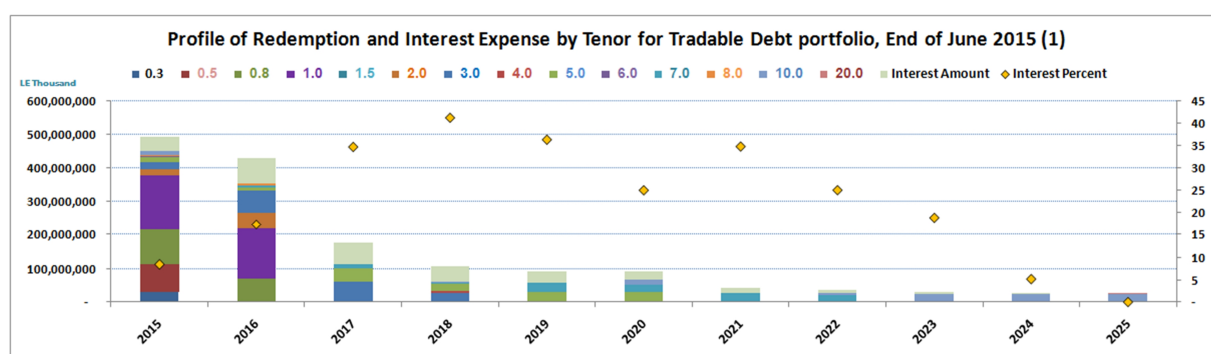
Figure 3: Total Issuances in Domestic Market



- One of the government's key objectives is to lengthen the maturity structure of the domestic tradable debt, as well as to consolidate a domestic yield curve in order to reduce refinancing risk. The MoF has succeeded in meeting this objective by moving gradually to a larger volume of issuances and re-openings of longer-dated treasury bonds.

- The issuance strategy implemented by the DMU has contributed to lengthening the average life of the domestic tradable debt (ATM) to reach 2.2 years at the end of June 2015, compared to only 0.34 year at the end of June 2004. In nominal terms, the outstanding stock of government medium and long term bonds increased to EGP 597 billion at the end of June 2015, up markedly from only EGP 13 billion in June 2004.
- While efforts to support the development of the government securities market have led to an increase in secondary market transactions, more effort must be exerted to activate trade in the secondary market for T-Bonds. Implementing this strategy will help in decreasing the 55 percent of the outstanding domestic debt under 1 year of maturity.
- Although there is a refinancing risk, it will be kept at close check. The DMU's operations have resulted in gradually lengthening the ATM of the total tradable debt outstanding (based on currency rather than residency for the external debt portion) to 2.2 years, as noted above.
- The ATM of the foreign currency denominated debt is slightly higher at 2.5 years due to the longer term of external issuances. The redemption profile is relatively smooth after 2017, with the only peak in FY 2015-2016 related to the amount of debt maturing within 1 year.

Figure 4: Redemption Profile by tenor for Tradable Debt Portfolio as end of June 2015



- While 100 percent of Egypt's tradable debt (both domestic and external) carries a fixed interest rate, interest rate risk is nonetheless relatively substantial due to the short-term nature of the debt portfolio. The share of debt carrying an interest rate to be re-fixed within 1 year is 55 percent for domestic debt and 56 percent for external debt. The large percentage of external debt maturing within 1 year is due to the issuance of USD and EUR denominated T-bills (1 year maturity) that were first issued in 2012. Although these foreign currency denominated bills are held by domestic banks, they represent an exposure to foreign exchange risk and are thus considered part of the external debt.

Table 1: Cost and Risk Indicators of total Tradable Debt (at the end of June 2015)

Risk Indicators		External debt **	Domestic debt ***	Total debt ****
Cost of debt	Interest payment as % GDP *	0.2	5.4	5.6
	Weighted Av. IR (%) *	3.3	12.3	11.3
Refinancing risk	ATM (years)	2.5	2.2	2.2
	Debt maturing in 1yr (% of total)	56.3	55.1	55.2
	Debt maturing in 1yr (% of GDP)	3.2	24.1	27.3
Interest rate risk	ATR (years)	2.5	2.2	2.2
	Debt refixing in 1yr (% of total)	56.3	55.1	55.2
	Fixed rate debt (% of total)	100.0	100.0	100.0
FX risk	FX debt (% of total debt)	11.3		11.3
	ST FX debt (% of reserves)	56.7		56.7

Source: MTDS output

*Nominal cost of debt and Weighted Average of Interest Rates include 20 percent withholding tax.

** External Debt includes T-Bills and T-bonds issued in the domestic market and denominated in US\$ and Euro € as well as the international issuances of Eurobonds.

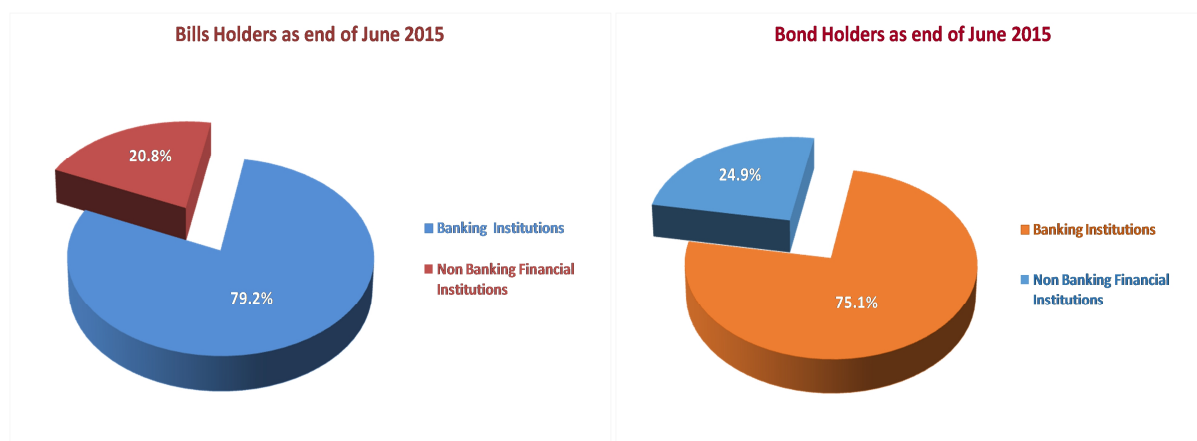
*** Domestic Debt includes only T-Bills and T-Bonds issued in the domestic market and denominated in EGP.

**** MTDS Model calculates the outstanding of external and domestic debt excluding interest payments of discounted instruments (T-Bills and Zero Coupon Bonds).

* / Classification of domestic and external debt are based on currency domination.

- Commercial banks hold almost 75percent of treasury securities, while non-banking financial institutions hold the remaining 25 percent. Foreign participation reached 25 percent of total holdings prior to 2011, but this has since dropped to a minimal level. Foreign participation is nonetheless slowly rising, with the trend expected to improve as the government's reforms continue to rebuild confidence and to address structural economic challenges.

Figure 2: Holders of T-Bills (Left) and T-Bonds (Right)



Sources of Financing

Domestic Sources of Funding

- The DMU has gradually succeeded in lengthening the average life of the debt to reduce refinancing risk, although achieving this outcome has been challenging due to the following reasons:
 1. The relative illiquidity of T-bonds (particularly 7 and 10 years) in the domestic secondary market;
 2. The concentrated investor base dominated by the banking sector, which tends to invest in shorter term instruments. This is due to the short-term nature of banks' deposits, which pushes them to invest in short-term instruments in order to avoid asset and liability mismatches.
- The challenges related to domestic borrowing include: diversifying the investor base and adding non-banking financial institutions; developing the secondary market, increasing the issuance of longer tenor bonds and adding new instruments to deepen the market. The MoF plans to pay further attention to the effects of government borrowing on the private sector in order to limit the crowding out effect, within the context of the government's need to raise funds from the domestic market.

External Sources of Funding

- Most of the government's external debt comprises Paris club bilateral debt and loans from multilateral institutions, and is therefore characterized by medium to long-term duration concessional rates; the objective of such loans is to finance specific investments and development projects (e.g. loans from the World Bank, the Islamic Development Bank and the African Development Bank).
- Tradable external debt is focused on market-oriented funding through the issuance of Eurobonds in the international capital markets according to prevalent market rates.
- Egypt's opportunity to access finance from multilateral institutions to lower the cost of funding remains a viable option that will enable the country to expand its sources of funding, while it will continue to be able to tap the international markets as conditions warrant.

Baseline Macroeconomic Assumptions and Key Risk Factors

Baseline Macroeconomic Assumptions

Since June 2014, Egypt has been progressing with a well-structured program to achieve high, sustainable and well-diversified growth, correct macroeconomic imbalances, and address social inclusion priorities. The government has made clear strides toward regaining confidence in the economy through serious and comprehensive reforms while moving steadily on advancing its constitutional objectives.

- The macroeconomic assumptions used in the MTDS are based on the latest projections generated by the Macro-fiscal policy Unit (MFPU) in the Ministry of Finance in conjunction with the monetary authority's projections. The MFPU's medium-term fiscal framework will serve as a basis for the assumptions underlying the analysis of the base case as well as alternative medium-term debt strategies. The time horizon for all projections is three years (FY 2015/16 – 2017-18), in line with the horizon of the debt management strategy document.
- The fiscal consolidation program represents the cornerstone of the government's plan to achieve and sustain macroeconomic stability. It is geared toward narrowing the fiscal deficit while improving the structure of spending and putting the government debt on a firm downward path. The government is targeting a budget deficit of 8 - 8.5% of GDP and government debt of 80 - 85% of GDP by FY 2019/20 through the implementation of both revenue- and expenditure-side reforms. The plan aims to create sustainable fiscal room, while using a part of the savings generated by the reform measures to fund social protection programs and increase spending on health, education and capital investment. Achieving these objectives will in tandem bolster confidence in the economy and crowd in private sector investment.
- Early in FY 2014/15, the government frontloaded the consolidation program by: implementing reforms to control the wage bill; introducing significant adjustments to the subsidized prices of major fuel products (ranging from 30 to 300 percent for oil products and 2 to 84 percent for electricity); enacting further reforms to the income tax code including the unification of the maximum rate for personal and corporate income at 22.5%, raising the exemption threshold from EGP 5,000 to EGP 6,500 in order to close loopholes, curb evasion and widen the tax base, as well as levying a 10% dividends tax; increasing the excises on alcoholic beverages and tobacco; and amending the property tax law.
- Enacted reforms during FY 2014/15 resulted in a 4% consolidation of the underlying budget deficit (excluding grants).
- The budget for FY 2015/16 includes additional measures on the order of 4.9% of GDP, which are expected to bring the fiscal deficit down to 8.9% of GDP.
- Fiscal reforms are positively contributing to the improvement of macroeconomic fundamentals and the return of confidence, thus enabling the expansion of domestic and foreign private sector activity. Higher rates of investment are expected to boost real GDP growth to 5% in FY 2015/16, rising to 6% by FY 2018/19. Rising growth will contribute to reducing the unemployment rate to below 10% during the same period.

Key Risk Factors

- There are upside risks coupled with notable opportunities and in particular those stemming from successful implementation of the government's fiscal consolidation policies and structural reforms. Early reform success and the completion of the political roadmap could boost

confidence and restore macroeconomic stability more rapidly than anticipated, and lead to higher growth, higher capital inflows and a faster pace of job creation. In particular, FDI could rebound more quickly than projected. Several sectors such as energy, manufacturing, mining, construction, and telecom have promising prospects – in particular, large investments have already returned to the energy sector and accelerated production from recent discoveries of large natural gas fields would have an important positive impact on the balance of payments. Although there have been recent episodes of volatility with respect to the emerging markets as an asset class, in Egypt's case portfolio investment could return more strongly than anticipated in response to reforms that renewed confidence and macroeconomic stability, in turn possibly bringing down financing gaps. Internal market reforms could reduce supply bottlenecks and have a beneficial impact on inflation. In sum, strong policy implementation and a positive domestic and international response could lead to better outcomes.

- It is also worth mentioning that Egypt succeeded in issuing a Eurobond with a value of US\$ 1.5 billion in the international markets in June 2015. The issuance was oversubscribed 3 times, reflecting investor confidence in the Egyptian economy, and achieved a favorable coupon relative to the issuance size, the timing of issuance and Egypt's sovereign credit rating.
- The government is also aware of other possible downside risks related to the macroeconomic outlook that may impact the growth potential. These include the risk of fiscal policy not adhering to targets, deterioration in the balance of payment position, worsening global conditions, and an increase in global interest rates. The materialization of these risks, whether singly or in combination, is likely to hamper Egypt's growth prospects, put pressure on the exchange rate, and lead to a rise in domestic and/or external borrowing costs.
- In light of expectations for global interest rate hikes—such as U.S. tapering and the gradual phasing out of the quantitative easing (QE) stance that was adopted following the 2008 global financial crisis—Egypt's ability to access international debt markets might be hindered during the immediate future. On the other hand, the higher funding requirements, the higher possibility of the banking sector's inability to cover these requirements, which will lead to the increase of risk to meet 100% of funding requirements.

Shock Scenarios

- Within the framework of the MTDS, the DMU has assessed the cost-risk implications of alternative debt management strategies under several shock scenarios, or stress tests. Shock scenarios include an increase in interest rates and exposure to foreign exchange rate risks.

Alternative Financing Strategies

- Alternative financing strategies reflect various means to finance the gross borrowing requirement, including the ratio of new debt from external and domestic sources in specified instruments. For all strategies, the mix of sources of finance (both domestic and external) is constant over the time horizon of the analysis (three years 2015/16 – 2017/18).

Cost-Risk Analysis of Alternative Debt Management Strategies

- The quantitative analysis conducted by the MTDS module captures the performance of alternative strategies under the baseline scenario and stress tests (shocks). Six cost measures were applied: 1. Nominal interest as a share of GDP; 2. Debt to GDP; 3. PV to GDP; 4. Cost of interest to revenue; 5. External debt to GDP; and 6. External debt service to international reserves. Risk for a given financing strategy is the difference between its cost under a risk scenario (i.e., one with a shock to the baseline) and its cost under the baseline. The maximum risk measure across all alternative scenarios is used to compare the risk associated with each of the strategies. For the purposes of comparison, the focus is on the outcome at the end of the three year simulation horizon—that is, FY 2017/18.
- Incorporating external sources of financing will decrease the cost of borrowing while increasing exposure to foreign exchange risk. As for domestic strategies, shorter term tenors are most cost effective, but imply a high rollover risk.
- In light of its review of alternative debt management strategies, the MoF views that it should continue with the current strategy that employs a mix of 60-40% for short vs. long term financing from the domestic market. Also, the MoF will increase gradually the amount of foreign currency borrowing. However, raising foreign currency exposure significantly is not deemed to be the best solution, even at attractive global rates, and will be carefully assessed in light of global market conditions.
- Nonetheless, the MoF recognizes that filling part of the financing gap externally will help reduce costs, diversify the investor base and re-introduce Egypt to the international capital market from time to time. In addition, such external borrowing will lend support as a benchmark for other domestic issuers in the international markets.

Concluding Remarks and the Way Forward

The debt management strategy aims at issuing gradually larger volumes of longer-dated Treasury Bonds by means of constant issuance and re-openings in order to lengthen the average life of the debt stock, to consolidate the government securities yield curve, and to reduce refinancing risk. In addition, the strategy encompasses a focus on diversifying the sources of financing through the issuance of new instruments such as "*sukuk*" to finance development and infrastructure projects as well as enlarging the investor base by attracting retail investors and incorporating more non-banking financial institutions. These strategies will decrease the cost of issuance of the government's debt securities.

To support market development and to move to a more transparent and visible phase, four steps related to the issuance plan are to be continued:

1. Focus on a limited number of benchmark maturities, that is, the 3, 5, 7 and 10 years, possibly issuing longer maturity as new benchmark
2. Increase the number of re-openings of each security in order to raise the target amount outstanding to approximately EGP 12-15 Billion per T-Bond.

3. In order to avoid maturities' crowding, maturities are organized to be issued every other week: 3 & 7 years T-Bonds are issued on the same day, while 5 & 10 years are issued on the following Monday.
4. Auctions days are organized to avoid crowding out among the competing maturities. Therefore, 6 and 12 month securities are issued on Thursday, 3 and 9 month are issued on Sunday, and T-Bonds issuance will take place on Mondays.

The government plans to raise funds from the international capital markets amounting to 1.5 - 3 billion US\$ on a yearly basis during the projected three-year period covering FY 2015/16 – 2017/18. Egypt has two programs to issue in the external markets comprising the GMTN - Global Medium Term Note Program for Eurobonds issuances up to 10 billion US\$ and the EMTN – Euro Medium Term Note program for Eurobond issuances up to 12 billion US\$.

Implementation Issues

- A clear institutional set-up is important for both the development and the implementation of the MTDS. In Egypt, the debt management function falls within the domain of the Ministry of Finance. According to the annual budget law, the Ministry of Finance is responsible for borrowing, whether domestically or internationally, to fund the budget deficit and to refinance existing debt.
- The Ministry of Finance and CBE will work closely together to deepen the development of both the primary and secondary domestic markets.