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) 2018-19 through 2020-21 based on the Government of Egypt's objectives and targets for debt management.

Content

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
PDs	Primary dealers
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
USD	US Dollar
WBG	World Bank Group

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 interest rate, including debt issued at a variable interest rates and debt with a maturity of less than one year.
Budget sector	The budget sector debt stock encompasses outstanding stocks of Central Administration, local Governments, and Public Service Authorities
Classification of debt by residency	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.
IPO	Initial Public Offering.
Re-opening	The reopening of existing government securities serves to build up benchmark bonds, 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.
Yield curve	A line that plots the structure of interest rates on securities over a range of maturities. For example, government securities with different maturities, from three-months Treasury Bills to ten years Treasury Bonds. It enables investors to compare the yields offered by short, medium- and long-term securities.
General Government debt stock	The general Government debt stock includes the consolidated debt stocks of the Budget sector, the NIB (National Investment bank) and SIF (Social Investment bank)
Public sector debt	The public sector debt stock corresponds to the consolidated debt of the general government and economic Authorities

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 to achieve a desired composition of central government debt portfolio, reflecting the government's preferences with regards to the cost-risk tradeoff. To operationalize this plan, the Minister of Finance has issued the Ministerial Decree no. 515 of year 2015 mandating the composition of a working group to review the debt management policies and to approve the MTDS document before being published.

- The purpose of this document is to identify the optimal central government debt strategy based on the government's key objectives and targets for debt management. The publication of this MTDS document complies with sound practice in international debt management 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 of the government's debt portfolio. It is a toolkit that enables decision-makers to quantify potential risks to the budget that might arise 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 in coordination with different relevant units in MoF.

- 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 the risk factors that the economy is exposed to and which the debt management strategy should consider;
    6. defining and analyzing the cost-risk performance of alternative debt management strategies;
    7. reviewing the preferred strategy with policy makers and market participants; and
    8. producing a debt management strategy document for approval by the Minister of Finance and prior to public dissemination.

Guidelines

- In 2015, the scope for MTDS was marketable (i.e. tradable) debt only, including domestic tradable debt (T-bills and T-Bonds), and external debt (International Issuances of Eurobonds and T-Bills and T-Bonds in USD & Euro).

- In 2019, DMU successfully expanded the scope to include bi- and multilateral external debt.

- For the MTDS analysis, the scope of debt shown in this report includes only domestic tradable, external tradable debt as well as bi- and multilateral loans.

- The classifications used for domestic and external conform to those used by the IMF and the World Bank, as follows:
    1. Domestic Tradable Debt includes only T-Bills and T-Bonds issued in the domestic market and denominated in EGP;
    2. External Tradable Debt includes T-Bills and T-bonds issued in the domestic market and denominated in USD and Euro as well as the international issuances of Eurobonds; and
    3. Bi- and multilateral external debt loans.

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) 2018/19– 2020/21 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 ongoing development of the domestic securities market.

MTDS Targets

- MTDS establishes four main targets:
    1) The domestic and foreign cental government debt as percentages of GDP
    2) The maximum share of central government domestic debt allowed to mature within one year and the maximum amount of debt subject to interest rate re-fixing
    3) Share of tradable debt vs. non-tradable debt
    4) Average Time to Maturity of domestic and foreign central government debt

Characteristic of the Existing Debt Portfolio

Outstanding Debt

- Total domestic debt, on central government, (both tradable and non-tradable) reached EGP 3.47 trillion at the end of June 2018, which amounts to 78.2 percent of GDP, out of which the domestic tradable debt recorded EGP 2.33 trillion, that is equivalent to 67.3 percent of the total domestic debt (please refer to Table 1 below).

- Domestic tradable debt is comprised of Treasury bills and Treasury bonds, both denominated in EGP. The former contributes to 66.3 percent of domestic tradable debt (forming 44.6 percent of the total domestic debt), while the remaining 33.7 percent of the total domestic tradable debt consists of Treasury bonds (forming 22.7 percent of the total domestic debt).

- Gross external Central Government debt amounted to USD 47.6 billion on the 30th of June 2018 (equivalent to 51 percent of total external debt), having increased by 36 percent from USD 34.9 billion (44.1 percent of total external debt) at the end of June 2017.

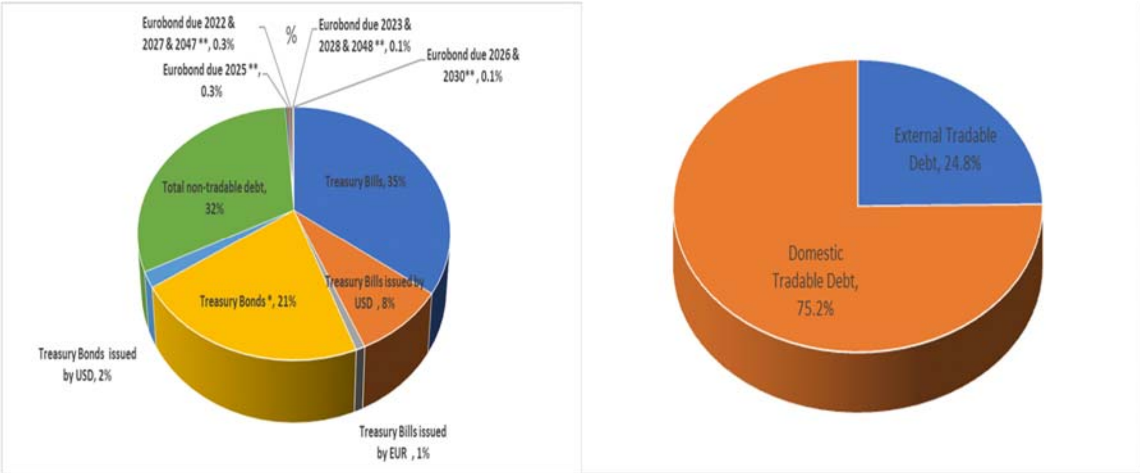
- The Central government's external tradable debt reached USD16.2 billion at 30 June 2018.

Table 1: Total Central Government Domestic Debt as at June 30,2018

Government Securities	Outstanding EGP	Outstanding in USD equivalent	% to total domestic debt	% of GDP
Total Domestic tradable debt	**2,334,356**	**130,120**	**67.3%**	**52.61%**
Total Domestic non tradable debt	**1,134,137**	**57,219**	**32.7%**	**25.56%**
Total Domestic Debt	**3,468,493**	**187,339**	**100%**	**78.17%**

- The bulk of central government's outstanding tradable debt is domestic debt. Debt denominated in domestic currency represents 75.2 percent of the total tradable debt, with the remaining 24.8 percent consisting of external debt and debt denominated in foreign currency (including USD T-Bills, USD 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 2018



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

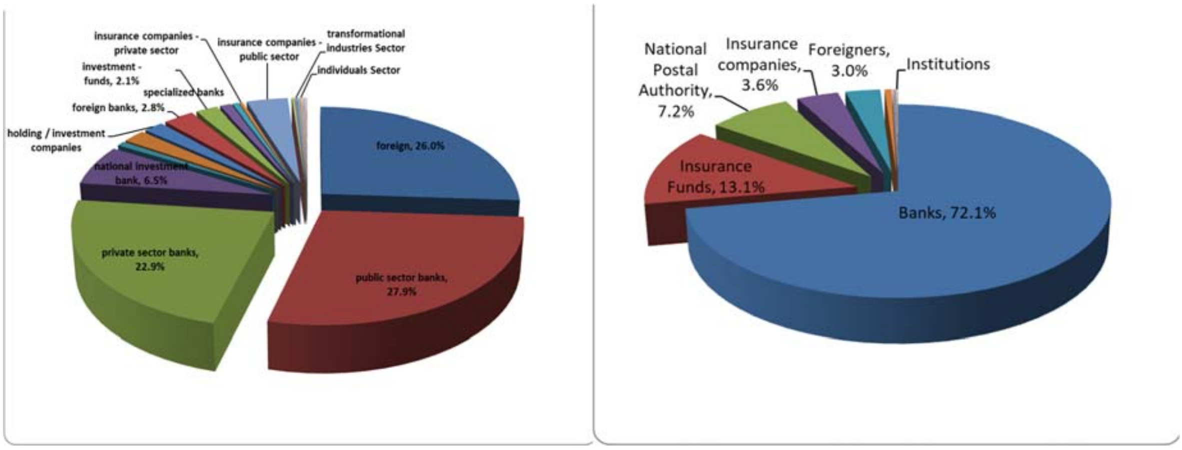
- Average Time to Maturity (ATM) reached 1.3 years for central government domestic tradable debt by the end of June 2018.[1]

- Commercial banks hold almost 60.6 percent of average treasury securities, while non-banking financial institutions hold 17.4 percent. Foreign participation reached 15.59 percent of total holdings in June 2018, yet its share declined to lower levels since then. Foreign participation is nonetheless relatively rising again, with such trend expected to improve as the government's reforms continue to rebuild confidence and to address structural economic challenges.[2]

[1] Domestic Tradable Debt (EGP Bills and Bonds) ATM reached 1.42 Years by end of March 2019, while External Tradable Debt ATM reached 12.07 Years. Thus, total tradable Domestic & External central government debt reached 3.11 Years as of end March 2019.

[2] Foreign participation reached 11.58 percent of total domestically issued government securities as of end March 2019.

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



Existing Debt Management Strategy

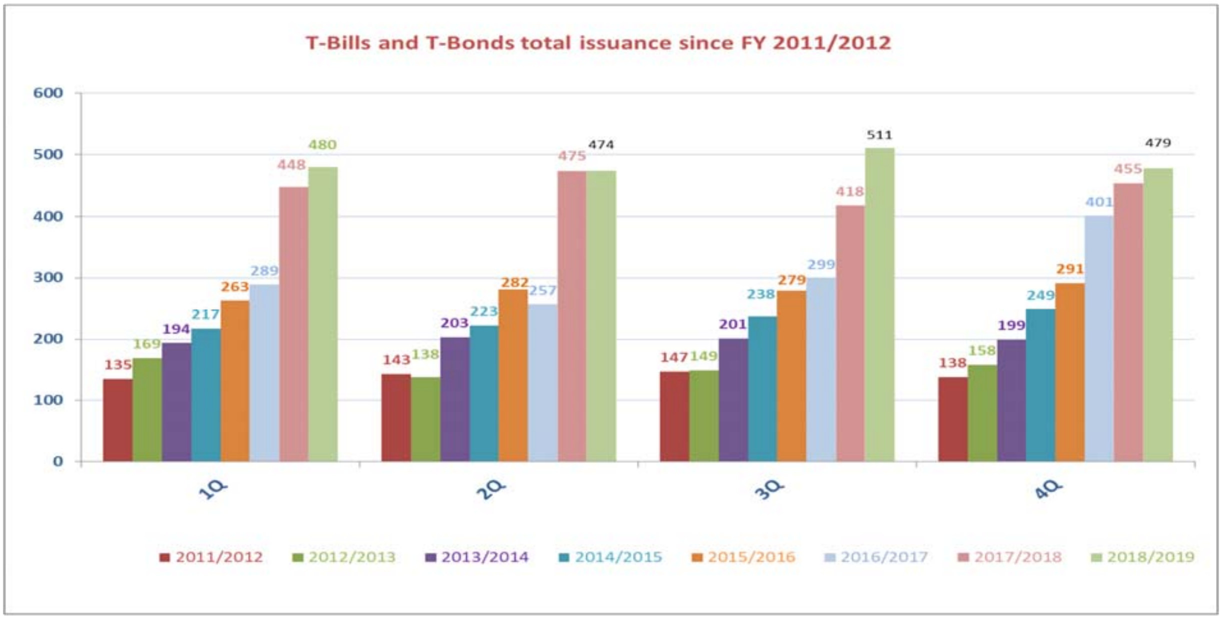
- The mission of the Debt Management Unit (DMU) is to carry out the government's debt management strategy and procure treasury funding requirements at the lowest long-term cost relative to the general level of interest rates, consistent with the government's fiscal and monetary policy framework. The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

- Because of the increases in interest rates following the Monetary Policy Committee (MPC) decisions to increase benchmark policy rates by 700 bps between November 2016 and July 2017, the Debt Management Unit has been implementing a temporary strategy to conduct issuances at the shorter end of the yield curve rather than the long end of the yield curve. Starting from July 2018 and in conjunction with lower prevailing interest rates, this strategy started to gradually shift towards issuing longer tenors.

- Supporting market developments is also an important objective for the debt management strategy, which the MoF is addressing by:
    1. Focusing on a limited number of benchmark maturities, namely, 3, 5, 7 and 10 years;
    2. Increasing the number of re-openings for each security to raise the target amount outstanding to approximately EGP 15-18 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
    3. Organizing the issuance schedule to avoid the crowding out of securities through alternating the issuance week for 3- and 7-years 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 2017/2018, the MoF (through the operations of the DMU) issued domestically a total amount of EGP 1,796 billion (EGP 1,676 billion T-Bills, EGP 120 billion T-Bonds).[2]

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 to reduce the 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.

- While the exerted 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.

- 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).

- 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 one year is 46.9 percent (66.9 percent for domestic debt and 25.5 percent for external debt). The large percentage of external debt maturing within one year is due to the issuance of USD and Euro denominated T-bills (one-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. The ratio has been declining steadily during 2018/2019.

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[2] For July 2018 to March 2019, the MoF has issued domestically approximately a total amount of EGP 1,422 billion (EGP 1,057 billion T-Bills, EGP 365 billion T-Bonds).

Table 2: Cost and Risk Indicators of total Tradable Debt (at the end of June 2018)

Risk Indicators		External debt **	Domestic debt ***	Total debt ****
Amount (in millions of EGP)*		1,325,613.5	1,729,421.9	3,055,035.4
Amount (in millions of USD)*		73,891.5	96,400.3	170,291.8
Nominal debt as percent of GDP		29.9	39.0	68.8
PV as percent of GDP		29.9	39.0	68.8
Cost of debt	Interest payment as percent of GDP	1.2	6.4	7.6
	Weighted Av. IR (percent)	4.0	16.5	11.1
Refinancing risk	ATM (years)	7.1	1.6	4.3
	Debt maturing in 1yr (percent of total)	25.5	66.9	46.9
	Debt maturing in 1yr (percent of GDP)	9.3	26.1	35.3
Interest rate risk	ATR (years)	7.1	1.6	4.3
	Debt refixing in 1yr (percent of total)	25.5	66.9	50.2
	Fixed rate debt incl T-bills (percent of total)	100.0	100.0	100.0
	T-bills (percent of total)	0.0	60.0	31.1
FX risk	FX debt (percent of total debt)			43.4

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 USD and Euro €, bilateral and multilateral loans as well as the international issuances of Eurobonds. This deficintion is used in this report for analytical puroses to be aligned with World Bank guidelines.

*** 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.

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 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 continue its fiscal consolidation program to further reduce government borrowing needs and limit any crowding out effect.

External Sources of Funding

- External debt consists of the external portion of long-term indebtedness incurred directly by the Central Government, external long-term indebtedness incurred by Economic Authorities and Service Authorities and private sector non-guaranteed debt.

- Tradable external debt is focused on market-oriented funding through the issuance of Eurobonds in the international capital markets according to prevalent market rates. The Eurobonds outstanding is composed of issuances denominated in USD dollars and Euros (with nominal value equal to USD 16.2 billion). The following graph shows the structure of issuances by maturities which are also listed in the followed table with each tranche's coupon rate at the end of June 2018.

Figure 4: External Tradable Debt Profile 2017/2018

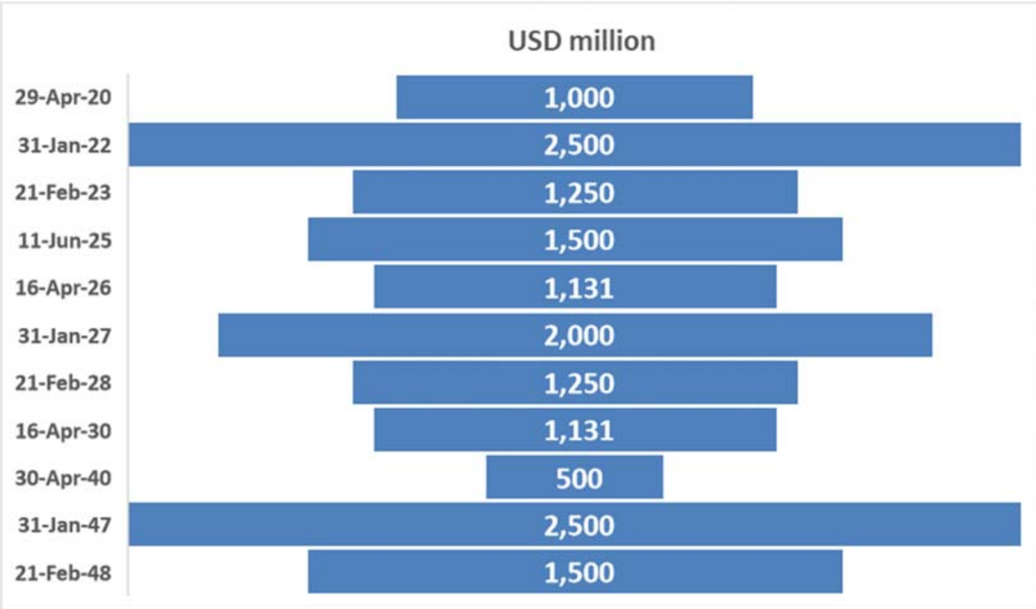

Table 3: List of Euro-bonds Issuances (at the end of June 2018)

Issue Date	Issue Size	Coupon	Maturity
		(percent per annum)	
29 April 2010	USD1,000,000,000	5.750	29 April 2020
31 January 2017	USD1,750,000,000	6.125	31 January 2022
29 May 2017*	USD750,000,000	6.125	31 January 2022
21 February 2018	USD1,250,000,000	5.577	21 February 2023
11 June 2015	USD1,500,000,000	5.875	11 June 2025
31 January 2017	USD1,000,000,000	7.50	31 January 2027
29 May 2017*	USD1,000,000,000	7.50	31 January 2027
21 February 2018	USD1,250,000,000	6.588	21 February 2028
30 April 2010	USD500,000,000	6.875	30 April 2040
31 January 2017	USD1,250,000,000	8.500	31 January 2047
29 May 2017*	USD1,250,000,000	8.500	31 January 2047
21 February 2018	USD1,500,000,000	7.903	21 February 2048
16 April 2018	Euro1,000,000,000	4.750	16 April 2026
16 April 2018	Euro1,000,000,000	5.625	16 April 2030

Notes:

*/ Notes issued as a tap issuance.

- The Euro bond issuances for the base year of the analysis (FY 2017/2018) were as follows:

  In February 2018, the Republic issued its USD1.25 billion 5.577 percent Notes due 2023 (Series 5), USD1.25 billion 6.588 percent Notes due 2028 (Series 6) and USD1.5 billion 7.903 percent Notes due 2048 (Series 7) under the GMTN Program. Each Series of these Notes is listed on London Stock Exchange.

  In April 2018, the Republic issued its first Euro denominated bond of Euro 1.0 billion 4.750 percent Notes due 2026 and Euro 1.0 billion 5.625 percent Notes due 2030 under GMTN Program. These Notes are listed on the London Stock Exchange.

Bilateral and multilateral loans

- Most of central 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).

- 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.

- Bilateral and multilateral loans reached USD 33.1 billion as at 30 June 2018 compared to USD 25.7 billion at the end of June 2017.

International Monetary Fund (IMF)

- In November 2016, the Executive Board of the IMF approved the three-year EFF for Egypt in an amount of 8.597 billion Special Drawing Rights ("SDRs") (approximately USD12 billion). The EFF is aimed at supporting the Government's economic reform program and is intended to help restore macroeconomic stability and promote inclusive growth. The approval of the EFF allowed for the immediate disbursement of SDR 1.970 billion (approximately USD2.75 billion).

- In July 2017, the IMF completed its first review under the EFF, which permitted the disbursement of the equivalent of SDR 895.5 million (approximately USD1.25 billion). This amount was disbursed in July 2017. As part of this first review, the Executive Board of the IMF approved the Egyptian authorities' request for waivers of the June 2017 performance criteria for the primary fiscal balance and the fuel subsidy bill, which were missed due to higher costs of imported food and fuel products, due to the depreciation of the Egyptian Pound.

- September 2017, the IMF noted that the financing gap for 2017/18 following planned disbursements under the EFF was USD2 billion to be financed through multilateral and bilateral financing. There can be no assurance, however, that the Government will be successful in obtaining financing to close this financing gap.

- The second review under the EFF was completed in December 2017, which permitted the disbursement of the equivalent of SDR 1.4 billion (approximately USD2.0 billion). This amount was disbursed in December 2017. As part of this second review, the Executive Board of the IMF approved the Egyptian authorities' request for modifications to the December2017 and June 2018 performance criterion for net domestic assets and the June 2018 performance criterion for the primary fiscal balance.

- The third review under the EFF was completed in June 2018, which permitted the disbursement of the equivalent of SDR 1,432.8 million (approximately USD2.0 billion). This amount was disbursed in June 2018, bringing total disbursements under the EFF to SDR 5,731.1 million (approximately USD8.1 billion). As part of this third review, the Executive Board of the IMF approved the Egyptian authorities' request for a waiver of non-observance of the December 2017 performance criterion for the primary fiscal balance and the modification of the June 2018 performance criterion in respect of the fuel subsidy bill.

- On 4 February 2019, the Executive Board of the IMF completed the fourth review under the EEF, which permits the Egyptian authorities to draw the equivalent of SDR 1,432.8 million (approximately USD2.0 billion), bringing total disbursements to SDR 7,163.8 million (approximately USD10.0 billion).

World Bank (WBG)

- In December 2015, the Government and the World Bank Group approved the Country Partnership Framework 2015-19. This framework, which is based on the Government's medium-term strategy and national priorities for economic development, envisages the disbursement of approximately USD8 billion to Egypt between 2015-2019. In September 2016, first disbursement of USD1.0 billion was made under this framework and a further loan of USD 500 million was approved by the World Bank Board. Further loans were agreed with the World Bank, which were disbursed in March 2017 (USD1.0 billion), December 2017 (USD1.2 billion) and March 2018 (USD1 billion), each of which was disbursed to support the Government's economic reform program.

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 2018/19 – 2021/22), 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 7.2percent of GDP in FY 2019/20 and budget sector debt of 89.2percent of GDP in FY 2019/20 through the implementation of both revenue- and expenditure-side reforms. The plan aims to create sustainable fiscal space, while using part of the savings generated by the reform measures to fund social protection programs as well as increasing spending on health, education and capital investment. Achieving these objectives will in tandem bolster confidence in the economy and crowd in private sector investment.

- During FY 2016/17, the government started a fiscal consolidation program by: implementing reforms to control the wage bill; introducing significant adjustments to the subsidized prices of major energy products (reaching around 90 to 95 percent cost recovery by 2018/19) noting that it reached around 85 – 90 percent in March 2019 (for first three quarters of the fiscal year); enacting further reforms to the income tax code including the unification of the maximum rate for personal and corporate income at 22.5percent, raising the exemption threshold from EGP 5,000 to EGP 8,000 in order to close loopholes, curb evasion and widen the tax base; increasing the excises on alcoholic beverages and tobacco; and amending the property tax law.

- The budget for FY 2019/20 includes additional fiscal consolidation measures that worth 0.9 percent of GDP, which are expected to bring the fiscal deficit down to 7.2 percent 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 6percent in FY 2019/20. Rising growth will contribute to reducing the unemployment rate to 9.1percent during the same period.

Table 4: Egypt: Macroeconomic Assumptions (EGP Billion)

	2019/20	2020/21	2021/22
Public Revenues	1,134,424	1,250,299	1,402,269
Public Sector Primary Expenditure	1,005,424	1,086,413	1,219,554
Public Sector Expenditure	1,574,559	1,701,877	1,755,203
Public Sector Interest Expenditure	569,135	615,464	535,649

Source: Ministry of Finance

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. 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 returned more strongly than anticipated thanks to reforms that renewed confidence and macroeconomic stability, bringing down financing gaps. The ongoing pursue of market reforms would also reduce supply bottlenecks and hence would have a beneficial impact on inflation.

- It is also worth mentioning that Egypt succeeded in issuing a multi-tranche 144A / RegS USD 4.0 billion multi-tranche offering rated B by S&P and B by Fitch, comprising of USD 750 mm 5-year, USD 1.75 billion 10-year and USD 1.5 billion 30-year tranches due 2024, 2029 and 2049 respectively in February 2019. Order book surged to peak at over USD 21.0 bn for Egypt with a cross-section of high quality global institutional investors allowing pricing compression of 40 bps across the tranches. Largest order book for any African sovereign ever and the highest oversubscription (at peak) since 2017 for a MENA sovereign issuer. All tranches priced with no new issue concession to be the first emerging market sovereign conventional issuance to price flat to its curve in 2019.

- Egypt completed a substantial amount of its total financing needs early in the year 2018-19 while pushing out its maturity profile as part of a coordinated effort to move away from reliance on short-term funding.

- The government is also aware of possible downside risks related to the macroeconomic outlook that may impact the growth potential. These include 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 regularly affect Egypt's growth prospects, put pressure on the exchange rate, and lead to a rise in domestic and/or external borrowing costs.

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, external, and bi- and multilateral loans) is constant over the time horizon of the analysis (three years 2018/19– 2020/21).

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 years simulation horizon that is, FY 2020/21.

Concluding Remarks and the Way Forward

- Starting from July 2019 the debt management strategy aims at issuing gradually larger volumes of longer-dated Treasury Bonds by means of constant issuance and re-openings to lengthen the average life of the debt stock, to consolidate the government securities yield curve, and to reduce refinancing risk and engage PDs to reintroduce instruments such as FRNs, zero coupon bonds. In addition, the strategy encompasses a focus on diversifying the sources of financing through the issuance of new instruments such as "sukuk", Green bond, Corridor-linked bonds and inflation-linked bonds 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 to raise the target amount outstanding to approximately EGP 15-18 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-months securities are issued on Thursday, 3 and 9 months are issued on Sunday, and T-Bonds issuance will take place on Mondays.
    5. Introduce liability and Cash management tools like bond buybacks and bond exchanges.

- The government plans to raise funds from the international capital markets amounting to USD 5-8 billion on a yearly basis during the projected three-year period covering FY 2018/19 – 2020/21. Egypt has two programs to issue in the external markets comprising the GMTN - Global Medium Term Note Program for Eurobonds issuances up to USD 30 billion and the EMTN – Euro Medium Term Note program for Eurobond issuances up to USD 12 billion.

- MTDS' targets:
    1. The central government debt as percentage of GDP to reach 84.9 percent (70.6 percent for domestic debt and 14.3 percent for external debt) by 2020/21 and to reach 79.5 percent (66.2 percent for domestic debt and 13.3 percent for external debt) by 2021/22.
    2. The maximum share of central government domestic tradable debt allowed to mature within one year and the maximum amount of debt subject to interest rate re-fixing both are limited to 50 percent of the total domestic tradable debt.

3. Share of tradable debt vs. non tradable debt to reach 70 percent tradable vs. 30 percent non tradable by end of 2020-2021.
4. Average Time to Maturity of central government domestic and foreign tradable debt to reach 4 years by end of FY (2020-2021) and 4.5 years by end of 2021-2022.

Market Developments

The Ministry of Finance's Debt Management Unit is in the process of developing a comprehensive reform program in respect of the domestic capital markets in collaboration with the CBE and other stakeholders (including the Financial Regulatory Authority, the EGX, Misr for Central Clearing, Depositary and Registry and certain primary dealers). The reform program is based on the following four pillars:

- ***Primary Market Reforms***: Amending legislation to focus on improving the balance of incentives and obligations for primary dealers and specifically market-makers, in respect of market making obligations; encouraging the use of primary dealers and market-makers for the distribution of Government securities; and promoting an acceptable level of domestic Government borrowing costs.

- **Secondary Market Reforms**: Development of secondary debt markets with a focus on the reduction of financing costs. Such reforms are expected to include: (i) market architecture reforms, including imposing quoting obligations on primary dealers to improve price transparency; (ii) measures to encourage new market participants, including the introduction of a second tier of market participants in the secondary market for treasury bills, introducing incentives and utilizing penalties; (iii) the introduction of a new electronic trading platform and improving the existing system; (iv) the introduction of additional secondary market products to encourage repo activity and to enhance liquidity in fixed income markets; and (v) the development of a new clearing system for clearing and settlement functions. The proposed reforms are intended to permit the Government to implement market-making obligations in the primary market while also providing the tools in the secondary market to permit primary dealers and market-makers to conduct repos, sales and buy-back of domestic securities.

- **Euroclearability**: In line with the economic reform measurements taken by Egypt across many fronts and the ongoing efforts exerted by the Ministry of Finance (MoF) to attract more foreign investors, in addition to the high appetite of the international investment community for the Egyptian fixed income instruments whether in local or foreign currencies (dollar and euro), MoF is working on the euroclearability of the domestic debt instruments.

  This connectivity with Euroclear shall enhance the debt management by contributing in reducing the cost of borrowing through:

  - attracting big ticket size investors (such as the central banks)

- increasing the demand side by expanding the investor base (especially the risk-averse investors who consider Euroclear a safe gateway to enter the market and that Egypt is confirming to the strict compliance and legal requirements of Euroclear)
- offering multi-currency trading option
- providing the latest world-class settlement and clearing systems
- and therefore, increasing the liquidity in the secondary market

It is also considered a marketing mechanism for the government securities as well as a step forward to pave the way for the inclusion in international indices, such as JPMorgan Emerging Markets Index.

On the 12th of April 2019, the Egyptian Ministry of finance (MOF) and Euroclear Bank have signed a memorandum of understanding (MOU) to mark the intention of MOF and Euroclear to work together to create the right conditions in the Arab Republic of Egypt (Egypt) for setting up the connectivity/ cross border link to enable international investors to easily invest in the Egyptian domestic fixed income instruments.

In addition, by being euroclearable, MoF is aiming to improve the market depth by expanding the international institutional investor base and facilitating the access to the Egyptian Government securities. It also allows the market to sustain a single, powerful pool of liquidity, resulting in strong macro -economic benefits including a reduction in bond yields and an increase in the local liquidity of assets, which in turn creates a deeper, stable and larger domestic market. Through the link, borrowing costs for sovereign debt issued by the MoF are therefor expected to decrease over time, thereby contributing to a better debt management strategy.

Dealing with a larger segment of foreign investors on government bonds and treasury bills issued in local currency shall decrease the cost of borrowing by 40 bps, based on our discussion with Euroclear and compared to the experience of other countries that followed suit.

The expected completion time of this project is Q1, 2020 and currently the term sheet is being prepared to be signed between MoF and Euroclear.

- **Official Yield Curve**: Constructing an official yield curve (one year – ten years) in collaboration with the CBE and the EGX, to be used in, inter alia, pricing financial assets, managing financial risk, allocating portfolios, structuring fiscal debt, conducting monetary policy and valuing capital goods.

  In addition, the CBE, in co-ordination with the EBRD, the Middle East and North African Transition Fund and the African Development Bank is currently implementing a central securities depository for government securities project, which consists of establishing the core system components for such depositary, an electronic trading platform, data warehouses and an information dissemination platform and a yield curve pricing model for Government securities. The main objectives of this project are to establish a single integrated settlement system for treasury bonds and treasury bills, enhance access to Government securities to use as collateral, promote high quality simultaneous delivery versus payment settlement and increase secondary market liquidity.

Contingent Liabilities' Policy

- As part of the debt management strategy, MOF is currently closely monitoring the sovereign guarantees in light of the fact that it represents a contingent obligation on the state treasury. A Sovereign Guarantee Committee has been established by the virtue of the Minister of Finance decree number 201 for the year 2017 headed by the Minister of Finance. The committee is responsible for the issuance and monitoring of sovereign guarantees. The committee's role is to put in place a sovereign guarantee policy and relay to all concerned entities the required data and information prior to initiating negotiations for borrowing. The committee is also in charge of determining whether the preconditions and requirements have been fulfilled as well as assessing the financial implications of the guarantees issued. In addition, the committee will propose setting limits on guarantees issued and fees to be charged against the issuance of such guarantees. A regular assessment will also be conducted post guarantee approval for the borrowers to evaluate their financial position with the aim of managing the overall risk associated with the guarantees issued. The guidelines for the guarantee policy guide have been discussed with the Debt Management Committee established by the Prime Minister by virtue of decree 2003 for year 2018. In addition, the draft guarantee policy guide is currently undergoing the required approvals.

- In parallel, the Economic Affairs department headed by the deputy minister of finance, is taking an active role in reviewing guarantees and negotiating its terms as well as reviewing the availability of the required information and approvals until the process is fully streamlined. MOF is currently working to undergo the needed capacity building required to enable an optimal guarantee issuance and review process including full credit and risk analysis. This should be done in tandem with due consideration as to how to best enable the borrowing entities to implement the needed forward looking assessment with the aim of confirming the latter's ability to generate enough cash flows to settle the loan.

State owned Enterprise debt

- The Ministry of Finance published on its website by end of December 2018 a detailed report on the financial situation of state-owned enterprises along with information about their governance structure and implemented as well as planned reforms. This was a key reform implemented under Egypt home grown economic reform program supported by the IMF. This reform aimed at enhancing transparency of SOE sector. As such, MOF published two releases of firm-level SOE financial data on its website, in July and December 2018. [3]

- Starting the IPO program in January 2019 will help enhance transparency and avail more timely data and information as well as enforce better corporate governance.

- Certain types of publicly owned entities such as economic authorities were only partly included in SoEs published data (and are not covered by this MTDS). However, economic authorities detailed annual budgets are sent to the Parliament for discussion and approval and are subject to within the year budget oversight by various Parliamentary committees. In addition, economic authorities final accounts are published at end of the year after they are approved by the Parliament and these final accounts are published at MOF website.

- Various directions to strengthen the quality of SOE debt data are underway.

  - ✓ First, with technical assistance of development partners, the Government of Egypt will work on expanding reporting on SOE assets and liabilities including presenting the data in a form more compatible with existing reported debt statistics. This is quite complex task as it would entail reviewing SOE loan by loan terms based on lender's identity as well as reviewing additional loan-level information which could be commercially sensitive.

  - ✓ Second, current and planned SOE reforms implemented by the Government will improve the quality of SOE financial information and complement the generation of detailed SOE debt data.

  - ✓ For the purposes of this MTDS, SOEs financial information published at MoF website -including SOEs liabilities- would hopefully serve to augment the detailed information already available for the main debt components covered by the MTDS. In addition, as the contingent liabilities policy discussed elsewhere in the MTDS is rolled out, it will generate a need for a similar level of data for entities borrowing with a guarantee issued by the MoF, so that prospective guarantees can be comprehensively assessed.

  - ✓ Finally, as many of these liabilities correspond to assets of financial institutions, the forthcoming FSAP can assess corresponding asset quality issues.

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[3] The link to the report can be found at MOF website through the following link: SOE financial Reports from Dec. 2018: http://www.mof.gov.eg/Arabic/esdarate/Pages/Financial_performance_report.aspx.
Report from Summer 2018: http://www.mof.gov.eg/MOFGallerySource/Arabic/PDF/SoE%20Report_Final.pdf.

Institutional Setup for Debt Management Office

- The Debt Management Unit (DMU) within the MoF manages the state debt in the most cost-effective way possible by borrowing through domestic and international market using a variety of instruments with different features and maturities that cater for the needs of different investors. And for the DMU to perform its functions effectively, it needs consolidation in the MoF with clear organizational structure that identifies clear and distinct roles for different positions under the structure. The current staff of the DMU are competent and very committed but they must devote most of their time to respond to urgent requests and projects, creating a large backlog of less urgent but nevertheless crucial tasks. Therefore, the DMU is very vulnerable to turnover and key person risk, as illustrated in 2014 by the departure of the assistant head, and in 2015/2016 by the departure of two deputy head. Therefore;

    - Strengthening debt management in Egypt is a very high priority and a key element is strengthening the institutional set-up.
    - Even though central and general government debt are on a declining trend since 2017/18 considering the bold fiscal consolidation plan adopted over past few years, the prevailing debt ratios are still high. Thus, we are committed to continue our reform pace and momentum to bring down debt to GDP ratio to 75-80 percent by June 2021/2022. In addition, we will continue our efforts to improve structure of central government debt to reduce impact of interest rates and exchange rates shocks on debt levels and debt servicing bill.
    - A strong debt management function and a regularly updated and published debt management strategy will contribute to increasing confidence of market participants and rating agencies and reduce cost of borrowing.

- Main Recommendations:

    - Take Ministerial decision to establish a Debt Management Office (DMO) within the Ministry of Finance (MoF) and hire additional (4-5) staff to join the current Debt Management Unit (DMU);
    - Gradually build the DMO centered on a strong middle office;
    - Add the DMFAS team (back-office) and decide at a later stage on the responsibility for recording of external loans (Central Bank);
    - Formally move the decisions on financial choices related to external loans to the DMO (choice of currency and maturity);
    - Formally move the decisions on providing state guarantees for external loans to the DMO in view of potentially significant exposure to contingent liabilities and strengthen the framework that governs the issuance and monitoring of state guarantees.

- A consolidated DMO offers the following benefits:

  - ensures operational independence between debt management, fiscal policy and monetary policy;
  - reduces coordination challenges as all borrowing decisions taken by the DMO will be guided by the debt management strategy;
  - limits operational risks and the risks of debt arrears occurring;
  - can substantially support the development of a domestic debt securities market.

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 are working closely together to deepen the development of both the primary and secondary domestic markets.