



DEPARTMENT OF TREASURY
FINANCIAL MANAGEMENT DIVISION



2021 ANNUAL DEBT FINANCING PLAN

FMD/SEB/3-3.4/005

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MEDIUM TERM DEBT STRATEGY (2021 – 2025)

Towards the end of 2020, the Government of the Independent State of Papua New Guinea through the Treasurer presented the 2020 Supplementary Budget. As part of the Supplementary Budget, the Medium Term Debt Strategy 2018-2022 (MTdS) was updated based on current economic conditions and events, taking into account the impact of COVID-19 and the debt relieve initiatives offered by both multilateral and bilateral donors. One of the key elements of the revised strategy over the medium term is to continue to build confidence in the PNG economy through transparent budgeting, in line with international standards. This will open up avenues to access low-cost concessional financing from both bilateral and multilateral sources, with an objective to keep debt at sustainable levels considering the cost-risk- trade-offs.

The revised Medium-Term Debt Strategy (MTdS) 2021-2025, operationalizes these objectives in order to achieve the desired composition of the Government's debt portfolio, which captures the Government's strategy with regard to the cost-risk trade-offs. The major strategies to support the debt management objective comprises the following:

Maintaining debt at sustainable levels. The revised Fiscal Responsibility Act (FRA) target band of Debt to GDP ratio of 45-60 percent applies to general Government Debt (including the state's contingent liabilities) at book value and includes valuation changes from exchange rate movements and incurring implicit and explicit state guarantees debt as and when they emerge. The change is required to enable the current Government to implement its desired fiscal policy within legally prescribed conditions of Papua New Guinea's constitutional framework. The change made to the FRA limit in 2020 after the COVID-19 impact provides flexibility for the Government to absorb further external shocks to the government's revenue and macro-fiscal framework. In addition, the extreme uncertainty around the future path in duration and magnitude of the impact of the COVID-19 pandemic could continue to weaken the economy adding more pressure on debt financing.

- Maintaining financial risk at prudent levels. Under the MTdS 2018-2022, the debt composition in the portfolio has changed. The share of foreign currency debt to total Government debt has increased from 30 percent in the previous strategy to 50 percent. The reduction in the domestic debt target relative to foreign debt is a trade-off between domestic liquidity and interest rate risk against foreign currency risk and

to capitalise on the current concessional lending offered by both bilateral and multilateral lenders.

- The Government's heavy reliance on the domestic debt market has had an impact on the domestic interest rates. The current weighted average interest paid on external loans is 3.2 percent while domestic weighted average interest is 8.7 percent showing interest rate differentials of 5.5 percent. Total interest cost as a share of Government revenue for 2021 is projected to be 17.4 percent.
- With the strategy to capitalise on low interest rate external loans, the Government anticipates interest rate as a share of Government Revenue (excluding grants) to stabilise and flatten out to below 20 percent over the medium term.
- Refinancing and rollover risks are the immediate concerns of the current MTdS. The repayment profile shows the majority of the debt falling due that needs to be refinanced in the next 5 years is the costly domestic debt. Therefore, in terms of Strategy going forward the Government will consider debt switches and debt buybacks to smoothen out the domestic maturity profile. More information on domestic debt buybacks and debt switches will be made available to the market at a later date.

• **Table 1: Percentage of Foreign Currency Debt to Total Central Government Debt**

Target	2019 Actual	2020 Estimate	2021 Projection	2022 Projection	2023 Projection	2024 Projection	2025 Projection
50%	43.0%	47%	47%	46%	43%	42%	45%

Source: Department of Treasury

• **Table 2: Percentage of Treasury Bills to Treasury Bonds under the Domestic Debt Portfolio**

Target	2019 Actual	2020 Estimate	2021 Projection	2022 Projection	2023 Projection	2024 Projection	2025 Projection
50%	53%	49%	51%	50%	51%	48%	46%

Source: Department of Treasury

• **Table 3: Average Maturity of the Domestic Debt Portfolio**

Target	2019 Actual	2020 Estimate	2021 Projection	2022 Projection	2023 Projection	2024 Projection	2025 Projection
5 Years	3.1	3.9	3	4.3	4.8	5.3	5.5

Source: Department of Treasury

The Strategy continues to maintain that developing and efficiently managing the domestic debt market involves broadening and deepening the market in domestic securities and improving the market infrastructure; the Government will endeavour to improve in this area by;

- Improving communication with the market by the publication of a more detailed and timely borrowing plan will also be undertaken in 2021;
- addressing a number of preconditions for the development of the domestic bond market including: improving the efficiency of the primary market (the current manual and cumbersome processes will need to be changed to attract non-resident investors and encourage secondary trading); promoting money market and interbank transactions through repurchase agreements; developing automated clearing, settlement and custody facilities; establishing a bond market code of conduct with effective oversight by BPNG; promoting the establishment of pools of liquidity to allow small investors access to the market; improved coordination between monetary, fiscal and regulatory authorities and market participants; and developing and maintaining a centralised source for bond market information and data. These preconditions will underpin the goals of expanding the existing highly concentrated investor base and promoting a more liquid and efficient secondary market;

Managing Debt Portfolio Risk

In implementing the debt and financing strategy, the Government will be managing a number of risks including exchange rate risk, liquidity risk, interest rate risk, refinancing risk and others. These risks will be mitigated through:

- managing the currency composition of external debt, especially as the share of foreign debt as a share of total debt has increases well above the target of 40 percent. The composition should also be aligned with export receipts and foreign exchange reserves;
- continuing through the year practice of accumulating funds in the dedicated debt account to pay debt service and redemptions when falling due and to cover issuance shortfalls;
- smoothing out the maturity and repayment profile of the domestic debt service schedule, within the projected financing envelopes, through debt switches and buybacks and establishing a reduced number of more liquid benchmark issues. To facilitate this measure, the Loans Securities Act 1960 and the T-Bills Act 1974 will need to be amended to clearly state the authority for Treasury to actively manage Government debt.

Financing Requirements for the 2021 Budget

The total financing requirement for 2021 Budget is K6,612.8 million. The 2021 Budget deficit will be financed through the same financing strategy employed for the 2020 Budget, but with added reform agenda to maintain debt sustainability. External financing will be from the concessional budget support programs from the multilateral and bilateral creditors. Part of the deficit will be from the concessional loan drawdowns for projects. The domestic borrowing will comprise of Treasury Bonds and Treasury Bills issuance over the year

supported possibly by BPNG's quantitative easing program and an expanded securities market.

In 2021, the Government will continue to exploit all avenues of cheap and concessional financing. The Government is engaging constructively with the Australian Government authorities for potential Australian Infrastructure Financing Facility for Pacific (AIFFP) program, especially on infrastructure projects that will assist PNG. This will be absorbed into concessional project-linked stock of loans available for drawdown in future years linked to project implementation.

The Government is also projecting to utilize World Bank's COVID-19 US\$100.0 million (K345.9 million) budget support facility, World Bank's Fiscal Emergency Development Policy Operations (EDPO) Budget Support of US\$150.0 million (K518.9 million). The Government is also in negotiations with the Japan International Corporation Agency (JICA) for additional budget support of JPY30 billion, approximately K1.0 billion. All these external budget support will assist finance the deficit.

Other options available to the Government in 2021 are – the ADB Partial Credit Guarantee Scheme, which allows the borrower to raise financing from a commercial source at a cheaper than the benchmark rate offered on the open market through either conventional lending or a Sovereign Bond.

The Government plans to increase its access to financing through concessional loan facilities already available on planned projects to K1,638.4 million. The concessional financing takes care of up to 24.8 per cent of GoPNG's capital funding requirement for 2021.

Over and above, the Government's main amortization commitments for 2021 include K100.5 million for two (2) domestic commercial guarantee loan and K983.2 million in external commercial liabilities to reduce its interest obligations in the future and reduce exposure to expensive forms of debt. With the amortization and concessional financing plan for 2021, the Government is anticipated to save some interest costs over the medium term on these expensive loans.

Together with the amortization, the Government's exposure to the domestic securities market for 2021 is estimated to be a net addition of K2,000.0 million that includes K1,600.5 million in net issuance of Treasury Bonds, K500.0 million in Treasury Bills and net amortization of K100.5 million on domestic loans.

Update on Domestic Market Conditions for Financing Deficit

By end of 2020, the Government was able to secure few external Budget Support loans from the bilateral and multilateral partners, which provided some relief on the domestic market requirements in 2020. Towards the end of this year, the Government is anticipating to receive external budget support funding from international agencies including the bilateral and multilateral partners. The external financing will ease further pressure on the domestic debt securities market and also smoothen out foreign exchange imbalances

The domestic debt market was able to provide the needed liquidity in the first half of the year backed by a quantitative easing by the Central Bank through a buy-back of government securities during the onset of COVID-19 Pandemic. However, throughout the remaining year the market was signaling reduced appetite for the shorter-term Treasury Bills in the last two quarters. Even though the Government was in a net issuance position in both instruments in the first three quarters, the periodic undersubscription was an on-going feature.

The domestic market, which consists predominantly of the four commercial banks including two foreign banks and two superfunds, continue to have internal limits on lending to the Government. The lack of PMMR transfers, in part, contributed to the illiquidity on the main local banks. The Bank of PNG continues to redeem its government securities to remain in compliance with its statutory end-year '*no lending to Government*' requirements in the Central Banking Act (CBA) and to meet the new Financial Reporting and Accounting Standards.

For 2021 financing, the Government will continue to refinance domestic maturities along with adding additional new issuance of Treasury Bills early in the year. Currently, planned external financing includes Budget Support loans from our bilateral and multilateral partners, including ADB and World Bank Budget Support loans. The remaining financing items will be signaled to the market immediately following conclusion of consultations.

With the anticipation of the large inflows of external budget support funds, reliance on the domestic market is expected to ease to allow the Government to restructure and smoothen out the maturity profile of its domestic debt portfolio.

2021 Government Debt Financing Plan

The Government is projecting a net increase of K1,600.6 million in Inscribed Stock (Treasury Bond) in 2021. With the total maturity projected to be K1,046.1 million, the government once again through the budget deficit increased borrowing up to K4,293.2 million incorporating the debt to GDP increase of 51.5%. The budget deficit aims to keep the domestic debt level to a sustainable level to maintain the Medium Term Debt Strategy. One of the strategy is to shift the borrowing to external and lower domestic borrowing with the net increase in domestic borrowing of K2,000.0 million. This includes a net increase of K1,600.6 million in Inscribed Stock (Treasury Bond) and K500.0 million in Treasury Bills and a net retirement of K100.5 million in Other Domestic Debt Service (Domestic Loans) which is still within the band of 45-60% Debt-to-GDP. With the external borrowing K2,293.2 million, the government also considers the foreign exchange risk that may keep the State at stake.

The Government will continue to meet and foster relationship with investors to find out their preference for Treasury Bond tenures of 2, 3, 5, 6, 7, 9 and 10 years respectively and be more flexible to meet investors demand. Under Treasury Bills, there is more demand in the longer tenure, which also helps ease the pressure on the refinancing risks.

2021 REPAYMENT AND NEW BORROWING

Outlined below is the indicative debt issuance plan for 2021. It provides updated details compared to those shown in Chapter 7 (Financing and Debt Management Strategy) and Appendix 2 of Volume 1 of the 2021 National Budget document. This information will be made available on the website:

http://www.treasury.gov.pg/html/national_budget/2020.html

Summary of Repayments and New Issuance during 2021 (Kina million)

Financing Source	Estimated Balance 31-Dec-20	Projected Repayment 2021	Projected Borrowing 2021	Projected Balance 31-Dec-21	Net Change 2021
DOMESTIC DEBT	20,337.40	11,666.00	13,666.10	23,256.60	2,000.10
Debt Securities	19,262.30	11,565.50	13,666.10	22,282.00	2,100.60
Treasury Bills	9,600.30	10,519.40	11,019.40	11,019.40	500.00
Treasury Bonds	9,662.00	1,046.10	2,646.70	11,262.60	1,600.60
Loans	1,075.10	100.50	-	974.60	100.50
EXTERNAL DEBT	18,595.00	1,533.90	6,146.60	23,207.70	4,612.70
Debt Securities	1,700.70	-	-	1,700.70	
Loans	16,894.30	1,533.90	6,146.60	21,507.00	4,612.70
Concessional	9,669.20	534.80	1,638.40	10,772.80	1,103.60
Commercial	1,088.20	983.20	44.40	149.40	-
Extraordinary	6,136.90	15.90	4,463.80	10,584.80	938.80
TOTAL	38,932.40	13,199.90	19,812.70	46,464.30	6,612.80

Budget Deficit K6,612.8 million

Financing Source: (a) Debt K6,612.8 million (b) Asset Sales K0.0 million

Total Debt to GDP: 51.5%

Treasury Bills

Treasury Bills will be auctioned on Wednesdays, and settled two days later on the Friday. Department of Treasury determines the amount of Treasury Bills required to ensure there are sufficient cash balances in the Government's bank account to pay the Government's expenses that are due. Bank of Papua New Guinea in its role as the debt management issuing agent of the Department of Treasury will announce to investors by close of business on Tuesdays the amount and term of Treasury Bills to be sold. The Government will continue to issue mainly 6 month, 9 month and 12 month Treasury Bills, but will also consider the investor demand for shorter term investment preferences by issuing under 91, 63 and 28

days in co-ordination with Bank of Papua New Guinea who are issuing the Central Bank Bills under the short-term.

Treasury Bonds (Inscribed Stock)

All Treasury Bond will be auctioned on the third Tuesday of each month and settled three days later on the Friday. The amounts to be issued each month will range from K200.0 million to K1,000.0 million starting in April 2021. A quarterly review will be conducted on performance of tender results and a revised amount depending on underlying investor demand and cash needs will be updated and conveyed to investors at least two weeks prior to the first tender of each quarter. The Bank of Papua New Guinea, will announce to investors during the first two business days of each month the amount of each Treasury Bonds series to be auctioned (each series has a specific maturity and coupon). Refer to the issuance calendar below for more information.

2021 Domestic Issuance Calendar – Treasury Bonds (Inscribed Stock)

Tender Date	Amount on Offer	Maturities & Coupon Rates
Tue, 20 th April 2021	K1,000.00 million	Market will be advised before the tender date
Tue, 18 th May 2021	K1,000.00 million	Market will be advised before the tender date
Tue, 22 nd June 2021	K646.70 million	Market will be advised before the tender date
Total Issuance	K2,646.70 million	

SHARE OF ISSUANCE BY TENOR		
Treasury Bond Tenors	Issuance Volume	Share of Offer Volume
2Y Bond	120.00	5%
3Y Bond	500.00	19%
5Y Bond	720.00	27%
6Y Bond	400.00	15%
8Y Bond	310.00	12%
9Y Bond	300.00	11%
10Y Bond	297.70	11%
	2,646.7	100%

Updates of the debt issuance plan

The above issuance plan is based on 2021 Budget projections. If there are any changes investors will be notified accordingly.

By the beginning of each quarter, Treasury will announce:

- The amount of Treasury Bills that mature over the next three months and the likely amount of Treasury Bills to be offered at tender; and
- The series (maturity and coupon) of Treasury Bonds to be auctioned over the next three months (quarterly basis).

Additional information

Further information on the historical results of auctions is available on the Public Debt folder of the Department of Treasury's website: www.treasury.gov.pg. If you have any questions please contact the Securities Execution Branch on telephone numbers: 313 3675, 313 3622, 313 3634 or 313 3720.

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