



KINGDOM OF LESOTHO

MEDIUM-TERM DEBT MANAGEMENT STRATEGY

WITH THE ASSISTANCE OF THE WORLD BANK, THE IMF AND MEFMI



MEFMI
Macroeconomic and Financial Management
Institute of Eastern and Southern Africa

January 2018

Table of Contents

ABBREVIATIONS AND ACRONYMS.....	4
PREFACE.....	5
EXECUTIVE SUMMARY	6
I. INTRODUCTION.....	8
II. LEGAL FRAMEWORK, OBJECTIVES AND SCOPE OF THE DEBT MANAGEMENT STRATEGY	12
III. CHARACTERISTICS OF THE EXISTING DEBT PORTFOLIO.....	15
A. Composition.....	15
B. Cost Indicators	19
C. Risk Indicators	20
IV. SOURCES OF FINANCING.....	22
A. External Financing.....	22
B. Domestic Financing	23
V. MACROECONOMIC ASSUMPTIONS AND KEY RISKS	25
A. Macroeconomic Developments and Baseline Assumptions.....	25
B. Key Risks Relevant to the Medium-Term Macroeconomic Forecast.....	26
VI. SPECIFICATION OF THE MODEL OF THE DEBT PORTFOLIO	30
A. Stylised Instruments.....	30
B. Baseline Exchange-Rate and Interest-Rate Assumptions	31
C. Shock Scenarios	33
D. Financing Strategies.....	35
VII. COST, RISK, AND FEASIBILITY ANALYSIS OF CANDIDATE DEBT MANAGEMENT STRATEGIES	38
A. Comparison of Candidate Strategies in Terms of Risk Indicators.....	42
B. Comparison of the Strategies in Terms of Feasibility.....	45
C. Conclusions as to the Characteristics of a Desirable Strategy	46
VIII. IMPLEMENTATION AND OTHER CONSIDERATIONS	47
A. Next Steps for Formulating and Approving a Strategy	47
B. Communication of the Strategy Once Approved.....	48
C. Actions Needed to Improve Debt Recording.....	49

ABBREVIATIONS AND ACRONYMS

ADB	African Development Bank
ADF	African Development Fund (ADB lending window)
ATM	Average term (time) to maturity
ATR	Average term (time) to refixing
CBL	Central Bank of Lesotho
CNY	Chinese Renminbi (Yuan)
EIB	European Investment Bank
EUR	Euro
GBP	United Kingdom pound sterling
IBRD	International Bank for Reconstruction and Development (World Bank lending window)
IDA	International Development Association (World Bank lending window)
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
INR	Indian rupee
LSL	Lesotho loti
LGA	Loans and Guarantees Act of 1967
MTDS	Medium-term debt management strategy
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
OFID	Organization of Petroleum-Exporting Countries Fund for International Development
SACU	Southern African Customs Union
SOE	State-owned enterprise
USD	United States dollar
XDR	Special Drawing Rights
ZAR	South African rand

PREFACE

The Government of the Kingdom of Lesotho through its Ministry of Finance in collaboration with the World Bank, the International Monetary Fund (IMF) and the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI), conducted an exercise of developing a debt management strategy. The workshop also served as a capacity building exercise for analytical skills in cost and risk analysis of the government's debt portfolio. The workshop was constituted of officials of the Ministry of Finance, the Ministry of Development Planning, and the Central Bank of Lesotho in applying the medium-term debt management strategy (MTDS) analytical toolkit developed by the World Bank and the IMF.

EXECUTIVE SUMMARY

Up until the development of this Debt Strategy report Lesotho has not had a formal Debt Strategy. The government's de facto debt management strategy to-date has been to borrow heavily from external concessional and semi-concessional sources and, when possible, to extend the maturity profile of domestic borrowing so as to minimize debt service costs and risks. The government seeks to strengthen the strategy, however, particularly given the challenging macroeconomic outlook, pressures in the domestic market, and changing dynamics of external creditors that are affecting the cost and availability of financing for the government.

This report examines the costs and risks inherent in the current debt portfolio, as well as in the debt portfolios that would arise from a range of possible issuance strategies, in light of factors such as the macroeconomic and financial market environment, the availability of financing from different creditors and markets, and vulnerabilities that may have an impact on future borrowing requirements and debt service costs.

The analysis in this report demonstrates how to evaluate the cost and risk characteristics, the feasibility, and the trade-offs of alternative financing strategies. Four different strategies were considered: (i) a "status quo" financing approach that follows the broad parameters of the borrowing mix in recent years; (ii) a shift toward more commercial external borrowing, without increasing the total share of external borrowing; (iii) a shift toward more domestic borrowing, away from external borrowing; and (iv) a shift toward more domestic borrowing accompanied by a lengthening of the maturity profile of domestic issuance. The four strategies are assessed under a baseline projection for financial-market variables over the medium term and also under three shock scenarios: (i) a significant depreciation of ZAR and, therefore, LSL; (ii) a significant increase in interest rates applicable to external and domestic commercial borrowing; and (iii) a moderate shock to exchange rates combined with a moderate shock to commercial interest rates.

In line with the capacity-building objective of the mission, this report does not make recommendations as to a specific debt management strategy that should be adopted. The results of the cost and risk analysis suggest areas for more in-depth examination by the authorities, however. For instance, a strategy with a greater reliance on external borrowing could lead to lower costs under both the baseline and shock scenarios, but caution is warranted if the external borrowing mix over-weights commercial instruments, as opposed concessional and semi-concessional financing sources. A strategy aiming at extending the maturity of domestic issuance would often lead to increased costs, but with a concomitant reduction in refinancing risk. In this search for the right balance in the cost-risk trade-off,

the feasibility of accessing the desired amounts of various forms of financing under the different strategies will be an important consideration.

The strategies that are formed from a sophisticated approach to debt management cannot offset for the fundamental imbalances that might arise from the government's medium term fiscal framework. The analysis indicates that Debt/GDP ratio would reach approximately 50 per cent in 2022 against the 40.3 per cent today, regardless of the strategy chosen. In addition, reducing the share of external debt in total debt is an objective that cannot be achieved in the short or medium-term horizon. At the end of the fiscal year 2016/2017, outstanding external debt represented 89 per cent of total outstanding debt. Most of the existing external debt is on concessional or semi-concessional terms, which means these loans will mature in the long-term and the debt manager cannot change quickly an existing portfolio comprised of a big stock of external concessional debt into something else.

Furthermore, a strategy aiming at increasing the financing from domestic sources and extending the maturity of domestic issuance should be further evaluated against domestic market absorption capacity and appetite for longer-dated securities. Here, further investigation is needed, notably through discussions and meetings with investors and market participants. Such a strategy would lead to a reduction in refinancing risk, but with a concomitant increase in costs that authorities must be committed to accept in the medium-term.

The debt management strategy should be formally reviewed and updated annually. The scope could gradually be extended. Notably, the baseline projection of the financing requirement and of financial-market variables over the medium term, as well as the relevant shocks to financial market variables, should be updated as soon as the new macroeconomic framework and budget become available. In addition, the analysis could be extended to take account of a wider set of liabilities that ultimately are, or are likely to become, the responsibility of the central government.

I. INTRODUCTION

1. A debt management strategy is a plan that the government intends to implement over the medium term to achieve a desired composition of the government debt portfolio that captures the government’s preferences regarding the trade-off between cost and risk. It operationalises debt management objectives—typically, ensuring that the government’s financing needs and payment obligations are met at the lowest possible cost consistent with a prudent degree of risk. The strategy has a strong focus on managing the risk exposure embedded in the debt portfolio—specifically, potential variations in the cost of debt servicing and its impact on the budget over the medium term—and identifying how cost and risk vary with the composition of the debt. The medium term is typically defined as three to five years. If the time horizon is too short, such as only one budget year, there is a risk that short-term expediency will dominate, turning the focus on short-term costs and away from risks that could materialise later; too long a horizon, conversely, introduces significant uncertainty regarding the assumptions underlying the strategy.

2. Another objective of the exercise was to identify the main challenges to the development of the government debt market of Lesotho. Typically, an important step to designing a medium-term debt management strategy is to understand the investor base, and the feasibility of different strategies depends on the degree of development of the domestic debt market. Lesotho relies largely on concessional external debt and the share of domestic debt is relatively small in the total debt portfolio. However, in the last years Lesotho has been issuing T-bills and bonds in the domestic market and the government is currently reflecting upon this strategy. In this context, the mission met with a diverse range of market participants and authorities.

3. The World Bank and the IMF jointly have developed a technical resource—called the medium-term debt management strategy (MTDS) toolkit—to guide authorities in the process of developing a debt management strategy. The toolkit includes a guidance note on the process of designing and implementing a debt management strategy and a quantitative cost-risk analytical tool. While a sound strategy can be developed without the use of a quantitative tool, the use of scenario analysis provides useful information, enabling the debt manager to quantify the potential risks to the budget and the size of the debt arising from alternative debt management strategies and shocks to interest rates and exchange rates.

4. This report describes the key steps for formulating a comprehensive debt management strategy and the necessary measures for supporting the development of the government debt market. The report assesses the cost and risk consequences of a

range of alternative debt management strategies, given a set of assumptions on the macroeconomic and market environments, and highlights key challenges ahead for development of the domestic debt market.

5. The process of formulating an effective MTDS includes the following broad steps (Figure 1)¹:

- a. *Identify the main objectives for public debt management and the scope of the MTDS.* The purpose is to help clarify what objectives the MTDS should seek to achieve. This will also help clarify the tasks and responsibilities for which the DM is accountable.
- b. *Review the current strategy and identify the cost and risk of existing debt.* The purpose is to identify the current, possibly de-facto, strategy and reviewing the cost-risk characteristics of existing debt to determine the desirability for change. This is to clearly determine the starting position for the analysis; this will help identify whether the MTDS should seek to change the characteristics of the existing debt portfolio in any specific way, e.g., reduce a specific risk.
- c. *Identify and analyse potential funding sources, including cost and risk characteristics.* The purpose is to determine the range of possible strategies that might be feasible and desirable to implement. This will also help identify any potential constraints that might impede the implementation of a chosen strategy. This may require interaction with financial market supervisors or other agencies (e.g., Ministry of Development Planning).
- d. *Identify baseline projections and risk in key policy areas—fiscal, monetary, external and market.* The plan is to review the macroeconomic and market environment and medium-term forecasts. The purpose is to determine the baseline scenario for the analysis of the performance of alternative strategies and identify specific risk scenarios to be evaluated. It requires interaction with fiscal, monetary policy and financial market authorities, and (where relevant) market participants.
- e. *Review long-term structural factors.* The purpose is to take a longer-term perspective and identify any factors that could influence how the debt composition should ideally change over the long term. It requires interaction with fiscal and monetary policy authorities.
- f. *Assess and rank alternative debt management strategies on the basis of the cost-risk tradeoff.* The purpose is to analyse a number of alternative debt management

¹ For more details see MTDS Guidance Note
(<http://treasury.worldbank.org/bdm/pdf/MTDSGuidanceNoteCA.pdf>)

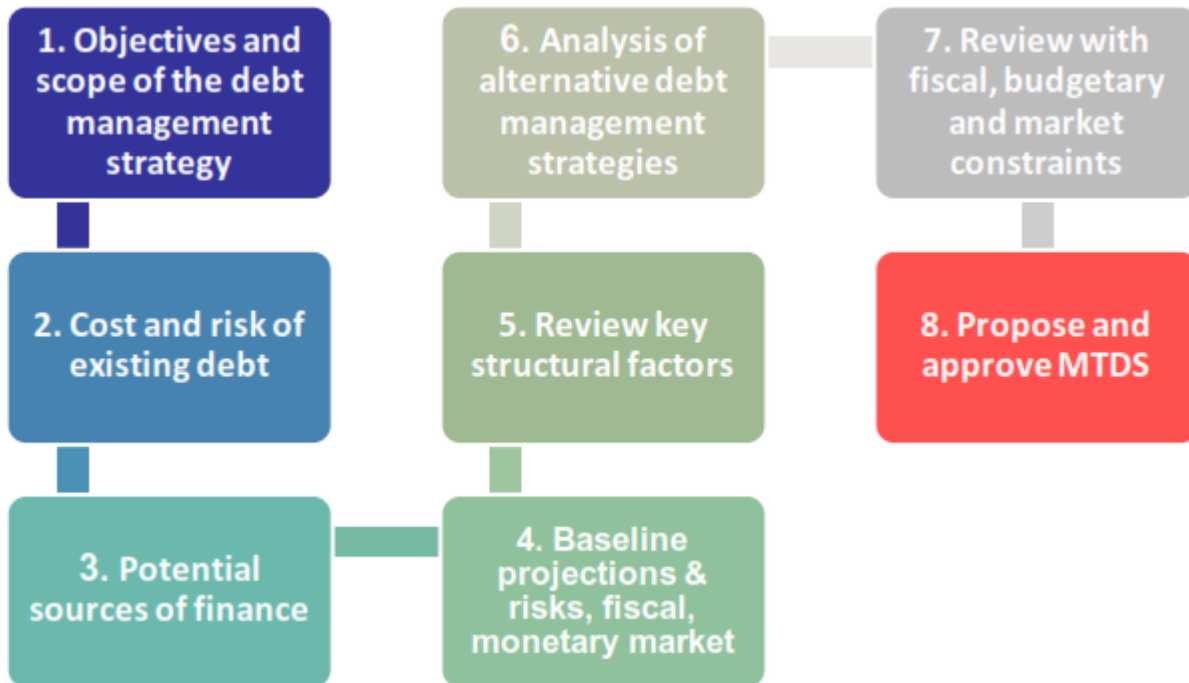
strategies, assess their performance, and identify a small number of candidate strategies, including a preferred strategy.

g. Review implications of candidate strategies with fiscal and monetary policy authorities, and for market development. The purpose is to clearly determine that the strategies are consistent with fiscal and monetary policies, maintain debt sustainability, and are in line with plans for market development.

h. Propose and approve the MTDS. The purpose is to propose the preferred strategy to the decision maker, and secure their agreement. This is where a debt management strategy document is produced, including an annual borrowing plan, for approval and dissemination

i. Make the MTDS public once it has been agreed upon and formalized. The purpose is to provide the public with: (i) the objective and scope of the MTDS; (ii) a description of the current and expected macroeconomic environments; (iii) an evaluation of the existing stock of debt; and (iv) an outline of the agreed MTDS, with a brief discussion of factors that influenced the choice of strategy.

Figure 1: MTDS Methodology: Key Steps for Deriving a Debt Management Strategy.



Source: MTDS Guidance Note.

6. This report describes how the MTDS toolkit could be applied in Lesotho. It reflects discussions between all participants from the Ministry of Finance, the Central Bank of Lesotho, and the Ministry of Development Planning involved in debt management operations, macroeconomic policy, and budgetary management together with the World Bank, the IMF and MEFMI. In particular, it examines the costs and risks inherent in the current debt portfolio, as well as in the debt portfolios that would arise from a range of possible issuance strategies, in light of factors such as the macroeconomic and financial market environment, the availability of financing from different creditors and markets, and vulnerabilities that may have an impact on future borrowing requirements and debt service costs.

II. LEGAL FRAMEWORK, OBJECTIVES AND SCOPE OF THE DEBT MANAGEMENT STRATEGY

7. The government of Lesotho does not have a written debt management strategy.

In practice, the government's strategy has been to borrow from external concessional sources and extending domestic maturity to minimise debt service costs and risks. The external financing strategy has proved to be costly in recent years because of the depreciating local currency, leading to high debt service costs. The Ministry of Finance received technical assistance from the World Bank in 2013 on developing a debt management strategy but the document was never finalised due to capacity constraints. Recognising the need for more active debt management, the authorities expressed commitment to develop a debt management strategy and finalise it by end-2017.

8. Public debt management operations in Lesotho are primarily governed by the Loans and Guarantees Act (LGA) of 1967 and its amendments, supported by other legislation.

Although the authority to borrow and issue guarantees on behalf of the Government is clear, there are some gaps in the current legal framework. The Minister of Finance has the authority to borrow and issue guarantees on behalf of the Government. He can also delegate his mandate further and he has chosen to delegate the authority to borrow in the form of T-bills and domestic government bonds to the Governor of the Central Bank of Lesotho (CBL). Other debt management legislation is contained in the Central Bank Act of 2000 which states that the Bank may provide overdrafts and loans to the Government of Lesotho on terms and conditions determined by the Board. However, the primary legislation does not specify the purposes for which the Minister may borrow, and there isn't a formal agreement between MoF and CBL (principal-agent agreement).

9. The legislative framework provides ceilings on public debt, but do not set purposes and objectives for debt management.

The LGA states that the Minister may raise loans provided that the total sum outstanding at any time in respect of a loan or loans shall not exceed the total recurrent revenue for the last three years as recorded in the latest available estimates of revenue presented to the national assembly under section 5 of the Finance order of 1988. The Central Bank Act states that the total of loans, advances and holdings of treasury bills and government securities shall not exceed per cent of the Government's actual revenue in the previous year's budget. However, the primary legislation does not state the purposes of borrowing, objectives of debt management or a requirement to develop a medium-term debt management strategy.

10. The government is working to fill those gaps and has already drafted a comprehensive new debt law.

The government has drafted a Public Debt Management Bill to address the gaps and weaknesses in the existing legislation. It should substitute the

current Loans and Guarantees Act of 1967. The new law will include among other topics: (i) the objectives of public debt management; (ii) the purposes for borrowing; (iii) the requirement for the MoF to design a medium-term debt management strategy; (iv) the formal establishment of debt management committees; and (v) the requirement of external auditing to public debt management activities. The law will also provide for a principal-agent agreement between MoF and CBL to regulate the role of the CBL as the fiscal agent MoF in the issuance of domestic bonds. The authorities expect to submit the bill to the National Assembly in September 2018 for ratification.

Objectives and Scope of the MTDS

11. The new Public Debt and Aid Management Act will clearly define the objectives of public debt management in Lesotho. As stated earlier, the objectives of public debt management are to: (i) ensure that Government's borrowing needs and its payment obligations are met at the lowest cost over the medium term to long term consistent with an acceptable and prudent degree of risk; (ii) ensure that public debt is managed consistently with fiscal sustainability; and (iii) support the development of a well-functioning market for Government securities within the framework of planned measures to support the overall development of the domestic debt market. The ideal situation is to have the objectives for public debt management defined in a primary legislation and Lesotho should achieve this situation in the short term by the approval of the new debt Act.

12. The scope of the debt management strategy covers central government domestic and external debt, including publicly guaranteed external loans. The analysis does not include a domestic guarantee to a commercial bank on loans to parliamentarians because the authorities could not provide relevant information such as outstanding amounts, interest rates and repayment schedules. The government is on track on payment of external and domestic obligations.

Institutional Arrangement

13. The Public Debt Management Department (PDMD) in the Ministry of Public Finance is the entity in charge of conducting public debt operations. However, domestic issuances of T-bills and government bonds are conducted by CBL without clear coordination with MoF.

14. The new Public Debt Management Act will also promote important improvements in the institutional arrangement for public debt management. The new Act also establishes the roles of the new department and will put in place a formal agreement between CBL and MoF that should improve coordination.

15. The functions inside PDMD could be further defined and formalised. PDMD is not divided into smaller units, although this might make sense because of the overall size of the debt office (around 14 officials). Although an attempt has been made to separate functions into front, middle and back-office, the operations need to be well defined and formalised.

Debt management strategy and debt sustainability analysis

Ex-ante the level of debt is mainly determined by fiscal policy, although ex-post the composition of debt may play an important role. Given the medium-term perspective of a debt management strategy, to be most effective, it should be formulated within a fully operational medium-term fiscal framework. Debt sustainability analysis assesses whether the fiscal policy implied by the fiscal framework—in particular, the associated debt level—is sustainable over the long term. DSA should include alternative scenarios in order to assess the realism of the outlook. This is undertaken by showing the development of debt ratios, for instance, if the primary balance does not change (improve), or if projections of GDP growth are closer to historic outcomes than the assumed outlook, as well as through bound tests for examining the impact on debt of shocks to key macroeconomic variables. The analysis behind the debt management strategy can add to this by allowing a detailed examination of the cost and risk characteristics of different debt compositions.

Debt management strategy analysis can also help country authorities move towards setting expenditure priorities independent of financing sources, by identifying strategies that generate a profile of interest costs consistent with debt sustainability, but which do not rely on the availability of specific project-tied financing. More generally, the process of developing the debt management strategy can strengthen fiscal planning through an analysis of the likely or possible budget implications of implementing the strategy.

III. CHARACTERISTICS OF THE EXISTING DEBT PORTFOLIO

A. Composition

16. The composition of the debt portfolio was analysed as of the fiscal year 2016/2017. In Lesotho, the fiscal year starts on first April and ends on 31 March. A dataset of debt on loan-by-loan and security-by-security basis was used for the analysis. This dataset was extracted directly from the debt recording system taking January 31st, 2017 as cut-off date.² Thus, estimations were made to get a picture of the current debt portfolio as at 31 March 2017.

17. The Central Bank, responsible for domestic securities issuance, provided accurate figures for Treasury Bills and Bonds. Indeed, domestic debt data extracted from the debt recording system were not up-to-date. By contrast, external debt data provided by the Public Debt and Aid Management Department (PDAMD) was complete. Unless otherwise indicated, the source of all tables and figures in this report is calculations by the mission team using underlying data provided by PDAMD and modelling performed using the MTDS analytical tool.

Table 1: Evolution of Debt outstanding from previous fiscal year

	Fiscal year 2015/2016			Fiscal year 2016/2017 (est.)		
	LSL m	% total	% GDP	LSL m	% total	% GDP
Domestic debt	1 274	9%	5%	1 307	11%	5%
Treasury Bills	592	4%	2%	555	5%	2%
Treasury Bonds	682	5%	3%	752	6%	3%
External Debt	13 082	91%	50%	10 265	89%	36%
Total	14 356	100%	55%	11 571	100%	40%

Source: 2015/2016 Annual Public Debt Bulletin and MTDS analytical tool. Both growth and the level of GDP has been updated in April, 2017 after the mission visited Lesotho. The authorities had agreed to update the MTDS with the new figures during the mission.

18. By March 2017, government debt stood at LSL 11,571 million, or approximately 40 per cent of GDP. Domestic debt in the amount of LSL 1,307 million accounted for 11 per cent of total debt, divided roughly in 42 per cent of Treasury Bills (short-dated securities) and 58 per cent of Treasury Bonds (medium- to long-dated securities). External debt was equivalent to LSL 10,265 million, or 89 per cent of total debt.

² The data consisted of a total of 329 outstanding instruments composed by 300 external loans, 25 T-Bills and 4 T-Bonds for a total of 329 instruments.

19. The external debt outstanding amount in local currency tends to fluctuate considerably with exchange rates movements. The local currency (Maloti) is pegged to the South African rand, which appreciated against major currencies during the fiscal year 2016/2017. Therefore, the reduction of external debt compared to previous fiscal year was essentially the result of the rand appreciation. External debt almost went back to the levels of 2014/2015. Indeed, the rand had depreciated substantially during the fiscal year 2015/2016, which explains the high amount of external debt (LSL 13,082 million) at the end of that year.

20. The domestic debt outstanding amount remained stable, but the share of Treasury Bonds slightly increased. In 2016/2017, outstanding domestic debt only increased by LSL 30 million, but Treasury Bonds outstanding went up by LSL 70 million. Authorities consider this is the result of a greater market appetite for T-bonds and government decision to issue only bullet repayment instruments (it used to issue securities amortising in the last three years before maturity). During the last fiscal year, authorities have mainly reopened the 7-years and 10-years Treasury Bonds (maturing in 2022 and 2025).

21. Government debt portfolio was composed of a large share of concessional and semi-concessional instruments. At the end of the fiscal year 2016/2017, external debt consisted of approximately 300 separate loans contracted with a range of creditors. Multilateral external creditors included the following: the African Development Bank (ADB), through the concessional African Development Fund (ADF) window; the World Bank, through the concessional International Development Association (IDA) window with “blend” terms; the European Investment Bank (EIB); and, in minor amounts, the International Fund for Agricultural Development (IFAD), the Arab Bank for Economic Development in Africa (BADEA) and the Organization of Petroleum-Exporting Countries Fund for International Development (OFID). Bilateral external creditors consisted of the Export-Import Banks of China and India, as well as the Kuwait, the Saudi and the Abu Dhabi Funds. Small amounts of external debt were also owed to commercial banks (refer to Table 2).

22. Holdings of domestic government securities were concentrated in the financial sector. The banking system holds more than two third of government securities. In the non-bank sector, individual investors are holding most of the Treasury Bills, while insurance companies are the main holders of Treasury Bonds.

23. Only 11 per cent of the total portfolio was debt denominated in local currency. Foreign-currency debt was denominated predominately in XDR (reflecting loans on concessional terms mainly from ADF and IDA) and USD (reflecting loans mainly from ADF Abu Dhabi Fund, IDA Saudi Fund, Kuwait Fund, OFID and BADEA). But, the portfolio also included debt denominated in ZAR (loan from EIB), in EUR (loans from ADF, EIB and a commercial bank), in CNY (from the Export-Import Bank of China), and AED, KWD and SAR (semi-concessional loans from Middle east sovereign funds). Finally, it is worth noting the portfolio included extremely minor amounts of debt denominated in CAD, CHF, DKK, GBP, JPY, NOK and SEK, which were due to old loans from the ADF that used to be issued in multi-currencies tranches.

Table 2: Creditor composition of debt outstanding as at March 30, 2017

	LSL m	% total
Domestic debt	1 306 604 300	11,3
Securities market	1 306 604 300	11,3
External debt	10 264 835 392	88,7
Multilateral	8 626 919 893	74,6
IDA	3 671 958 194	31,7
ADF	1 592 654 174	13,8
EIB	1 510 451 160	13,1
IMF	848 475 312	7,3
BADEA	415 757 691	3,6
IFAD	390 927 410	3,4
OFID	196 695 953	1,7
Bilateral	1 564 253 797	13,5
China Exim Bank	648 719 990	5,6
Kuwait Fund	355 386 053	3,1
Saudi Fund	296 392 829	2,6
Abu Dhabi Fund	189 388 476	1,6
India Exim Bank	74 366 449	0,6
Commercial	73 661 701	0,6
Banks	73 661 701	0,6
Total	11 571 439 692	100,0

Table 3: Outstanding treasury bills and bonds by holders (in percentage of the total)

	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16
Total Outstanding Bills and Bonds	100%	100%	100%	100%	100%	100%
Treasury Bills	67%	52%	47%	51%	51%	46%
Banking System	53%	40%	37%	38%	35%	31%
Non-Bank Sector	14%	12%	10%	13%	16%	16%
Insurance Companies	0%	5%	3%	1%	3%	2%
Individuals	5%	4%	5%	9%	10%	11%
Others	9%	4%	2%	3%	4%	3%
Treasury Bonds	33%	48%	53%	49%	49%	54%
Banking System	18%	34%	35%	31%	29%	37%
Non-Bank Sector	15%	14%	18%	18%	20%	16%
Insurance Companies	6%	5%	9%	8%	9%	7%
Individuals	1%	2%	3%	3%	4%	4%
Others	8%	7%	7%	8%	7%	5%

24. **Decomposing the XDR into its constituent currencies, the share of USD, EUR and CNY increases significantly in the portfolio currency mix.** The decomposition of the XDR was based on the shares of basket currencies prevailing as March 15, 2017.

Table 4: Currency exposure of debt outstanding as of end-March 2017

	Before decomposition of XDR		After decomposition of XDR	
	LSL m	% total	LSL m	% total
XDR	4 707 851 473	40,7		
USD	1 810 461 541	15,6	3 775 047 961	32,6
ZAR	1 423 433 253	12,3	1 423 433 253	12,3
LSL	1 306 604 300	11,3	1 306 604 300	11,3
EUR	674 750 598	5,8	2 130 889 058	18,4
CNY	648 719 990	5,6	1 162 817 371	10,0
Others	999 618 536	8,6	999 618 536	8,6
Total	11 571 439 692	100	11 571 439 692	100

B. Cost Indicators

25. The implied interest rate on total debt was 2.6 per cent at the end of the fiscal year 2016/2017. This was driven by the dominance of external debt in the portfolio and its relatively low cost (with an implied interest rate of only 1.9 per cent) compared to domestic debt (with an implied interest rate of 8.1 per cent). Total interest payments represented 1.1 per cent of GDP.

26. Debt in nominal terms was 40 per cent of GDP. The present value of debt was significantly lower, at 26 per cent of GDP, due to the important part of concessional and semi-concessional debt in the existing debt portfolio (refer to Table 5).

Table 5: Cost and risk indicators of debt outstanding as at end-March 2017

Cost and Risk Indicators		External debt	Domestic debt	Total debt
Amount (in millions of LSL)		10 264,8	1 306,6	11 571,4
Amount (in millions of USD)		788,0	100,3	888,3
Nominal debt as % GDP		35,8	4,6	40,3
PV as % of GDP		21,4	4,6	25,9
Cost of debt	Interest payment as % GDP	0,7	0,4	1,1
	Weighted Av. IR (%)	1,9	8,1	2,6
Refinancing risk	ATM (years)	11,0	3,1	10,1
	Debt maturing in 1yr (% of total)	4,6	42,5	8,9
	Debt maturing in 1yr (% of GDP)	1,7	1,9	3,6
Interest rate risk	ATR (years)	11,0	3,1	10,1
	Debt refixing in 1yr (% of total)	5,2	42,5	9,5
	Fixed rate debt (% of total)	99,3	100,0	99,4
FX risk	FX debt (% of total debt)			88,7

C. Risk Indicators

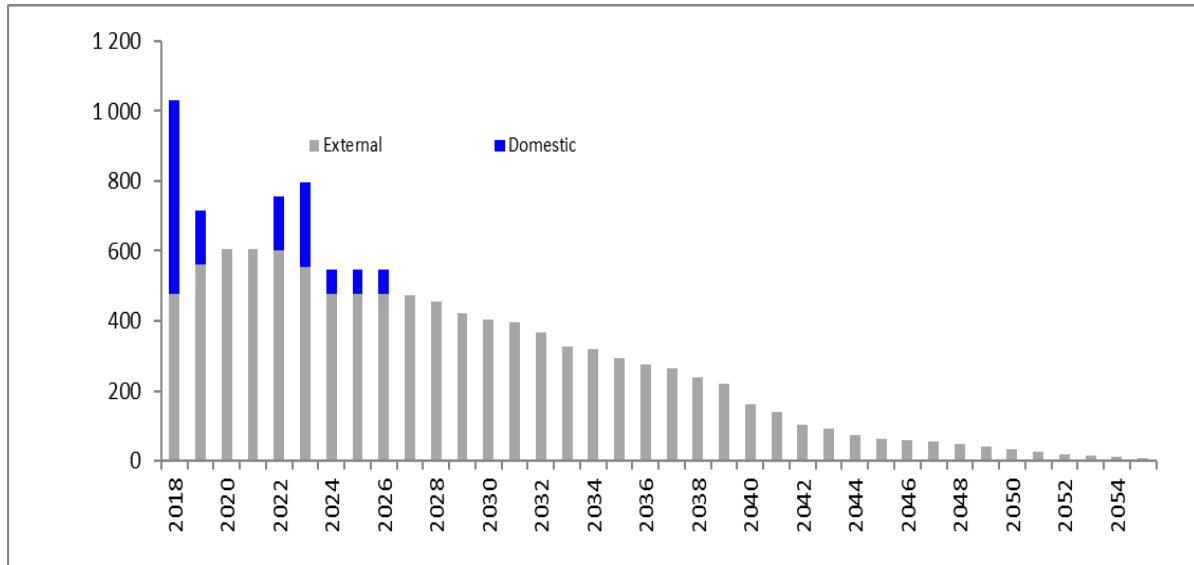
27. Exchange rate risk was certainly the major risk associated with the existing debt portfolio, due to the dominance of FX debt. Indeed, 89 per cent of the debt was denominated in foreign currencies and, thus, exposed to changes in exchange rates. In the past, this risk has materialised several times and led to rise in the external debt outstanding amount. Considering the high share of external debt in total portfolio, it will take time for authorities to decrease substantially their exposure to exchange rate risk. It is worth monitoring the ratios of external debt and short-term external debt to international reserves and the current account balance.

28. Refinancing risk associated with domestic debt is high with 42,5 per cent of domestic debt maturing within 1 year. This risk is partially mitigated by the dominance of external debt in the portfolio that reduces the percentage of total debt maturing within 12 months to 8,9 per cent. However, this might increase further in the coming years considering authorities claim that issuance volume of Treasury Bonds could rise in the future following the implementation of new investment regulations for Pension Funds and Insurance companies.

29. Refinancing risk associated with external debt was low, as shown by the ATM of the external portfolio of 11 years. This reflected the important share of concessional and semi-concessional debt in the existing debt portfolio. Only 4.6 per cent of external debt was due to mature within 1 year, and its redemption profile was lengthy and smooth.

30. Excluding domestic bills, the redemption profile of government debt portfolio was reasonably paced. This was a consequence of the long maturities and amortizing structure of the concessional and semi-concessional loans that dominate the whole existing debt portfolio (refer to Figure 1).

Figure 2: Redemption profile of debt outstanding as at end-March 2017



31. Interest rate risk was driven primarily by upcoming redemptions of Treasury Bills. Interest rates on 9.5 per cent of the portfolio were due to be re-fixed within 1 year, and the average term to re-fixing (ATR) was long, reaching 10.1 years. Given the bullet structure of Treasury Bills and Treasury Bonds (as well as the fixed coupons on Treasury Bonds), the ATR of domestic debt was equal to its ATM. Considering that only 0.6 per cent of the total debt outstanding was comprised of variable rate instruments, the interest rate risk indicators did not add much information compared to the refinancing risk indicators.

IV. SOURCES OF FINANCING

32. Sources of financing can be categorised and analysed across a number of dimensions, in particular the nature of the creditor and the characteristics of the financial terms and conditions of the instrument in which borrowing takes place. Creditors can be distinguished in regard to residency—whether they are foreign or domestic sources of financing. In addition, they can be distinguished on the basis of institutional type—whether they are official multilateral institutions (such as the World Bank or the African Development Bank), official bilateral entities (such as export-import credit agencies), or private creditors (such as commercial banks or capital markets). Borrowing instruments can be distinguished between non-marketable instruments (such as loans) and marketable instruments (such as treasury bills and bonds, and also bonds issued on international capital markets). Likewise, they can be distinguished on the basis of use of the financing raised—whether it is tied to a particular investment project or activity or can be applied to general budgetary needs. Furthermore, borrowing instruments can be distinguished in regard to their financial terms—whether they are concessional (typically with long or ultra-long final maturities, amortizing repayment structures but with long grace periods, and deeply below-market interest rates), semi-concessional (typically with medium or long final maturities, amortising repayment structures but with medium grace periods, and below-market interest rates), or commercial (typically with short to medium maturities, bullet repayment structures, and market-determined interest rates).

A. External Financing

33. Going forward, it is expected that Lesotho will continue to rely predominantly on foreign sources of financing, including from multilateral institutions. Multilateral investment banks have traditionally been and will remain important creditors. They offer loans on concessional and semi-concessional terms, usually to fund specific investment projects and also, in the form of budget support. Other multilateral creditors to which Lesotho turns for concessional and semi-concessional financing include the Arab Bank for Economic Development in Africa (BADEA), the European Investment Bank (EIB), the International Fund for Agricultural Development (IFAD), and the Organization of Petroleum-Exporting Countries Fund for International Development (OFID), all of whose support is usually project-linked.

34. Among foreign sources of financing, bilateral creditors are becoming increasingly important. They offer semi-concessional loans, almost invariably on a project-linked basis. They include development funds, such as the Abu Dhabi Fund, the Kuwait Fund, and the Saudi Fund. They also include export-import credit agencies, such as EXIM Bank China and EXIM Bank India. Caution is especially warranted with loans from

export-import agencies, whose primary objective is not to support international development but, instead, to expand market access for their domestic firms. The procurement arrangements with credits from these agencies are usually highly restrictive and non-transparent and, in some circumstances, may not represent good value for money.

35. Commercial loans can be considered in case of funding of project with high rate of return. Loans from commercial banks may be attractive in terms of flexibility and the speed within which they can be transacted, but they are costly and often subject to confidentiality requirements, which undermines transparency of debt management operations. These loans may be helpful for Lesotho over the medium term mainly when short-term bridging financing is needed, such as when concessional or semi-concessional financing has been secured for an infrastructure project but is experiencing temporary disbursement delays.

B. Domestic Financing

36. The local capital market is likely to remain a limited source of financing. The government has issued LSL 70 million in Treasury Bonds during the fiscal year 2016/2017 through four auctions (June, September, December and March). All the auctions were reopenings of benchmark bonds and authorities increased the size of reopenings compared to previous years from LSL 10 million to LSL 15 and 20 million because authorities consider the market appetite for TBonds has increased. Authorities have mainly reopened the 7-year and 10-year bonds (maturing in 2022 and 2025) since 2015. Other outstanding T-Bonds are maturing in 2019 and 2021. Each year, authorities also issue T-Bills with tenors of 91, 182, 273 and 364 days. Usually, there are 26 T-Bills auctions during the fiscal year with total issuance amount ranging from LSL 30 to LSL 40 million per auction.

37. The investor base for treasury securities is limited, but the authorities expect that the market will grow moderately over time. Banks are currently the main holders of treasury securities (both bills and bonds), usually applying buy and hold strategies. While insurance companies are important holders of treasury bonds, individual investors tend to hold mainly TBills. Authorities believe there is room to diversify investor base by increasing the share of foreign investors looking for higher returns (due to Lesotho credit) with an exposure to ZAR currency risk (LSL is pegged to ZAR). Authorities are currently evaluating market appetite for a 15-year TBond which could be launched for the first time in the next three years. Although authorities are confident there is demand for longer-dated securities, following bigger amounts reopened for the 7 and 10 year bonds during last fiscal year, some caution is required considering that the 7 and 10 years bonds were undersubscribed when they were first launched in 2015 (due to the large amount offered of

LSL 100 million). Further investigation and meetings with market participants are still necessary to understand the market appetite and the reasons behind under-subscription.

38. The government has stated, as an objective, to support development of the treasury securities market and the local capital market more widely, but greater clarity as to what this will involve—and the allocation of corresponding responsibilities—is required. Some aspects of market development—largely in respect of the primary market—are under the control of, or may be influenced by, the government—for instance, the selection of the maturities and volumes of treasury bills and bonds to be offered, the regularity of issuance, and the issuance mechanism. Other aspects of market development are largely the responsibility of the central bank—in its role as regulator of the banking system and as registrar of treasury securities—or of market participants themselves. In particular, market development—especially in respect of the secondary market—depends on having in place norms and mechanisms for pre-trade price discovery and post-trade price transparency, conventions for trade execution, and efficient clearing, settlement, and custody systems.

Table 6: Characteristics of the stylized debt instruments

Stylized Instruments	Interest Rate type	Maturity (y)	Grace (y)	Currency code
Multilateral_Concessional_XDR_fixed	Fix	25	5	XDR
Bilateral_Semi-Conces_USD_fixed	Fix	20	5	USD
Bilateral_Semi-conces_USD_floating	Var	20	5	USD
Bilateral_Semi-conces_EUR_fixed	Fix	20	5	EUR
Bilateral_Semi-conces_CNY_fixed	Fix	20	5	CNY
Commercial_ZAR_fixed	Fix	10	3	ZAR
Commercial_EUR_fixed	Fix	10	9	EUR
Commercial_USD_fixed	Fix	10	9	USD
T-Bills_Fixed	Fix	1	0	LSL
T-Bonds 5 YR_Fixed	Fix	5	4	LSL
T-Bonds 10 YR_Fixed	Fix	10	9	LSL
T-Bonds 15 YR_Fixed	Fix	15	14	LSL

V. MACROECONOMIC ASSUMPTIONS AND KEY RISKS

A. Macroeconomic Developments and Baseline Assumptions

39. After recovering strongly from the global financial and economic crisis, Lesotho's economy has slowed in recent years. Real GDP growth declined from an average of 6.2 per cent during 2010/11 – 2012/13 to 2.1 per cent in FY2013/14 before rebounding to 3.9 per cent in 2014/15 (Table 7). Low growth was mainly due to contraction of the construction and manufacturing sectors and negative external spill-overs. The construction sector contracted by 7.5 per cent due to reduction in public investment following the winding-up of the United States funded Millennium Challenge Account. The manufacturing sector contracted by an average of 4.3 per cent during 2013/14 - 2014/15 mainly due to weak performance in the textile sector.³ Preliminary estimates indicate that the economy grew by 1.6 per cent in 2015/16 compared to a forecast of 2.2 per cent. Real GDP growth in 2016/17 is estimated at 3.3 per cent, driven by the mining, construction, wholesale and retail trade, and transport and communication sectors which were expected to grow by 8.1 per cent, 6.9 per cent, 12.1 per cent and 5.1 per cent respectively.⁴

Table 7: Lesotho: Fiscal operations of the central government, 2011/12 – 2022/23
(Millions of Loti, unless otherwise noted)

	Proj.					Est.	Proj.	Proj.	Proj.	Proj.		
		2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	
2021/22												
Revenues and grants		9,627.2	13,144.9	13,274.5	14,593.6	15,254.7	14,040.2	15,846.8	16,938.9	18,950.6	20,000.0	21,457.8
o/w SACU		2,752.6	5,966.3	6,054.6	7,034.1	6,398.6	4,518.9	5,059.0	5,233.7	5,346.9	5,466.8	6,043.5
Revenues												
Total primary expenditures		11,544.6	11,876.1	13,377.2	14,870.1	15,378.0	16,332.2	17,167.0	17,753.1	20,166.5	21,469.1	23,258.3
Total expenditures		11,681.6	12,042.0	13,565.8	15,047.4	15,652.1	16,618.8	17,519.7	18,099.0	20,577.5	21,919.8	23,747.5
Total interest expenditure		137.1	165.9	188.6	177.2	274.1	286.6	352.7	345.9	411.0	450.7	489.2
Overall Balance		-2,054.5	1,102.9	-291.4	-453.7	-397.4	-2,578.6	-1,672.9	-1,160.1	-1,626.9	-1,919.8	-2,289.7
Real GDP Growth (%)		7.0	5.4	2.1	3.9	1.6	3.3	3.8	4.1	4.0	4.8	4.7
Inflation (%)		6.0	5.5	5.0	4.0	4.9	6.2	6.0	5.3	5.1	5.6	6.1
Nominal GDP		18,660.0	20,074.3	22,370.6	24,944.6	26,311.6	28,690.4	31,618.7	34,891.4	38,192.1	42,052.1	46,488.1

³ Uncertainties regarding the renewal of the AGOA agreement between Lesotho and the USA beyond 2015 led to reduced external demand for Lesotho textile exports as early as 2013. However, the agreement was extended for a ten year period in 2015 thus ensuring continued preferential market access for Lesotho textile exports into the USA, while there is still a risk of losing AGOA.

⁴ GDP figures have been updated after April, 2017. Authorities had agreed to update MTDS with the new data updates.

SACU Revenues in % of GDP	14.8	29.7	27.1	28.2	24.3	15.8	16.0	15.0	14.0	13.0	13.0
Primary Balance (% of GDP)	(10.3)	6.3	(0.5)	(1.1)	(0.5)	(8.0)	(4.2)	(2.3)	(3.2)	(3.5)	(3.9)
Overall Balance (% of GDP)	(11.0)	5.5	(1.3)	(1.8)	(1.5)	(9.0)	(5.3)	(3.3)	(4.3)	(4.6)	(4.9)

Source: Ministry of Finance, Lesotho.

40. Real GDP growth is expected to improve in the medium term, supported by the primary and tertiary industries as well as improved productivity arising from on-going structural reforms. The primary sector is projected to grow by 4.0 per cent on average from 2017 to 2022, supported primarily by increased activity in agriculture, mining, construction, and transport and communication activities. Accordingly, real GDP growth rate is projected to increase to 3.8 per cent in FY2017/18 and average 4.4 per cent until 2022 (Table 7).

41. Inflation is projected to remain stable over the medium term, moving in line with price developments in South Africa due to the peg of Lesotho Loti (LSL) to the South African Rand. Inflation for FY 2017/18 is estimated at 6.0 per cent and the authorities expect it to decline below this level in the medium-term assuming that the South African Rand remains stable (Table 7).

42. The fiscal deficit is projected to remain high in the medium term due to decline in SACU revenues. Total revenues are projected to decline drastically from 58 per cent of GDP in FY2015/16 to 48.5 per cent of GDP on average from 2017 to 2022 due to reduced SACU revenues. Meanwhile, while total government expenditure remains high and is projected to average 53 per cent of GDP from 2017 to 2022. The authorities expect the overall fiscal deficit to reduce from 9 per cent of GDP in FY 2016/17 to 4.3 per cent of GDP in the medium term due to fiscal adjustment efforts (Table 7). These reforms include restraining the wage bill, pay roll audit and other public finance management reforms.

B. Key Risks Relevant to the Medium-Term Macroeconomic Forecast

43. The high integration of Lesotho's economy with South Africa implies increased exposure to external shocks. In recent years, South Africa's real GDP growth has slowed due to declining commodity prices as well as domestic constraints such as diminished business and consumer confidence, higher borrowing costs, labour disputes and drought. As discussed above, the slowed economic performance in South Africa adversely affected Lesotho's SACU revenues in FY2016/17 and SACU revenues are expected be lower in the medium term. The weak growth prospects in South Africa could also reduce demand for Lesotho's exports given that South Africa is its main trading partner.

44. The high volatility in SACU revenues remains a major challenge for budget management in Lesotho. SACU revenues constituted about 45 per cent of the total expenditure from 2012 to 2016 and an average of 68 per cent of the recurrent expenditure. As discussed above, these revenues are projected to drastically decline to about 28 per cent of the total budget over the medium term. Achieving fiscal balance depends on diversification of revenue sources and containing government expenditure going forward.

45. Lesotho's wage bill is one of the highest in the world and represents a key challenge for the government. The wage bill stands at 18 per cent of GDP and is projected to remain at that level over the medium term. Recognising the importance of reducing the wage bill, the Government began implementing a World Bank Public Sector Modernisation Project in 2016 focusing mostly on pay roll audit. The failure to contain the wage bill and other recurrent expenditures could increase the fiscal deficit going forward.

46. Further depreciation of the South African Rand against the US dollar could significantly increase external debt service costs in local currency terms. Foreign debt dominates Lesotho's public debt portfolio, which exposes the macroeconomic framework to adverse currency movements. The depreciation of the of the Rand in 2014 and 2015 increased external debt service payments from 0.5 per cent of GDP in FY 2014/15 to 0.8 per cent of GDP in FY 2015/16.

47. Political uncertainties could also affect Lesotho's growth prospects over the medium term. Lesotho held general elections two years ahead of schedule in February 2015 to resolve a political and constitutional deadlock amid an uncertain security situation. However, a coalition government formed after the elections could not complete its five-year mandate, leading to dissolution of Parliament in March 2017. Elections were held in June 2017 to elect representatives of the national assembly and lower house of parliament. Continued uncertainties could seriously hurt Lesotho, particularly textile exports under the AGOA agreement which emphasizes the importance of political stability.

48. A materialisation of any of these risks could increase the cost of financing, debt servicing and worsen the public debt dynamics in the short and medium term (Table 8).

49. A debt sustainability analysis conducted by the authorities in November 2016 concluded that Lesotho would to have a moderate risk of external debt distress from going forward. However, based on the mechanical approach to debt sustainability analysis, the DSA suggested that Lesotho's external debt distress rating will deteriorate from moderate to high risk of debt distress, mainly due to a temporary breach of the baseline scenario between 2016 and 2018. The public DSA indicated that Lesotho's public debt would broadly remain manageable over the projection period. The debt-to-GDP ratio would

remain below its threshold under the baseline scenario. However, higher fiscal deficits from 2017 onwards would rapidly increase the various public debt ratios.

Table 8: Risks to the Baseline Macroeconomic Framework

Time Horizon	Source of Risks	Relative Likelihood	Impact if Realized	Implication for Debt Management
Short and Medium Term	Volatile SACU Revenues	High	High High volatility in SACU revenues already increased the fiscal deficit in FY2016/17. Fiscal deficit is projected to remain high	Increased gross financing has needs, which could affect Lesotho's debt sustainability prospects
Short and Medium-Term	High wage bill	High	High Given the high volatility in SACU revenues, the failure to contain the wage bill and other recurrent expenditures could increase the fiscal deficit.	Cost of domestic and external financing and debt servicing could increase substantially
Short-Term	Increase in election related spending	High	High Increased pre-election related spending could result into fiscal slippages	Increased domestic borrowing leading that could elevate the risks to total public debt sustainability
Short and Medium-Term	Uncertainty created by the political impasse	High	High Reduced or low foreign direct investment, leading to lower growth	Increased public sector borrowing requirements that could increase the cost of borrowing and raise sustainability concerns further.

Short and Medium-Term

(a) rise in global interest rates and risk aversion affecting external funding costs; and (b) inflationary pressures and tendency to depreciation arising from conditions in the monetary union, possibly resulting in a policy reaction involving higher real and nominal domestic interest rates.

High

Higher cost of domestic borrowing arising from higher interest rates.

High

Increase in the domestic interest payments as investors charge high interest rates to compensate for higher inflation. High external debt service costs arising from a depreciating exchange rate

VI. SPECIFICATION OF THE MODEL OF THE DEBT PORTFOLIO

A. Stylised Instruments

50. The analysis in this report uses 12 stylised instruments denominated in six different currencies. Stylised instruments are used to aggregate debt-service projections of the existing debt portfolio which are extracted from the debt database on a loan-by-loan and security-by-security basis. Stylised instruments synthesise the characteristics of existing financing instruments and take into account the likely new borrowing terms and conditions of sources of financing available to Lesotho.

51. Eight instruments represent forms of external financing. They are as follows:

- Fixed-rate loans, denominated in XDR, with a 25-year maturity and a 5-year grace period. This instrument represents concessional or semi-concessional financing such as IDA or ADF loans on blend terms.
- Fixed-rate loans, denominated in USD, with a 20-year maturity and a 5-year grace period. This instrument represents semi-concessional financing available from bilateral (or multilateral) creditors, including export-import agencies.
- Floating-rate loans, denominated in USD, with a 20-year maturity and a 5-year grace period. This instrument represents semi-concessional financing available from bilateral (or multilateral) creditors, including export-import agencies.
- Fixed-rate loans, denominated in EUR, with a 20-year maturity and a 5-year grace period. This instrument represents semi-concessional financing available from bilateral (or multilateral) creditors, such as the EIB and other European official creditors.
- Fixed-rate loans, denominated in CNY, with a 20-year maturity and a 5-year grace period. This instrument represents semi-concessional financing available from China Export-Import Bank.
- Fixed-rate loans, denominated in ZAR, with a 10-year maturity and a 3-year grace period. This instrument represents financing available from commercial banks and the Development Bank of Southern Africa.
- Fixed-rate loans, denominated in USD, with a 10-year maturity and a bullet repayment. This instrument represents financing available from commercial banks or international capital markets.

- Fixed-rate loans, denominated in EUR, with a 10-year maturity and a bullet repayment. This instrument represents financing available from commercial banks or international capital markets.

52. Four instruments represent forms of domestic financing. They are as follows:

- Treasury bills, denominated in LSL, in discount format, issued with a 1-year (or shorter) maturity and a bullet repayment.
- Treasury bonds, denominated in LSL, with fixed coupons, issued with a maturity of 5 years and a bullet repayment.
- Treasury bonds, denominated in LSL, with fixed coupons, issued with a maturity of 10 years and a bullet repayment.
- Treasury bonds, denominated in LSL, with fixed coupons, issued with a maturity of 15 years and a bullet repayment.

B. Baseline Exchange-Rate and Interest-Rate Assumptions

Exchange-rate assumptions

53. Actual exchange rates for LSL against CNY, EUR, USD, XDR, ZAR, and other currencies are used to convert existing foreign-currency debt stocks and flows. To convert projections of debt service for debt outstanding as at end-March 2017 into a common numeraire, exchange rates as at 15 March 2017 are used.

54. For the period from 2017/18 to 2021/22, the movement of ZAR—and therefore LSL, since the fixed parity is assumed to continue to hold—against the other currencies is projected under the assumption of purchasing power parity. The baseline scenario is a depreciation of ZAR against other currencies in the portfolio. According to the October 2016 update of the World Economic Outlook, inflation in South Africa is forecast to be each year on average approximately 2.9 percentage points higher than inflation in the United States, 4.5 percentage points higher than inflation in the Euro zone, 3.1 percentage points higher than inflation in China, and 3.5 percentage points higher than the “inflation” implied for the XDR basket.

Interest-rate assumptions for foreign-currency debt

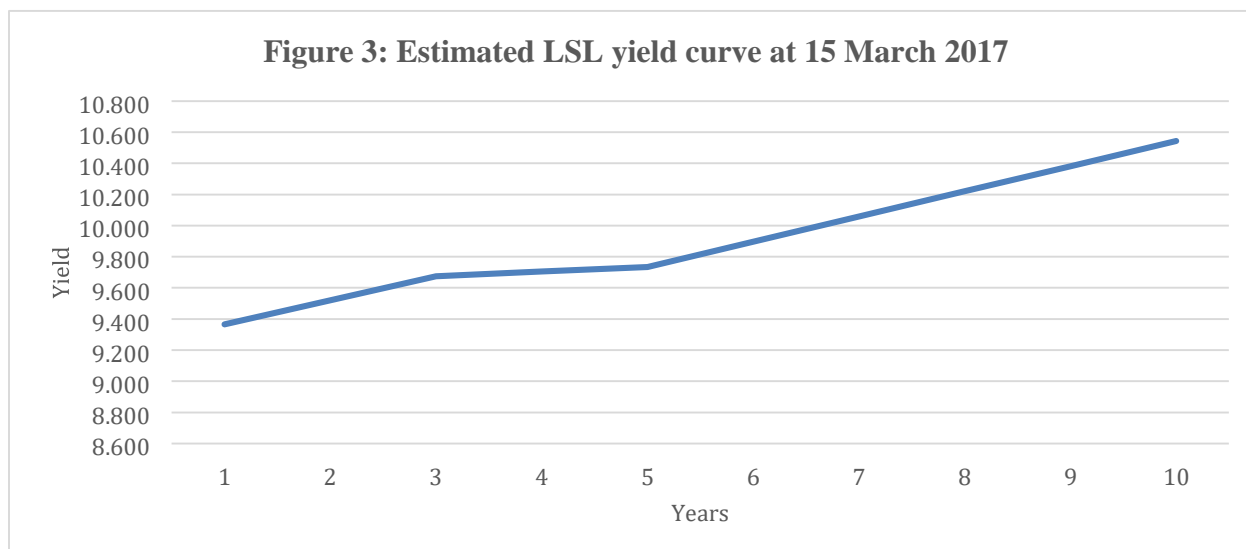
55. Commercial market-determined interest rates are projected using actual yield curves as at 15 March 2017 and forward yield curves derived from them for

borrowing during 2017/18 to 2021/22. For borrowing denominated in USD, future USD interest rates are estimated off a USD benchmark yield curve—either the United States Treasury yield curve or the USD LIBOR/swap yield curve. For the 10-year USD stylized instrument, a fixed-rate instrument, a fixed margin of 500 basis points is added to the 10-year United States Treasury yield. This spread was determined by examining current margins above the United States Treasury yield on international bonds of approximately 10 years remaining maturity, denominated in USD, issued by governments with sovereign credit ratings roughly similar to what that of Lesotho would be likely to be. A similar approach is taken for the 10-year EUR instrument, where the same fixed margin of 500 basis points is added to the 10-year German government yield. For the 10-year ZAR instrument, a fixed margin of 200 basis points is added to the 10-year South African government yield.

56. A similar approach is followed for semi-concessional interest rates whose pricing incorporates market-based elements. The floating-rate semi-concessional USD instrument is estimated using the 1-year USD swap rate as the reference rate, plus a spread of 50 basis points. The spread was calibrated to reflect a pricing reasonably comparable to that for semi-concessional floating-rate loans from multilateral and bilateral creditors.

57. Interest rates for concessional and semi-concessional fixed-rate loans from multilateral and bilateral official creditors are treated as policy-determined and are assumed to remain constant at their March 2017 values through 2021/22. Concessional loans denominated in XDR are priced at 2.00 per cent, based on indicative pricing for IDA loans. Semi-concessional loans denominated in CNY, EUR, and USD are all priced at 2.50 per cent, in line with recent agreements from bilateral creditors.

Interest-rate assumptions for local-currency debt



58. LSL interest rates are projected using a synthetic yield curve. A yield curve for treasury bills and bonds based on secondary market trading is not observable, and primary market yields are observable only infrequently, when auctions take place. Consequently, a yield curve for LSL stylized instruments is constructed as follows: (i) The South African government yield curve as at 15 March 2017 serves as the benchmark; (ii) To that benchmark, a margin of 200 basis points is added to account for factors such as the credit spread of Lesotho relative to South Africa and the illiquidity of Lesotho government securities compared to South African government securities; and (iii) No further margin is applied to account for the inflation differential between Lesotho and South Africa, since the assumption is that the fixed parity and, moreover, the free convertibility between LSL and ZAR will continue. (iv) Interest rates during 2017/18 to 2021/22 are projected using the implied forward curve yields derived from this synthetic yield curve.

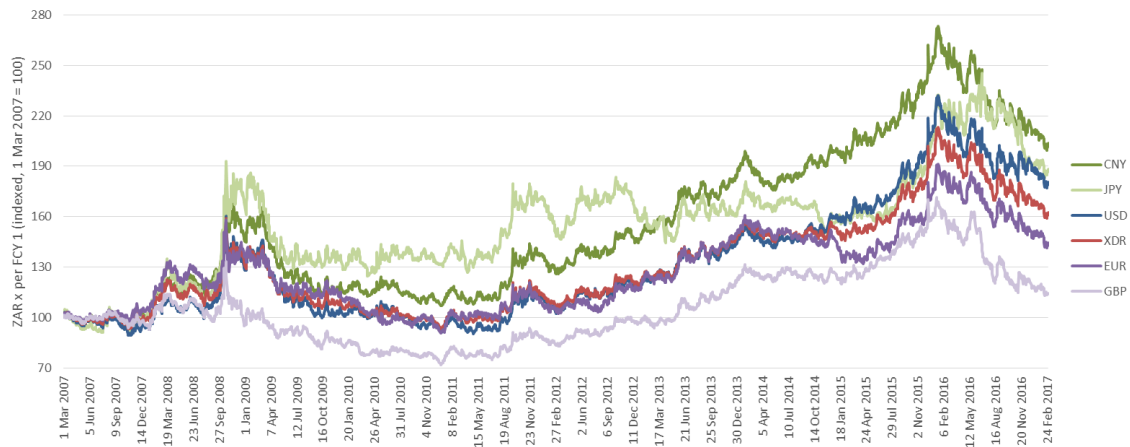
C. Shock Scenarios

59. Three shock scenarios generating deviations from the baseline assumptions for market variables are considered. These scenarios reflect downside risks for debt management and test the robustness of the candidate borrowing strategies.

60. The first shock scenario is a depreciation of ZAR— and, therefore, of LSL— against CNY, EUR, USD, and XDR. This scenario assumes a 30 per cent depreciation of the LSL against all the other currencies in 2018. Thereafter, ZAR continues to depreciate from its new level in line with the depreciation in the baseline. The rationale behind this

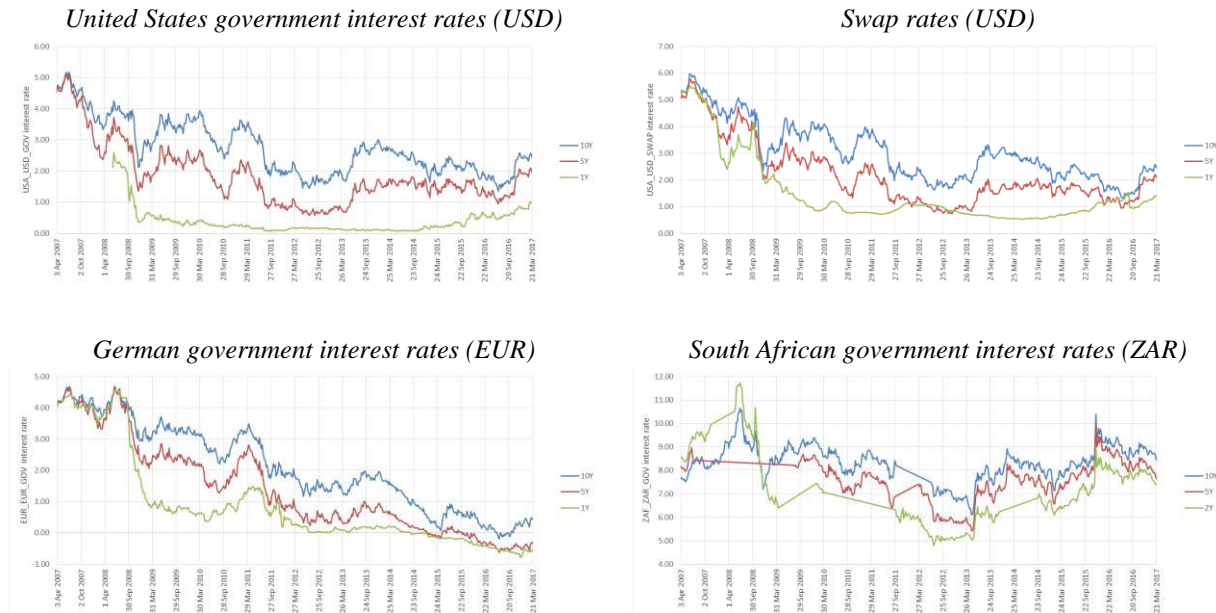
scenario is to examine the impact of possible weakness in ZAR, which would be expected to have consequences for Lesotho's export-related revenues and the fiscal balance. A 10-year time series of the exchange rate of ZAR against other currencies shows that movements of that magnitude over a horizon of one to three years—and even within a single year—has not been uncommon.

Figure 4: ZAR versus other currencies since March 2007
(indexed, March 2007 = 100)



61. **The second shock scenario is an upward shift in USD, EUR, and ZAR commercial market-determined interest rates.** Consequently, this scenario assumes an increase of 400 basis points in commercial interest rates in 2018, both abroad and locally, since an increase in ZAR interest rates will affect LSL interest rates. No reversal of the shock takes place in the subsequent years. This shock could arise from a number of factors. The shock could be specific to Lesotho, such as a deterioration in Lesotho's perceived sovereign creditworthiness relative to that of other countries. Conversely, the shock could be a more generalised phenomenon, such as a flight-to-quality movement in capital flows from emerging markets as a whole towards developed economies. Similarly, the shock could arise from increases in the underlying reference rates due to, for instance, interest-rate tightening in the United States or the Euro zone. A 10-year time series of USD, EUR, and ZAR interest rates shows that lengthy periods of stable interest rates can be interrupted by periods of volatility, including episodes when interest rates increase or decrease dramatically within a single year.

Figure 5: USD, EUR, and ZAR interest rates since March 2007



62. The third shock scenario is a combined interest-rate and exchange-rate event. This scenario assumes an increase of 200 basis points in commercial market-determined interest rates in 2018, together with a 15 per cent depreciation of ZAR—and, therefore, of LSL—relative to the other currencies. No reversal of the shock takes place in subsequent years.

D. Financing Strategies

63. Four different debt management strategies are analysed with the goal of assessing their impact on the cost and risk characteristics of the government’s future debt portfolio. The strategies represent alternative ways to finance each year the government’s gross borrowing requirement. The strategies are intended to illustrate the relative effect of different policy choices.

64. The first candidate strategy (S1) reflects a “status quo” financing mix. It follows the broad parameters of the financing mix in the fiscal year 2016/2017. External sources satisfy 50 per cent of the gross borrowing requirement, with all external borrowing achieved through concessional and semi-concessional instruments, of which 60 per cent is from multilateral sources and 40 per cent from bilateral sources. It is worth noting that the financing mix from external sources can change considerably one year from another. For

example, a large disbursement in a specific year can represent more than half of the external borrowing (it was the case in 2016/2017 with a large disbursement from an EIB loan). Thus, the breakdown of the external borrowing instruments is rather based on what authorities think would be the upcoming financing mix in the next years.

65. S1 envisages the remaining 50 per cent of the borrowing requirement is satisfied through domestic market securities. A 90/10-percent split between Treasury Bills and Treasury Bonds has been considered. This split corresponds roughly to the previous year financing mix from domestic source, when government issued LSL 75 million of Treasury Bonds and made a net issuance of Treasury Bills amounting to LSL 490 million. Authorities could not provide the Treasury Bills net issuance amount and, therefore the mission assumed that the 26 auctions of TBills achieved in the last fiscal year will also take place in the next fiscal year, with an average auction amount of LSL 30 million split equally between four instruments (T-Bills 92, 182, 273 and 364 days). Thus, the total volume of T-Bills issuance would be LSL 780 million, but 3-months, 6-months and 9-months T-bills will be partially rolled over leading to a net issuance amount of approximately LSL 490 million ($26 \times 7,5 \times 0,25 + 26 \times 7,5 \times 0,5 + 26 \times 7,5 \times 0,75 + 26 \times 7,5 \times 1$).

Table 9. Borrowing mix during 2017/2018 to 2021/2022

Stylized Instruments		S1	S2	S3	S4
External		50%	50%	30%	30%
Multilateral_Concessional_XDR_fixed	FX	30%	15%	18%	18%
Bilateral_Semi-Conces_USD_fixed	FX	7,5%	7,5%	4,5%	4,5%
Bilateral_Semi-conces_USD_floating	FX	0%	2,5%	0%	0%
Bilateral_Semi-conces_EUR_fixed	FX	7,5%	2,5%	4,5%	4,5%
Bilateral_Semi-conces_CNY_fixed	FX	5%	7,5%	3%	3%
Commercial_ZAR_fixed	FX	0%	5%	0%	0%
Commercial_EUR_fixed	FX	0%	5%	0%	0%
Commercial_USD_fixed	FX	0%	5%	0%	0%
Domestic		50%	50%	70%	70%
T-Bills_Fixed	DX	45%	45%	63%	42%
T-Bonds 5 YR_Fixed	DX	2,5%	2,5%	3,5%	14%
T-Bonds 10 YR_Fixed	DX	2,5%	2,5%	3,5%	7%
T-Bonds 15 YR_Fixed	DX	0%	0%	0%	7%
		100%	100%	100%	100%

66. The second candidate strategy (S2) reflects a shift toward more commercial external borrowing, without increasing the total amount of external borrowing. The division between external and domestic borrowing is the same as under S1—50 per cent external and 50 per cent domestic. Within the external borrowing mix, 30 per cent is

through multilateral loans and 40 per cent through semi-concessional borrowing, with the remaining 30 per cent split into 3 commercial borrowing instruments denominated in ZAR, EUR and USD. The domestic borrowing mix remains the same as under S1. This strategy S2 aims at simulating what could happen if government has to finance part of the upcoming projects through commercial borrowing, considering that Lesotho will have a limited access to concessional borrowing due to its status of low middle-income country.

67. The third candidate strategy (S3) increases the share of domestic borrowing to 70 per cent of the total financing mix. However, the split between external borrowing instruments remains the same as under S1, as well as the split between domestic borrowing instruments. S3 responds to government desire of financing a larger part of its deficit through domestic sources in the case of the market has limited appetite for longer dated securities.

68. The fourth candidate strategy (S4) increases the share of domestic borrowing and extends the maturity profile of domestic issuance. In this strategy, domestic borrowing represents 70 per cent of total borrowing like under S3. The split between external borrowing instruments remains the same as under S1. However, the increase in the volume of domestic borrowing is accommodated through more issuance of longer dated securities. As a result, within the domestic borrowing mix, 60 per cent is achieved through Treasury Bills, 20 per cent through 5years Treasury Bonds, 10 per cent through 10-years Treasury Bonds and the remaining 10 per cent through a new 15-year Treasury Bond, a tenor government has never issued yet.

VII. COST, RISK, AND FEASIBILITY ANALYSIS OF CANDIDATE DEBT MANAGEMENT STRATEGIES

69. The performance of the selected four strategies was assessed under both the baseline and shock scenarios. Based on debt service projections of the existing portfolio and using the baseline forecasts for relevant macro-fiscal and market rate variables, four alternative financing strategies have been applied. The chosen horizon for the analysis was 5 years. The MTDS toolkit provides information on future debt composition and size during and at the end of the period, both under baseline and shock scenarios.

Table 10: Cost and risk indicators under different financing strategies

Risk Indicators		2017	As at end 2022			
		Current	S1	S2	S3	S4
Nominal debt as % of GDP		40,3	49,3	49,8	49,8	50,1
Present value debt as % of GDP		25,9	34,3	36,7	36,2	37,3
Interest payment as % of GDP		1,1	1,5	1,8	1,8	2,1
Implied interest rate (%)		2,6	3,4	4,1	4,3	4,8
Refinancing risk	Debt maturing in 1yr (% of total)	8,9	14,7	15,1	23,9	15,4
	Debt maturing in 1yr (% of GDP)	3,6	7,3	7,5	11,9	7,7
	ATM External Portfolio (years)	11,0	10,9	9,9	10,7	10,5
	ATM Domestic Portfolio (years)	3,1	1,8	1,8	1,8	4,6
	ATM Total Portfolio (years)	10,1	9,4	8,5	8,1	8,4
Interest rate risk	ATR (years)	10,1	9,4	8,3	8,1	8,4
	Debt refixing in 1yr (% of total)	9,5	14,8	17,5	24,0	15,5
	Fixed rate debt (% of total)	99,4	99,9	97,6	99,9	99,9
FX risk	FX debt as % of total	88,7	83,1	82,8	70,9	64,4

70. The four strategies are showing an increase in Lesotho debt level in 2022 due to fiscal imbalance. All the strategies indicate that Debt/GDP ratio would reach approximately 50 per cent in 2022, while the ratio is currently at 40 per cent. Hence, the analysis suggests that there is a fundamental fiscal imbalance that must be resolved. A sound debt management strategy alone cannot overcome that imbalance. Notwithstanding that underlying fiscal challenge, each strategy for financing the government's borrowing requirements has advantages and disadvantages (refer to **Table 11**). A discussion on strategies' feasibility is available under the sub-section B of this section (paragraphs 78 to 82).

Table 11: Comparison between the candidate strategies

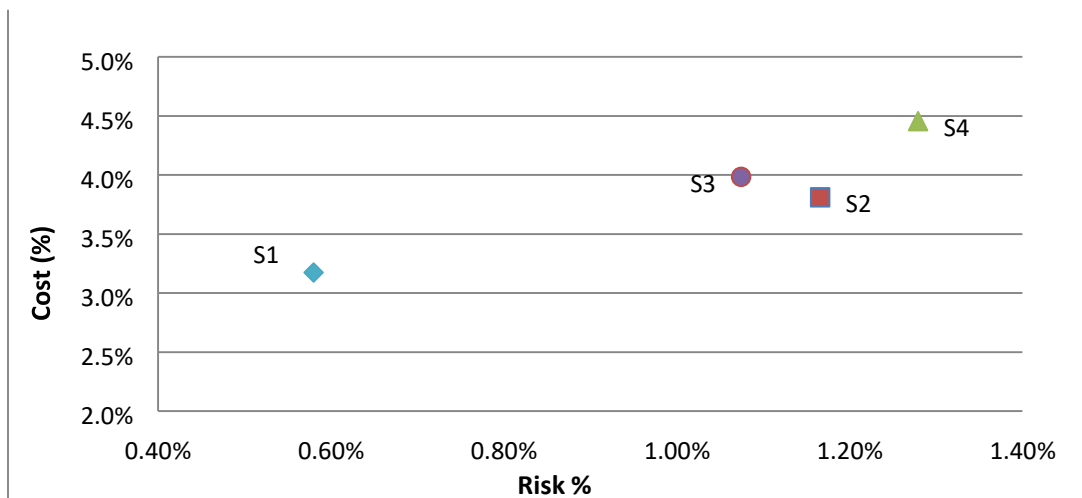
Strategy	Advantages	Disadvantages
S1	<ul style="list-style-type: none"> • Lowest increase in total debt level • Lowest increase in debt/GDP ratio • Lowest increase in implied interest rate • Low sensitivity to shock on interest rate 	<ul style="list-style-type: none"> • Exposure to exchange rate risk stays high • Highest share of External Debt • ATM of domestic debt decreases considerably
S2	<ul style="list-style-type: none"> • Low refinancing risk on the whole portfolio 	<ul style="list-style-type: none"> • High implied interest rate (borrowing cost) • Exposure to exchange rate risk stays high • Low ATM of the domestic portfolio
S3	<ul style="list-style-type: none"> • Exposure to exchange rate risk diminish considerably • Share of External Debt in total debt portfolio falls 	<ul style="list-style-type: none"> • High implied interest rate (borrowing cost) • Worst redemption profile • Highest share of debt maturing within 1 year • Low ATM of the domestic portfolio • High refinancing risk
S4	<ul style="list-style-type: none"> • Major reduction of Exposure to exchange rate risk • Only strategy where the ATM of domestic debt portfolio increases • Reduced refinancing risk 	<ul style="list-style-type: none"> • Highest implied interest rate (borrowing cost) • Highest increase in debt/GDP ratio • Highest sensitivity to shock on interest rates

71. Compared to the current portfolio, borrowing costs will increase regardless of the strategy adopted. The implied interest rate of the aggregate portfolio will be higher in 2022 compared to the implied interest rate as at end-March 2017. This is due to the greater reliance on external commercial borrowing for S2 and a larger increase in domestic debt issuance for S3 and S4. The ratio of interest payments over GDP or revenues will also increase across all strategies compared to the current situation, although moderately.

72. Comparing the strategies to one another, results suggest that a strategy with a greater reliance on external borrowing could lead to lower costs. Particularly when the borrowing is done through concessional instruments, as it is the case with S1, 60 per cent of external borrowing is done through loans from multilateral agencies. This strategy results in the lowest cost indicators, such as interest payments and total debt service in terms of both GDP and revenue. Furthermore, when shocks are applied to the baseline projections of market variables, this strategy shows the lowest increase in the cost indicators, which means a lower risk in terms of the deviation from the baseline scenario. However, a strategy increasing reliance on external borrowing may also increase the sovereign risk premium and, therefore, may limit any expected lowering of borrowing costs.

73. However, costs increase generated by the other three strategies compared to S1 remains manageable. For S2 and S3, the ratios of interest payments over revenues ratios are only 0.64 and 0.81 percentage point higher than S1, and for S4 1.29 percentage point higher (refer to Figure 5). Furthermore, the implied interest rate of the portfolio remains low even for the most expensive strategy S4 at 4.8 per cent compared to 3.4 per cent for S1. It is worth noting that S4 implies a higher volume of domestic borrowing and, therefore, more pressure on local banks leading undoubtedly to an increase in the level of domestic interest rates.

Figure 6: Costs and risk in 2022, as measured by interest payments/revenues



Note: Cost (%) refers to interest payments/revenues and the horizontal axis is the maximum deviation in shock scenarios compared to the baseline scenario for the ratios.

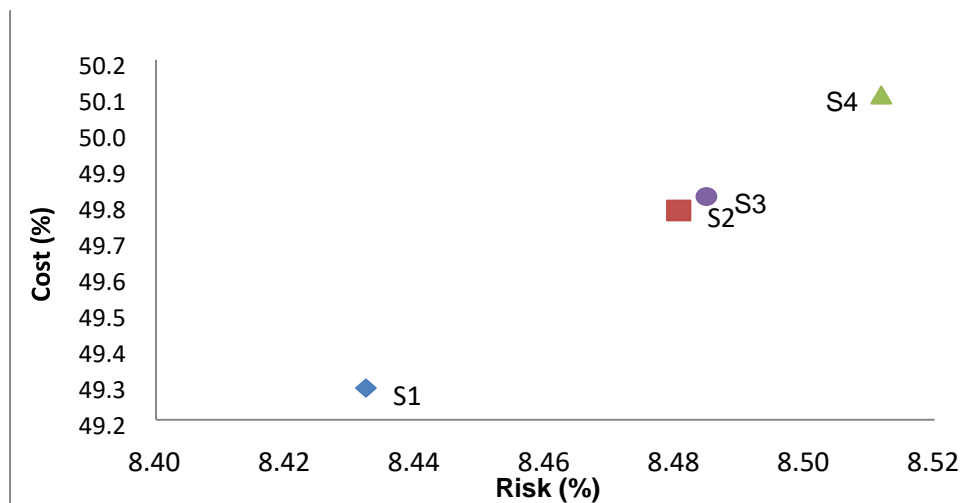
74. Even when shocks are applied to the baseline scenario, the volatility of cost indicators remains limited. For instance, Figure 5 shows an extreme shock on interest rates (400 basis points on domestic and foreign interest rates) would increase the ratio interest payments/revenues by 1.28 percentage point compared to the baseline scenario for S4. Thus, for S4, interest payments would represent 5,73 per cent of government revenues in 2022, instead of 4,46 per cent under the baseline scenario. For S1, an extreme shock on interest rates would increase the ratio interest payments/revenues by 0.58 percentage point compared to the baseline scenario, reaching 3,75 per cent instead of 3,17 per cent. Consequently, such an extreme shock on interest rates would not provoke a huge rise of interest costs, independently of the strategy chosen. This is

because current debt portfolio is composed of an important share of external concessional/semi-concessional debt and the candidate strategies will not change much the current portfolio composition over the next five years.

75. A status-quo strategy results in the lowest increase in the total debt level and the lowest debt/GDP ratio. At the end-March 2022, the lowest debt/GDP ratio would be 49.3 per cent for S1 and the highest 50.1 per cent for S4 (refer to Figure 6). S1 is relying more than the other strategies on concessional/semi-concessional funding sources and, as one would expect, the increase in total debt level is, thus, lower. However, the difference in debt level and debt/GDP ratio is minimal between the four strategies. Indeed, the main factor driving the evolution of the debt/GDP ratio is the increase in debt level due to fiscal imbalance (as explained in paragraph 64). The strategy choice has less impact on this ratio because the level of debt is, first and foremost, a consequence of fiscal policies rather than debt management decisions. This explains why the projected ratio's increase from 2017 to 2022 is large, while the choice between candidate strategies makes less difference.

76. An extreme shock on exchange rates would provoke the highest deviation of debt/GDP ratio from baseline scenario. A depreciation of 30 per cent of the South African rand (local currency is peg to rand) would result in an increase of more than 8 percentage points on the debt/GDP ratio at end-March 2022 for all the strategies. Compared to the other shocks, an extreme shock on exchange rates has the largest impact on the debt/GDP ratio because the share of debt denominated in foreign currencies represents approximately 90 per cent of the total debt. This high percentage of external debt stock also explains why there is no significant difference between the strategies from this perspective.

Figure 7: Cost and risk in 2022, as measured by debt/GDP



Note: Cost refers to Debt/GDP ratio and risk refers to the maximum deviation in shock scenarios compared to the baseline scenario.

A. Comparison of Candidate Strategies in Terms of Risk Indicators

77. Risk expressed as the potential deviation in cost from the baseline scenario must be examined in conjunction with other indicators. They include indicators of refinancing risk, interest-rate risk, and the exchange-rate risk (Table 11). In particular, the ratio of annual interest payments over government revenues captures how a potential increase of interest rates will translate into higher costs for the upcoming budgets. While stock indicators, such as the debt-to-GDP ratio, captures how markets rates risks (exchange rates and interest rates) will change the characteristics of the debt portfolio in the medium-term.

78. Increasing the share of domestic borrowing in the financing mix results in a lower exposure to exchange rate risk. Government debt portfolio is principally exposed to exchange rate risk due to its large share of foreign currency denominated debt (89 per cent of total outstanding debt). Therefore, by increasing the share of government deficit financed through domestic sources to 70 per cent, S3 and S4 are resulting in a significant diminution of the share of external debt in total debt at end-March 2022, respectively 71 per cent and 64 per cent. These two strategies are reducing portfolio exposure to the exchange rate risk far more than S1 and S2.

79. S4 is the only strategy to reduce significantly the refinancing risk of the domestic debt portfolio. By issuing longer term government securities, S4 would lead to an increase of the ATM of the domestic debt portfolio to 4.6 years in 2022, while none of the three other strategies would lead to an ATM higher than 1.8 years. Furthermore, the ATM of domestic debt was 3.1 years at the end of the fiscal year 2016/2017, which means that S4 is the only strategy to increase the ATM over time.

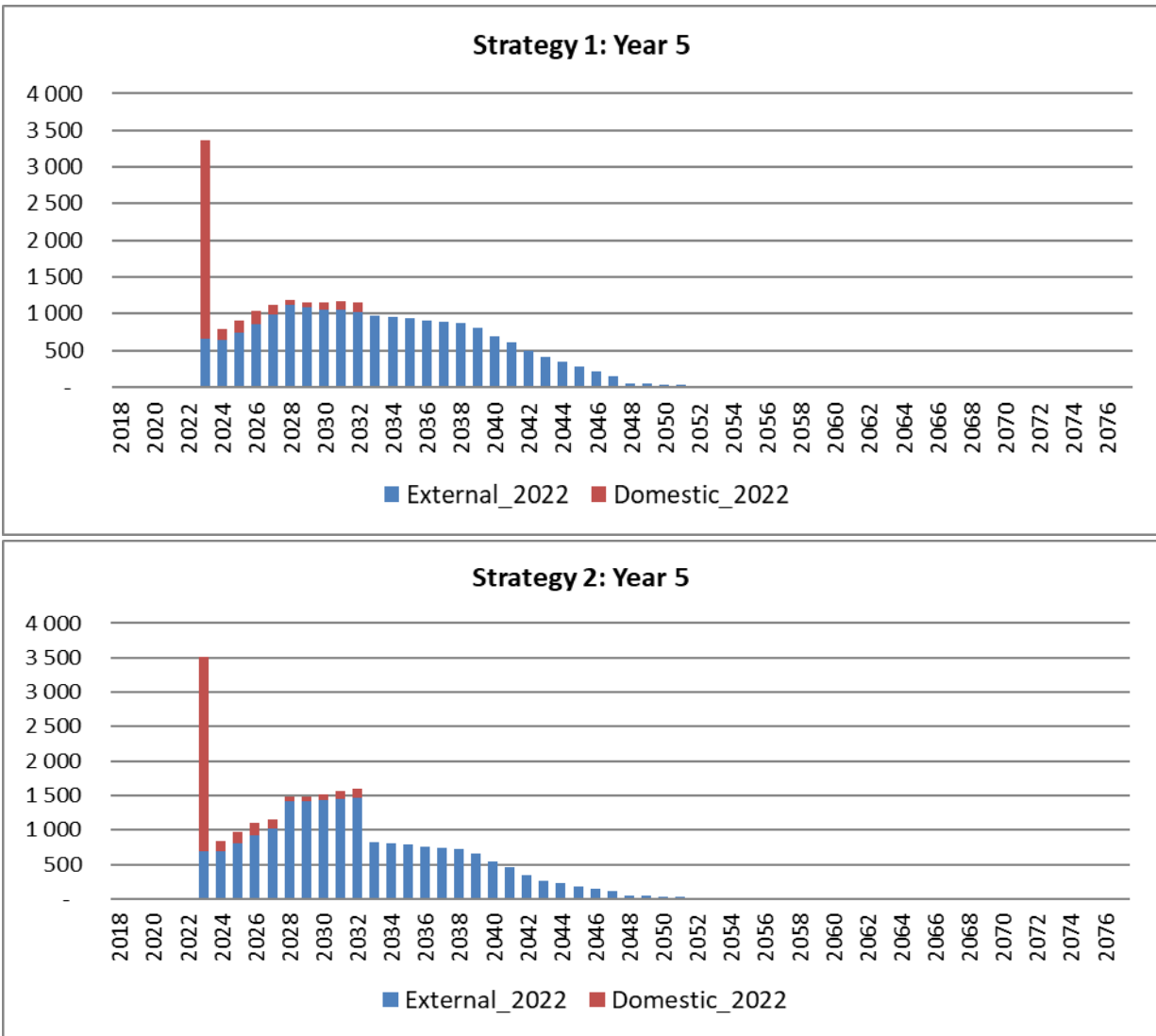
80. However, the total debt maturing within 1 year increases compared to the existing portfolio. This is the case under all strategies because the share of T-Bills issuance remains high in any case. But, S3 is clearly the worst strategy from this perspective, with almost 24 per cent of the whole debt maturing in the next 12 months at end-March 2022, because it increases the share of domestic financing without extending the maturities of government securities.

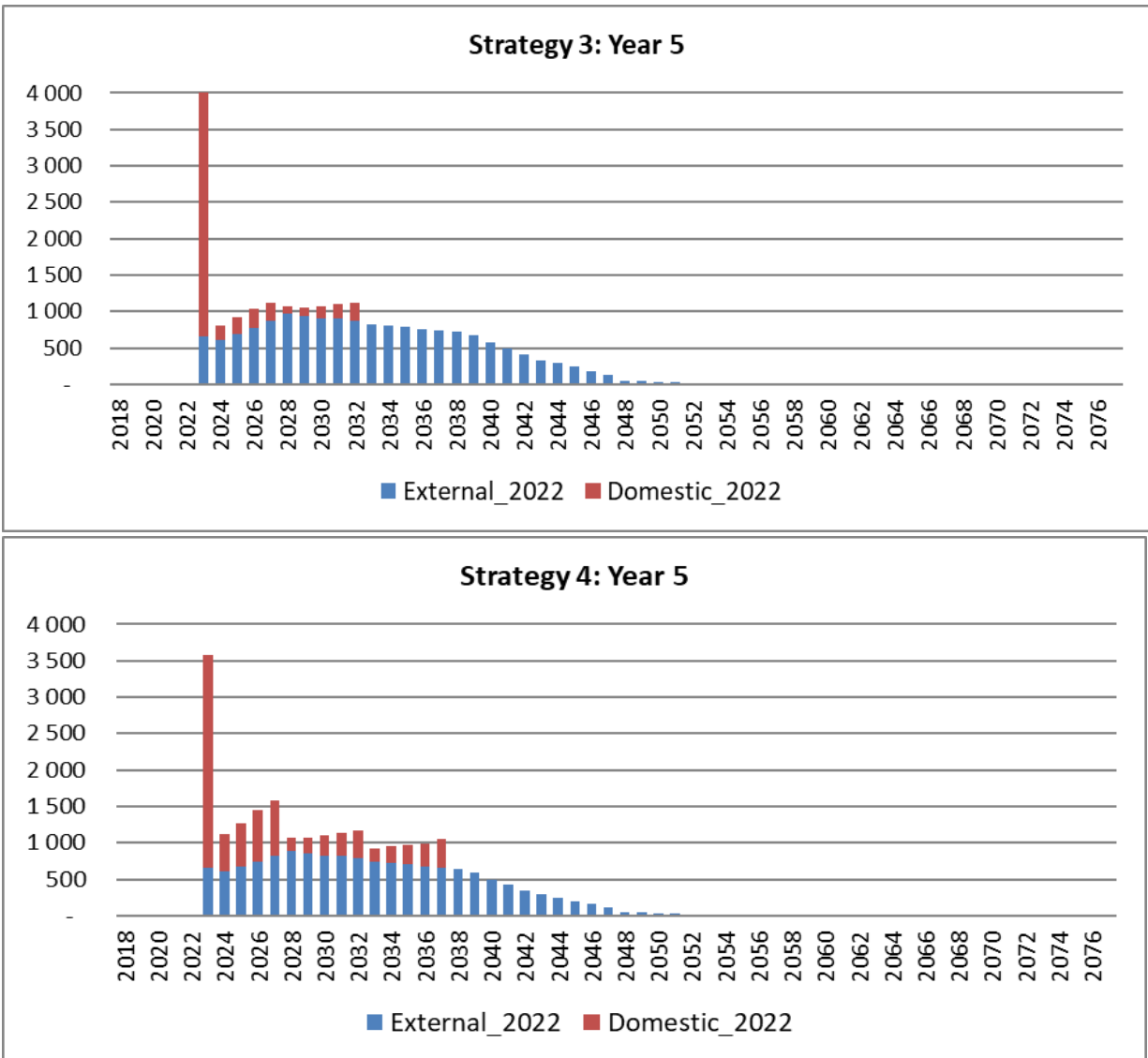
81. Strategies S1 and S2 with a higher share of external borrowing in the financing mix do not show a significantly lower percentage of debt maturing within 1 year than S4, as one could expect. This is due to the reliance of S4 on longer dated domestic securities (5-years, 10years and 15-years). As a consequence, S4 results in 15.4 per cent of debt portfolio maturing within 12 months in 2022, while S1 and S2 are showing slightly lower shares (respectively 14.7 per cent and 15.1 per cent), but not remarkably lower. Although the prevalence of long-dated multilateral loans in the status quo strategy which result in the lower share of debt maturing within 1 year, as at end 2022, S1 is not achieving any interesting reduction of the portfolio refinancing risk compared to the strategy S4.

82. Commercial external borrowing is entirely undertaken through fixed-rate debt, without implications for interest-rate risk. In fact, authorities consider that only few bilateral creditors (like Exim-bank India) could eventually lend to Lesotho with variable-rate terms. Thus, in 2022, almost 100 per cent of the portfolio will be composed of fixed-rate debt, except for S2 (97.6 per cent). Consequently, the interest rate risk indicators do not add any interesting information to the portfolio analysis compared to refinancing risk indicators.

83. Portfolio redemption profile will deteriorate at the end of the fifth year for all the strategies. This is due to the large share of T-Bills in the financing mix which creates a peak in the first year of the redemption profile for any strategy compared to the existing portfolio. But, comparing the four strategies, the redemption profile under S1 in 2022 is smoother (refer to Figure 7). S4 shows an important share of debt maturing within 1 year, but after 12 months the redemption profile is relatively smooth. S2 and S3 are clearly suboptimal.

Figure 8. Redemption profile of all the strategies at the end of the fifth year





B. Comparison of the Strategies in Terms of Feasibility

84. The implementation of a strategy increasing financing from domestic sources will depend on market appetite for longer dated securities. Indeed, S3 seems not realistic considering that the bulk of increase in domestic debt issuance would be borne by T-Bills, therefore putting too much pressure to refinance the portfolio in the short-term. Thus, increasing financing from domestic sources should necessarily go along with issuing more on the long-end of the domestic curve. Furthermore, S4 is certainly also constrained by a limited presence of buyers for long-term securities, which calls for further investigation on market absorption capacity in order to evaluate if the increase in domestic debt issuance envisaged with S4 is really achievable.

85. Treasury Bonds issuance will hardly cover the financing gap, an increase in commercial borrowing will certainly be necessary to close it. Indeed, although there seems to be some room more domestic debt issuance, local market absorption capacity is probably not vastly extensible. Considering fiscal deficits forecasted for the coming years and the limited access to concessional funds due to Lesotho's lower middle income country status, external commercial borrowing will certainly increase to cover government financing needs.

86. The degree of cost-surge associated with a greater reliance on domestic issuance depends in part on South African monetary policy. As the local currency is pegged to the rand, the Central Bank of Lesotho will need to mirror South African monetary policy to keep the peg. This could mean an increase of debt costs if the South African Central Bank decides to increase its interest rates.

87. Debt cost will also depend on the government's sovereign credit rating. Any deterioration in the credit rating would be likely to result in higher costs or even prevent government from implementing a strategy aiming at increasing reliance on market based instruments (government securities).

88. The expected rise in the borrowing requirements will necessitate a careful consideration of the cost/risk trade-offs associated with each alternative financing strategies. With limited availability of external concessional borrowing, the bulk of the funding gap would have to be met through even greater issuance of domestic government securities, which may not be feasible in the current environment. The remaining borrowing requirements would, then, be covered by external commercial borrowing which is relatively costly, without reducing the exchange rate risk of the existing portfolio.

C. Conclusions as to the Characteristics of a Desirable Strategy

89. The desirable strategy should focus on reducing the high exchange rate risk of the existing portfolio. This means increasing the share of government deficit financed through domestic issuance, which could be achieved only by issuing longer dated government securities. A status-quo approach will not give any results in reducing portfolio's exchange rate risk.

90. Extending maturities of domestic securities will also reduce the refinancing risk associated with the domestic debt portfolio. This should also be a key target of the desired strategy. Thus, the strategy should aim at increasing liquidity on specific points of the

domestic yield curve by concentrating the issuance on few benchmark securities to increase their size.

91. The implementation of such strategy will certainly increase government borrowing costs in the next five years. However, this increase in costs could be acceptable for the authorities, especially if it also helps improving the size and liquidity of domestic market.

VIII. IMPLEMENTATION AND OTHER CONSIDERATIONS

A. Next Steps for Formulating and Approving a Strategy

92. The most important step to formulate the strategy is to review first the current macroeconomic framework. The Ministry of Finance should update the analysis with the new macroeconomic variables forecasts because this MTDS exercise has used forecasts that were produced in November 2016 and, since then, the political context of Lesotho has changed substantially. Furthermore, a broad revision of budget figures will certainly happen in July or August 2017, considering that the budget for the fiscal year 2016/2017 has not been tabled yet. The strategy should embrace all these changes.

93. Strategic targets should be set to reach the medium-term desired government debt portfolio. The analysis has identified the exchange rate risk and the domestic debt refinancing risk as the main market risks associated with the debt portfolio. Thus, authorities should define strategic targets that will reduce these risks over the medium-term. However, strategic targets do not need to necessarily have quantifiable values. For the moment, strategic targets could be directional guidelines such as “reducing the share of external debt in total debt” or “increasing average time to maturity of the domestic debt portfolio.”

94. To formalise the strategy, the debt management strategy document must be approved by the Minister of Finance. Indeed, the choice of the desired strategy embodies the government’s preferred risk tolerance, which involves a political judgement. Depending on government choice to adopt a conservative position or tolerate more risk, the strategy selected could differ.

95. A summary document and a presentation of the selected strategy should be prepared for the Minister. The Minister needs to see the highlights of the strategy and information for decision-taking purposes. He might not be interested by the details of the strategy, but the person presenting the strategy to the Minister should be ready to answer his questions.

96. It is important that financing decisions are guided by the approved strategy. If borrowing decisions are taken on an ad-hoc basis and outside of the plan, there is little point in producing a debt management strategy. The effective implementation of the approved strategy depends on decision-makers' awareness of the strategy and their willingness to respect it. Then, the strategy will be an important tool to monitor and manage risks to the budget.

97. It will be important for the PDAMD to be more involved in domestic debt issuance and decision making processes. Although the PDMAD participates during auctions of domestic securities, the decision about pricing are made by high level authorities in the Ministry of Finance. It is therefore important that the PDMAD should take full and active responsibility for decision-making regarding domestic borrowing, including preparation of auction calendars, and acceptance of bids at the auctions.

98. Additional technical assistance would be available on request by the authorities. This could include support in drafting a debt management strategy document, developing strategic targets towards achieving the desired government debt portfolio, and designing a borrowing plan. The World Bank, the IMF, and their partners could also assist the authorities design a structured debt management reform plan for the medium term.

B. Communication of the Strategy Once Approved

99. Once the Minister has approved the strategy document, it could be published on the website of the Ministry. Publication of the strategy is for enhancing accountability and transparency of debt management operations. However, the published strategy document should not be the same as the internal one. Public and investors are the target audience of the published strategy. Therefore, only the selected strategy should be communicated to the outside, not the alternative strategies analysed and then discarded by the officials.

100. The debt management strategy should usually be published at the end of the fiscal year, together with an annual borrowing plan for the coming fiscal year. Eventually, a formal presentation to the press and market participants could be organised the day of the release. This gives the opportunity to the staff of the PDAMD to put the department under the spotlights and explain rationale behind the strategy.

101. The selected strategy should be reviewed—and, if necessary, updated—annually as part of the budget process. This periodical review is made to assess whether the assumptions still hold in the light of changed circumstances. If the existing strategy is

viewed as appropriate, then PDAMD should explain it in the strategy document and argument in favour of the continuation of the strategy. There should be a brief description in the strategy document of the analysis undertaken, including setting out any critical assumptions and acknowledging any limitations to the analysis. More generally, the strategy could elaborate on how the measures to be taken over the medium term will be consistent with the overall debt management objectives of ensuring the availability of financing and reducing cost subject to a prudent degree of risk.

102. In addition, a section of the strategy document—or, alternatively, a separate document published simultaneously—could report on the outcome of the implementation of the previous fiscal year’s debt management strategy and annual borrowing plan. This would provide valuable information on the performance of debt management, as well as the challenges experienced during the previous year in managing the debt portfolio. Notably, it should discuss transparently any deviations from the strategy arising from changes in fiscal policy, the macroeconomic environment, or financial-market conditions, and whether those factors are expected to be one-off or only temporary. If the factors are expected, however, a reorientation of the strategy to some degree would be warranted.

C. Actions Needed to Improve Debt Recording

103. PDAMD should undertake urgently a revision of domestic debt recorded in the debt recording system. Indeed, domestic debt outstanding amount is undervalued and several domestic instruments are missing. The staff need to coordinate with Central Bank officers in charge of government securities auctions to receive up-to-date figures on a security-per-security basis. To formalise exchange of domestic debt information, there is need for an agency agreement between the Ministry of Finance and the Central Bank which would also specify the roles of the different institutions in this regard.

104. The Central Bank of Lesotho should update government securities data published in its website. Domestic debt aggregate figures are not up-to-date; the aggregated amounts do not include the results of the latest auctions.