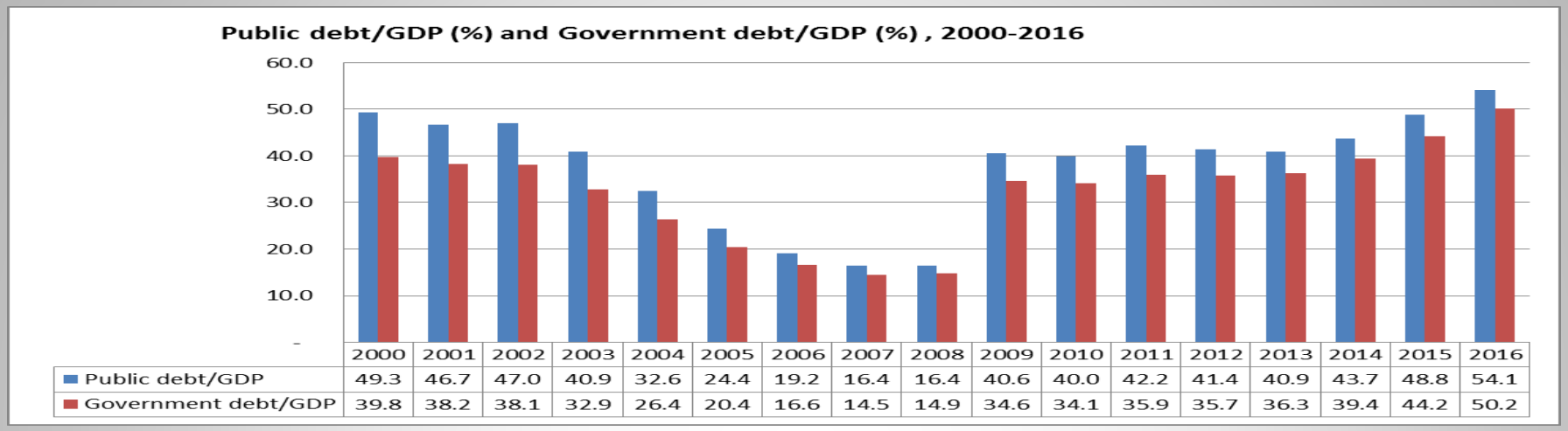
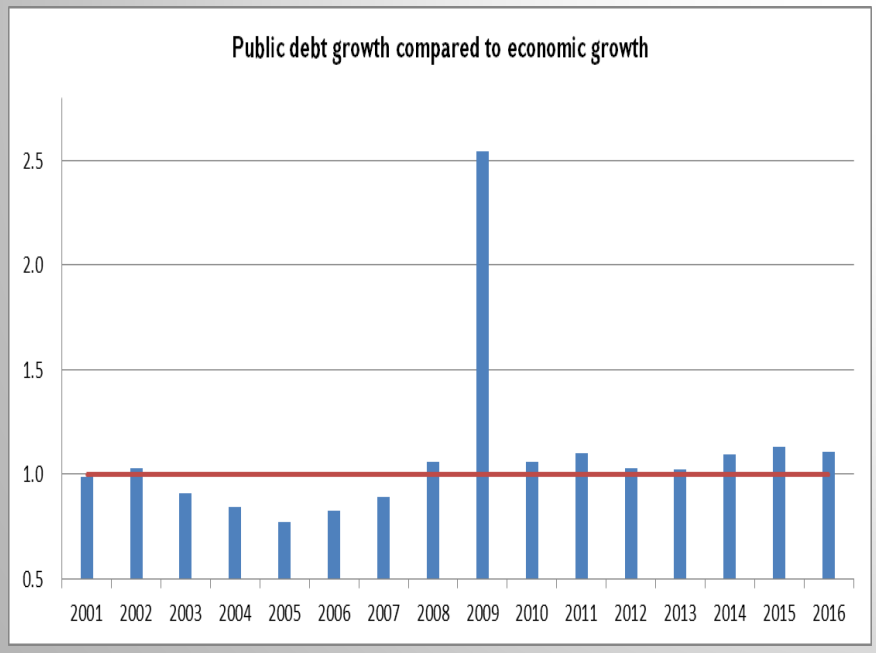
LINKAGES BETWEEN DEBT SUSTAINABILITY AND DEBT MANAGEMENT STRATEGIES

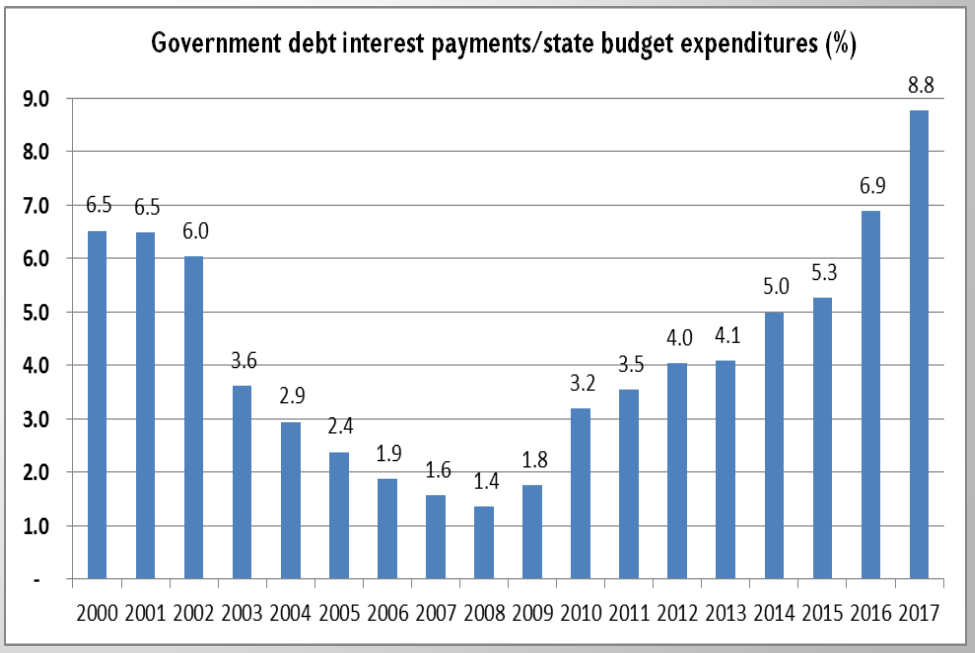
Marine Melikyan
Public Debt Management Department
Ministry of Finance
Sovereign Debt Management Forum
19-20 October 2016
Washington DC

ARMENIA PUBLIC DEBT



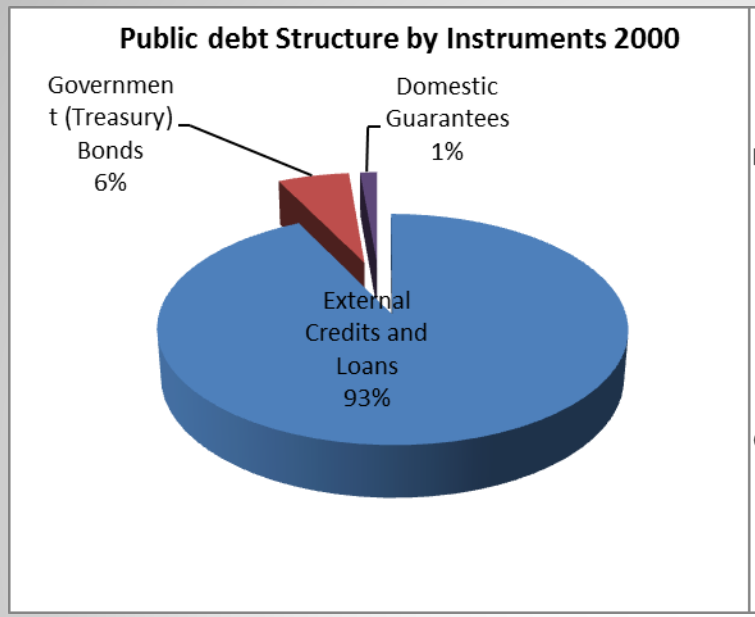
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Public debt/GDP	49.3	46.7	47.0	40.9	32.6	24.4	19.2	16.4	16.4	40.6	40.0	42.2	41.4	40.9	43.7	48.8	54.1
Government debt/GDP	39.8	38.2	38.1	32.9	26.4	20.4	16.6	14.5	14.9	34.6	34.1	35.9	35.7	36.3	39.4	44.2	50.2

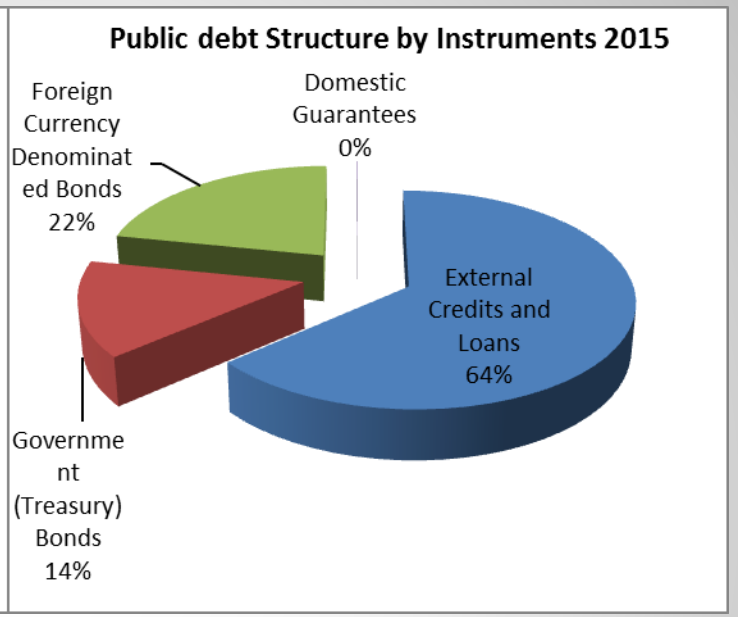


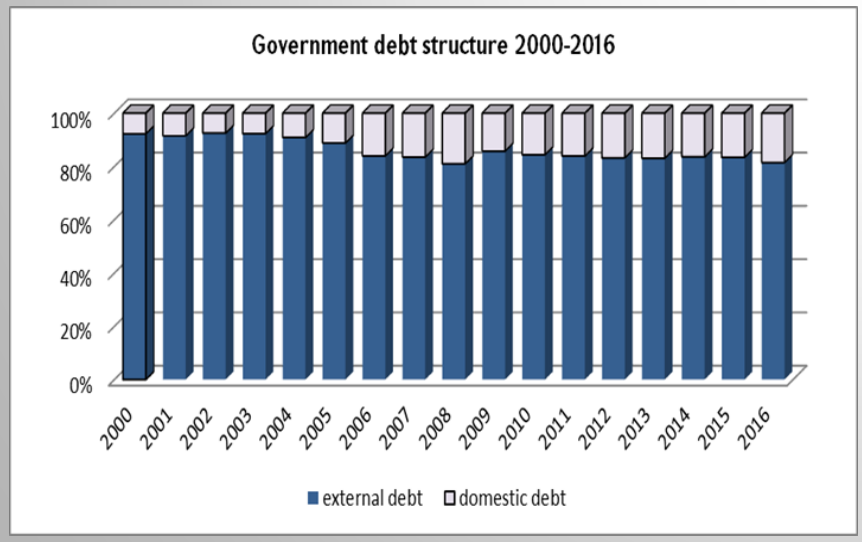


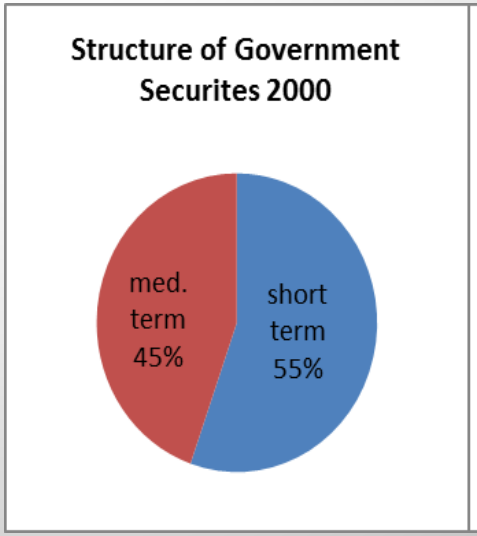
Data for 2016 and 2017 are forcasted based on draft of 2017 budget law.

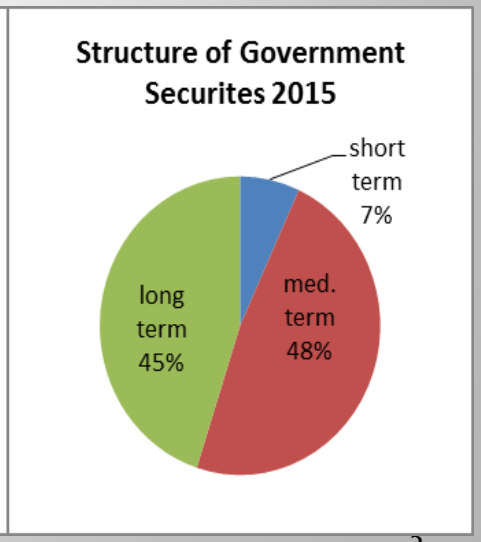
ARMENIA PUBLIC DEBT











What is the debt sustainability for MAC?

Public debt can be regarded as sustainable when the primary balance needed to at least stabilize debt under both the baseline and realistic shock scenarios is economically and politically feasible, such that the level of debt is consistent with an acceptably low rollover risk and with preserving potential growth at a satisfactory level.

DSA can be improved in MACs in these areas.

i) *realism of baseline assumptions;*

(ii) risks associated with the debt profile (financing structure);

(iii) analysis of macro-fiscal risks;

(iv) vulnerabilities related to the level of public debt;

(v) coverage of fiscal and public debt aggregates.

What is the medium term debt strategy(MTDS) ?

An MTDS is a plan that the government intends to implement over the medium- term in order to achieve a desired composition of the government debt portfolio, which captures the government's preferences with regard to the cost-risk tradeoff.

It operationalizes country authorities' debt management objectives—e.g., ensuring the government's financing needs and payment obligations are met at the lowest possible cost consistent with a prudent degree of risk.

An MTDS 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. In particular, an *MTDS identifies how cost and risk vary with the composition of the debt*.

RA Government Debt Management Benchmark Indicators in 2017-2019

	Benchmark
Refinancing risk	
Average Time to Maturity (ATM)	8-11 years
Share of government bonds maturing in coming year in the stock of government bonds	Max 20%
Interest rate risk	
Share of fixed rate debt in the stock of debt	Min 85%
Exchange rate risk	
Share of domestic debt in the stock of debt	Min 20%

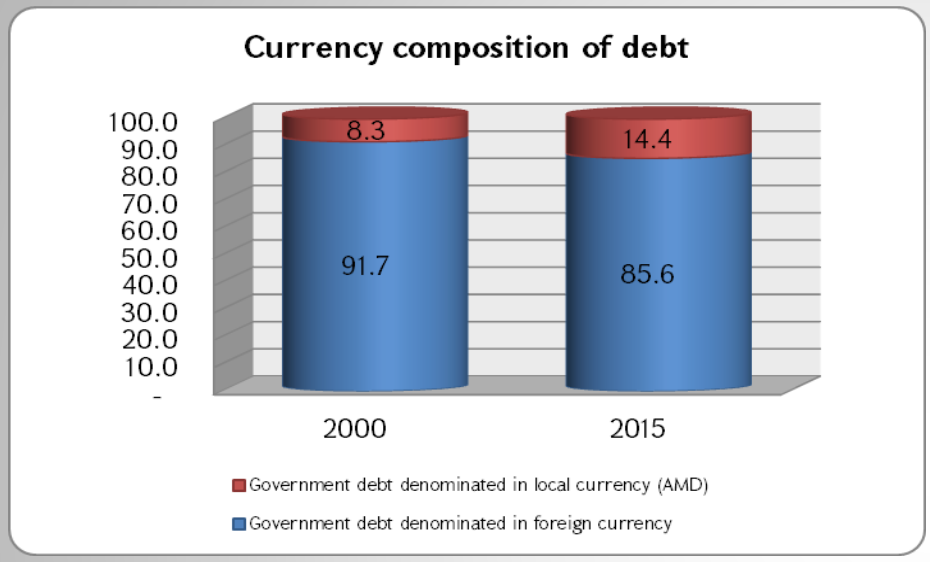
Cost and Risk Indicators of the government debt of Armenia at the end of 2015

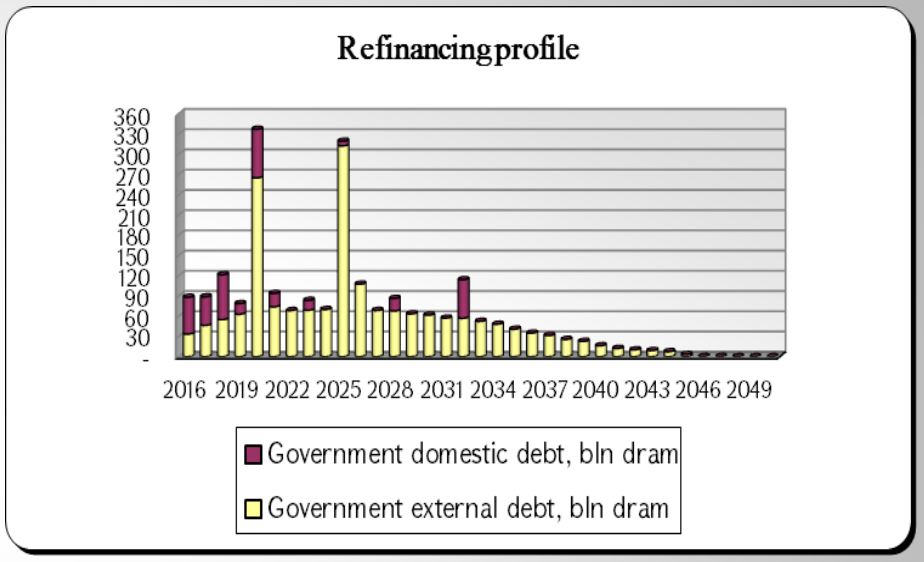
As cost indicators for a debt portfolio are used

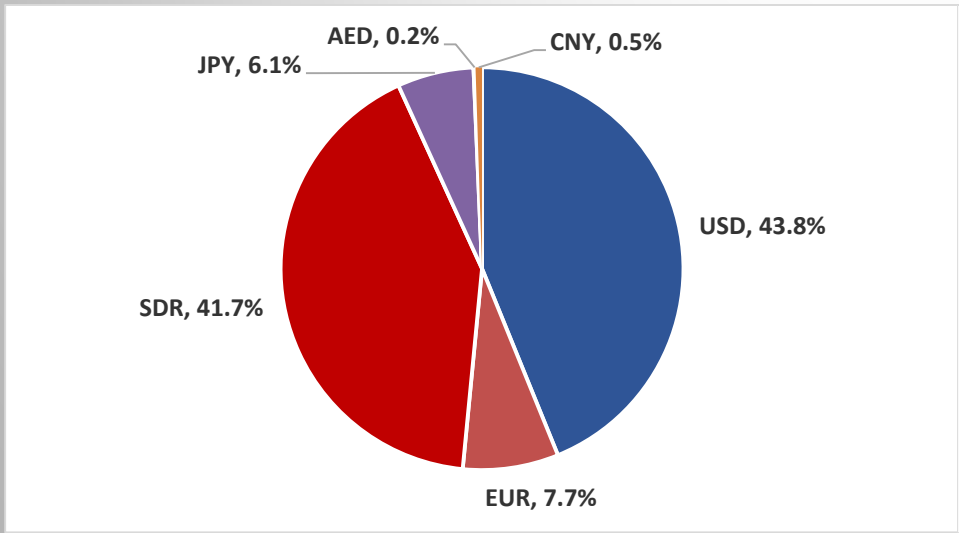
- *Interest payments per unit of debt-3.9%,*
- *The nominal interest cost-to-nominal government revenues ratio-6.3%,*
- *The nominal interest cost-to-nominal GDP ratio-1.5%.*

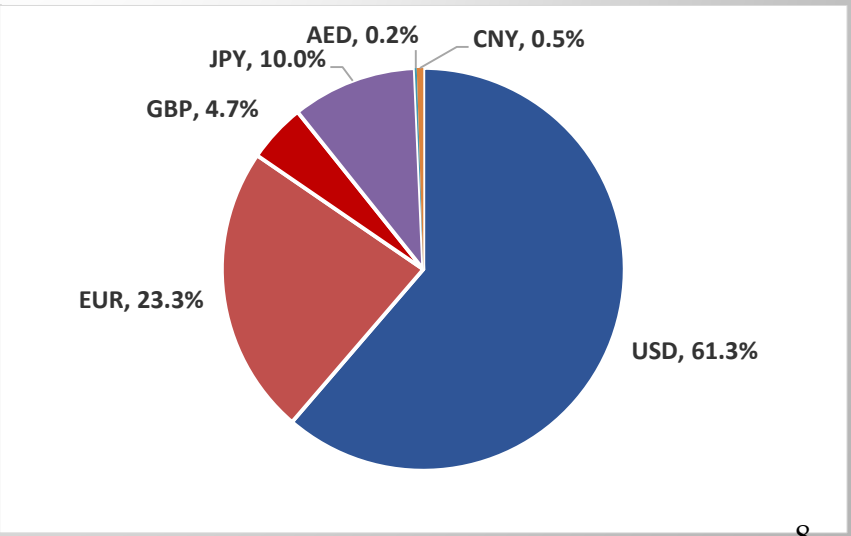
Risk measures	
Fixed rate debt/total debt (%)	89.5
Share of debt refixing the interest rate in 1 year (%)	14.4
Average time to refixing (year)	8.4
Debt maturing in 1 year (%)	4.0
ATM (year)	9.7
Foreign currency debt/total debt (%)	85.6
Foreign currency current debt/foreign exchange reserves (%)	23.2

Cost and Risk Indicators of the government debt of Armenia at the end of 2015









Linkages between debt sustainability and strategy (empirical findings)

The financing profile can pose risks to debt sustainability for market-access countries.

Debt structure characteristics—maturity, currency composition, and the creditor base— can inform the assessment of debt sustainability.

- *A high share of short-term debt at original maturity, which may reflect the inability of certain sovereigns to issue long-term debt, and a high share of debt held by non-residents increases vulnerability to rollover and interest rate risks.*
- *A high share of foreign currency-denominated debt increases vulnerabilities to exchange rate adjustment and can put pressure on foreign exchange reserves.*
- *The nature of the creditor base—for example, whether it is diversified, reliable, captive, domestic, or foreign—also matters for rollover risk.*

- Debt distress events have typically been preceded by an increase in the shares of short-term debt and foreign currency-denominated debt and by an increase in external financing needs, which increase pressure on existing foreign exchange reserves.
- Bond spreads also tend to increase before debt distress episodes, although fluctuations in spreads may be related to a number of underlying factors associated with country-specific macroeconomic fundamentals and political risk, as well as other factors related to global financial conditions and investors' preferences.

Linkages between debt sustainability and strategy in Armenia

Distinctions between DSA and strategy

	DSA	Strategy
Policy	Fiscal policy	Debt Management
Responsibility	Macroeconomic policy Department	Debt Management Department
Focus	Debt burden	Debt structure
Instrument	Primary balance	Cost and Risk

Common assumptions

- *Projections of macroeconomic variables , including the future path of the primary balance,*
- *For projections of disbursements, it is recommendable to contact key creditors in order to receive information on their lending strategies,*
- *Not only the level of new borrowing, but also its terms affect a country's debt sustainability. The source of debt structure and terms is the strategy.*

Linkages between debt sustainability and strategy in Armenia

MTDS in Armenia is based on these rules defined by the law on Public Debt

- *Government debt as at December 31 of the year in question shall not exceed 60% of GDP of the previous year.*
- *Where Government debt as at December 31 of the year exceeds 50% of GDP of the previous year, the state budget deficit of the next year shall not exceed 3% of the annual average GDP for the previous three years.*

- Government debt management strategy is included in the Medium Term Expenditures Framework (MTEF) according to the Law on Public Debt.
- The Ministry of Finance drafts and represents the annual budget law based on MTEF.

Armenia Public DSA Risk Assessment

Heat map

Debt level 1/	**Real GDP Growth Shock**	**Primary Balance Shock**	**Real Interest Rate Shock**	**Exchange Rate Shock**	**Contingent Liability shock**
Gross financing needs 2/	**Real GDP Growth Shock**	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	**Contingent Liability Shock**
Debt profile 3/	**Market Perception**	**External Financing Requirements**	**Change in the Share of Short- Term Debt**	**Public Debt Held by Non-Residents**	**Foreign Currency Debt**

1/The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.
2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Armenia Public DSA Risk Assessment