

REPUBLIC OF SRPSKA

GOVERNMENT

**REPUBLIC OF SRPSKA DEBT MANAGEMENT STRATEGY
FOR THE PERIOD 2019-2022**

August, 2019

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1. Goals and assumptions

Republic of Srpska Medium-term debt management strategy (RS MTDS) specifies medium term goals and operations within the debt management, that Republic of Srpska Government (RS Government) intends to implement in the medium term in order to achieve desired debt portfolio structure, taking into account cost and risk preferences. Implementation of the RS MTDS is continuously being monitored and reported to the RS Government annually.

The scope of the RS MTDS covers all debt representing direct or indirect obligation of Republic of Srpska¹, with some exceptions.

External debt data include:

- 1) RS Government debt (except the part of the debt to the Paris Club of creditors-Germany, for which the repayment mechanism has not yet been determined);
- 2) Local governments debt, incurred on the basis of Republic of Srpska indirect debt;
- 3) Debt of SOEs and the RS Investment Development Bank (RS IDB), incurred on the basis of Republic of Srpska indirect debt.

Domestic debt data include:

- 1) RS Government debt (verified domestic debt according to the RS Law on domestic debt, debt in the form of treasury bills², bonds, bank loans and activated guarantees);
- 2) debt of the social security funds, incurred on the basis of Republic of Srpska indirect debt.

Debt (domestic and external) contracted directly by local governments and social security funds is not covered by the MTDS, since it represents neither direct nor indirect obligation for Republic of Srpska, hence it cannot be managed by Republic of Srpska Ministry of Finance (RS MoF), on behalf of RS Government. Obligations related to frozen foreign currency savings, war damages and general liabilities are included in the MTDS only if they have been formally verified. Detailed table on the scope of the RS MTDS is presented in Annex I.

Republic of Srpska debt management goal is to provide financial resources for financing approved investment projects, RS MTDS debt refinancing and Republic of Srpska Budget execution, at minimal costs and risks, while taking into account development of the economy and domestic securities market, as well as debt limits specified in the law.

The RS MTDS is based on the following assumptions:

- 1) In the medium term, RS Government will continue with implementation of the fiscal consolidation and reform plan, as presented in the RS Economic Reform Programme 2019-

¹ In accordance with the RS Law on borrowing, debt and guarantees ("Official Gazette of Republic of Srpska", number 71/12, 52/14 and 114/17), indirect debt of Republic of Srpska is debt incurred on behalf of debtors (local governments, social security funds, Investment-Development Bank and the funds it manages, public companies and public sector institutions) and is being repaid by Republic of Srpska, from the funds debtors are paying for their relevant debt.

² As of December 31, 2018, there was no debt outstanding in the form of treasury bills, since all the issuances in 2018 have been repaid in the same year.

2021 (RS ERP 2019-2021), in order to ensure long term fiscal sustainability and transparency (as stipulated by the Fiscal Discipline Law);

- 2) Macroeconomic projections and fiscal framework (presented in tables 1 and 2), in accordance with the Medium-term Budget Framework Document for the period 2020-2022³ (MTBFD 2020-2022);
- 3) Any new borrowing on behalf of the RS government will be contracted in accordance with the RS Law on borrowing, debt and guaranties, i.e. through the RS MoF;
- 4) There will be no takeover of debt from other levels of Government;
- 5) Verification and reconciliation of war damage and frozen foreign currency savings obligations will proceed in accordance with the projections included in the MTBFD 2020-2022;
- 6) Central Bank of Bosnia and Herzegovina (CBBH) will continue to maintain monetary stability in accordance with the Currency Board Arrangement, by the provisions of the Law on Central Bank, and will not be issuing any securities in the domestic financial market;
- 7) Credit rating of Bosnia and Herzegovina will not be downgraded within the medium term⁴;
- 8) Institutional investor base in Republic of Srpska domestic financial market will be maintained and broadened in the medium term;
- 9) There will be no significant increase of the European central bank reference rate⁵;
- 10) Creditors will provide funds at acceptable terms.

³ MTBFD 2020-2022 presents detailed assumptions of macroeconomic projections and fiscal framework, as well as associated risks.

⁴ [Actual BH Credit rating](#) is "B/positive outlook" (Standard and Poors) and „B3/stable outlook" (Moody's).

⁵ European Central Bank; [Press Release as of June 6th, 2019](#)

Table 1. Review of the macroeconomic indicators for the period 2015-2017, forecast for 2018 and 2019 and projections for the period 2020-2022

	2015	2016	2017	2018	2019	2020	2021	2022
GDP								
GDP nominal, mil.BAM	9.205,0	9.630,6	10.077,0	10.681,6	11.041,4	11.533,0	12.074,6	12.653,7
Population, in mil.	1,2	1,2	1,2	1,1	1,1	1,1	1,1	1,1
GDP per capita, in BAM	7.920,6	8.320,0	8.739,7	9.305,4	9.626,2	10.081,1	10.582,3	11.119,1
GDP growth, nominal (%)	3,6	4,6	4,6	6,0	4,2	4,5	4,7	4,8
Inflation measured by the currency price index (CPI), average annual rate (%)	-1,4	-1,2	0,5	1,2	1,1	1,4	1,3	1,5
Real growth rates %								
GDP growth, real	2,8	3,5	3,1	3,9	3,4	3,7	3,9	4,0
Private consumption	2,6	2,4	2,6	2,5	2,0	2,2	2,0	2,2
Public consumption	-1,9	2,1	-0,8	1,5	0,5	0,9	0,6	1,0
Gross investments in fixed assets	-0,1	3,8	-0,7	4,3	-0,5	4,0	0,4	3,9
Nominal growth rates %								
Average salaries after taxation, in BAM	831,0	836,0	831,0	857,0	897,0	905,1	913,2	921,4
Import of goods, in mil. BAM	4.369,2	4.426,9	4.899,1	5.216,6	5.362,7	5.770,3	6.174,2	6.587,9
Import of goods, annual growth (%)	-11,7	1,3	10,7	6,5	2,8	7,6	7,0	6,7
Export of goods, in mil. BAM	2.613,9	2.869,1	3.476,1	3.741,2	3.913,3	4.257,6	4.606,8	4.970,7
Export of goods, annual growth (%)	-2,9	9,8	21,2	7,6	4,6	8,8	8,2	7,9
Export over Import (%)	59,8	64,8	71,0	71,7	73,0	73,8	74,6	75,5
Unemployment rate (%)	25,2	24,8	21,0	17,2	16,4	15,8	15,4	15,0

Source: MTBFD 2020-2022, RS MoF, RS IoS

Table 2: Fiscal framework for the period 2019-2022⁶

	Budget 2019	MTBFD 2020	MTBFD 2021	MTBFD 2022
A. BUDGET REVENUES (I+II+III+IV)	2.795,7	2.930,8	3.035,0	3.126,3
I Tax revenues	2.589,1	2.702,9	2.800,1	2.883,9
II Non tax revenues	206,3	227,3	234,3	241,7
III Grants	0,0	0,0	0,0	0,0
IV Transfers among the budgetary units	0,3	0,6	0,6	0,6
B. BUDGET EXPENDITURES (I+II+III)	2.658,8	2.751,7	2.766,5	2.773,1
I Current expenditures	2.475,1	2.522,6	2.550,7	2.558,1
II Transfers among the budgetary units	176,1	178,0	180,5	180,3
III Budget reserve	7,5	51,2	35,3	34,6
C. GROSS BUDGET SURPLUS/DEFICIT (A-B)	136,9	179,1	268,5	353,2
D. NET EXPENDITURES FOR NON FINANCIAL ASSETS	-80,3	-94,1	-97,6	-102,6
E. BUDGET SURPLUS/DEFICIT (C+D)	56,6	85,0	170,9	250,6
F. NET FINANCING (G+H)	-56,6	-85,0	-170,9	-250,6
G. NET PROCEEDS FROM FINANCIAL ASSETS	57,9	58,5	61,4	68,7
H. NET BORROWING	-105,5	-121,5	-220,6	-307,6
I. OTHER NET PROCEEDS	-8,9	-22,0	-11,7	-11,6

Source: MoF RS

⁶ Presented fiscal framework covers Republic of Srpska budget in terms of Fund 01 (revenues, expenditures and budget financing).

2. Existing debt

2.1. Portfolio review

RS MTDS debt amounts to 4,7 billion BAM (2,7 billion USD) i.e. 43,8% of GDP⁷, as of December 31st 2018. External debt accounted for 71,3% of the total (3,3 billion BAM or 2,0 billion USD, i.e. 31,2% of GDP), while domestic debt accounted for 28,7% of the total (1,3 billion BAM or 0,8 billion USD, i.e. 12,6% of GDP).

The external MTDS debt is composed of:

- 1) Relevant external debt, i.e. loans contracted through the BH Ministry of Finance and treasury, as well as allocated „old” external debt (debt originated before April 2nd, 1992); Relevant external debt outstanding amounted to 2.963,8 million BAM at the end of 2018 (1.735,7 million USD).
- 2) Direct external debt (debt directly contracted with external creditors); Direct external debt outstanding amounted to 373,9 million BAM at the end of 2018 (219,0 million USD).

Debt contracted with multilateral creditors accounts for the largest share in external MTDS debt (72,2%), followed by bilateral creditors (16,8%), as well as bonds issued at the international market (11,0%). In terms of individual creditors, the largest share in external MTDS debt obligations belongs to the World Bank - IDA and IBRD (WB; 31,2%), European Investment Bank (EIB; 30,3%), Paris Club (6,1%), International Monetary Fund (IMF; 4,4%), European Bank for Reconstruction and Development (EBRD; 2,4%). In terms of currency composition, EUR and SDR have the largest share, with 63,7% and 23,9%, respectively, JPY participates with 3,6%, USD with 3,2%, while other currencies (KRW, CPU, CHF, SEK, DKK, CAD) participate with 5,5%.

Domestic MTDS debt is composed of:

- 1) medium-term T-bonds;
Debt outstanding under medium-term T-bonds (4 and 5 year amortization bonds and 3, 5, 7, 10 years bullet bonds) amounted to 730,5 million BAM (427,8 million USD), at the end of 2018.
- 2) Domestic commercial bank loans;
Debt outstanding under these loans as of end-2018 amounted to 216,2 million BAM (126,6 million USD). These are amortizing loans with fixed or variable interest rate, 4-12 years maturity and 0-3 years grace period.
- 3) Bonds issued for repayment of debt stipulated by the RS Law on domestic debt:
 - i) amortizing war claim bonds with 13-15 year maturity and 3-5 year grace period, and interest rate of 1,5%;
 - ii) amortizing frozen foreign currency savings bonds, with 5 year maturity, no grace period and interest rate of 2,5%;

⁷ GDP for 2018 is 10.682 million BAM, according to the preliminary data of Republic of Srpska Institute of Statistics, as of July 15th, 2019.

- iii) amortizing bonds for the settlement of liabilities to suppliers and liabilities under executive court decisions, with a 15 year maturity, 5 year grace period and interest rate of 1,5%;

These bonds are registered at the RS Central Registry of Securities and listed on Banja Luka Stock Exchange. As of end-2018, debt outstanding under these instruments totalled 300,3 million BAM (175,9 million USD).

- 4) Cash payments (action plans) for reconciliation of obligations under the executive court decisions related to war damage claims and general liabilities, as stipulated by the RS Law on Domestic Debt;

Debt outstanding under this category, as of end-2018, totalled 77,5 million BAM (45,4 million USD).

Obligations for war damage claims, frozen foreign currency savings and general liabilities, which have not yet been verified and therefore do not represent obligation for Republic of Srpska, are excluded from the RS MTDS debt portfolio. However, expenditures for period 2020-2022, planned within MTBFD 2020-2022, are increased for the projected repayments of these obligations, based on projected bonds issuances (according to projected dynamics of verification), which influences gross financing needs.

The most important cost and risk indicators of the existing portfolio are presented in table 3, while table 4 shows cost and risk indicators in the period 2014-2018.

Table 3: Cost and risk indicators of the existing portfolio

	External debt	Domestic debt	Total debt
Amount (in million BAM)	3.330,5	1.345,0	4.675,5
Amount (in million BAM)	1.950,5	787,7	2.738,1
Nominal value of debt to GDP (%)	31,2	12,6	43,8
Present value of debt to GDP (%)	24,5	12,6	37,1
Cost of debt			
Interest to GDP (%)	0,6	0,4	1,0
Weighted average interest rate ⁸ , in % (WAIR)	1,8	3,4	2,3
Refinancing risk			
Average time to maturity, in years (ATM)	8,0	3,5	6,7
Debt maturing in 1 year (% of total)	6,8	19,5	10,4
Debt maturing in 1 year (% of GDP)	2,1	2,5	4,6
Interest rate risk			
Average time to refixing, in years (ATR)	6,2	3,4	5,4
Debt refixing in 1 year (% of total)	30,1	24,3	28,4
Fixed rate debt (% of total)	72,9	92,8	78,6
Currency risk			
External debt (% of total)			71,2
Short term external debt (% of reserves)			5,8

Source: MoF RS

⁸ Weighted average interest rate is calculated as a ratio of aggregate interest payments to aggregate debt outstanding at the end of 2018.

Table 4: Cost and risk indicators of the existing portfolio at the end of 2014 and values in the period 2015-2018

	2014	2015	2016	2017	2018
Nominal value of debt to GDP (%)	48,0	48,3	49,8	45,5	43,8
Present value of debt to GDP (%)	41,4	41,1	42,4	39,2	37,1
Cost of debt					
Interest to GDP (%)	1,0	1,1	1,2	1,0	1,0
Weighted average interest rate, in % (WAIR)	2,1	2,2	2,3	2,2	2,3
Refinancing risk					
Debt maturing in 1 year (% of total)	10,2	12,1	13,7	16,0	10,4
Debt maturing in 1 year (% of GDP)	4,9	5,8	6,8	7,3	4,6
Average time to maturity of external debt, in years (ATM)	7,7	7,6	7,8	8,0	8,0
Average time to maturity of domestic debt in years (ATM)	4,2	3,2	3,4	3,4	3,5
Average time to maturity of total debt in years (ATM)	6,6	6,1	6,3	6,4	6,7
Interest rate risk					
Average time to refixing, in years (ATR)	4,4	4,1	4,6	4,8	5,4
Debt refixing in 1 year (% of total)	46,1	45,4	42,0	38,2	28,4
Fixed rate debt (% of total)	60,7	62,5	66,0	71,9	78,6
Currency risk					
External debt (% of total)	67,7	68,0	66,6	64,1	71,2
Short term external debt (% of reserves)	5,7	7,4	9,2	8,1	5,8

Source: MoF RS

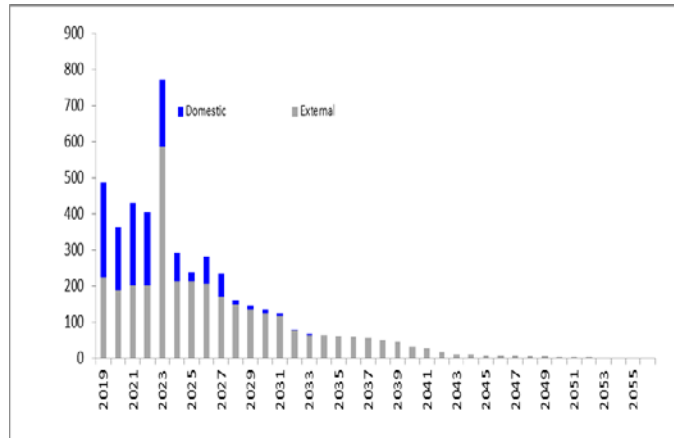
The composition of Republic of Srpska debt analyzed under the MTDS (RS MTDS debt) is mostly the result of the basic debt management principle implemented in the past, which is maximization of external concessional borrowing. Therefore, the RS MTDS debt portfolio is characterized by a high share of external debt with relatively long maturities and low average implied interest rate of the external debt portfolio at the level of 1,8%.

Overall, existing portfolio is associated with low costs. The weighted average interest rate of the total portfolio is 2,3%, external portfolio 1,8% and domestic portfolio 3,4%. This is mainly the reflection of external concessional loans and low interest rates on bonds issued for reconciliation of domestic debt obligations, defined by the RS Law on domestic debt.

Exchange rate risk is moderate. Out of the total portfolio, 45,4% is denominated in EUR, while 28,8% is denominated in BAM. Under the current currency board arrangement, with BAM pegged to EUR, only 25,9% of the portfolio is exposed to exchange rate risk (or 20,6% after SDR decomposition and excluding the debt in EUR). In USD is denominated 2,3% of the portfolio (or 9,4% after SDR decomposition), which impose some risk, having in mind historical volatility of the USD against the EUR, as well as projections for the future.

Refinancing risk and refixing risk is moderate. Fixed rate instruments stand for 78,6% of the total portfolio. Average time to maturity of the portfolio is 6,7 years. Average time to maturity of external portfolio is 8,0 years, as a result of long-term concessional loans, while average time to maturity for domestic debt is 3,5 years. Redemption profile of existing debt, presented in the Chart 1, shows the peak in 2023, as a result of significant amounts coming due on the basis of external debt (17,6% of the total MTDS external debt), mainly bonds issued at the international market, as well as beginning of repayment for several tranches of EIB loans and bullet repayment of the tranche provided by European Commission.

Chart 1. Redemption profile of the existing portfolio



Source: MoF RS

Maintaining cost and risk indicators at a relatively low level is the challenge for RS, considering the change in the structure of financing sources. The current debt portfolio is characterized by relatively favorable cost and risk indicators, as a result of significant use of the concessional financing sources, as well as bonds issued for reconciliation of domestic debt obligations with a relatively low costs and long maturities. As concessional financing sources are expected to be less available in the future, there will be a need for increased reliance on commercial funds from external and domestic sources, provided that increase in costs and risks is at the acceptable level.

2.2. Strategy implementation in 2018 and evaluation of identified debt indicators

Debt management in 2018 was conducted in accordance with the guidelines defined by the Debt Management Strategy for the period 2017-2020 (MTDS 2017-2020), which has been adopted by the Republic of Srpska Government in August 2017, and in line with the financing structure defined by the Debt Management Strategy for the period 2018-2021 (MTDS 2018-2021), adopted by the Republic of Srpska Government in November 2018.

For the purpose of achieving the main debt management goal, defined in the MTDS 2017-2020, i.e. providing necessary financial resources, in 2018 investment projects were financed mainly from external concessional sources, while budget consumption was financed mainly from external sources, in the form of bonds issued at the international market, as well as from loans provided by international financial institutions (i.e. WB loan), and in part from domestic sources, i.e. securities issued at the domestic market.

Aiming to diversify financial sources, having in mind negative experience from previous years, when RS Government faced unavailability of financing sources defined in the Debt Management Strategy and Budget, in 2018 Republic of Srpska issued bonds at the international

financial market, for the first time. Thus, Republic of Srpska successfully positioned itself on the international financial market, providing access to the additional source of financing.

Out of the total financing in 2018, 86,6% was provided through the external instruments, while 77,7% was provided through fixed instruments. In terms of currency composition of total financing in 2018, 67,5% was denominated in EUR, 19,1% in other foreign currencies, while 13,4% was denominated in BAM.

In terms of financing sources for budget consumption in 2018, 20,0% was provided through external variable instruments (14,3% of the total financing), while 80,0% was provided through external and domestic fixed instruments (57,3% of the total financing). With regards to the currency composition of financing the budget consumption in 2018, 72,2% was denominated in EUR, 18,7% was denominated in BAM, while 9,1% was denominated in other foreign currencies.

Out of the total financing for investment projects in 2018, 71,9% was provided through external fixed instruments (20,4% of the total financing), while 55,7% was provided in EUR (15,8% of the total financing). In 2018, the possibility of choosing loan conditions at the withdrawal of tranches existed for 5 tranches, withdrawn on the basis of 5 previously approved loans (7,7% of the external financing, i.e. 6,7% of the total financing), and for all that 5 tranches the fixed interest rate was chosen, in average 1,8%.

In 2018, four new external loans were adopted by the Republic of Srpska National Assembly, three loans were denominated in EUR and one loan was denominated in SDR, three loans with variable interest rate (out of which two loans have the possibility of fixing the interest rate at the withdrawal) and one loan with fixed interest rate. These borrowings partially influenced the debt structure in 2018, as some funds were withdrawn. Out of the total funds withdrawn in 2018 on that basis, 76,5% has fixed interest rate, while 88,7% is denominated in EUR, which results in positive influence on debt structure, having in mind guidelines defined by the Debt Management Strategy. Complete influence of those borrowings on the debt structure will be visible in the future, when the remaining funds will be withdrawn.

In 2018, Republic of Srpska Ministry of Finance initialized the procedure for fixing the interest rate for 6 World bank loans (International Bank for Reconstruction and Development - IBRD) which had such possibility, having in mind the guideline defined by the Debt Management Strategy, with regards to managing the interest rate risk, defining that share of fixed rate debt should be above 60% of the total debt. Republic of Srpska Ministry of Finance initiative was supported by the Federal Ministry of Finance and Ministry of Finance and Treasury, and in 2018 the request for interest rate conversion was submitted to the World Bank. Conversion was approved in 2019, with weighted average interest rate at 1,8%.

The following table shows debt indicators identified by the Strategy, their target values and evaluation at the end of 2015, 2016, 2017 and 2018.

Table 5. Strategy defined indicators of debt structure and their values in the period 2015 - 2018

Objective	Indicator	Strategy defined	Values			
			end-2015	end-2016	end-2017	end- 2018 ⁹
Foreign exchange risk						
	External debt, excluding debt in EUR (% of total)	≤ 35	32,6	30,6	26,5	25,9
Domestic market development						
	Domestic debt (% of total)	≥ 25	32,0	33,4	35,9	28,8
Refinancing risk						
	ATM (years)	≥ 4	6,2	6,3	6,4	6,7
	Short term debt - original maturity (% of last year revenues)	≤ 8	5,4	5,5	3,3	0,0
Interest rate risk						
	Fixed rate debt (% of total)	≥ 60	62,5	66,0	71,9	78,6
Cost of debt						
	WAIR ¹⁰ (%)	≤ 3,5	2,3	2,3	2,2	2,3

Source: MoF RS

In 2018, comparing to previous 3 years, refinancing risk is decreasing (measured by average time to maturity and share of short term debt in last year revenues), as well as interest rate risk (measured by fixed rate debt as % of total), foreign exchange risk (measured by the share of external debt, excluding debt in EUR, in total), while cost of debt (measured by weighted average interest rate) slightly increased in 2018, comparing to 2017, as a result of bond issuance at the international market. In the last four years, all strategy defined indicators of debt structure showed favourable trend, except in 2018, when, comparing to 2017, share of domestic debt in total debt is deteriorating (as a result of replacing domestic with external instruments, mainly securities issued at the international market), as well as weighted average interest rate which slightly increased, but still remaining at low level.

3. Medium term debt management strategy

The main RS debt management goal is to provide financial resources for financing the approved investment projects, RS government debt refinancing and RS budget execution, at minimal costs and risks, while taking into account development of the economy and domestic securities market, as well as debt limits specified in the law.

⁹ Share of fixed rate debt in total and weighted average interest rate at the end of 2018, as shown in table 3, differ from the values presented in the Information on debt as of December 31, 2018, due to fixing the interest rate for 6 World bank loans that had such possibility, in accordance with World bank notification as of March 2019.

¹⁰ See footnote 8.

In order to achieve the main goal, the following goals of borrowing are defined:

- 1) to ensure continuous borrowing opportunities at the domestic financial market;
- 2) to minimize costs subject to acceptable level of risk, taking into account development of the domestic securities market, as well as change in the structure of financing.

In the following medium term period (2019-2022), the above mentioned goals will be achieved through the *Strategy of diversifying financing sources, instruments and investor base*, which has been chosen as preferred strategy among four analyzed medium term debt strategies¹¹. This strategy ensures low costs with acceptable level of risk, reflecting continued utilization of the available support from multilateral creditors, while at the same time improving Republic of Srpska position in the context of future financing sources, through the domestic financial market development using short term and medium term instruments, with focus on instruments with longer terms. At the end of observed 4 year period, comparing to end-2018, solvency indicators (nominal and present value of debt as a share of GDP), as well as liquidity indicators (service of interest as a share of GDP and weighted average interest rate) are improved, refinancing risk of domestic debt (measured by average time to maturity) is decreased, as well as interest rate risk (measured by fixed rate debt as a share of total) and foreign exchange risk (measured by external debt as a share of total and external non EUR debt as a share of total). At the same time, some indicators deteriorate at the end of observed 4 year period, comparing to end-2018, such as: debt maturing in 1 year (% of total and % of GDP), average time to maturity of external and total debt, average time to refixing, debt refixing in 1 year (% of total) and short term external debt (% of reserves). Deterioration of those indicators at the end of observed 4 year period is a result of significant amounts coming due in 2023, on the basis of bonds issued at the international market in 2018.

During the strategy implementation, all borrowing activities will be performed in accordance with the following best practice principles:

- 1) activities at the domestic and international financial market will be performed professionally, transparently, expediently and in a timely manner, while contracted obligations will be fulfilled in the due time and amount;
- 2) selection of the borrowing conditions will be (in priority order) focused at government debt refinancing, providing funds for financing the budget execution, compliance with the debt covenants set in the Fiscal discipline law and achievement of the identified debt indicators;
- 3) when planning borrowing activities, attention will not be focused on the comparative short term advantages of each specific borrowing transaction, but rather on the development and enhancement of long term borrowing opportunities in financial market;
- 4) in general, the most favorable borrowing terms and conditions will be ensured, while taking into account principle under 3).

In order to implement the preferred strategy, following basic tasks of the RS MoF have been set out:

¹¹ More details can be found in Annex 2.

- 1) developing and maintaining relations with partners and investors at the domestic and international market;
- 2) designing and, if necessary, revising medium term Borrowing Plan and Auctions calendar based on the cash flow, in order to ensure stable model of total budget inflows on monthly basis;
- 3) publishing auction calendar on the quarterly basis and, whenever possible, providing information on planned issuances for a longer time period, as well as medium term borrowing plan;
- 4) continuously maintaining the offer of short term and medium term financial instruments at the domestic financial market, ensuring that instruments and procedures are efficient and favourable for primary trading in order to facilitate the development of domestic securities market;
- 5) identifying the specific debt indicators - maturity profile, interest rate structure, cost of borrowing, domestic debt outstanding, currency risk exposure (excluding the debt in EUR, considering currency board arrangement) and specifying targets for cost and risk indicators;
- 6) monitoring the debt portfolio in relation to identified debt indicators and reporting on their values on an annual basis.

In the medium term, the RS MoF task will be to analyze opportunities and harmonize practices and procedures related to domestic securities market with those of EU, if it's feasible in the given time.

In accordance with the defined objectives and basic principles of debt management, considering RS MTDS debt composition and situation at the financial markets, previously defined parameters of the RS MTDS debt portfolio structure and their values will not be changed, as shown in the table 5.

Annex 1. Scope of the RS MTDS

	Included (✓) / Excluded (X)	Reasoning behind including into MTDS	Amounts as of 12/31/2018	
			mil. BAM	mil. USD ¹²
1	Total debt (1.1.+1.2.+2a)		5.178,5	3.032,7
1.1.	External debt	64,9%	3.363,1	1.969,6
1.1.1.	Republika Srpska		2.101,8	1.230,9
1.1.1.1.	"Relevant" external debt	✓	1.762,0	1.031,9
1.1.1.2.	"Relevant external debt" - Paris Club Germany	X	9,1	5,3
1.1.1.3.	Direct external debt	✓	330,7	193,6
1.1.2.	Local governments		131,8	77,2
1.1.2.1.	"Relevant" external debt	✓	115,4	67,6
1.1.2.2.	Direct external debt	X	16,3	9,6
1.1.3.	SOEs and Investment Development Bank		1.129,6	661,5
1.1.3.1.	"Relevant" external debt	✓	1.086,3	636,2
1.1.3.2.	Direct external debt	✓	43,2	25,3
1.2.	Domestic debt	35,0%	1.812,2	1.061,3
1.2.1.	Republika Srpska		1.335,1	781,9
1.2.1.1.	Verified domestic debt		398,3	233,3
1.2.1.1.1.	Issued bonds (frozen foreign currency savings, war claims, suppliers, executive court decisions)	✓	300,3	175,9
1.2.1.1.2.	Planned bond issuances (war claim bonds)	✓	20,5	12,0
1.2.1.1.3.	Cash payments (general liabilities, war claims, frozen foreign currency savings, tax refunds)	✓	77,5	45,4
1.2.1.2.	T-bonds	✓	730,5	427,8
1.2.1.3.	T-bills	✓	0,0	0,0
1.2.1.4.	Commercial bank loans	✓	206,3	120,8
1.2.2.	Local governments	X	298,3	174,7
1.2.3.	Social security funds		178,9	104,8
1.2.3.1.	Direct debt	X	172,2	100,8
1.2.3.2.	Indirect debt	✓	6,7	3,9
2	Guaranties (a+b+c)		534,3	312,9
a	Activated RS guaranties	✓	3,2	1,9
b	Non activated RS guaranties	X	531,1	311,0
c	Implicit RS guaranties	X	0,0	0,0
3	Total debt included in MTDS	90,4%	4.682,7	2.742,3
4	Total debt excluded from MTDS	9,6%	495,8	290,4

Source: MoF RS

¹² Values in USD based on the exchange rate USD /BAM = 1,707552, in accordance with Currency exchange of Central Bank of Bosnia and Herzegovina, as of December 29, 2018.

Annex 2. Analytical underpinnings

This section presents scenario analysis, description of alternative borrowing strategies for the RS and consideration of their costs and risks. Debt service projections are generated for each strategy under the baseline and alternative scenarios, applying interest rate and exchange rate shocks. Costs are calculated based on the debt service profile generated under the baseline scenario, while risk is measured as debt service increase due to the interest rate and exchange rate shocks applied.

I. Scenario analysis

For the purpose of sensitivity analysis of the strategies, following shocks are applied:

- **Exchange rate shock:** 30% depreciation against USD in 2019, comparing to the initial exchange rate projection for the same year;
- **Interest rate shock:** comparing to the baseline scenario, in 2020 it has been applied 4% increase in interest rate for long term domestic and long term variable external instruments and 2% increase in interest rate for short term domestic instruments;
- **Combined shock:** comparing to the initial projection, it has been applied 20% depreciation against USD in 2019, combined with 2% interest rate shock in 2020 for long term domestic and long term variable external instruments, as well as 1% interest rate shock for short term domestic instruments.

II. Description of analyzed strategies

The analysis shows rigidities of the financing options. Structure of financing budget expenditures in the current year, as well as structure of financing the approved investment projects (based on the latest data provided by the project implementation units for the period 2019-2022, i.e. reports as of March 31st, 2019) is the same in all the observed strategies. The instruments for financing those needs are predetermined. Besides that, all the strategies include the same dynamics of verification and reconciliation of domestic debt obligations (defined by the Law on domestic debt). Variations in strategies relate primarily to the sources of financing budget expenditures (including refinancing needs) in the next 3 years (2020-2022) - 33% of the total initial financing needs over the projection period (2019-2022).

Available options for RS are limited. After a long period of using solely the concessional multilateral and bilateral financing that sources are now becoming less available due to the level of development, hence they are used mostly for financing investment projects. Therefore, there is a need for diversification of the financing sources, having in mind limitations of the domestic market (shallow and underdeveloped) and international market (country credit rating, relatively modest financing needs which may increase costs and constrain possibilities for continuous bond issuances).

The following strategies were considered:

- **Strategy 1 - Financing at the international capital market.** Financing needs are met exclusively through issuing Eurobonds or similar external commercial instruments, which, due to the limitations such as country credit rating and relatively modest

financing needs, can lead to the increased costs. Investment projects are financed with external sources, due to exploitation of available concessional funds (WB, EIB, EBRD, CEB, etc.), which contributes to the decrease of refinancing risk and costs.

- **Strategy 2 - Financing with short term domestic fixed instruments.** Strategy implies financing the budget consumption exclusively on the domestic market, through short term fixed instruments i.e. t-bills and 3 year bullet bonds, in the proportion 30%:70%. This financing structure, on the one hand, contributes to the cost decrease, while, on the other hand, it leads to the increase of refinancing and refixing risk. Investment projects are financed with external sources, due to exploitation of available concessional funds (WB, EIB, EBRD, CEB, etc.), which contributes to the decrease of refinancing risk and costs.
- **Strategy 3 - Diversifying financing sources, instruments and investor base.** Share of external financing is decreasing during the period, in favor of domestic financing. Investment projects are financed with external sources, due to exploitation of available concessional funds (WB, EIB, EBRD, CEB, etc.), which contributes to the decrease of refinancing risk and costs. Budget expenditures are financed, to a lesser extent, with external concessional instruments, focusing on short term and medium term financing sources at the domestic market. Share of domestic instruments with longer terms in 2020, comparing to 2019, is significantly increased, while in the period 2021-2022 it increases moderately. Using the external concessional financing sources, as well as issuing medium term bullet bonds at the domestic market, contributes to the decrease of refinancing risk and interest rate risk (having in mind those are mainly fixed instruments), with acceptable level of costs.
- **Strategy 4 - Choice of financing instruments based on the biggest market participant's preferences.** Budget expenditures are financed at the domestic market, with diversion to the instruments preferred by banks, as the biggest market participant, i.e. fixed instruments in the form of loans and 5 year bullet bonds, in the proportion 50%:50%. Investment projects are financed with external sources, due to exploitation of available concessional funds (WB, EIB, EBRD, CEB, etc.), which contributes to the decrease of refinancing risk and costs.

The following table shows the structure of financing instruments in the analysed strategies, over the observed period.

**Table 6: Structure of financing instruments in the analysed strategies
(average over period)**

Instruments for new financing	S1	S2	S3	S4
External Var USD	0,0%	0,0%	0,0%	0,0%
External Var EUR	8,5%	7,9%	9,5%	8,5%
External Fix USD	8,4%	7,7%	8,3%	8,3%
External Fix EUR	22,3%	20,6%	22,1%	22,2%
IMF Var USD	0,0%	0,0%	0,0%	0,0%
Eurobonds	37,2%	0,0%	0,0%	0,0%
Commercial bank loans Var	0,0%	0,0%	0,0%	0,0%
Commercial bank loans Fix	5,9%	5,4%	5,8%	24,6%
T-bills Fix DX	0,0%	12,7%	2,4%	0,0%
T-bonds 3y Fix DX	0,0%	29,5%	2,4%	0,0%
T-bonds 5y Fix DX	6,8%	6,3%	10,5%	25,6%
T-bonds 7y Fix DX	6,9%	6,4%	22,5%	6,9%
T-bonds 10y Fix DX	3,9%	3,6%	16,4%	3,8%
External	76,5%	36,1%	39,8%	39,1%
Domestic	23,5%	63,9%	60,2%	60,9%

Source: MoF RS

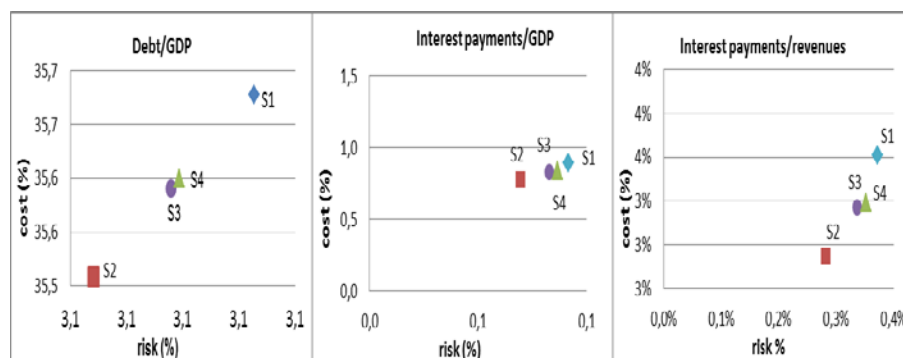
At the end of observed 4 year period, comparing to the cost and risk indicators as of end-2018, all the analysed strategies show the improvement of solvency indicators (nominal and presented value of debt as a share of GDP), as well as liquidity indicators (servicing of interest as a share of GDP). At the same time, all the strategies show increase of refinancing risk, in terms of increasing the share of debt maturing in 1 year as a % of total and % of GDP, as well as in terms of shortening average time to maturity of external, domestic and total debt (except average time to maturity of domestic debt in Strategy 3). Also, all the strategies show the increase of interest rate risk, in terms of shortening average time to refixing and increasing the share of debt refixing in 1 year. In terms of interest rate risk indicators, all strategies show the improvement in the share of fixed rate debt (% of total). Foreign exchange risk, measured by the share of external debt, excluding debt in EUR, in total debt, is decreased under all the analyzed strategies. Previously described relation of cost and risk indicators at the end of 2018 and 2022, is a result of existing portfolio at the end of 2018, i.e. significant amounts coming due in 2023, on the basis of bonds issued at the international market in 2018.

III. Costs and risks of the observed strategies

The performance of the selected four strategies was assessed under the baseline and alternative scenarios, with applied shocks to the baseline. The debt/GDP ratio is important when analyzing those changes in the debt stock resulting from exchange rate movements, since that ratio reflects valuation effects.

Interest payments to GDP and to revenues show the potential impact of each strategy on the Republic of Srpska budget. For a given financing strategy, the risk represents the difference between costs under the baseline scenario comparing to risk scenario (after applying certain shocks to the baseline). The maximum risk deriving from the three stress scenarios is used to compare the risk associated with each of the borrowing strategies. For comparison purposes, the focus is on the outcome at the end of the time horizon, i.e. 2022. Standard cost and risk indicators for the four strategies are shown in the Chart 2 and table 7.

Chart 2. Cost and risk indicators of the observed strategies



Source: MoF RS

Table 7: Cost and risk indicators of the analysed strategies at the end of 2022

	Initial 2018	as of 12/31/2022			
		S1	S2	S3	S4
Debt/GDP (%)	43,8	35,7	35,5	35,6	35,6
Debt PV/GDP (%)	37,1	30,9	30,7	30,7	30,8
Cost of borrowing					
Interest/GDP (%)	1,0	0,9	0,8	0,8	0,8
Weighted average interest rate, in % (WAIR)	2,3	2,3	2,1	2,2	2,2
Refinancing risk					
Debt maturing in 1 year (% of total)	10,4	17,4	22,4	18,0	18,2
Debt maturing in 1 year (% of GDP)	4,6	6,2	8,0	6,4	6,5
Average time to maturity for external debt, in years (ATM)	8,0	6,2	6,8	6,8	6,8
Average time to maturity for domestic debt, in years (ATM)	3,5	2,7	2,2	4,0	3,0
Average time to maturity for total debt, in years (ATM)	6,7	5,6	5,4	5,9	5,6
Interest rate risk					
Average time to refixing, in years (ATR)	5,4	4,7	4,4	5,0	4,7
Debt refixing in 1 year (% of total)	28,4	31,0	36,0	32,0	31,8
Fixed rate debt (% of total)	78,6	84,7	84,7	84,3	84,7
Currency risk					
External debt (% of total)	71,2	82,1	69,8	70,0	69,6
Short term external debt (as % of reserves)	5,8	11,9	11,9	11,9	11,9

Source: MoF RS

Within 4 analysed strategies, in terms of interest rate costs and stock of debt, Strategy 2 and 3 shows the lowest cost, Strategy 4 shows slightly higher costs, while the highest cost is shown under Strategy 1. Costs are the highest under Strategy 1, i.e. Strategy 4, due to complete, i.e. increased reliance on more expensive financing sources. The higher share of domestic short term and medium term instruments in Strategy 2, as well as higher share of external concessional and domestic instruments with all maturities in Strategy 3, comparing to Strategy 4 and 1, leads to decreasing costs, while refinancing risk and refixing risk are at the acceptable level. The present value of debt is the lowest under Strategy 2 and 3, due to increased utilization of instruments with shorter maturities, and thus higher negative net financing, comparing to other two analysed strategies.

Refinancing risk is the lowest under Strategy 1 and 3, as well as refixing risk, while the worst results in terms of those risks are shown under Strategy 2. Strategy 3 provides the longest average time to maturity for the domestic, external and total debt, due to higher share of external concessional instruments, as well as increased utilization of domestic fixed instruments with longer maturities, comparing to other analysed strategies. Average time to refixing is the longest under Strategy 3, slightly shorter under Strategy 4 and 1, the shortest under Strategy 2, as a reflection of the largest share of domestic fixed instruments with longer maturities in Strategy 3, comparing to other analyzed strategies.

In terms of currency risk, share of debt denominated in foreign currencies is the highest under Strategy 1, which is exclusively relying on external instruments. However, it is important to notice that currency risk is softened due to the currency board arrangement, with BAM pegged to EUR, and that currency risk, measured by the share of external non EUR debt in total, is the lowest under Strategy 1, and slightly higher under Strategy 3 and 4.

Based on all the considerations given, Strategy 3 is the chosen strategy for the upcoming period. Comparing to other strategies, this strategy ensures relatively low costs and acceptable risks. At the same time, this strategy ensures utilization of available support from multilateral creditors, as well as good position for Republic of Srpska in terms of potential future funding sources, through the support to domestic market development, by maintaining continuous offer of short term and medium term financing instruments at the domestic market, with focus on longer terms. Average time to maturity for domestic, external and total debt, as well as average time to refixing is the longest. Financing costs, debt maturing in 1 year (as a share of GDP and share of total), as well as currency risk, are at the acceptable level. Redemption profile under the chosen strategy is more favourable comparing to other strategies, with a peak in 2023, due to the maturity of bonds issued at the international market in 2018.