

REPUBLIC OF SRPSKA

GOVERNMENT

**REPUBLIC OF SRPSKA DEBT MANAGEMENT STRATEGY
FOR THE PERIOD 2021-2024**

December, 2021

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1. Goal, scope 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 intends to implement in the medium term. Implementation of Strategy measures and activities shall secure desired debt portfolio structure, taking into account cost and risk preferences of the Republic of Srpska Government.

Having in mind that key lever for active debt management is regular identification and publishing of debt management strategy implementation, with goals that are based on cost and risk analysis, taking into consideration macroeconomic and market circumstances and limitations, the Strategy is continuously monitored and the Republic of Srpska Government is informed annually on its implementation.

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

External debt data includes:

- 1) Republic of Srpska debt (except the part of debt to the Paris Club of creditors - Germany, for which the repayment mechanism has not yet been determined);
- 2) Debt of local governments, 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 bills, medium-term 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) incurred by direct borrowing of local governments, social security funds, SOEs and RS IDB 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. Detailed scope of the RS MTDS is presented in Annex I.

¹ In accordance with the RS Law on Borrowing, Debt and Guarantees („Official Gazette of Republic of Srpska “71/12, 52/14, 114/17, 131/20, 28/21 and 90/21), indirect debt of Republic of Srpska is debt incurred on behalf of debtors (local governments, social security funds, Investment-Development Bank and its’ funds, public companies and public sector institutions) and is being repaid by Republic of Srpska, from the funds debtors are paying for their relevant debt.

Republic of Srpska debt management goal is to provide financial resources for financing approved investment projects, debt refinancing and Republic of Srpska Budget execution, at minimal costs and risks.

The RS MTDS is based on the following assumptions:

- 1) In the medium-term, Republic of Srpska Government will continue with implementation of the fiscal consolidation and reform plan as presented in the RS Economic Reform Programme 2022-2024 (RS ERP 2022-2024), in order to ensure long term fiscal sustainability (in accordance with the Fiscal Discipline Law);
- 2) Projections of macroeconomic indicators and fiscal framework (presented in Table 1 and 2), presented in the RS ERP 2022-2024² and “Harmonization of Medium Term Budget Framework for the period 2022-2024 with Republic of Srpska Government policies” (HMTBF 2022-2024);
- 3) Any new borrowing where the borrower is Republic of Srpska Government will be contracted in accordance with the Law on Borrowing, Debt and Guaranties, i.e. through the Republic of Srpska Ministry of Finance;
- 4) There will be no recognition (takeover) of debt from other levels of Government;
- 5) Verification and settlement of obligations regulated in the Law on Domestic Debt of the Republic of Srpska (hereinafter: LDD RS) shall be performed in accordance with projections included in HMTBF 2022-2024;
- 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 and Republic of Srpska will not be downgraded within the medium term³;
- 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 rate⁴;
- 10) Creditors will provide funds at acceptable terms;
- 11) Other analytical assumptions used for quantitative analysis of the Strategy presented in Annex II.

² [RS ERP 2022-2024](#) contains detailed assumptions of macroeconomic projections and fiscal framework, as well as associated risks.

³ [Current BH credit rating](#) is „B/stable outlook“ (Standard and Poors), and „B3/stable outlook“ (Moody's). Current credit rating of Republic of Srpska is „B/stable outlook“ (Standard and Poors) and „B3/stable outlook“ (Moody's).

⁴ European Central Bank; [Press release as of October 28th, 2021](#) .

Table 1: Overview of the macroeconomic indicators for the period 2017-2021, forecast for 2022 and projections for the period 2023-2024

	2017	2018	2019	2020	2021	2022	2023	2024
GDP								
GDP nominal, mil. BAM	10.099,3	10.701,6	11.251,3	11.131,8	11.894,5	12.690,2	13.410,3	14.260,1
Population, in mil.	1,2	1,1	1,1	1,1	1,1	1,1	1,1	1,1
GDP per capita, in BAM	8.759,0	9.322,0	9.848,0	9.795,0	10.529,0	11.287,1	11.986,1	12.809,5
GDP growth, nominal (%)	4,6	6,0	5,1	-1,1	6,9	6,7	5,7	6,3
Inflation - average annual rate	0,5	1,2	0,5	-1,2	1,2	1,9	1,1	1,3
Real growth rates %								
GDP growth, real	3,1	3,9	2,5	-2,5	5,4	4,5	4,3	4,6
Private consumption	2,6	2,5	2,8	0,2	3,0	2,7	2,9	2,8
Public consumption	-0,8	1,8	1,5	3,9	-0,5	1,3	0,8	1,2
Gross investments in fixed assets	-0,7	11,0	-2,1	10,1	2,0	9,0	6,8	8,0
Assumptions:								
Average net salaries, in BAM	831,0	857,0	906,0	956,3	1.005,0	1.055,3	1.086,9	1.130,4
Unemployment rate (%) ⁵	-	-	-	-	14,6	13,7	13,0	12,5

Source: RS ERP 2022-2024, RS MoF, RS IoS

Table 2: Fiscal framework for the period 2021-2024⁶

	Budget revision 2021	Budget 2022	HMTBF 2023	HMTBF 2024
A. BUDGET REVENUES (I+II+III+IV)	3.267,6	3.303,8	3.442,8	3.588,0
I Tax revenues	2.825,2	3.021,9	3.187,6	3.320,3
II Non tax revenues	436,6	275,7	249,0	261,4
III Grants	1,2	0,0	0,0	0,0
IV Transfers among or within budgetary units	4,7	6,3	6,3	6,3
B. BUDGET EXPENDITURES (I+II+III)	3.225,7	3.301,1	3.368,4	3.438,8
I Current expenditures	2.821,9	2.920,6	2.952,0	3.019,7
II Transfers among or within budgetary units	400,6	372,3	397,3	399,3
III Budget reserve	3,3	8,2	19,1	19,8
C GROSS BUDGET SURPLUS/DEFICIT (A-B)	41,9	2,8	74,4	149,2
D.NET EXPENDITURES FOR NON-FINANCIAL ASSETS	-157,7	-212,9	-133,9	-132,9
E. BUDGET SURPLUS/ДЕФИЦИТ (Ц+Д)	-115,8	-210,1	-59,5	16,3
F. NET FINANCING (G+H+I)	115,8	210,1	59,5	-16,3
G. NET PROCEEDS FROM FINANCIAL ASSETS	73,3	82,1	113,4	110,3
H. NET BORROWING	68,9	159,8	-28,8	-105,6
I. OTHER NET PROCEEDS	-26,4	-31,9	-25,2	-21,0

Source: RS MoF

⁵ In accordance with the Regulation of EU Parliament and EU Council, that came into force on January 01st, 2021, RS Institute of Statistics performed methodological harmonization of the content of the ARS inquiry, used in data collection for 2021, therefore indicators for second quarter of 2021 are not completely comparable with indicators published for previous years. For that reason, previous years' data are not shown in the table.

⁶ Republic of Srpska Budget means general fund 01.

2. Existing debt

2.1. Portfolio overview

RS MTDS debt amounts to 5,221.8 million BAM (3,278.9 million USD, i.e. 46.9% of GDP), as of December 31st, 2020. External debt amounts to 66.9% of the total (3,495.6 million BAM or 2,194.9 million USD, i.e. 31.4% of GDP), while domestic debt amounts to 33.1% of the total (1,726.3 million BAM or 1,084.0 million USD, i.e. 15.5% of GDP).

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 02nd, 1992);
As of December 31st, 2020, relevant external debt outstanding amounted to 3,133.6 million BAM (1,967.7 million USD, which is 60.0% of the total debt and 28.2% of GDP).
- 2) direct external debt (debt directly contracted by Republic of Srpska with external creditors);
As of December 31st, 2020, direct external debt outstanding amounted to 361.9 million BAM (227.3 million USD, which is 6.9% of the total debt or 3.3% of GDP).

Debt contracted with multilateral creditors accounts for the largest share in external MTDS debt (74.5%), followed by bilateral creditors (15.8%), as well as bonds issued at the international market (9.8%). In terms of individual creditors, the largest share in external MTDS debt is towards European Investment Bank (EIB; 30.2%), World Bank - IDA and IBRD (WB; 30.0%), International Monetary Fund (IMF; 9.4%), Government of Japan (5.2%), and Paris Club of creditors (5.1%). In terms of currency composition of external debt, EUR and SDR have the largest share, with 61.9% and 26.5%, respectively, JPY participates with 5.2%, KRW with 2.5%, while other currencies (USD, CPU, CHF, SEK, DKK, CAD) participate with 3.9%.

Domestic MTDS debt is composed of:

- 1) T-bills and medium-term bonds;
Debt outstanding in the form of T-bills, as of December 31st, 2020, amounts to 108.7 million BAM (68.3 million USD, which is 2.1% of total debt or 1.0% of GDP). Original maturity of these securities is 6 and 12 months. Debt outstanding in the form of medium-term bonds, as of December 31st, 2020, amounts to 1,084.6 million BAM (681.1 million USD, which is 20.8% of total debt, or 9.7% of GDP). Maturity of bonds issued with amortisation repayment is 5 years, with 1 year grace period, while maturity of bonds with bullet repayment is 5, 7 and 10 years.
- 2) Domestic commercial bank loans;

Debt outstanding under these loans, as of December 31st 2020, amounts to 246.7 million BAM (154.9 million USD, which is 4.7% of total debt, or 2.2% of GDP). These are amortizing loans with fixed or variable interest rate, 5 to 12 years maturity and 1 to 3 years grace period.

- 3) Bonds issued for repayment of debt stipulated by the RS LDD, as follows:
 - i) bonds for repayment of war claims with maturity of 13 to 15 years and grace period of 3 to 5 years, with 1.5% interest rate and amortising repayment;
 - ii) amortising frozen foreign currency savings bonds with 5 years maturity, without grace period, and with interest rate of 2.5%;
 - iii) amortizing bonds for the settlement of liabilities to suppliers and liabilities under executive court decisions, with 15 years maturity, 5 years grace period and interest rate of 1.5%;

As of December 31st, 2020, debt outstanding in the form of these bonds amounts to 221.5 million BAM (139.1 million USD, which is 4.2% of total debt, or 2.0% of GDP).

- 4) Planned bond issuance for repayment of verified debt - war claims, with 13 years maturity and 3 years grace period, interest rate of 1.5% and amortizing repayment;

As of December 31st, 2020, this debt outstanding amounts to 15.9 million BAM (10.0 million USD, which is 0.3% of total debt, or 0.1% of GDP).

- 5) Cash payments (according to action plan) for settlement of obligations under the executive court decisions related to war damage claims and general liabilities, as stipulated by the RS LDD, cash payments related to frozen foreign currency savings, as well as tax refund obligations towards municipalities and social funds, on the basis of replacement of tax obligations with bonds;

As of December 31st, 2020, this debt outstanding amounts to 48.8 million BAM (30.6 million USD, which is 0.9% of total debt, or 0.4% of GDP).

Expenditures for 2022-2024 planned in HMTBF 2022-2024 are increased by projected amount of liabilities coming due on the basis of planned issuances and cash payments (according to projected dynamics of verification of war claims, frozen foreign currency savings and general liabilities), which affects 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 2014-2020.

Table 3: Cost and risk indicators of the existing portfolio

	External debt	Domestic debt	Total debt
Amount (in million BAM) ⁷	3,495.6	1,725.5	5,221.0
Amount (in million USD)	2,194.9	1,083.4	3,278.4
Nominal value of debt to GDP (%)	31.4	15.5	46.9
Present value of debt to GDP (%)	25.0	15.5	40.5
Cost of debt			
Interest to GDP (%)	0.5	0.4	1.0
Weighted average interest rate ⁸ , in % (WAIR)	1.7	2.9	2.1
Refinancing risk			
Average time to maturity, in years (ATM)	7.4	3.6	6.2
Debt maturing in 1 year (% of total)	5.9	20.6	10.7
Debt maturing in 1 year (% of GDP)	1.8	3.2	5.0
Interest rate risk			
Average time to refixing (ATR)	5.4	3.6	4.8
Debt refixing in 1 year (% of total)	33.3	21.8	29.5
Fixed rate debt (% of total)	70.0	97.6	79.1
Currency risk			
External debt (% of total)			67.0
Short term external debt (% of reserves)			4.4

Source: RS MoF

Table 4: Cost and risk indicators of the existing portfolio at the end of 2014 and values in the period 2015-2020⁹

	2014	2015	2016	2017	2018	2019	2020
Nominal value of debt to GDP (%)	47.7	47.9	49.2	45.4	43.7	43.0	46.9
Present value of debt to GDP (%)	41.4	40.7	41.9	39.1	37.0	36.7	40.5
Cost of debt							
Interest to GDP (%)	1.0	1.1	1.1	1.0	1.0	1.0	1.0
Weighted average interest rate, in % (WAIR)	2.1	2.2	2.3	2.2	2.3	2.3	2.1
Refinancing risk							
Debt maturing in 1 year (% of total)	10.2	12.1	13.7	16.0	10.4	7.9	10.7
Debt maturing in 1 year (% of GDP)	4.9	5.8	6.7	7.3	4.6	3.4	5.0
Average time to maturity of external debt, in years (ATM)	7.7	7.6	7.8	8.0	8.0	8.0	7.4
Average time to maturity of domestic debt, in years (ATM)	4.2	3.2	3.4	3.4	3.5	3.9	3.6
Average time to maturity of total debt, in years (ATM)	6.6	6.1	6.3	6.4	6.7	6.8	6.2
Interest rate risk							
Average time to refixing, in years (ATR)	4.4	4.1	4.6	4.8	5.4	5.5	4.8
Debt refixing in 1 year (% of total)	46.1	45.4	42.0	38.2	28.4	24.5	29.5
Fixed rate debt (% of total)	60.7	62.5	66.0	71.9	78.6	81.3	79.1

⁷ For the purpose of cost and risk indicators calculation, T-bills debt outstanding is calculated in the amount of receipts i.e. 107.9 million BAM, while the discount amount of 0.8 million BAM is calculated as interest, therefore the amount of domestic debt outstanding and total debt outstanding presented in the table is different from debt outstanding presented in the text on the page number 5 and Annex I.

⁸ Weighted average interest rate is calculated as sumproduct of interest rates (ratio of interest in 2021 and debt outstanding at the end of 2020) and debt outstanding by each instrument at the end of 2020, put in a relation to total debt outstanding at the end of 2020.

⁹ Indicators presented as % of GDP are corrected for the period 2014-2019, comparing to those presented in previous documents, according to the GDP data published by RS Institute for Statistics on November 12th, 2021 ([„Gross domestic product, ESA 2010“](#)).

Table 4: Cost and risk indicators of the existing portfolio at the end of 2014 and values in the period 2015-2020⁹

	2014	2015	2016	2017	2018	2019	2020
Currency risk							
External debt (% of total)	67.7	68.0	66.6	64.1	71.2	69.9	67.0
Short term external debt (% of reserves)	5.7	7.4	9.2	8.1	5.8	4.6	4.4

Source: RS MoF

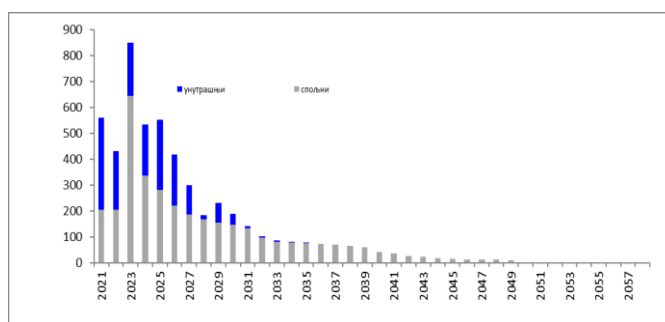
The composition of Republic of Srpska debt analyzed under the MTDS (RS MTDS debt) is mostly the result of the basic debt management principle implemented in the past, which is maximization of external concessional borrowing. Therefore, the RS MTDS debt portfolio is characterized by a high share of external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

Overall, existing portfolio is associated with low costs. Weighted average interest rate of the total portfolio is 2.1%, external portfolio 1.7%, and domestic portfolio 2.9%. This is mainly the reflection of external concessional loans and low interest rate on bonds issued for reconciliation of domestic debt obligations, defined by the RS LDD.

Exchange rate risk is moderate. Out of the total portfolio, 41.5% is denominated in EUR, while 33.0% is denominated in BAM. Under the current currency board arrangement, with BAM pegged to EUR, only 25.5% of the portfolio is exposed to exchange rate risk (or 20.0% after SDR decomposition and excluding the debt in EUR). In USD is denominated 1.4% of the portfolio (or 8.8% 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 79.1% of the total portfolio. Average time to maturity of the total portfolio is 6.2 years. Average time to maturity of external portfolio is 7.4 years, as a result of long-term concessional loans, while average time to maturity for domestic debt is 3.6 years. Redemption profile of existing debt, presented in Chart 1, shows the peak in 2023, as a result of significant amounts coming due on the basis of external debt (18.5% of the total MTDS external debt), mainly bonds issued at 2018, as well as beginning of repayment of IMF RFI¹⁰ loan, several tranches of EIB loans, and bullet repayment of European commission loan.

Chart 1. Repayment profile of the existing portfolio



Source: RS MoF

¹⁰ Rapid Financing Instrument, RFI.

Maintaining cost and risk indicators at a relatively low level is a challenge for RS, considering the change in the structure of financing sources. The current debt portfolio is characterised 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, increased reliance on commercial funds from external and domestic sources will be needed, provided that increase in costs and risks is at the acceptable level.

1.1. Strategy implementation in 2020 and evaluation of identified debt indicators

In 2020, due to the COVID-19 pandemic caused by virus SARS-CoV-2, and the commitment of RS Government to implement measures to minimize negative consequences of the pandemic on peoples' lives and the economy of Republic of Srpska, borrowing significantly varied from the guidelines defined in the Debt management strategy for the period 2019-2022 (hereinafter: Strategy 2019-2022), adopted by RS Government in September 2019.

For the purpose of achieving the main debt management goal, defined in the MTDS 2019-2022, i.e. providing necessary financial resources, in 2020 investment projects were financed from external concessional sources, while budget consumption was financed mainly from domestic sources, in the form of securities issued at the domestic market, as well as from loans provided by domestic banks, and in part from external sources i.e. loans provided by international financial institutions.

Out of the total financing in 2020, through the external instruments was provided 45.1% (out of which 15.6% in fixed instruments and 21.4% in EUR), while 61.9% was provided through fixed instruments. In terms of currency composition of total financing in 2020, in BAM was denominated 54.9%, in EUR 9.7%, while 35.4% was denominated in other foreign currencies except EUR.

In terms of instruments for financing budget consumption in 2020, 37.1% was provided through external variable instruments (32.3% of the total financing), while 62.9% was provided through domestic fixed instruments (54.9% of the total financing). With regards to the currency composition of the budget consumption financing in 2020, 62.9% was denominated in BAM, 2.7% was denominated in EUR, while 34.3% was denominated in other foreign currencies except EUR.

Following table shows budget consumption financing structure in 2020 planned in MTDS 2019-2022, and realized financing in 2020, per instruments.

Table 5: Budget consumption financing structure planned in MTDS and realized financing in 2020, per instruments

Instruments	Planned	Realized
External variable EUR	2.0%	2.7%
IMF variable USD	0.0%	34.3%
Domestic loans fixed	0.0%	6.3%
T-bills	6.6%	15.3%
Domestic bonds 3y fixed	7.0%	0.0%
Domestic bonds 5y fixed	10.9%	32.2%
Domestic bonds 7y fixed	44.3%	4.9%
Domestic bonds 10y fixed	29.2%	4.2%
	100.0%	100.0%

Source: RS MoF

Budget consumption financing in 2020 planned in the Strategy was realized in 309.1%, where realization of external variable instruments was 5,711.3% (denominated in EUR 419.2%), and realization of domestic fixed instruments was 198.5%¹¹.

Out of total financing realized in 2020 for investment projects, 54.9% was provided through external fixed instruments (7.0% of total financing) and 57.0% was denominated in EUR (7.3% of total financing).

Following table shows financing structure of investment projects in 2020 planned in MTDS 2019-2022, and realized financing in 2020, per instruments.

Table 6: Investment projects financing structure planned in MTDS and realized financing in 2020, per instruments

Instruments	Planned	Realized
External variable EUR	24.4%	45.1%
External fixed USD	22.1%	43.0%
External fixed EUR	53.5%	12.0%
	100.0%	100.0%

Source: RS MoF

Investment projects financing in 2020 planned in the Strategy was realized in 65.0%, where external variable instruments (denominated in EUR) were realized in 120.1%, and external fixed

¹¹ Budget consumption financing planned in MTDS 2019-2022 amounted to 230.2 million BAM, and realized amount was 711.5 million BAM, which is 309.1% of the plan. Planned amount of the external variable instruments was 4.6 million BAM (2.0% of the total budget consumption financing), and realized amount was 263.6 million BAM (37.1% of the total budget consumption financing) which is 5,711.3% of the plan.

instruments were realized in 47.2% (denominated in EUR 14.6%, denominated in other foreign currencies except EUR 126.3%).

In 2020, the possibility of choosing repayment terms at withdrawal existed for two tranches, within two previously approved loans (which is 3.3% of external financing, or 1.5% of total financing) and for both tranches the fixed interest rate was chosen, while weighted average interest rate was 0.6%.

In 2020, five new external loans were accepted, four were denominated in EUR and one in SDR, three loans were with variable interest rate (within two loans there is possibility of fixing the interest rate at withdrawal), while for two loans interest rate will be chosen at withdrawal. Effects of the previously mentioned borrowing on debt structure will be visible in the following period after the withdrawal of funds.

The following table shows debt structure indicators identified by the Strategy, their target values and values in the period 2015-2020 (at the end of the period).

Table 7: Identified debt structure indicators and their values in 2015-2020

Goal	Indicator	Strategy defined	Values					
			2015	2016	2017	2018	2019	2020
Foreign exchange risk								
	External debt, excluding debt in EUR (% of total)	≤ 35	32.6	30.6	26.5	25.9	24.5	25.5
Domestic market development								
	Domestic debt (% of total)	≥ 25	32.0	33.4	35.9	28.8	30.1	33.0
Refinancing risk								
	ATM (years)	≥ 4	6.2	6.3	6.4	6.7	6.8	6.2
	Short term debt - original maturity (% of last year revenues)	≤ 8	5.4	5.5	3.3	0.0	0.0	3.8
Interest rate risk								
	Fixed rate debt (% of total)	≥ 60	62.5	66.0	71.9	78.6	81.3	79.1
Cost of debt								
	WAIR ¹² (%)	≤ 3.5	2.3	2.3	2.2	2.3	2.3	2.1

Source: RS MoF

¹² Same as footnote 7.

Debt structure indicators in the previous years are showing that share of external debt, excluding debt in EUR is decreasing until 2020, when it is increasing due to the borrowing from International Monetary fund. Share of domestic debt in total debt is increasing until 2017, while in 2018 it is decreasing (due to the switch from domestic financing instruments to external instruments, mainly in the form of bonds issued at the international capital market) and in 2019 and 2020 it shows upward trend again, but still under the level recorded in 2017. Average time to maturity showed upward trend until 2019, while in 2020 is decreasing due to the borrowing from International Monetary fund, which has shorter maturity. Share of short term debt in the last year revenues increased in 2016, while from 2017 it is decreasing, in 2020 this indicator increased again with the value close to the one recorded in 2017. Share of fixed rate debt was increasing until 2019, while in 2020 value of this indicator went down, being above the level recorded in 2018, which is mainly due to the borrowing from International Monetary fund. Weighted average interest rate during the period had volatile trend, even that variations were not significant, and in last two years, i.e. from 2019, its' value is decreasing and at the end of 2020 is at the lowest level.

3. Financing sources

In the medium term, the Strategy is focused on financing mainly through securities issued on domestic and international financial markets. According to the development level of the Republic of Srpska, concession multilateral and bilateral financing sources will be less available and will be used mainly for investment projects financing. Also, it is important to point out that, in order to receive concessional funds, certain objectives at Bosnia and Herzegovina level are to be fulfilled, which could be a limiting factor.

Following table presents external financing sources included in the Strategy.

Table 8: External financing sources

Creditor	Interest rate	Maturity	Grace period	Currency	Risk
IBRD	variable/fix	15-32	5-7	EUR	refixing risk for variable interest rate
EIB	variable/fix	25-30	5-8	EUR	refixing risk for variable interest rate
EBRD	variable	15	3	EUR	refixing risk for variable interest rate
KfW	fix	9-16	0.5-7	EUR	refinancing risk
Eurobonds	fix	5	4	EUR	refinancing risk

Table 8: External financing sources

Creditor	Interest rate	Maturity	Grace period	Currency	Risk
Eurobonds	fix	7	6	EUR	refinancing risk
European commission	fix	15	14	EUR	refinancing risk
Other ¹³	variable/fix	18-31	3-10	EUR/SDR/JPY	refixing risk for variable interest rate; foreign exchange risk for JPY and SDR

Source: RS MoF

Domestic financing sources are mainly used for financing budget consumption. Investors in domestic securities i.e. bonds (maturity 3, 5, 7 and 10 years with bullet repayment and fixed interest rate) and T-bills (maturity 6 months) are mainly entities with headquarters in Bosnia and Herzegovina. Along with expanding the investor base within Bosnia and Herzegovina, lately also investors outside Bosnia and Herzegovina are showing interest in buying domestic securities. Investors are mainly domestic banks, but also insurance companies, funds and others. It is important to have in mind bank limits, in terms of their exposure to public sector, especially considering that fiscal deficit in 2020 caused by the COVID-19 pandemic was mainly financed by domestic market funds. That could be potential constraint for financing, considering projected budget deficit in period 2021-2023 and gross financing needs in period 2021-2024. Bonds and T-bills are traded at the secondary market, but to a limited extent. The most common type of trade at the secondary market refers to the bonds issued for war damage claims, frozen foreign currency savings and general liabilities. Development of the secondary market is one of the preconditions for attracting investors, which would at the same time influence lowering the interest rate. Along with previously mentioned securities, Republic of Srpska has the possibility to use domestic banks loans as a financing instrument.

With regards to the market choice, currency and financing instrument, it will be taken into account current level and trend of domestic and international financial market development (interest rates level, risk premiums, yield curves, etc.), as well as acceptable level of risk exposure.

Debt management policy will be led mainly by achieving identified medium-term goals, but decisions on short-term and long-term borrowing will be adopted annually in accordance with provisions of the Law on Borrowing, Debt and Guarantees of the Republic of Srpska. Borrowing plan might be changed during the fiscal year, depending on the changes of general fiscal aggregates and contingencies¹⁴.

¹³ Japan, IFAD, CEB, IDA

¹⁴ Contingencies such as COVID-19 pandemic.

4. 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.

In order to achieve the main goal of debt management, the following operational goals and principles of borrowing are defined:

- 1) Continuous promotion and presence on domestic and international financial markets through issuance of securities and other instruments which could eventually lower the borrowing costs in medium and long-term;
- 2) Achieving debt portfolio in accordance with previously identified debt structure indicators - maturity profile, interest rate structure, borrowing costs, domestic debt balance, currency risks exposure (without the debt in EUR, due to the currency board arrangement) and its' target values¹⁵;
- 3) Continue to conduct transparent and predictable borrowing process.

In the following medium term period (2021-2024), the above mentioned goals will be achieved through the Strategy of *diversifying financing sources, instruments and investor base*. This strategy is based on financing budget consumption mainly through issuing medium-term securities at the international and domestic financial market, with bullet repayment, and to a lesser extent through the domestic loans. Investment projects are financed from external financing sources, as a result of maximum exploitation of access to concessional sources (WB, EIB, EBRD, KfW etc.), which contributes to the reduction of refinancing risk and costs. Average share of financing from domestic sources is decreased in favor of financing from external sources.

This Strategy improves the position of Republic of Srpska regarding future sources of financing, through presence at the international financial market, domestic market development through the usage of short-term¹⁶ and medium-term instruments, with focus on instruments with longer maturities, with acceptable level of increase in costs and risks, which is softened by continued usage of available support from multilateral creditors.

¹⁵ For the following period 2021-2024 target values presented in table 7 will be kept for all the indicators, except for domestic debt as % of total, for which target is changed to ≥ 20 , due to the increased reliance on external financing sources in the mentioned period, as shown in table 9.

¹⁶ Short term instruments will be used only to finance temporary cash flow deficit.

The following table shows stylized financing instruments in debt portfolio, their share in gross financing in the period 2021-2024, and their projected share in debt portfolio at the end of 2024.

Table 9: Stylized financing instruments, their share in gross financing in 2021-2024 and their projected share in the debt portfolio at the end of 2024

Instrument	Maturity	Grace period	% of portfolio at end-2020	Average through the period	% of gross financing needs				% of portfolio at end-2024
					2021	2022	2023	2024	
External variable USD (concessional)	18	4	1.3	0.0	0.0	0.0	0.0	0.0	0.4
External variable EUR (concessional)	18	4	12.5	14.8	13.8	22.5	14.4	2.7	15.4
External fix USD (concessional)	20	5	17.9	0.2	0.9	0.0	0.0	0.0	9.9
External fix EUR (concessional)	20	5	22.7	11.3	14.6	10.4	11.2	7.1	21.3
IMF variable USD (concessional)	5	3	6.3	0.0	0.0	0.0	0.0	0.0	1.7
Eurobonds 5y fix EUR (market)	5	4	6.3	29.8	67.1	45.9	0.0	0.0	15.9
Eurobonds 7y fix EUR (market)	7	6	0.0	24.3	0.0	0.0	73.0	0.0	13.0
Domestic loans variable (market)	6	1	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Domestic loans fix (market)	10	1	3.5	3.8	0.0	0.0	0.0	27.7	2.0
Domestic bonds 3y fix (market)	3	2	3.7	1.2	0.0	1.6	0.0	5.5	1.2
Domestic bonds 5y fix (market)	5	4	11.2	6.6	0.0	10.5	0.0	27.4	7.7
Domestic bonds 7y fix (market)	7	6	5.2	4.0	1.6	6.0	0.7	12.9	4.5
Domestic bonds 10y fix (market)	10	9	8.6	3.9	2.0	3.0	0.7	16.6	7.0
External sources			67.0	80.5	96.3	78.9	98.6	9.8	77.6
Domestic sources			33.0	19.5	3.7	21.1	1.4	90.2	22.4

Source: RS MoF

Standard cost and risk indicators, as well as projected values for 2021, target values for 2022 and forecasts for 2023-2024 are shown in the following table.

Table 10: Cost and risk indicators in the period 2021 - 2024

	Initial		Strategy		
	2020	2021	2022	2023	2024
Debt/GDP (%)	46.9	46.8	47.3	46.6	43.2
Debt PV/GDP (%)	40.5	40.7	41.5	41.1	38.5
Borrowing cost					
Interest/GDP (%)	1.0	0.9	1.0	1.1	1.2
Weighted average interest rate, in % (WAIR) ¹⁷	2.1	2.1	2.3	2.5	2.7
Refinancing risk					
Debt maturing in 1 year (% of total)	10.7	7.8	14.3	8.7	9.3
Debt maturing in 1 year (% of GDP)	5.0	3.6	6.7	4.0	4.0
Average time to maturity for external debt, in years (ATM)	7.4	7.6	6.9	6.7	6.1
Average time to maturity for domestic debt, in years (ATM)	3.6	4.9	4.5	4.0	3.5
Average time to maturity for total debt, in years (ATM)	6.2	6.9	6.3	6.1	5.5
Interest rate risk					
Average time to refixing, in years (ATR)	4.8	5.5	4.9	4.7	4.2
Debt refixing in 1 year (% of total)	29.5	23.0	28.1	24.2	24.7
Fixed rate debt (% of total)	79.1	81.5	81.5	81.1	82.5
Currency risk					
External debt (% of total)	67.0	74.8	76.4	76.4	77.6
External debt excluding debt in EUR (% of total)	25.5	23.1	19.6	15.8	12.0
Short-term external debt (as % of reserves)	4.4	4.2	12.8	6.6	5.4

Source: RS MoF

At the end of four year period, comparing to the end-2020, some indicators will deteriorate, such as borrowing costs indicators (interest/GDP and weighted average interest rate), refinancing risk indicators (average time to maturity), interest rate risk indicators (average time to refixing, debt refixing in 1 year as % of total) and currency risk indicators (external debt as % of total, short-term external debt as % of reserves), which is a result of change in financing structure, as well as projected budget deficit and financing needs for the period 2021-2024. On the other hand, at the end of the four year period, nominal value of debt as % of GDP will decrease and some other indicators will improve such as refinancing risk indicators (debt maturing in 1 year as % of total and % of GDP), interest rate risk indicators (debt refixing in 1 year as % of total, fixed rate debt as % of total), and currency risk indicators (external debt, excluding debt in EUR, as % of total), due to the significant use of fixed instruments for financing the needs.

¹⁷ Weighted average interest rate for the period 2021-2024 is calculated as a ratio of interest amount for specific year and debt outstanding for previous year. Calculation of this indicator for 2020 is explained in footnote 8.

For the purpose of debt sensitivity analysis, the following table shows values of some indicators under the baseline scenario and alternative scenarios after applying currency and interest rate shocks.

Table 11: Costs and risk indicators in the period 2014 - 2020. године, projections for period 2021 - 2024 under different scenarios for exchange rate and interest rate

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Debt/GDP (%)											
Baseline scenario	47.7	47.9	49.2	45.4	43.7	43.0	46.9	46.8	47.3	46.6	43.2
Scenario 1 ¹⁸	-	-	-	-	-	-	-	46.8	50.4	49.5	46.0
Scenario 2 ¹⁹	-	-	-	-	-	-	-	46.8	47.3	47.1	43.9
Scenario 3 ²⁰	-	-	-	-	-	-	-	46.8	49.4	48.8	45.5
Interest/GDP (%)											
Baseline scenario	1.0	1.1	1.1	1.0	1.0	1.0	1.0	0.9	1.0	1.1	1.2
Scenario 1	-	-	-	-	-	-	-	0.9	1.1	1.2	1.3
Scenario 2	-	-	-	-	-	-	-	0.9	1.0	1.7	1.4
Scenario 3	-	-	-	-	-	-	-	0.9	1.0	1.4	1.3
Interest/revenues (%)											
Baseline scenario	5.6	6.2	4.4	3.9	3.8	3.8	3.9	3.4	3.9	4.3	4.7
Scenario 1	-	-	-	-	-	-	-	3.4	4.1	4.5	5.0
Scenario 2	-	-	-	-	-	-	-	3.4	3.9	6.5	5.6
Scenario 3	-	-	-	-	-	-	-	3.4	4.0	5.6	5.3

Source: RS MoF

From the previous table it is visible that the biggest deterioration in the value of debt/GDP is caused by the extreme shock of local currency depreciation, while the biggest deterioration in the value of interest/GDP and interest/revenues is caused by the extreme shock of interest rates.

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

¹⁸ 30% depreciation of exchange rate KM/USD in 2022.

¹⁹ In 2022, interest rates on medium term domestic and long term external instruments are higher for 4% and interest rates on short term domestic instruments are higher for 2%. Having in mind that in the following period short term instruments will not be used for budget financing, but only to finance temporary deficit in the cash flow, shock on the short term instruments will not create additional financing needs.

²⁰ 20% depreciation of exchange rate KM/USD in 2022, in combination with 2% interest rate shock in 2022 on medium term domestic and long term external instruments and 1% interest rate shock on short term domestic instruments. Having in mind that in the following period short term instruments will not be used for budget consumption financing, but only to finance temporary deficit in the cash flow, shock on the short term instruments will not create additional financing needs.

- 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 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, in 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 favourable borrowing terms and conditions will be ensured, while taking into account principle under 2).

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

- 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) monitoring the debt portfolio with regards to identified debt indicators and reporting on their values on an annual basis;
- 6) analysing the opportunities and harmonization of practices and procedures related to domestic securities market with those of EU, if it's feasible in medium-term;
- 7) managing Republic of Srpska credit rating process providing necessary participation of line institutions.

In order to minimize exposure to financial risks, following measures should be implemented:

- 1) extending the maturity of debt in the form of securities, as much as possible with regards to the situation on domestic and international market,
- 2) extending the average maturity of domestic debt,
- 3) decreasing the share of external debt denominated in other currencies except „EUR“,
- 4) smoothing the redemption profile in the long term.

In accordance with the defined objectives and basic principles of debt management, considering debt structure, change of financing structure and situation at the financial markets, previously defined debt structure indicators and their values, as shown in the Table 7, will not be changed, except for domestic debt as % of total, which is changed to ≥ 20 , due to the significant reliance on external financing sources in the following period.

MINISTER

Zora Vidović

Annex 1. Scope of the RS MTDS

		Included/ Excluded	% of total	Amount as of 31.12.2020.		% GDP
				mil. BAM	mil. USD ²¹	
1	Total debt (1.1.+1.2.+2.a.)		100.0%	5,833.4	3,662.9 \$	52.4%
1.1.	External debt		60.5%	3,526.4	2,214.3 \$	31.7%
1.1.1.	Republika Srpska		39.39%	2,297.6	1,442.7 \$	20.6%
1.1.1.1.	Relevant external debt	✓ ²²	33.6%	1,959.9	1,230.7 \$	17.6%
1.1.1.2.	Relevant external debt - Paris Club Germany	X ²³	0.2%	9.1	5.7 \$	0.1%
1.1.1.3.	Direct external debt	✓	5.6%	328.6	206.3 \$	3.0%
1.1.2.	Local governments		2.1%	121.4	76.2 \$	1.1%
1.1.2.1.	Relevant external debt	✓✓ ²⁴	1.7%	99.7	62.6 \$	0.9%
1.1.2.2.	Direct external debt	XX ²⁵	0.4%	21.8	13.7 \$	0.2%
1.1.3.	SOEs and Investment Development Bank		19.0%	1,107.4	695.4 \$	9.9%
1.1.3.1.	Relevant external debt	✓✓	18.4%	1,074.1	674.4 \$	9.6%
1.1.3.3.	Direct external debt	✓✓	0.6%	33.3	20.9 \$	0.3%
1.2.	Domestic debt		39.5%	2,305.0	1,447.4 \$	20.7%
1.2.1.	Republika Srpska		29.5%	1,721.8	1,081.1 \$	15.5%
1.2.1.1.	Verified domestic debt		4.9%	286.2	179.7 \$	2.6%
1.2.1.1.1.	Issued bonds (frozen foreign currency savings, war claims, general liabilities)	✓	3.8%	221.5	139.1 \$	2.0%
1.2.1.1.2.	Planned bonds issuances (war claim bonds)	✓	0.3%	15.9	10.0 \$	0.1%
1.2.1.1.3.	Cash payments (general liabilities, war claims, frozen foreign currency savings, tax refund)	✓	0.8%	48.8	30.6 \$	0.4%
1.2.1.2.	Medium-term bonds	✓	18.6%	1,084.6	681.1 \$	9.7%
1.2.1.3.	T-bills	✓	1.9%	108.7	68.3 \$	1.0%
1.2.1.4.	Commercial bank loans	✓	4.2%	242.2	152.1 \$	2.2%
1.2.2.	Local governments	XX	6.4%	370.7	232.8 \$	3.3%
1.2.3.	Social security funds		3.6%	212.6	133.5 \$	1.9%
1.2.3.1.	Direct debt	XX	3.6%	210.1	131.9 \$	1.9%
1.2.3.2.	Indirect debt	✓	0.0%	2.5	1.5 \$	0.0%
2	Guaranties (a+b+c)			656.1	412.0 \$	5.9%
a	Activated RS guaranties	✓✓✓ ²⁶	0.0%	2.0	1.3 \$	0.0%
b	Non activated RS guaranties included in total debt ²⁷	XX	3.0%	177.8	111.6 \$	1.6%
c	Non activated RS guaranties	XXX ²⁸	-	476.2	299.0 \$	4.3%
3	Total debt included in MTDS		89.5%	5,221.8	3,278.9 \$	46.9%
4	Total debt excluded from MTDS		10.5%	611.6	384.0 \$	5.5%

Source: RS MoF

²¹ Values in USD are based on exchange rate USD/KM = 1,592566, according to the CB BH currency exchange number 259, as of 12/31/2020.

²² Direct liability with clear repayment obligation.

²³ Direct liability with repayment method not defined yet.

²⁴ Indirect liability with clear repayment obligation.

²⁵ Neither direct nor indirect liability.

²⁶ Called guaranties converted in RS debt.

²⁷ RS guaranties issued for direct debt of local governments and social security funds, non activated.

²⁸ RS guaranties issued for direct debt of SOEs and public sector, non activated.

Annex 2. Analytical underpinnings

This section presents other analytical underpinnings used for quantitative strategic analysis. Debt service projections are generated 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.

Baseline scenario is based on most probable market conditions. Following table includes projections for interest rates of stylized instruments and foreign exchange rate in 2021-2024, used in baseline scenario.

Table: Projections of interest rates of stylized financing instruments and foreign exchange rate in 2021-2024

	2021	2022	2023	2024
Stylized instruments				
External Var USD (concessional)	1.2%	1.5%	1.9%	2.2%
External Var EUR (concessional)	0.5%	0.6%	0.7%	0.9%
External Fix USD (concessional)	2.5%	2.8%	3.2%	3.5%
External Fix EUR (concessional)	1.7%	1.8%	2.0%	2.2%
IMF Var USD (concessional)	1.1%	1.3%	1.7%	2.0%
Eurobonds 5y fix EUR (market)	4.8%	5.0%	5.2%	5.4%
Eurobonds 7y fix EUR (market)	5.0%	5.2%	5.4%	5.6%
Domestic loans variable (market)	2.0%	2.0%	2.2%	2.4%
Domestic loans fix (market)	3.2%	3.3%	3.5%	3.6%
Domestic bonds 3y fix (market)	1.7%	1.7%	1.9%	2.0%
Domestic bonds 5y fix (market)	3.0%	3.1%	3.2%	3.4%
Domestic bonds 7y fix (market)	3.3%	3.4%	3.5%	3.6%
Domestic bonds 10y fix (market)	3.5%	3.6%	3.7%	3.8%
Exchange rate				
BAM/USD	1.6	1.6	1.6	1.6

Source: RS MoF and BH MoFT

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

- **Exchange rate shock:** 30% depreciation against USD in 2022, comparing to the initial exchange rate projection for the same year;
- **Interest rate shock:** comparing to the baseline scenario, in 2022 it has been applied 4% increase in interest rate for medium-term domestic and long-term external instruments and 2% increase in interest rate for short-term domestic instruments. Having in mind that in the following period short term instruments will not be used for budget financing, but

only to finance temporary deficit in the cash flow, shock on the short term instruments will not create additional financing needs.

- **Combined shock:** comparing to the initial projection, it has been applied 20% depreciation against USD in 2022, combined with 2% interest rate shock in 2022, for medium-term domestic and long-term external instruments, as well as 1% interest rate shock for short-term domestic instruments. Having in mind that in the following period short term instruments will not be used for budget consumption financing, but only to finance temporary deficit in the cash flow, shock on the short term instruments will not create additional financing needs.