

30 June 2015



Government of Tonga
Annual Public Debt Bulletin

Prepared by

Debt Management Section

Ministry of Finance & National Planning

Authorised for release by

Minister for Finance & National Planning

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Acronyms and Abbreviations

ADB	Asian Development Bank
APDB	Annual Public Debt Bulletin
ATF	Average Time to Refixing
ATM	Average Time to Maturity
AUD	Australian Dollar
CBD	Central Business District
CDB	China Development Bank
CNY	Chinese Yuan Renminbi
ComSec	Commonwealth Secretariat
DMS	Debt Management Section
DSA	Debt Sustainability Analysis/Assessment
DOD	Disbursed Outstanding Debt
EGS	Exports of Goods and Services
EIB	European Investment Bank
EUR	Euro
EXIM	Export–Import Bank of China
FC	Foreign Currency
FI	Financial Institution
FY	Financial Year
GDP	Gross Domestic Product
GoT	Government of Tonga
GBP	Great British Pounds
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
IN	Interest
JPY	Japanese Yen
MoFNP	Ministry of Finance and National Planning
MTDS	Medium Term Debt Strategy
NRBT	National Reserve Bank of Tonga
NPV	Net Present Value
NZD	New Zealand Dollars
PAT	Ports Authority Tonga
PFMA	Public Finance Management Act
PR	Principal
PRC	People Republic of China
RFB	Retirement Fund Board
SDR	Special Drawing Rights
TA	Technical Assistance
TCC	Tonga Communication Corporation
TDB	Tonga Development Bank
TDS	Total Debt Service
TDDS	Total Domestic Debt Service
TEDS	Total External Debt Service
TOP	Tongan Pa'anga
TPL	Tonga Power Limited
TSDF	Tonga Strategic Development Framework
USD	United States Dollar
WB	World Bank
WBOT	Westpac Bank of Tonga
WPAC-AUS	Westpac Australia
WPAC-NZ	Westpac New Zealand



Acknowledgements

This is the fourth Annual Public Debt Bulletin (APDB) as based on an Outline recommended by Commonwealth Secretariat (ComSec) in line with international reporting requirements of Public Debt Statistics Guide issued by (International Monetary Fund) IMF and affiliated associations.

The key role played by the Debt Management Section (DMS) for co-ordinating production of this important report is acknowledged also the other contributors of data from the Economic and Budget divisions of Ministry of Finance and National Planning (MoFNP), also related divisions of the National Reserve Bank of Tonga (NRBT).

Milestones that have been achieved in the implementation of debt management reforms during the last year are referred in Section 2.3. under Reforms.



Foreword

The Government of Tonga (GoT) continues to recognise the importance of prudent debt management in the medium term and for better reporting of its debt portfolio for informed decision making.

For development of debt management and to ensure sufficient capacity building of staff, the MoFNP has been working closely with development partners such as the ComSec and the World Bank (WB) in priority areas that assistance is required such as risk management of the external debt portfolio also on-lent debt and on the domestic debt market in particular GoT securities.

As part of the Ministry's effort to disseminate information on the public debt position, regular reporting is provided to Cabinet and information is also available on our website.

This APDB is a comprehensive format which reports annually on the state of public debt management over the last few years with reference to current reforms in this area and also includes projections of both debt stock and debt service in the future years.

GoT is mindful of the debt management policy to maintain sovereign debt within levels that are sustainable over time. This requires regular monitoring of debt levels against commonly accepted debt targets or thresholds established by multilateral institutions while also ensuring that any financing requirements are met at low cost with a minimum degree of risk in the medium term.

A draft Medium Term Debt Strategy (MTDS) for GoT has been developed by DMS of MoFNP which refers to some options that are considered as practical for GoT to explore during the next three years and for review annually in line with progress of macro and fiscal developments. This policy to be submitted to Cabinet for endorsement and implementation by the MoFNP as part of its medium term fiscal consolidation.

With the recent upgrade of Tonga in 2013 by the IMF and WB from a **high risk to debt distress to a moderate level**, under the revised debt sustainability ratios that it provides some room for prudent borrowing by Government. In view of the Budget theme for 2014/2015 of "Partnership: Government and People Together Building the Economy and Society", Despite our limited financial circumstances and other constraints, the budget focuses on improving performance, growth and well being, while ensuring sound fiscal conditions are in turn an essential requirement for Government's policies and priorities to be successful. Proposed budget initiatives by the Ministry of Finance include assistance to the primary



economic sectors from domestic sources through new issue of bonds and concessional borrowing from external sources of the WB to assist with reconstruction in the Ha'apai islands after the cyclone in January 2014 also for 50% loan component of budget support from the WB and ADB.

Financing challenges will remain for Government in the medium term but with continued prudence, it is a top priority that we work on encouraging inclusive sustainable growth and to ensuring fiscal stability.

We acknowledge the generous financial assistance to Tonga from all development partners who continue to assist Government in bridging the financing gap to meet our various obligations.

A handwritten signature in blue ink, consisting of stylized letters and a long horizontal stroke.



'Aisake Valu Eke

Minister for Finance & National Planning



Executive Summary

- **The total disbursed outstanding debt (DOD)** of loans by Government as at 30th June 2015 in nominal value at millions of Pa'anga over the 5 year period, is shown below:

Loans	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 yr change	5 yr change
External	274.9	322.6	343.1	336.5	381.6	45.1	106.7
Domestic	29.5	29.5	29.5	29.5	41.0	11.5	11.5
Total Public Debt	304.3	352.1	372.6	366.0	422.6	56.6	118.3
Guarantees	12.1	7.8	0.1	0.15	0.01	-0.14	-12.1
On-lent	40.8	63.9	62.5	62.5	51.1	-11.4	10.3
GOT Fund	-	-	-	-	1.2	1.2	1.2
Total Contingent Debt	357.2	423.8	428.6	428.6	474.9	46.3	117.7

- **Total public debt** was estimated at \$422.6m (51.5% of GDP), with External debt at \$381.6m (46.5%) and Domestic debt at \$40.98m (5.0%). During the 5 year period, there was a huge increase in external debt (\$106.7m) mainly due to loan disbursements from EXIM for CBD and Roads and appreciation of the CNY currency.
- **Main external debt creditors are:** EXIM at \$250.3m (66%), and ADB at \$61.4m (16%). During the 5 year period, there was an increase of \$106.0m in the DOD to EXIM as result of disbursements for CBD and Roads. The total disbursement was made in FY 2015 for Budget Support estimated at \$4.8m.
- **Domestic debt** comprises of bond issues, with the majority of holdings by Financial Institutions (FI) at \$19.2m (47%) and Retirement Fund Board (RFB) at \$15.0m (37%).
- **The main external loan currency denomination** is the CNY at \$250.3m (66%); SDR at 70.2m (18%) and USD at \$52.5m (14%). During the 5 year period, there was a *significant* increase in CNY composition of \$106.0m, due to disbursement made.
- **Total External DOD in net present value (NPV)** by 30 June 2015 is estimated at \$359.2m (43.7% of GDP) at current FC/TOP rates. For the next 2 years and with reference to debt sustainability targets below, most of the indicators will not be breached (includes fluctuations¹).

¹ Nominal GDP, Exports & Remittances decrease by 2%, Revenue decrease by 1%, & FC rates increase by 5%



Figure1. Debt Sustainability Indicators

Debt Sustainability Indicators	IMF-GoT Target %	FY 2015 %	FY 2016 %	FY 2017 %
NPV of debt as:				
% of GDP	40	47	42	42
% of GDP (& remittances)	36	35	34	34
% of exports	150	233	233	237
% of exports & remittances	120	99	99	101
% of recurrent revenue	250	220	204	202
Total Debt Service as:				
% of exports	20	15	15	13
% of exports & remittances	16	6	6	5
% of recurrent revenue	20	14	13	11

- **External DOD to GDP will continue to exceed the recommended level in the medium term** and the main Creditor and Currency composition will remain as EXIM and CNY currency. This results in high risk and exposure to volatility of exchange rates especially with strengthening of the CNY.
- **External debt service** is estimated to significantly increase to \$26m (*at around 3% of GDP and 12% of expenditure*) from FY 2018/19 and this is mainly due to the rescheduling of the two large EXIM Bank loans, with first repayments now delayed by five years.
- **To maintain debt sustainability in future**, it is vital that our current level of economic activity prospects improve together with prudent public debt management through priority implementation of MTDS, in order to mitigate the vulnerability to shocks.



1. Introduction

The *APDB as at 30 June 2015* presents the major public debt management activities between July 2014 and June 2015 including review of historical data over the last 5 fiscal years and with projections over the next 10 fiscal years or so. It reports key data and ratios on the public debt portfolio (stocks and flows) and how these have changed over the course of the year.

Looking forward, the Bulletin will discuss the GoT's MTDS and priority action for debt reduction programs, fiscal consolidation, estimations for GDP growth, projections of fiscal deficits and other macroeconomic developments.

Section 2 will provides the framework for public debt management operations highlighting the legal structure in place and the reforms that took place in the reporting year. This is followed by Section 3 which reports on the recent developments in debt management as a result of changes in the fiscal conditions, debt risk level and debt structure. This provides the insight and the introduction into the current portfolio which is discussed in Section 4. This is complemented by Section 5 which reports the contingent liability position. Section 6 assesses the debt sustainability through forecasting based on past trends and looking at the possible impact on the Debt indicators. The paper concludes with the summarised position of debt.

2. Framework for Debt Management Operations

The PFMA 2002 specifies that the Minister of Finance is responsible for economic, fiscal and financial management by Government. Part V of the PFMA 2002, provides the basic legal framework for Government's borrowings, loans and guarantees.

The DMS under the Treasury Division is primarily responsible for debt management duties on behalf of MoFNP and the mandated task of meeting the GoT's objective for public debt management as referred in the GoT's inaugural draft MTDS at June 2015 which is yet to be finalised, is:

That the GoT maintains sovereign debt within levels that are sustainable over time. This requires regular monitoring of debt levels against commonly accepted debt targets or thresholds established by multilateral institutions while also ensuring that any financing requirements are met at low cost with the minimum degree of risk in the medium term.



Debt Management Unit's objective is to ensure that government's financing needs and payment obligations being met at lowest possible cost over the medium to long run, consistent with a prudent degree of risk.

The risk management function of Debt Management has become a central feature of the operation of debt office. In some cases Debt Management unit has responsibility for a wide range of analytical tasks, including the development of alternative debt strategies, as in MTDS, and the monitoring and operational management of the stock of outstanding sovereign debt. The principal reason is the need to include all departments with related staffs and all aspects of the debt office's work in the risk control framework, thereby incorporating all relevant departments and all debt management activities in an integrated risk management framework. This portfolio framework should be based on clearly articulated responsibilities for all staff involved, a transparent framework for the monitoring and control of activities, as well as clear and transparent reporting arrangements. In order to execute effectively the risk management function, the head of Debt Management should have the proper level of seniority and authority, while reporting directly to the National Reserve Bank of Tonga, Minister and senior managements of the Ministry.

2.1 Reforms

During the 1 year period (FY 2014/15), some of the main debt management activities carried out were:

- (i) Regular reporting to Cabinet on the status of GoT's loan portfolio and progress of the CBD and Roads loan projects;
- (ii) Publication of the Annual Public Debt Bulletin at June 2014 with Debt Sustainability Analyses (DSA);
- (ii) Annual and Quarterly Debt Bulletin available on the Ministry's website;
- (iv) Draft MTDS 2013/14-2015/16 completed in June 2014 and pending review for submission and formalise by Cabinet;
- (v) Follow up discussion with PRC officials on options for debt relief of the major loan projects from EXIM Bank;
- (vi) TA missions by World Bank (MTDS work) and ComSec (Domestic Market Development) during August and September 2014;
- (vii) Ongoing capacity building of staff by participation in donor funded trainings as related to debt management data issues, during July 2014 – June 2015.



2.2 Regulatory Structure/ Arrangements

The PFMA, Part V, Sections 23 to 34 refers to the main provisions on Borrowings, Loans and Guarantees: Authority to borrow; Power to raise loans; Loans to GoT; Subsidiary Loan Agreements; Stocks, Bonds and Promissory Notes; Treasury Bills; Liability of GoT; Power to give Guarantees and Indemnities; Taking and release of security to GoT; Expenditure for protection of public securities and Register of Loans and Guarantees.

The MoFNP has a draft Policy Framework for GoT Guarantees and will consider review to also include the on-lent loans to public enterprises and other entities, as arises.

2.3 Role of the Central Bank

The NRBT acts as registrar for Government's securities and fiscal agent for external and domestic loan payments

3. Developments in the Past Year

3.1 Macroeconomic Developments

Table 1: Main Economic Variables in TOP\$m

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 yr change	5 yr change
Gross Domestic Product	775.0	800.6	779.7	829.5	821.3	-8.2	46.3
Fiscal Balance	-57.3	-22.1	-7.7	8.6	20.7	12.1	78.0
Current Account Balance	-72.1	-55.4	-66.5	-25.3	-23.3	2.0	48.8
Inflation (%)	6.1	3.3	0.7	2.3	0.2	-2.1	-5.9
Exports of Goods & Services	100.2	108.1	137.5	159.7	197.6	37.9	97.4
Debt Services	23.0	15.2	20.4	21.3	21.3	-	-1.7
Expenditure	173.7	163.7	178.6	192.2	203.6	11.4	29.9
Revenue	137.7	143.0	157.5	163.1	187.3	24.2	49.6
Remittances	146.5	112.3	113.3	215.2	213.5	-1.7	67.0
Foreign Reserves	203.8	246.1	263.3	274.4	289.7	15.3	85.9

As referred in the GoT's Budget Statement of 2014-15, in view of the key macroeconomic developments and impact on borrowing during the past fiscal year. Following slowdown in growth on completion of the EXIM Bank funded construction loans in 2010/11; Increase in forecast GDP, is is forecasted to strengthen sharply over the next few years, driven largely by the post cyclone reconstruction efforts and also continued strength and contribution to GDP. Government seeks to maintain higher growth rates.

3.2 The Borrowing Programme

The annual borrowing by GoT during FY 2014/15 is approved by Legislative Assembly in July 2014 as part of the Budget estimates. Total public debt disbursements is



estimated at \$22.9m, for external loan component of budget support from WB (\$4.8m) and for financing of maturing bonds and new issuance (\$18.1m).

With the upgrade of Tonga's Debt Sustainability position to a moderate risk level of debt distress, it results in revised thresholds and provides some room for prudent borrowing. However, there is also a change in future financing from multilateral donors such as the WB and ADB, to a 50:50 loan and grant component.

As such, there has since been a review of the prior "No New Loan Policy", and as referred in the budget for 2014/15, Government has proposed financing to fund priority budget initiatives. With a focus on domestic borrowing by issue of Government bonds to support direct cost savings and economic growth. New concessional external borrowing will focus on budget support and reconstruction of Ha'apai.

3.2.1 Fiscal Outcome

The financing gap of GoT's recurrent budget has continued to widen over the last few years, with budget support from donors estimated at 0.6% of GDP. Over the medium term, recurrent revenue increased by \$24.2m and operating expenditure increased by \$11.4m.

Table 2: Fiscal Outcome in TOP\$m

Item	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 yr change	5 yr change
1. Total Receipts	137.7	143.0	157.5	163.1	187.3	24.2	49.6
2. Total Expenditure	173.7	163.7	178.6	192.2	203.6	11.4	29.9
3. Gross Fiscal Deficit/Surplus	-36.0	-20.7	-21.1	-29.1	-16.3	12.8	19.7
As a % of GDP	-4.6	-2.6	-2.7	-3.5	-2.0	1.5	2.7
4. Financing of Fiscal Deficit	-	-	-	-	-	-	-
(a) Local Currency Financing	-	-	-	-	-	-	-
(i) Bonds	10.4	3.0	7.5	6.0	6.6	0.6	-3.8
(b) Foreign Currency Financing	-	-	-	-	-	-	-
(i) Loans	67.6	47.5	8.7	4.8	4.8	-	-62.8

3.2.2 Government New Borrowing

In this section, the Bulletin will discuss the GoT's borrowing target and borrowing strategy for the year under review (FY 2014/15). External debt accounts for 90% and domestic debt accounts for 10%. Loans sourced externally are mainly on a concessional basis at an average of 36 years and 1.3% interest per annum, mainly from the EXIM and ADB. Domestic debt comprises of public bonds issued on a more commercial basis at an average of 5 years and 4.0% interest per annum.

Table 3: Government Borrowing in TOP\$m

	FY 2015 Original	FY 2015 Actual	Change
Total Net Borrowing			
Domestic	6.0	18.1	12.1
External	-	4.8	-4.8
Total	6.0	22.9	16.9
Gross Borrowing by Instrument			
Bonds	40.98	40.98	-
Loans	381.7	381.7	-
Total	422.7	422.7	-

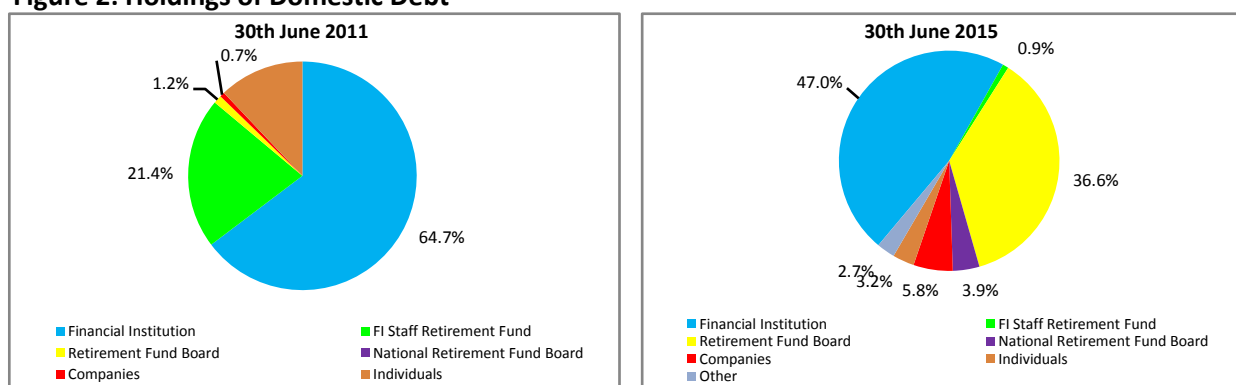


On net basis, a total borrowing was estimated at \$22.9m in FY 2015. However, total net borrowings exceeded the original target by \$16.9m due disbursement of Budget Support and ne bond issued during FY 2015.

3.2.3 Domestic Debt Issuance

GoT's bonds are mainly issued on a roll-over basis with exception of any redemptions or new issues. FI's now account for the majority of holdings at \$19.2m with RFB at \$14.9m and Companies at \$2.4m.

Figure 2: Holdings of Domestic Debt



3.2.4 External Debt Borrowing

The grant element specifies the level of concessionality of external loans taken from bilateral or multilateral creditors. In countries such as Tonga with higher debt vulnerabilities, the concessionality threshold or minimum grant element as recommended by the IMF and WB should be at minimum average of 35%.

At such level, it implies that loans will have a longer grace and maturity period with lower interest rates. Concessionality of GoT's external loans over the last 5 year period is shown below:

Table 4: Average Terms of New Loans

	FY 2011	FY 2015
Maturity (Years)	20	40.0
Grace Period (Years)	10	10.0
Interest Rate (%)	2	0.75
Grant Element (%)	55.6	57.4



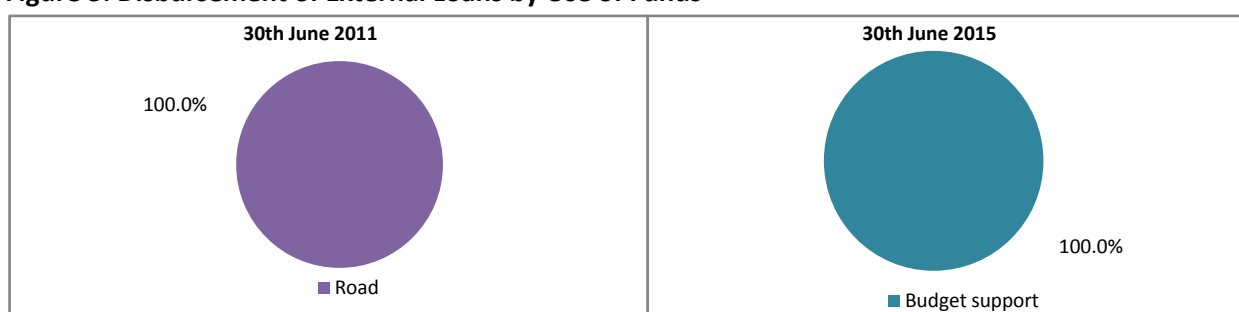
3.2.5 Disbursement of External Loans

The following Table shows the position of total external loan disbursements over the 5 year period. There has been a significant change in disbursements of Tonga National Road Improvement project, as shown in the following Charts.

Table 5: Disbursement of External Loans in TOP\$m

DETAILS	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 yr change	5 yr change
Disbursed Outstanding Debt	274.89	322.6	343.1	336.5	381.6	45.1	106.8
Disbursements	67.6	47.5	8.7	4.8	5.0	0.2	-62.6
Principal Repayments	6.0	5.7	5.8	6.3	7.5	1.2	1.5
Net Flows On Debt	61.6	41.8	2.9	-1.5	-2.5	-1.0	-64.1
Interest Payments	4.3	4.8	5.3	5.7	5.9	0.2	1.6
Net Transfers On Debt	57.3	37	-2.4	-7.2	-8.4	-1.2	-65.7
Total Debt Service	10.3	10.5	11.1	12.0	13.4	1.4	3.1

Figure 3: Disbursement of External Loans by Use of Funds



3.2.6 Developments in the Secondary Market

As at 30 June 2015, there was still a high level of liquidity in the banking system and market interest rates were lower than prior years. Prior to amendment of the NRBT Act in 2007 to repeal Section 49 in the Principal Act that NRBT may hold GoT bonds, NRBT held the majority of holdings in GoT's bonds and the Financial Institutions now account for the main bond holders. This has now been reviewed during FY 2015.

The NRBT is registrar of Government's securities and a public tender of bonds available is made in the local media and NRBT website. There is no auction system used and NRBT also makes direct contact with the main bond holders to confirm interest for investment.

There is a need to develop the domestic market and particularly the issue of GoT's securities according to best market practices. In line with the main findings and based on some of the recommendations by the ComSec and WB follow up missions during 2014 that the MTDS considers some practical strategies to be explored by GoT during the next 3 years. Other recommendations on development of debt management as made by experts as a way forward to be considered by MoFNP.



4. Public Debt Portfolio

The Government's fiscal position has also remained very tight with a heavy reliance on budget support from donors to supplement the recurrent budget deficit. Further, the Government has sought and rescheduled its major repayment obligations due to the Export-Import (EXIM) Bank of China in People's Republic of China. In view of Government's draft Medium Term Debt Strategy, agreement has recently been made for rescheduling of these obligations with principal repayments for both EXIM Bank loans deferred for five years. This option will provide temporary fiscal space but will cost Government more with the extra interest to be paid and higher principal installments once repayments start. Projected cost may also rise from escalation of the Chinese currency in the years to come against the pa'anga and other currencies.

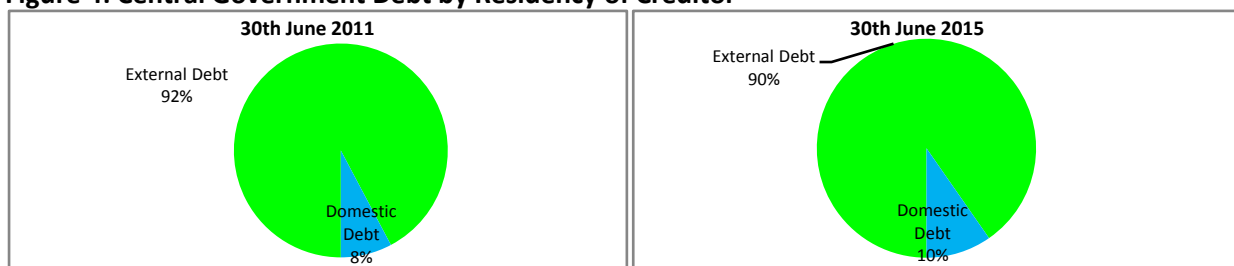
With the current high external debt outstanding level, especially to China, and future proposed external financing, Government may continue to face difficulty in maintaining debt levels within the recommended levels. This is one of the reasons for Government focus on promoting growth and improved revenue collection along with prudent public debt management, to help pay for future debt while mitigating against the vulnerability to shocks on the Government's debt portfolio.

Table 6: Main Debt Indicators in TOP\$m

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 yr change	5 yr change
Gross central govt debt	304.3	352.1	372.6	366.0	422.68	56.7	118.3
<i>Debt-to-GDP (%)</i>	39.3	44.0	47.8	44.1	51.9	7.8	12.6
External Debt	274.9	322.6	343.1	336.5	381.6	45.2	106.8
<i>External debt-to-GDP (%)</i>	35.5	40.3	44.0	40.6	46.9	6.3	11.4
<i>External debt-to-EGS (%)</i>	274.3	298.4	249.5	210.7	239.0	28.3	-35.3
<i>External debt-to-Reserves (%)</i>	134.9	131.1	130.3	122.6	139.1	16.5	4.2
Domestic Debt	29.5	29.5	29.5	29.5	40.9	11.5	11.5
<i>Domestic debt to GDP (%)</i>	3.8	3.7	3.8	3.6	5.0	1.5	1.2

As at 30th June 2015, both external and domestic debt stock increased to \$381.6m and \$40.9m respectively. External debt continues to account for the majority of total public sector debt. (Figure 4).

Figure 4: Central Government Debt by Residency of Creditor



The breakdown of GoT debt by instrument type is referred below.



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Table 7: Debt by Instrument Type in TOP\$m

Gross debt by instrument type	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 yr change	5 yr change
Loans	274.9	322.6	343.1	336.5	381.6	45.1	106.8
Securities	29.5	29.5	29.5	29.5	40.9	11.5	11.5
Arrears	-	-	-	-	-	-	-

Other essential items on status of the public debt portfolio are:

The following information shows the impact of external debt on Government's loan portfolio, during the 5 year period:

Figure 5: Total Public Debt to Nominal GDP % (TOPm), FY 2010/11 – 2014/15

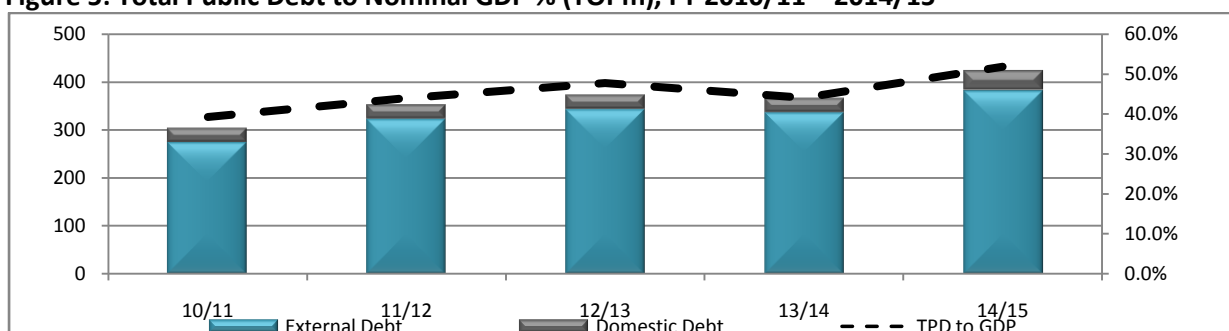


Figure 6: Total Public Debt service in ratio to Revenue and Expenditure, FY 2010/11 – FY 2014/15

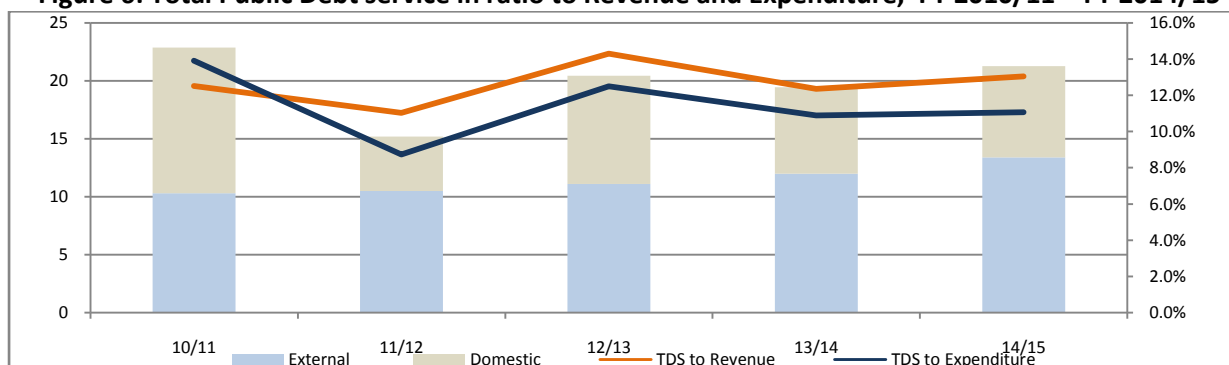
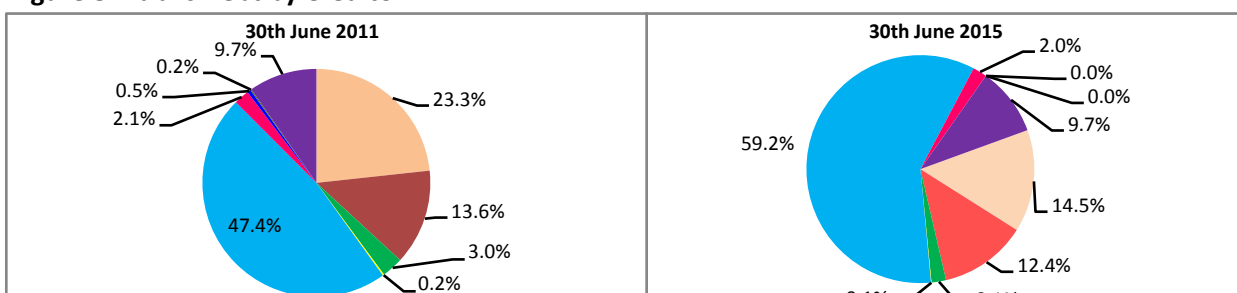


Figure 7: Public Debt by Instrument



Figure 8: Public Debt by Creditor

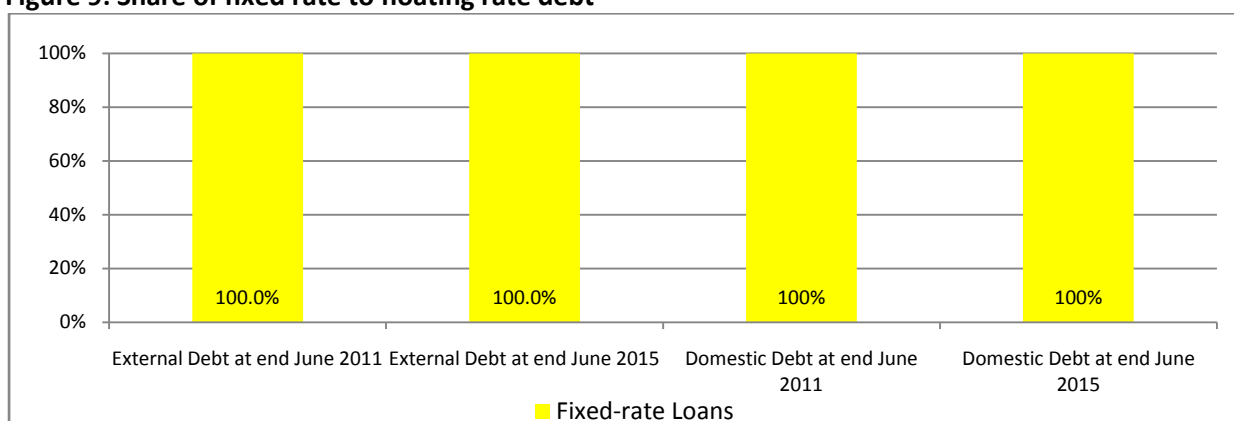




4.1 Portfolio Risks

The basic risk measures include:

Figure 9: Share of fixed rate to floating rate debt



As the majority of GoT's external and domestic borrowing is on a fixed interest basis, there is currently minimal interest rate risk and this is expected to apply during the next 3 years.

Short term debt is defined as instruments of less than 1 year on original maturity plus long-term instruments with a remaining maturity of less than 1 year.

Figure 10: Share debt maturing within 1 year

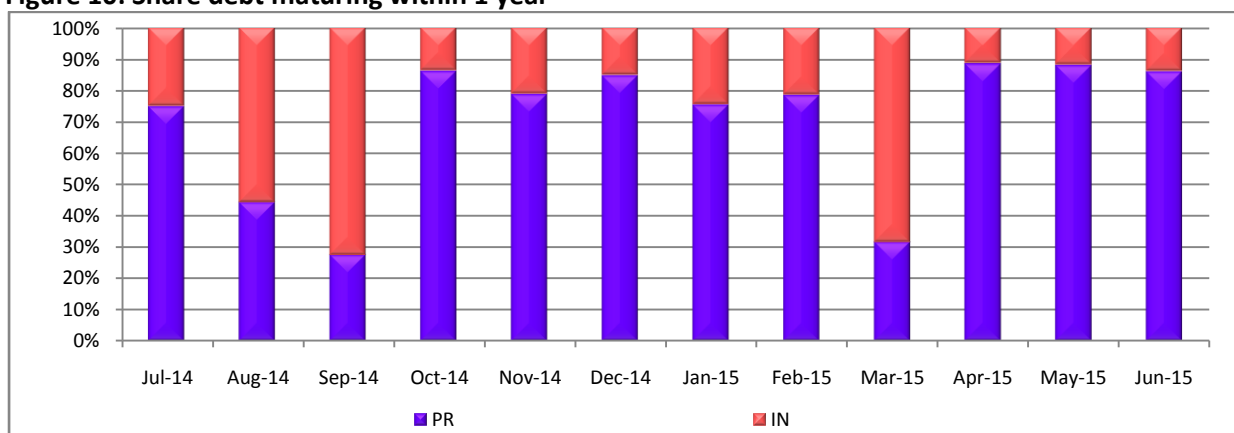


Figure 11: Currency composition

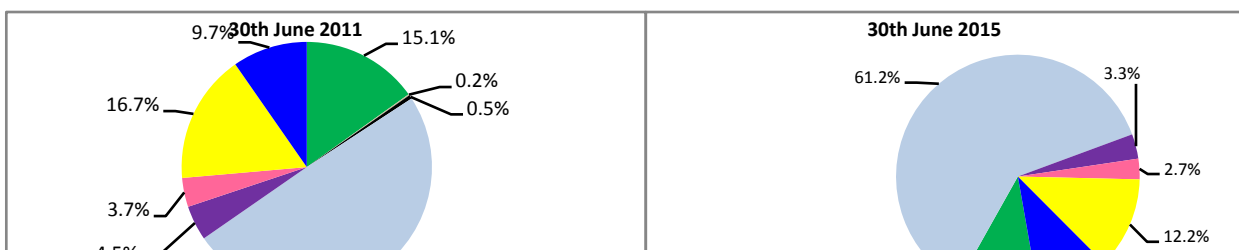




Figure 12: Volatility of Foreign Exchange Rates to Tongan Pa'anga

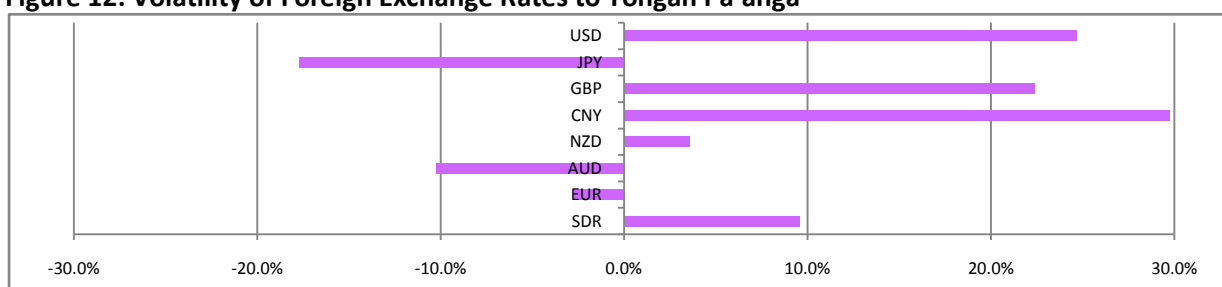
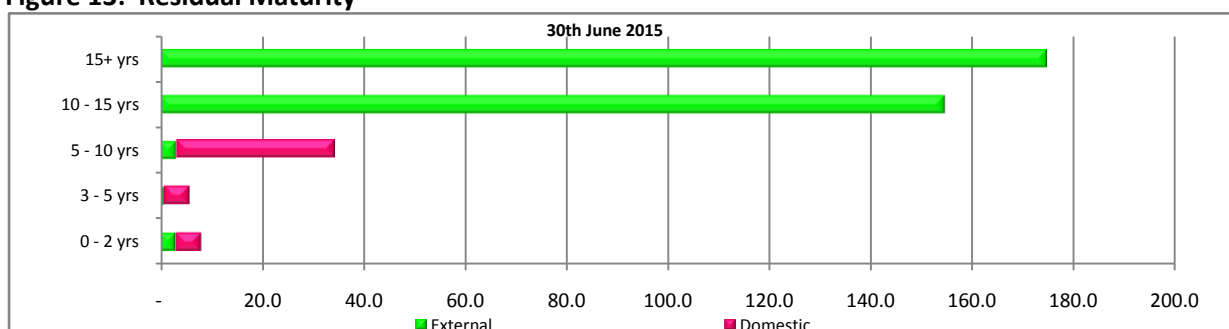


Table 8: Cost and Risk Indicators for Existing Debt as at 30 June 2015

Risk Indicators		External debt	Domestic debt	Total debt
Amount (in millions of USD)		177.4	15.9	193.3
Nominal debt as % GDP		46.4	4.2	50.5
PV as % of GDP		33.9	4.2	38.1
Cost of debt	Weighted Av. IR (%)	1.6	3.7	1.8
Refinancing risk	ATM (years)	10.3	3.2	9.7
	Debt maturing in 1yr (% of total)	2.2	19.2	3.7
Interest rate risk	ATR (years)	10.3	3.2	9.7
	Debt refixing in 1yr (% of total)	2.3	19.2	3.9
	Fixed rate debt (% of total)	99.9	100.0	99.9
FX risk	FX debt (% of total debt)			91.8
	ST FX debt (% of reserves)			14.1

At the end of 2015, the ATM of the total debt portfolio is 9.7 years in FY 2014/15, with external and domestic debt portfolios recording 10.3 years and 2.5 years respectively.

Figure 13: Residual Maturity



4.2 Domestic Central Government Debt

As shown in Table 9, GoT's domestic debt stock increases to \$41.0m.



4.2.1 Domestic Debt by Instrument

As at FY end 2015, Bonds account for 100% of the securities issued and also the main type of instrument issued on a 5 yearly duration.

4.2.2 Domestic Debt by Holder

Bonds that matured during the fiscal year were rolled over as financing for payments and also new issuance of bonds. During last 5 years, FI's remain the largest holder of GoT debt, with holdings by non-bank sources increasing from \$11.1m to \$21.7m, while those of commercial banks increased from \$18.3m to \$19.3m.

Table 9: Domestic Debt by Funding Source in TOP\$m

Holder	FY 2011		FY 2015		5 yr change
	Amount	%	Amount	%	
Banks of which:					
Commercial Bank	18.3	62.2	19.3	47.0	0.9
Non Banks of which:					
Other Non Bank Sources	11.1	37.8	21.7	53.0	10.6
Total	29.5	100.0	41.0	100.0	11.5

The outstanding bonds during the 5 year period resulted in more holdings by FI, RFB and Individuals, and less holdings by the FI Staff Retirement Fund, Companies and Others. FI's continued to hold the majority (47.0%) of bonds, followed by RFB (36.5%) and Companies (5.8%).

Table 10: Bonds by Holder in TOP\$m

Holder	FY 2011		FY 2015		5 yr change
	\$m	%	\$m	%	
Financial Institutions	18.3	62.2	19.2	47.0	0.9
FI Staff Retirement Fund	6.2	21.1	0.4	0.9	-5.9
Retirement Fund Board	0.9	2.9	15.0	36.5	14.1
National Retirement Fund Board	-	-	1.6	4.0	1.6
Companies	0.2	0.6	2.4	5.8	2.2
Individuals	3.9	13.1	1.3	3.1	-2.6
Other	-	-	1.1	2.8	1.1
Total	29.5	100.0	41.0	100.0	11.5

4.2.3 Domestic Debt by Tenor

GoT mainly issues bonds with a maturity of 5 and 6 year and also Treasury Bills on a short-term basis, as required. The majority of outstanding bonds will mature in 5 – 6 years time.

Table 11: Bonds by Tenor in TOP\$m (remaining maturity)

Security Type Bonds (Years)	FY 2011			FY 2015			5 yr Change
	Amount	Cum. Amount	Cum. %	Amount	Cum. Amount	Cum. %	
0 - 1 Years	-	-	-	-	-	-	-
1 - 2 Years	-	-	-	5.0	5.0	12.2	5.0
3 – 4 Years	6.0	6	20.4	5.0	10.0	24.4	-1.0



5 – 6 Years	23.5	29.5	100.0	31.0	41.0	100.0	1.5
Total	29.5			41.0			41.0

4.3 External Central Government Debt

Table 13 shows that the stock of external debt increased from \$274.9m (35.5% of GDP) at June 2011 to \$381.6m (46.5% of GDP) at June 2015 due to disbursement made and currency fluctuations.

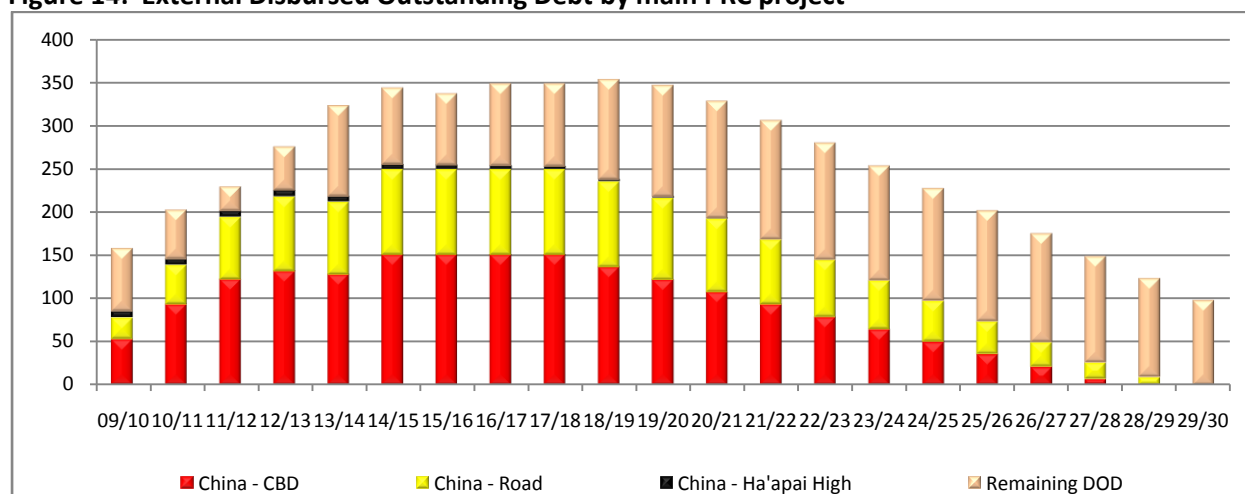
Worthy of note, is the fact that the debt service to exports ratio gradually decreasing in 2011 to 2015 from 22.9% to 10.0%. This is mainly due to the higher rise of debt service for the loans to PRC compared to lower growth rate in exports in the prior years.

Table 12: Key External Debt Indicators *in TOP\$m*

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 yr change	5 yr change
External Debt	274.9	322.6	343.1	336.5	381.6	45.2	106.8
Ratio of total external debt to GDP (%)	35.5	40.3	44.0	40.6	46.5	6.3	11.4
Ratio of total debt service to exports (%)	22.9	14.0	14.9	13.3	10.0	-3.3	-12.9
Ratio of concessional debt to total debt (%)	42.5	42.5	42.8	43.9	43.1	-0.8	-2.5

Following reschedule of the two major loans from PRC, there is no reduction in the debt level until FY 2018/19 when principal repayments are projected to begin.

Figure 14: External Disbursed Outstanding Debt by main PRC project

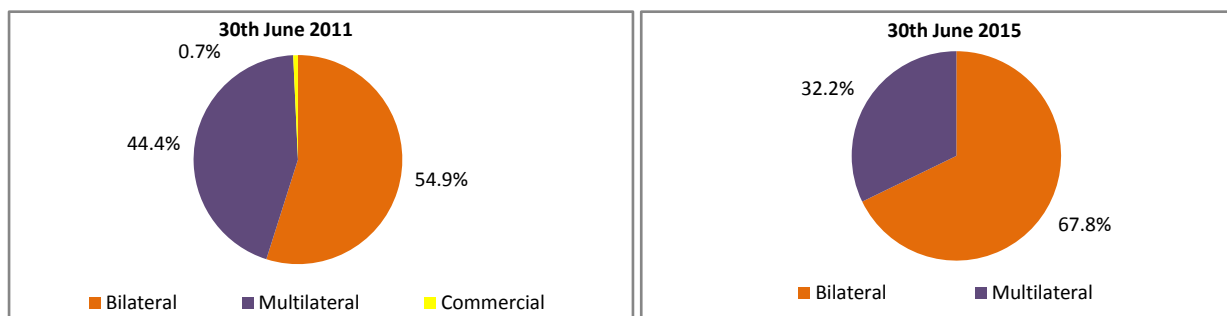


4.3.1 External Debt by Creditor Category

At the end of June 2015, Tonga's external debt stock was dominated by debt owed to the bilateral creditors, accounting for 67.8% of the total debt stock. However in comparison to the position at the end of 2011, bilateral debt accounted for 54.9% of the total external debt stock.



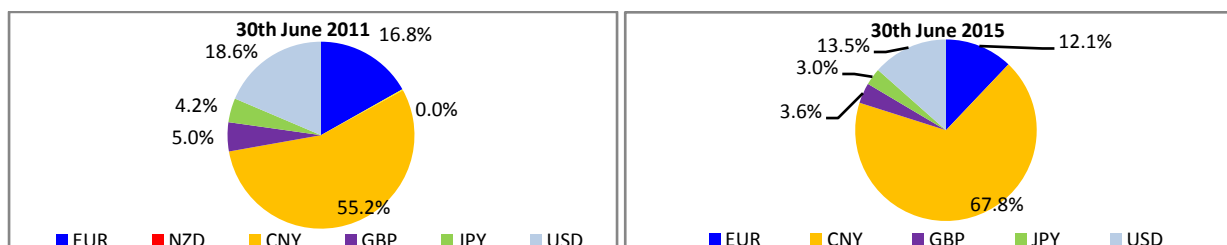
Figure 15: External Debt by Creditor Category



4.3.2 External Debt by Currency

As at 30 June 2015, the main outstanding loan currency denomination is in the Chinese Yuan Renminbi currency (CNY) at 67.8%, United States Dollar (USD) at 13.5% and Euro (EUR) at 12.1%, as shown below.

Figure 16: External Debt by Currency



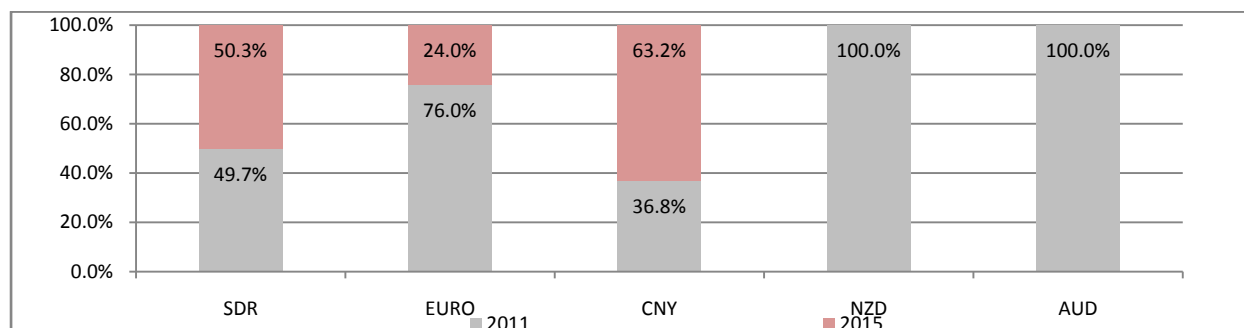
In reference to denomination of Tonga's foreign reserves there is a significant mismatch as the major currency component is the USD Dollar.

During the 5 year period, external debt was denominated in five currencies, mainly due to revaluation of all ADB loans to SDR from USD and loan in AUD which was fully settled in March 2015. In particular, there has been a significant change in the CNY composition.

Figure 17: External Debt by Currency



Annual Public Debt Bulletin (June 2015)



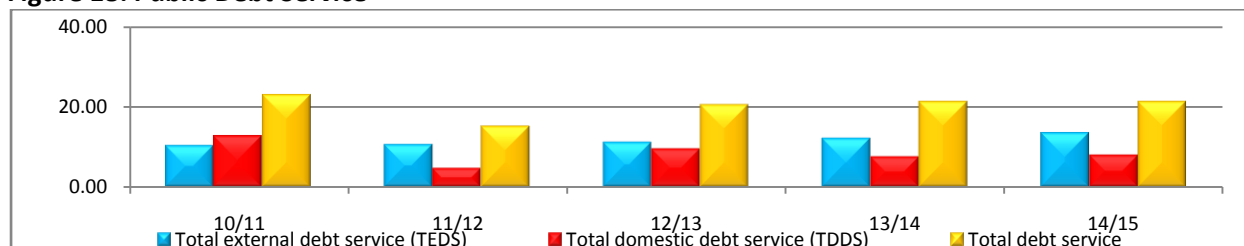
4.4 Total Public Debt Service

The debt data includes the impact of the borrowing along with the recent rescheduling of the two large EXIM Bank loans, with first repayments now delayed by five years, to start in FY 2018/19 with a significant rise in external debt service estimated at over \$13m (further 1.6% of GDP), at a total of \$24.0m.

Table 13: Public Debt Service in TOP\$m

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 yr change	5 yr change
External Principal	6.0	5.7	5.8	6.3	7.5	1.2	1.5
External Interest	4.3	4.8	5.3	5.7	5.9	0.2	1.6
Total External debt service (TEDS)	10.3	10.5	11.1	12.0	13.4	1.4	3.1
TEDS as a % of total debt service (TDS)	44.9	69.2	54.3	56.4	63.0	6.6	18.1
Domestic Principal	10.4	3.0	7.5	6.0	6.6	0.6	-3.8
Domestic Interest	2.2	1.7	1.9	1.5	1.3	-0.2	-0.9
Total Domestic debt service (TDDS)	12.6	4.7	9.3	7.5	7.9	0.4	-4.7
TDDS as a % of TDS	54.7	30.8	45.7	35.1	37.0	1.9	-17.7
Other debt service	0.1	-	-	1.8	-	1.8	-0.1
Total debt service	23.0	15.2	20.4	21.3	21.3	-	-1.7
Recurrent Revenue	137.7	143.0	157.5	163.1	187.3	24.2	49.6
Export Earnings	100.2	108.1	137.5	159.7	159.7	-	59.5
Total debt service as % of revenue	16.7	10.6	13.0	13.0	11.4	-1.7	-5.3
Total external debt service as % of exports	10.3	9.7	8.1	7.5	8.4	0.9	-1.9

Figure 18: Public Debt Service



4.4.1 External Debt Service by Creditor Category

Total external debt service increased significantly from \$10.3m in 2011 to \$13.4m in 2015. Principal repayments decreased from \$6.0m in 2011 to \$7.5m in 2015 while the interest payments increased from \$4.3m to \$5.9m in 2015. In the year ending 2015, a significant proportion of debt service was paid to multilateral creditors at 51% and to bilateral creditors at 49%, of the total debt service.



Table 14: External Debt Service by Creditor Category in TOP\$m

Creditor Category	Payments	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 yr change	5 yr change
Bilateral	Principal	1.3	1.1	1.1	1.2	1.3	0.1	0.1
	Interest	3.0	3.5	4.1	4.5	4.8	0.3	1.8
	Total	4.3	4.6	5.2	5.7	6.1	0.4	1.9
Commercial Bank	Principal	0.2	0.2	0.04	0.03	0.4	0.4	0.3
	Interest	0.1	0.1	0.02	0.03	0.02	-	-0.1
	Total	0.3	0.3	0.1	0.1	0.4	0.4	0.2
Multilateral	Principal	4.6	4.4	4.6	5.1	5.8	0.7	1.2
	Interest	1.2	1.2	1.2	1.1	1.1	-	-0.1
	Total	5.8	5.6	5.8	6.2	6.9	0.7	1.1
Grand Total	Principal	6.1	5.7	5.7	6.3	7.5	1.2	1.5
	Interest	4.3	4.8	5.3	5.6	6.0	3.6	3.4
	Total	10.4	10.5	11.1	12.0	13.5	4.8	4.9

4.4.2 Principal and Interest Payments

As shown in the following Chart, external debt service will double from FY 2018/19 following reschedule of the first repayment of principal for the two large EXIM Bank loans now delayed by five years and will remain over the medium term until maturity of loans from PRC (EXIM) for CBD and Roads projects in FY 2029/30. Annual installments will also be much higher, given that the period for principal repayment is reduced from 15 years to 10 years.

Figure 19: External Debt Service by payment type

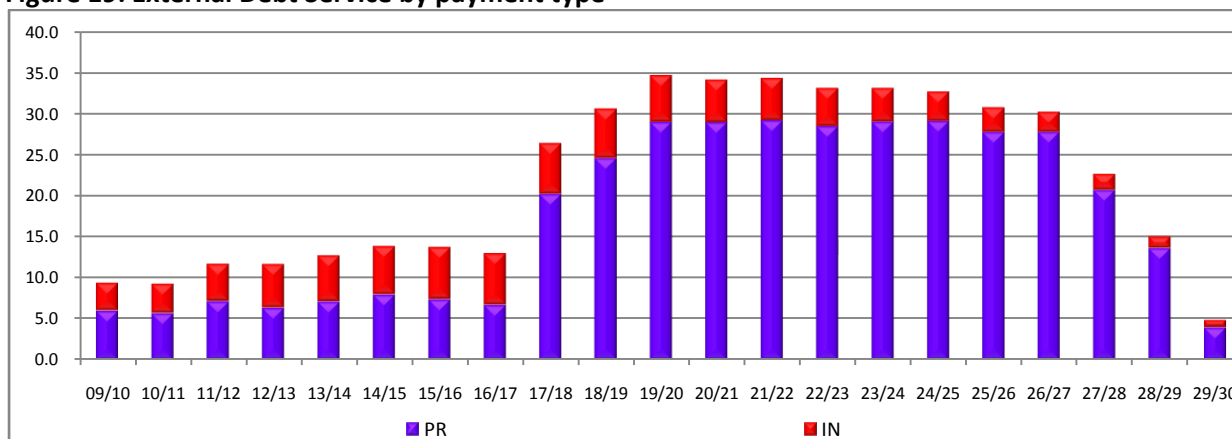
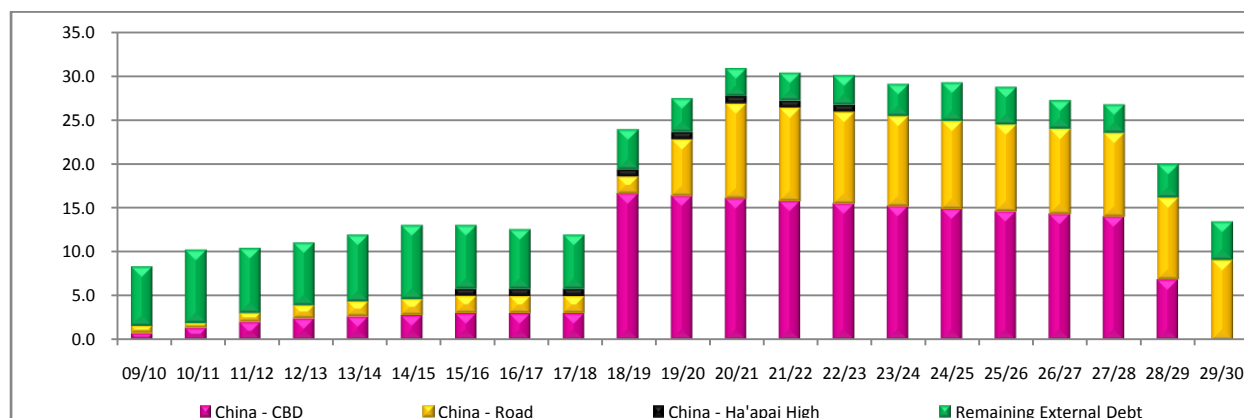


Figure 20: External Debt Service by main PRC project



5. Contingent Liabilities

5.1 Loans On-lent

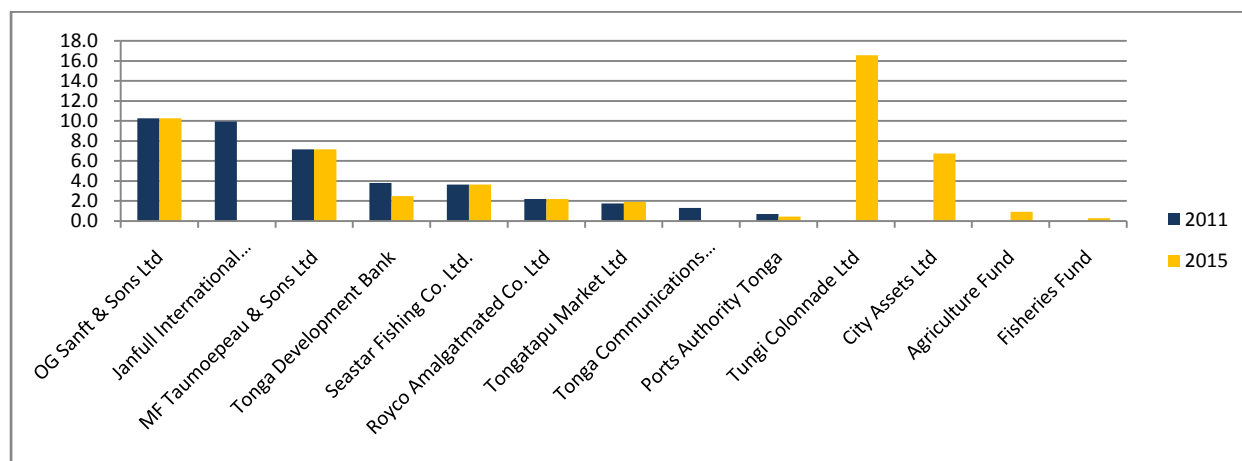
The following Table shows the outstanding balance due to Government from various public and other enterprises, and the repayment received during the reported periods.

Table 15: On-Lent Debt in TOP\$m

Borrower	Loan Balance		5 yr Change
	FY 2011	FY 2015	
OG Sanft & Sons Ltd	10.3	10.3	-
Janfull International Dateline Hotel	9.9	-	-9.9
MF Taumoepeau & Sons Ltd	7.2	7.2	-
Tonga Development Bank	3.8	2.5	-1.3
Seastar Fishing Co. Ltd.	3.7	3.7	-
Royco Amalgamated Co. Ltd.	2.2	2.2	-
Tongatapu Market Ltd.	1.8	1.9	0.2
Tonga Communications Corporation	1.3	-	-1.3
Ports Authority Tonga	0.7	0.5	-0.2
Tungi Colonnade Ltd.	-	16.6	16.6
City Assets Ltd.	-	6.8	6.8
Total	40.8	51.5	10.7

During the 5 year period, there has been a significant change in the outstanding balance of on-lent loans and the number of Borrowers. The increase in total onlent loans balance caused by the CBD projects completed since 2011.

Figure 21: On-lent Debt by Borrower



The total on-lent loan repayment as at 30 June 2015 is estimated at \$0.8m. The payments received were from TDB (51.3%), PAT (22.5%), and CBD (26.2%).

5.2 Loan Guarantees

Publicly guaranteed debt includes local and external debt obligations of Tonga's public corporations and development banks, which are guaranteed by the Central Government. In providing these guarantees, the government commits to pay (if called upon to do so) out of public funds, such outstanding balances to satisfy the extent of its guarantee.

Section 31 of the PFMA 2002, states the conditions for guarantees or indemnities that may be given in a fiscal year.

As shown in Table 17, the outstanding guaranteed debt as at 30 June 2015 decreased by \$13.8m from 30 June 2011 to \$0.01m. The decrease in outstanding debt was result in cancellation for guarantee of the loans by Tonga Power Ltd. (TPL) and settlement of the loan guarantee for Janfull Hotel by GoT during the liquidation process.

Table 16: Publicly Guaranteed Debt in TOP\$m

Organisation	Year Loan Contracted	Obligation Guaranteed	Creditor Country	Loan Balance		5 yr Change
				FY 2011	FY 2015	
Janfull IDH (WBOT)	2007	Renovation Project	Tonga	0.4	-	-0.4
TPL (WBOT)	2008,2010	TPL Term Loan	Tonga	11.5	-	-13.6
TDB (Bond)	2011	Bond Issue	Tonga	0.2	0.01	0.2
TOTAL				12.0	0.01	-13.8

Figure 22: Guaranteed Disbursed Outstanding Debt



As at 30 June 2015, there were no guaranteed loan payment arrears.

6. Debt Sustainability

6.1 Debt Sustainability Analysis

Drawing on the TSDF and its key area of “Maintaining macroeconomic (monetary and fiscal) stability, which includes sound management of debt management while making prudent use of the renewed capacity for limited borrowing.”

With the upgrade of Tonga to a moderate risk level of debt distress it has significantly increased the debt sustainability thresholds. However, risks continue to remain especially with the high level of external debt at 90% of public debt and vulnerability to currency risk particularly anticipated impact from the major borrowing currency of CNY.

As such, a similar path for debt dynamics will follow in the medium term with challenges for Government to maintain external debt at a sustainable level in line with progressive economic growth.

Following loan rescheduling of the two major loans from PRC by 5 years, it does not improve the NPV ratio and also results in higher debt service costs with extra interest and by FY 2018/19 external debt service is estimated to increase by 99.2% (at 1.4% of GDP), this excludes any future currency fluctuations.

For future external borrowings, this includes concessional financing for 50% loan component of budget support from IDA and ADB also for project loan for reconstruction of Ha'apai.

Over the last 5 years (FY 2010/11-2014/15), the Charts below shows the debt sustainability position of the GoT's debt portfolio (includes fluctuations). The NPV of External Debt ratio to Exports was breached in the last five years while the other NPV ratios were breached in FY 2011/12. The TDS ratios have shown a fluctuating trend but have remained well below the thresholds.



Figure 23: NPV of External Debt as % of GDP

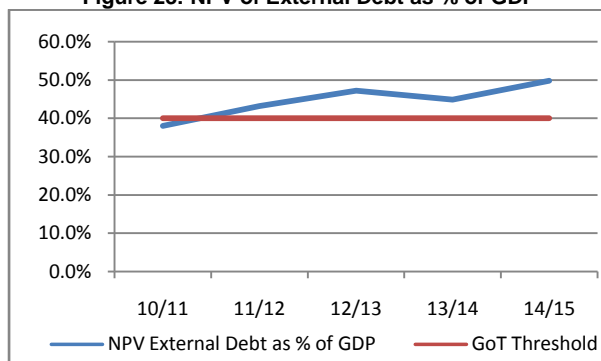


Figure 24: NPV of External Debt as % of GDP & Remittances

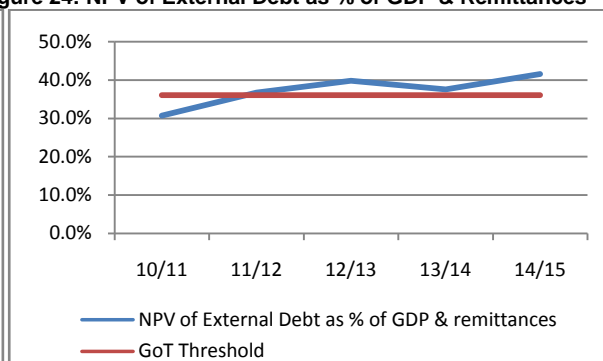


Figure 25: NPV of External Debt as % of Exports

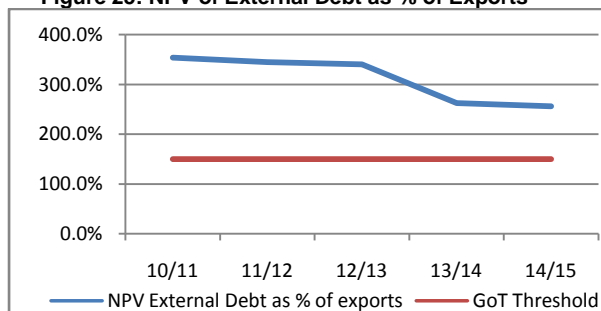


Figure 26: NPV of External Debt as % of Exp & Remittances

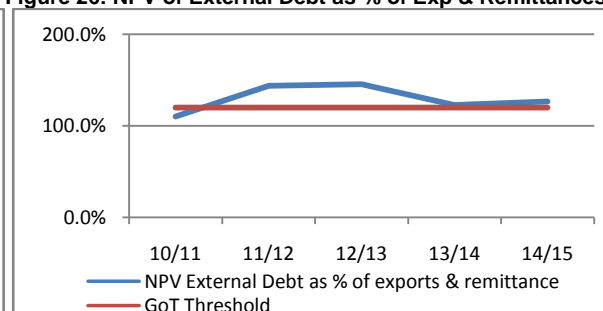


Figure 27: NPV of External Debt as % of Recurrent Revenue

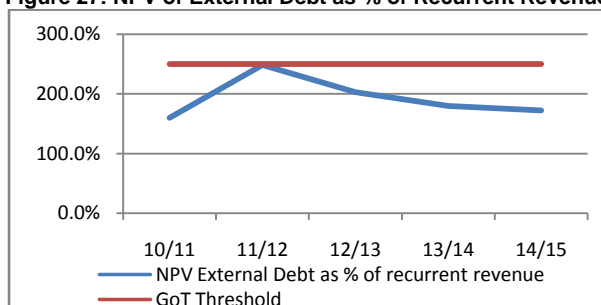


Figure 28: TDS as % of export

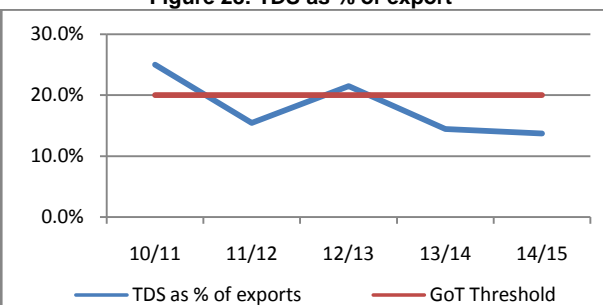


Figure 29: TDS as % of Exp & Remittances

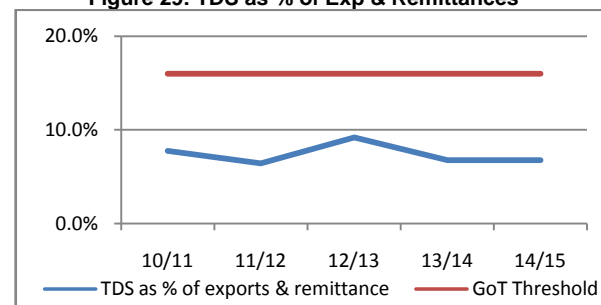
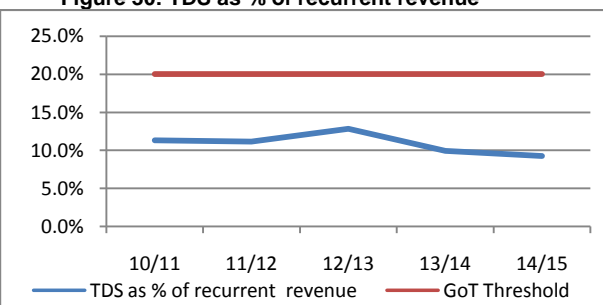


Figure 30: TDS as % of recurrent revenue





Looking forward over the next 3 years, the debt sustainability position will change as result of the revised thresholds and except for Budget support 50%, that most of the indicators will not be breached (includes fluctuations²).

However, cautious monitoring by MoFNP of GoT's debt sustainability level is required and especially on any ease for future external borrowing and to coincide with improvement in our current level of economic activity and prudent public debt management, in order to mitigate the vulnerability to shocks.

Table 17: GoT Debt Sustainability Position, FY 2015/16-2017/18

Debt Sustainability Indicators	IMF-GoT Target %	FY 2016 %	FY 2017 %	FY 2018 %
NPV of debt as:				
% of GDP	40	44	42	42
% of GDP (& remittances)	36	35	34	34
% of exports	150	233	233	237
% of exports & remittances	120	99	99	101
% of recurrent revenue	250	220	204	202
Total Debt Service as:				
% of exports	20	15	15	13
% of exports & remittances	16	6	6	5
% of recurrent revenue	20	14	13	11

7. Conclusion and Way Forward

As at 30 June 2015, Government's **external debt** in nominal value is estimated at **46% of GDP**, which **exceeds** the revised **IMF and GoT target** of **40%**. However, **with inclusion of remittances** the current **position is estimated at 35%** which is below the 36% target. With the projected position including rescheduling of both the Reconstruction and Roads projects and future external borrowing, some of these ratios are expected to further exceed the recommended thresholds going forward (*as shown in Table 19*).

The external debt sustainability position remains vulnerable and cautious efforts are required in the medium term in order to minimize the risks going forward.

Further to draft MTDS in June 2015, this document will be reviewed and to be formalised soonest as a guidance for Government in the medium term.

The main principles to consider, include:

- Maintaining external debt at a sustainable level within the recommended targets;

² Nominal GDP, Exports & Remittances decrease by 2%, Revenue decrease by 1%, & FC rates increase by 5%



- Reduce the external debt outstanding to the People's Republic of China (PRC) and the foreign exchange risk associated with the CNY also the high portion of external debt from the ADB and IDA denominated in SDR;
- Have a more balanced composition between external and domestic debt including development of the Government Securities Market.

Given that some strategies will be beyond the direct control of DMS, that the MoFNP will be work closely with other stakeholders, as required.

Details of these strategies will be referred in the MTDS document and will be available on the MoFNP's website once it is approved by Cabinet.

For ongoing capacity building of staff in this important area of work, staff attend donor funded trainings as available. The Ministry also continues to work closely with the WB and ComSec for follow up TA on priority areas of concern.

8. Statistical Annex

Table 1: Summary Debt Tables

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 YR Change %	5 YR Change %
Total Public Debt (USDm)	179.9	200.8	204.4	204.2	200.4	-1.8	11.4
Total Public Debt (TOPm)	304.3	352.1	372.6	366.0	422.7	15.5	38.9
External Debt	274.9	322.6	343.1	336.5	381.6	13.4	38.9
Domestic Debt	29.45	29.5	29.5	29.5	40.9	38.9	39.2
Total Public Debt to GDP (%)	39.3	44.0	47.8	44.1	51.46	16.6	31.1
External Debt to GDP	35.5	40.3	44.0	40.6	46.5	14.6	31.0
Domestic Debt to GDP	3.8	3.7	3.8	3.6	5.0	40.3	31.3
Total Debt Service (TOPm)	23.0	15.2	20.4	21.3	21.3	-	-7.4
Principal	16.4	8.7	13.3	12.3	14.1	14.6	-13.8
Interest	6.5	6.5	7.2	7.2	7.2	0.1	10.3
External	10.3	10.5	11.1	12.0	13.4	11.7	30.1
External Debt by Creditor category (TOPm)	274.4	322.6	343.2	344.0	381.7	10.9	39.1
Multilateral	122.0	115.5	114.3	115.2	122.9	6.6	0.7
Bilateral	150.9	205.3	228.4	228.4	258.8	13.3	71.5
Commercial	1.5	1.8	0.5	0.4	-	-100.0	-100.0
Debt Composition by Instrument Type (TOPm)	304.3	352.1	372.6	366.0		15.5	38.9



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					422.7		
Loans	274.9	322.6	343.1	336.5	381.7	13.4	38.9
Bonds	29.5	29.5	29.5	29.5	41.0	38.9	39.2
Foreign Currency Risk (%)							
% of debt in Chinese Yuan	55.0	63.6	66.6	66.4	67.8	2.1	23.3
% of debt in SDR	44.2	35.7	33.2	33.4	32.1	-3.9	-27.4
% of debt in other currencies	1.0	0.7	0.2	0.2	0.1	-58.4	-91.8
Interest Rate Risk (%)							
% of debt at floating rate	0.6	0.6	0.1	0.1	-	-100.0	-100.0
% of debt at fixed rate	99.4	99.4	99.9	99.9	100.0	0.1	0.6
Roll-over Risk (Yrs)							
Average term to maturity - domestic (years)	4.6	4.6	4.7	4.7	5.3	12.8	15.2
Average term to maturity - external (years)	35.6	34.8	34.8	34.8	36.1	3.7	1.4
Fiscal Indicators (%)							
Total Debt Service to Expenditure	13.2	9.3	11.4	11.1	10.4	-5.5	-20.9
Total Debt Service to Revenue	16.7	10.6	13.0	13.0	11.4	-12.9	-31.9
Interest cost to Expenditure	3.7	4.0	4.0	3.7	3.5	-5.4	-5.9
Vulnerability Indicators (%)							
Reserves to External Debt	74.3	76.3	76.7	79.8	75.9	-4.8	2.2
External Debt Service to Exports & Remittances	111.4	146.4	89.8	89.8	92.8	3.4	-16.7
Main Economic Variables (TOPm)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	1 YR Change %	5 YR Change %
Gross Domestic Product	775.0	800.6	779.7	829.5	821.3	-1.0	6.0
Exports of Goods & Services	100.2	108.1	137.5	159.7	197.6	23.7	97.2
Remittances	146.5	112.3	113.3	215.2	213.5	-0.8	45.7
Expenditure	173.7	163.7	178.6	192.2	203.6	5.9	17.2
Revenue	137.7	143.0	157.5	163.1	187.3	14.8	36.0
Foreign Reserve	203.8	246.1	263.3	274.4	289.7	5.6	42.1
Exchange Rate USD/TOP	1.6914	1.7535	1.8232	1.7924	2.1088	17.7	24.7

Sources: MoFNP, NRBT and IMF Staff Report for 2014

Article IV Consultation

Table 2: Total Public Disbursed Outstanding Debt (TOPm), FY 2007/08 – 2029/30

	China CBD	China Roads	China Ha'apai High	Remaining External Debt	Domestic Debt	Total
FY 2008	-	-	6.7	151.2	22.5	180.4
FY 2009	41.5	-	7.3	153.5	22.5	224.9
FY 2010	52.7	25.0	7.1	144.0	29.5	258.3
FY 2011	92.5	46.0	6.5	129.9	29.5	304.4
FY 2012	121.3	72.0	6.8	122.6	29.5	352.1
FY 2013	130.5	86.3	7.4	118.9	29.5	372.6



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FY 2014	126.8	83.9	7.2	118.6	29.5	366.0
FY 2015	126.8	83.9	5.9	131.4	49.5	397.5
FY 2016	126.8	83.9	5.2	131.9	49.5	397.3
FY 2017	126.8	83.9	4.4	137.5	49.5	402.1
FY 2018	126.8	83.9	3.7	131.8	49.5	395.7
FY 2019	114.7	83.9	3.0	126.2	49.5	377.3
FY 2020	102.7	79.9	2.2	120.8	49.5	355.0
FY 2021	90.6	71.9	1.5	115.4	49.5	328.9
FY 2022	78.5	63.9	0.7	110.2	49.5	302.9
FY 2023	66.4	55.9	0.7	104.1	49.5	276.6
FY 2024	54.3	47.9	-	99.1	49.5	250.9
FY 2025	42.3	39.9	-	92.8	49.5	224.5
FY 2026	30.2	31.9	-	86.6	49.5	198.2
FY 2027	18.1	24.0	-	81.3	49.5	172.9
FY 2028	6.0	16.0	-	76.1	49.5	147.6
FY 2029	-	8.0	-	71.0	49.5	128.5
FY 2030	-	-	-	66.3	49.5	115.8

Source: MoFNP

Table 3: Total Public Debt Service (TOPm), FY 2007/08 – FY 2029/30

	China CBD	China Roads	China Ha'apai High	Remaining External	Other debt service	Domestic Debt Service	Total
FY 2008	-	-	-	6.7	0.8	8.1	15.6
FY 2009	1.9	-	-	6.4	0.6	8.6	17.5
FY 2010	1.4	1.7	-	5.2	9.4	8.6	26.4
FY 2011	1.8	1.0	-	7.5	0.1	12.5	22.9
FY 2012	2.2	1.2	-	7.1	0.1	4.7	15.2
FY 2013	2.4	1.6	-	7.1	0.01	9.3	20.4
FY 2014	2.7	1.8	-	7.6	1.8	7.4	21.3
FY 2015	2.8	1.9	-	8.7	-	7.9	21.3
FY 2016	2.6	1.7	0.7	8.1	-	8.5	21.7
FY 2017	2.6	1.7	0.7	7.6	-	5.1	17.7
FY 2018	2.6	1.7	0.7	7.0	-	7.1	19.1
FY 2019	14.6	1.7	0.7	6.9	-	4.6	28.5
FY 2020	14.3	5.7	0.7	6.6	-	8.1	35.5
FY 2021	14.1	9.6	0.7	6.4	-	8.7	39.6
FY 2022	13.9	9.4	0.7	6.3	-	8.5	38.8



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FY 2023	13.6	9.2	0.7	6.5	-	5.1	35.2
FY 2024	13.4	9.1	0.7	5.8	-	7.1	36.1
FY 2025	13.1	8.9	-	7.1	-	4.6	33.8
FY 2026	12.9	8.8	-	7.1	-	8.1	36.9
FY 2027	12.6	8.6	-	6.0	-	8.7	35.9
FY 2028	12.4	8.4	-	5.9	-	8.5	35.3
FY 2029	6.1	8.3	-	5.6	-	5.1	25.1
FY 2030	-	8.1	-	5.4	-	7.1	20.6

Source: MoFNP