Medium Term Debt Management Strategy 2025 -2029

and

Annual Borrowing Plan 2025

Ministry of Finance, Planning and Economic Development

Public Debt Management Office
THE SECRETARIAT, COLOMBO 01 |SRI LANKA

Medium Term Debt Management Strategy 2025 -2029

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Medium Term Debt Management Strategy (MTDS) 2025 – 2029

1. Overview

The Public Debt Management Act No. 33 of 2024 (PDMA) which was enacted on June 18, 2024 and declared effective from November 25, 2024, sets out the framework for effective public debt management in Sri Lanka. The PDMA requires the formulation and implementation of MTDS in consistent with the Medium Term Fiscal Framework (MTFF). It takes into account macroeconomic and financial market conditions, the cost and risks embedded in the current public debt portfolio, the availability of financing from various creditors, and vulnerabilities that could impact future borrowing requirements and debt service costs. The scope of the MTDS is limited to the Debt of the Government.

The MTDS covering the five years from 2025 to 2029 (MTDS 2025-2029) is a plan for managing the Government's debt, aimed at achieving the desired debt portfolio of the Government consistent with the public debt management objectives. It will guide the Government's borrowing decisions to fund its overall fiscal deficit, within the context of its cost and risk objectives. The MTDS will be reviewed annually and accordingly, MTDS 2025-2029 will be reviewed and updated in November 2025.

Since late 2023, macroeconomic conditions have been stabilized faster than expected following the deep economic crisis. Key reforms implemented since 2022 including cost-reflective utility pricing, new revenue measures, and return to prudent monetary policy have been vital in restoring macroeconomic and financial stability and bolstering confidence in the country's future growth. Domestic debt restructuring was concluded successfully and significant progress has been made in restructuring external debt, with negotiations with few official bilateral creditors now in the final stages. Interest rates have come down sharply and access to the domestic market for government borrowing has been restored, which is vital for securing sustainable financing to meet fiscal needs. The access to external market is also expected to get restored in the medium term.

Reduction of the Government debt from the high of 114 percent of GDP in end 2022 to 98 percent of GDP in end- December 2024, primarily reflects impact of debt restructuring as well as primary surplus which is recorded in 2023 and 2024. The MTDS 2025-2029 was formulated on an evaluation of the cost and risks of four (4) alternative debt strategies which were feasible under the prevailing domestic and international financial market conditions. The debt strategy selected through this process seeks to extend average time to maturity, provide higher borrowing through fixed interest rate instruments, and increase the share of domestic borrowings.

2. Debt Management Objectives and Scope

The objectives of Public Debt Management, as outlined in Section 3 of the Public Debt Management Act (PDMA), are as follows:

1. to meet financing needs and debt payment obligations on a timely basis;
2. to borrow at the lowest costs as possible over the medium to long term, consistent with a prudent degree of risk, and
3. to promote the development of the domestic debt securities market.

The MTDS 2025-2029 is the first strategy developed by the Public Debt Management Office (PDMO), Ministry of Finance, Planning and Economic Development (MoF), which came into existence on December 02, 2024 following the enactment of the PDMA. The PDMO which consolidates all debt functions previously scattered across various departments within the MoF and the Central Bank of Sri Lanka (CBSL) is currently in the process taking over the relevant functions from the related agencies and is expected to be fully operationalized by the end of December 2025.

The MTDS 2025-2029 provides a strategic roadmap for managing the Government's financing requirements, emphasizing the need to achieve the most cost-effective borrowing while ensuring debt levels remain stable and sustainable. The strategy is aligned with the Government's fiscal policy, as outlined in the 2025 Fiscal Strategy Report (FSR) and the Annual Budget for FY2025, which include macroeconomic assumptions and medium-term fiscal targets. The MTDS is also consistent with the debt reduction goals and debt sustainability targets outlined in the Public Financial Management Act No. 44 of 2024.

3. Recent Macro Fiscal Developments

In 2020, 2021 and 2022, double-digit budget deficits; 10.7 percent, 11.7 percent and 10.2 percent, have been recorded, respectively as a percentage of Gross Domestic Product (GDP) reflecting the poor fiscal performance of the country which experienced a record low government revenue of 8.3 percent of GDP in 2021. Accordingly, there has been a material increase in government debt in absolute terms, since the budget deficits had to be financed with additional borrowings incurring new debt.

Following the credit rating downgrades issued by Moody's, Fitch and S&P, Sri Lanka couldn't access global capital market since 2020, resulting steady decline of country's foreign currency reserves until usable reserves declined to near zero levels by April 2022. The minus trade balance and the current account balance also impacted on the deflating the Gross official reserves. The earning from the tourism also significantly reduced due to Easter Sunday attack in 2019 and the subsequent COVID 19 outbreak.

In response to this situation, on April 12, 2022, the Government implemented a temporary moratorium on the service of Sri Lanka's official bilateral debt and external commercial debt, pending an orderly and consensual restructuring of the debt in a manner consistent with an economic adjustment program supported by the International Monetary Fund (IMF).

The Government commenced discussions with the IMF in April 2022 with a view to implementing an IMF-supported macroeconomic reform programme to address the root causes of the economic crisis. Under the IMF- EFF program, the Government of the Democratic Socialist Republic of Sri Lanka has undergone macroeconomic policy reforms, fiscal reforms, legislative transformations, anti- corruption initiative, debt sustainability initiatives, cost recovery pricing models, safeguarding financial stability, and has taken progressive steps towards macroeconomic stability and sustainable economic growth.

Under the legislative transformation, the Government introduced new laws and revised existing ones based on past experiences and lessons learned. This legislative transformation is focused on structural reforms within executive and administrative setups, with proposed laws covering areas such as public finance, procurement, public-private partnerships, state enterprises, public debt management, stabilization of monetary policy and offshore economic activities.

This comprehensive approach underscores a commitment to modernize governance structures and foster transparency and accountability. The proposed legal and policy reforms signify a proactive approach to adapt the current situation to evolving economic and regulatory landscapes, potentially paving the way for enhanced efficiency and effectiveness in governance and economic management systems. These reforms will be essential for addressing corruption risks, rebuilding economic confidence, and making growth more robust and inclusive.

4. Debt Restructuring Programme and its impact on Debt Sustainability

Following the interim policy of suspension of normal debt servicing announced on April 12, 2022, the financial and legal advisors to the Government of Sri Lanka (GoSL) who were selected through the applicable government procurement procedures, together with the Sri Lankan authorities started engaging with the external creditors of Sri Lanka on a restructuring strategy.

Sri Lanka negotiated with bilateral creditors including the 17 members of the Official Creditor Committee (the OCC - co-chaired by Japan, India, and France), and the Exim Bank of China to restructure the relevant debt for which debt relief was provided through maturity extensions, capital grace periods, and interest rate reductions. Following over a year of negotiations, the Memorandum of Understanding (MoU) with the OCC and debt treatment agreement with the Exim Bank of China was signed on June 24, 2024.

The USD 12.55 bn International Sovereign Bonds (ISB) debt stock restructuring provides Sri Lanka with the following:

- Upfront debt stock reduction of USD 3.7 bn which can increase to USD 4.9 bn in case of economic downturn or reduce to USD 2.6 bn in case of economic over performance
- USD 9.6 billion debt service payments reduction during the 4-year IMF program period
- 33 percent reduction in the coupon rate of Sri Lanka's Bonds to 4.4 percent
- Extension of the average maturity profile of around 5 years

Sri Lanka concluded the restructuring and required settlements of China Development Bank (CDB) liabilities on December 24, 2024. Accordingly, all large outstanding external debt has been successfully restructured.

The remaining smaller commercial debts (HSBC/ICBC etc.) are in advanced stages of finalization. Restructuring agreements with smaller bilateral creditors outside of the OCC (Kuwait, Saudi Arabia, Iran, and Pakistan) are also being finalized. Beyond the Government debt, the USD 175 mn bond issued by Sri Lankan Airlines is also expected to be restructured.

Accordingly, the GoSL will have obtained about USD 17 bn of debt service relief during the IMF programme period (around USD 2.4 bn from Exim Bank of China, USD 2.9 bn from the OCC, USD 2.5 bn from CDB and USD 9.5 bn from the bondholder).

5. Debt Sustainability Targets

According to Sri Lanka's Debt Sustainability Analysis (DSA) conducted by IMF, the following targets would need to be achieved in order to restore debt sustainability in the country:

1. Reducing the ratio of public debt to GDP to below 95 percent by 2032,
2. Reducing the government's annual gross financing needs below 13 percent of GDP, on average from 2027 to 2032,
3. Reducing the government's annual debt service in foreign currency below 4.5 percent of GDP in every year in 2027-32, and
4. Closing the balance of payments financing gaps of USD 17 billion over the IMF Extended Fund Facility (IMF- EFF) program period which is being implemented by the GoSL as per the agreement reached with the IMF

6. The Medium Term Macro Fiscal Framework

For achieving debt sustainability targets, the Government of Sri Lanka has undertaken fiscal reforms to increase the Government revenue and to manage the Government expenditure in order to reduce the budget deficit. In line with the Medium Term Fiscal framework (MTFF) the Government's priorities for 2025-2029 are;

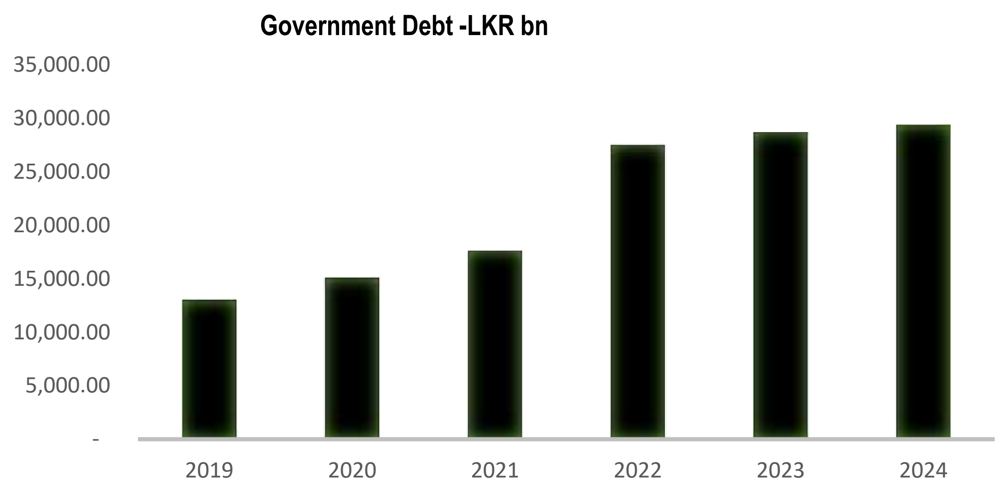
1. Increasing the revenue to GDP ratio to 15 percent in 2025 and at least maintaining the same level or higher thereafter.
2. Managing the expenditure within 20 percent of GDP
3. Continuing the budget deficit to less than 5 percent of GDP by 2026 and beyond
4. Achieving a primary surplus at least 2.3 percent of GDP by 2025 and beyond
5. Reducing the Government debt to GDP ratio, gross financing needs and foreign debt service at a sustainable level in line with IMF- EFF Program

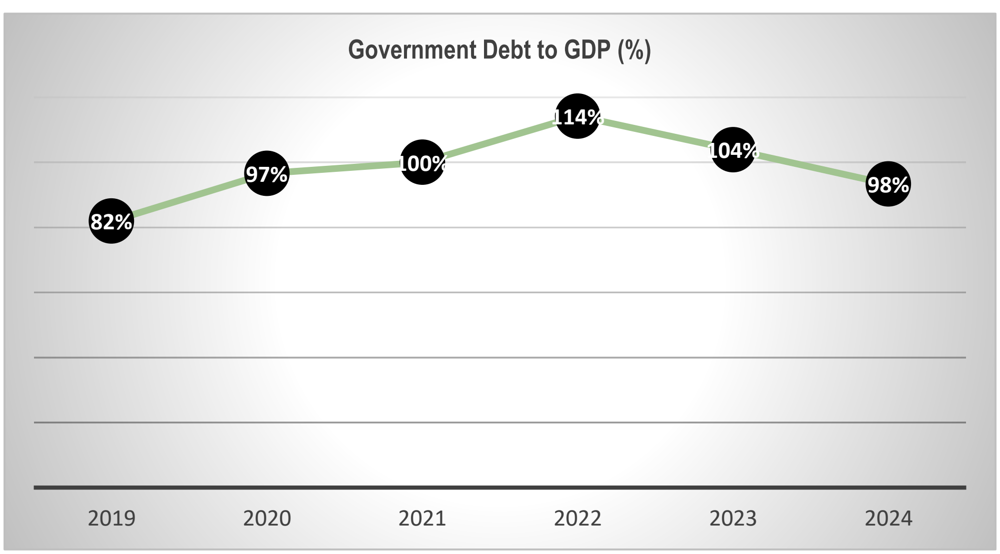
MTDS has taken into consideration targets on IMF-EFF programme, government primary surplus of 2.3 percent of GDP by 2025 and in subsequent years and ensure that annual budget approved by Parliament is consistent with the programme parameters including the targets on the primary balance, revenues, and non-interest expenditure.

7. Analysis of Existing Debt Portfolio

Sri Lanka's Government debt reached 100 percent of GDP in 2021, which was increased to 114 percent of GDP in 2022. By 2023, this adverse trend has reversed and the government debt to GDP ratio declined to 104 percent. The Government debt to GDP ratio is 98 percent in 2024. The reduction of debt to GDP in comparison to past years resulted through expected GDP growth due to macro fiscal reform conducted in line with IMF - EFF programme.

Figure 1: Government Debt Stock and Debt to GDP Ratio in Recent Years



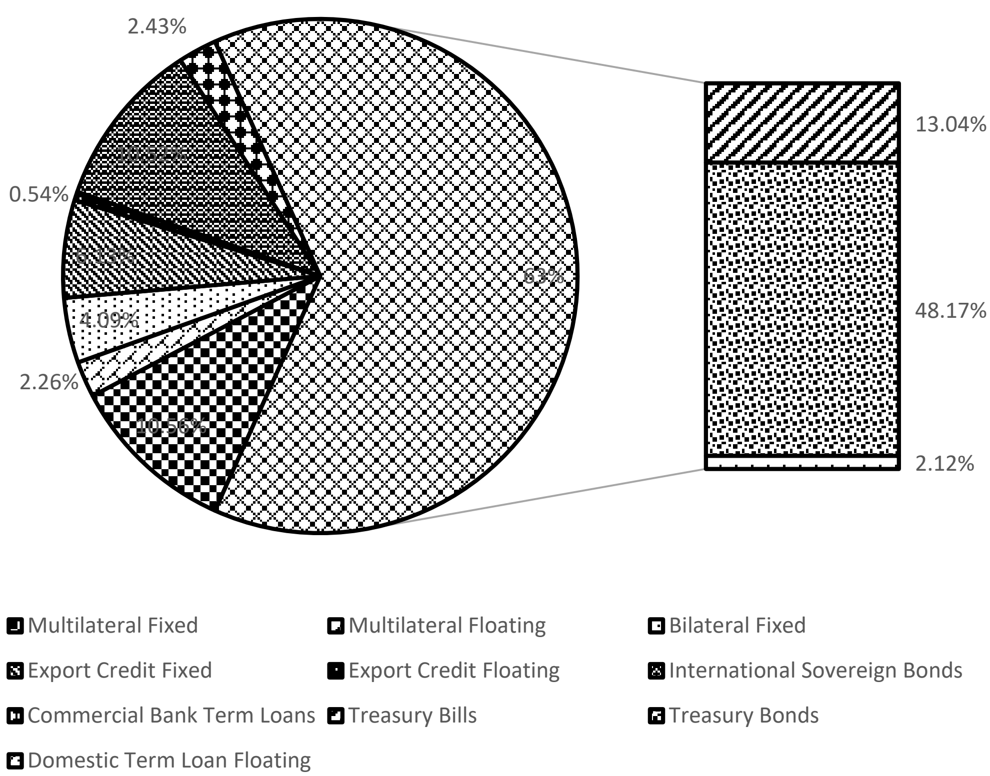


Source: Annual Economic Review – 2023, Central Bank of Sri Lanka and Ministry of Finance, Planning and Economic Development

7.1 Outstanding Debt by Instrument

The total debt portfolio of the Democratic Socialist Republic of Sri Lanka has been recorded as USD 100,294 million by end 2024, out of which 63 percent debt is from domestic sources while 37 percent of the debt is from external sources. In the debt portfolio, Treasury bond takes the largest portion, which is 48 percent of total debt. In the external debt portfolio, a significant portion of debt has been incurred by issuing International Sovereign Bonds (ISBs). 97 percent of Sri Lankan Government debt portfolio comprises debt contracted with fixed interest rate.

Figure 2 : Outstanding Debt by Instrument as at End of December 2024



Source: Public Debt Management Office, Department of Treasury operations, Central Bank of Sri Lanka

7.2. Cost and Risk Embedded in Current Debt Portfolio as at End of 2024

Table 1: Cost and Risk Embedded in Current Debt Portfolio

Risk Indicators		External Debt	Domestic Debt	Total Debt
Amount (in billions of LKR)		10,752.41	18,633.84	29,386.25
Amount (in millions of USD)		36,697.6	63,596.7	100,294.4
Nominal debt as percent of GDP		36.0	62.3	98.3
PV as percent of GDP[1]		31.7	62.3	94.1
Cost of debt[2]	Interest payment as percent of GDP[3]	**1.2**	**6.2**	**7.4**
	Weighted Av. IR (percent)	**3.4**	**9.9**	**7.5**
Refinancing risk[2]	ATM (years)	**9.8**	**5.0**	**6.7**
	Debt maturing in 1yr (percent of total)	**4.8**	**26.8**	**19.1**
	Debt maturing in 1yr (percent of GDP)	**1.5**	**16.0**	**17.6**
Interest rate risk[2]	ATR (years)	**9.3**	**5.0**	**6.5**
	Debt refixing in 1yr (percent of total)	**11.2**	**26.8**	**21.4**
	Fixed rate debt incl T-bills (percent of total)	**92.3**	**100.0**	**97.3**
	T-bills (percent of total)	**0.0**	**21.4**	**13.9**
FX risk	FX debt (percent of total debt)			37.5
	ST FX debt (percent of reserves)			29.2

As per the MTDS Analytical Tool of World Bank IMF (MTDS AT), cost and the risk of the debt portfolio is analysed by using main risk and cost parameters such as nominal debt to GDP, cost of debt, refinancing risk, interest rate risk and exchange rate risk.

[1] PV as percent of GDP is calculated based on projected debt service payments where discount rate of 5% is applied to those instruments on concessional or semi-concessional terms.

[2] Cost-Risk indicators that use projected cash flows such as weighted average interest rate, refinancing and interest rate risks use projected exchange rate assumptions.

[3] Interest payment as percent of GDP is calculated by dividing interest payment on outstanding debt

7.2.1. Cost of the Debt

Table 1 depicts the Government spends 7.4 percent of GDP merely to service the interest on its debt. This is particularly due to the post crisis tendency of the Government to borrow form the domestic market with high interest rate due to the restriction faced by the Government to acceding to the international capital market followed by the downgrading of country's sovereign credit ratings.

7.2.2 Refinancing Risk

After debt restructuring process the maturity period of bilateral debt, ISBs and Treasury bonds have been extended. As a result of that, the Average Time to Maturity (ATM) of the current debt portfolio became 6.7 years. The total debt to be matured in 2025 is amounting to USD 18 bn including USD 13 bn of Treasury Bills and USD 3 bn of Treasury Bonds. Accordingly, 19.1 percent of the total debt will mature (due for repayment) within the next year and such a proportion of total debt maturing in the short term is notable and indicates a certain degree of short-term refinancing risk. If a large portion of debt matures in the near term, the Government will need to either refinance this debt or pay it off, which could be challenging given the unforeseen liquidity issues or unfavorable market conditions. The refinancing risk will further increase, especially in case of failure to realize the economic outlook forecasted in the MTFF.

7.2.3. Interest Rate Risk

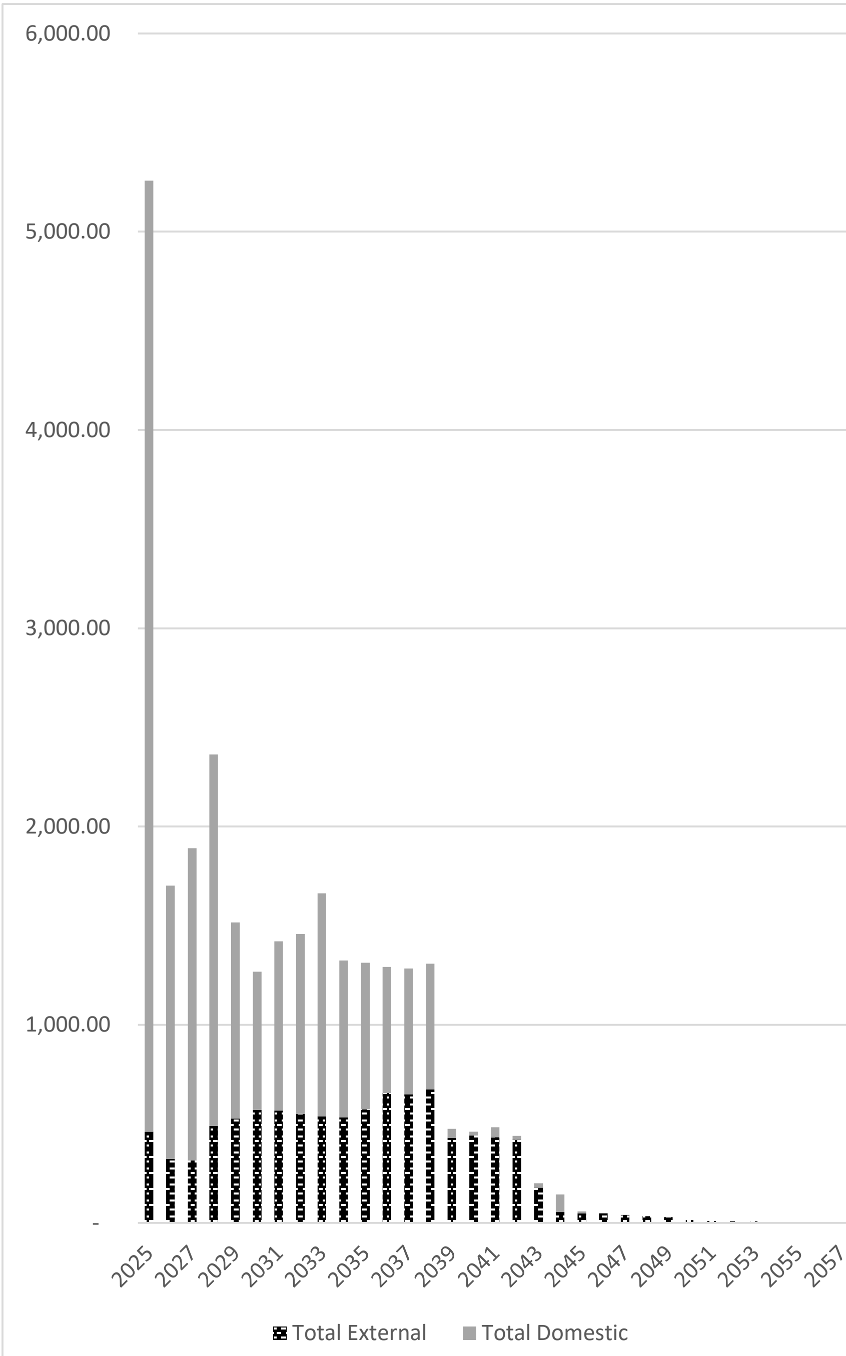
The Average Time to Refixing (ATR) of the debt, measured in years indicates how long, on average, the debt will remain at its current interest rate before being adjusted. A large portion (97.3 percent) of the debt is in fixed-rate instruments, which provides stability and reduces the risk of interest rate fluctuations. However, 21.4 percent of the debt will be refixed within a year, which suggests some exposure to short-term interest rate changes. This could be a bit concerning if interest rates increase, it will adversely affect to the debt portfolio. The presence of 13.9 percent in T-bills shows that some portion of the debt is in short-term government securities, which are low-risk but could be subject to higher refinancing rates depending on future interest rate movements. Overall, the Government debt structure appears to have a strong foundation in fixed-rate debt, with moderate exposure to short-term interest rate changes due to the significant portion set to refix within one year period.

7.2.4 Exchange Rate Risk

37.5 percent of the total debt is denominated in foreign currencies (i.e., FX debt) indicating high exposure to foreign exchange fluctuations, meaning changes in exchange rates could impact the value of the debt or its repayment costs. As a percentage of foreign reserves recorded in December 2024, short-term foreign currency debt is 29.2 percentage indicating a considerable amount of short-term foreign currency debt obligations to the reserves. It implies a certain level of risk and liquidity pressure, especially if the foreign currency value rises or if there are sudden changes in exchange rates.

7.3 Redemption Profile

Figure 3 : Redemption Profile (in bilions LKR)



*** LKR 3,827 bn Treasury Bills are due to mature within 2025. Balance ISB amounting to USD 268,685,000 (including ISB relevant to Hamilton Reserve Bank, which is pending due to ongoing court case) is assumed to be refinanced in 2025.

Treasury Bills worth of LKR 3,827.16 billion is maturing in 2025 and it will significantly increases the forecasted debt service obligations for this year. This indicates the requirement of taking precautionary measures to manage the short-term liquidity pressure if any, for the Government in 2025, as a large portion of the debt will be due for repayment or refinancing. After external debt restructuring, the Government is expected to commence restructured debt servicing (including bilateral debt, commercial debt in the form of ISBs, and export credit) from 2028 onward. This debt restructuring has provided the Government a considerable relief in its cash flow management in the medium term. A positive development in the long term is that 98 percent of existing Treasury bonds will mature by 2038, leading to a LKR 13,884.64 billion reduction in the domestic debt burden for the Government.

The Government will continue to service external debt at similar levels until 2038, when ISBs is scheduled to mature. This suggests that while the external debt servicing will increase substantially from 2028, the cost of this servicing will plateau in the medium term, with the highest pressure being felt between 2028 and 2038.

8. Key Cost and the Risk Targets

Table 2 depicts targeted Cost and the Risk indicators for the MTDS at the end of Strategy period 2025- 2029.

Table 2: Key Cost and Risk Targets

Key Cost and the Risk indicators	Current Situation (end of 2024)	Target for 2029	Tolerance
Cost of the Debt			
Nominal Government debt to GDP	98.3%	85%	+/-10
Share of External Debt as a percentage of total debt	37.5%	35%	+/-5
Interest Payment as Percentage of GDP	7.4%	5%	+/-1
Interest Payment as Percentage of Revenue	44.72%	40%	+/-2
Refinancing Risk			
Debt Maturing in 1 year as a percentage of Total debt	19.1%	10%	+/-3
ATM of total debt portfolio (Years)	6.7	7.5	+/-1
Interest rate risk			
Fixed Rate Debt (including T-bills) as a percentage of total debt	97.3%	95%	+/-2
Average Time for Refixing (years)	6.5	7	+/-1
FX Risk			
ST FX Debt as Percentage of Reserves	29.2%	25%	+/-2

9. Medium Term Debt Management Strategy 2025-2029

The MTDS incorporates the medium term macro-economic projections of the Government as given in the MTFF. The non-budget expenditure resulting from contingent liabilities has not been considered for the analysis.

United State Dollar (USD) is taken as the base currency for the analysis. The loan denominated in different currencies has been converted in to local currency and then the base currency using the indicative rates published by the CBSL on December 31, 2024 The exchange rate used for the conversion is USD1=LKR 293.

9.1 Assumptions

The Disbursed Outstanding Debt (DOD), principal forecast and interest forecast of foreign loans under the perimeter of the interim policy of suspension of normal debt servicing announced on April 12, 2022 are calculated based on the following assumptions.

- Japan, India EXIM, Hungary, USA - as per the finalized amended agreements
- Kuwait - as per the terms and conditions agreed between the lender and the GoSL
- Pakistan, Germany, France, UK - as per OCC agreement (amendment to the agreements are yet to be finalized)
- All other lenders – DOD calculated based on OCC agreement however, without considering the default interest
- Refinancing of balance ISB amounting to USD 268,685,000 (including ISB relevant to Hamilton Reserve Bank, which is pending due to ongoing court case) in 2025.

9.2 Strategies

To run the MTDS AT, four debt management strategies were tested.

Strategy 1 (S1): Continue the Status quo

- Continue the present composition of 40% of External borrowing and 60% of Domestic borrowing

Strategy 2 (S2): Domestic Oriented Financing Strategy

- 20% of External Debt and 80% of domestic debt
- Increase the issuance of medium term to long term treasury bonds to address refinancing and borrowing cost and gradually reduce the reliance on treasury bills
- Reduce reliance on external commercial borrowings and limiting the external borrowing to bilateral and multilateral concessional loans

Strategy 3 (S3): Equal Mix of Financing Strategy

- 50% of domestic debt and 50% of External Debt
- Increase external financing particularly fixed rate concessional financing seeking to secure more favorable terms for foreign loans
- Reduce reliance on treasury bills and increase the composition of treasury bonds

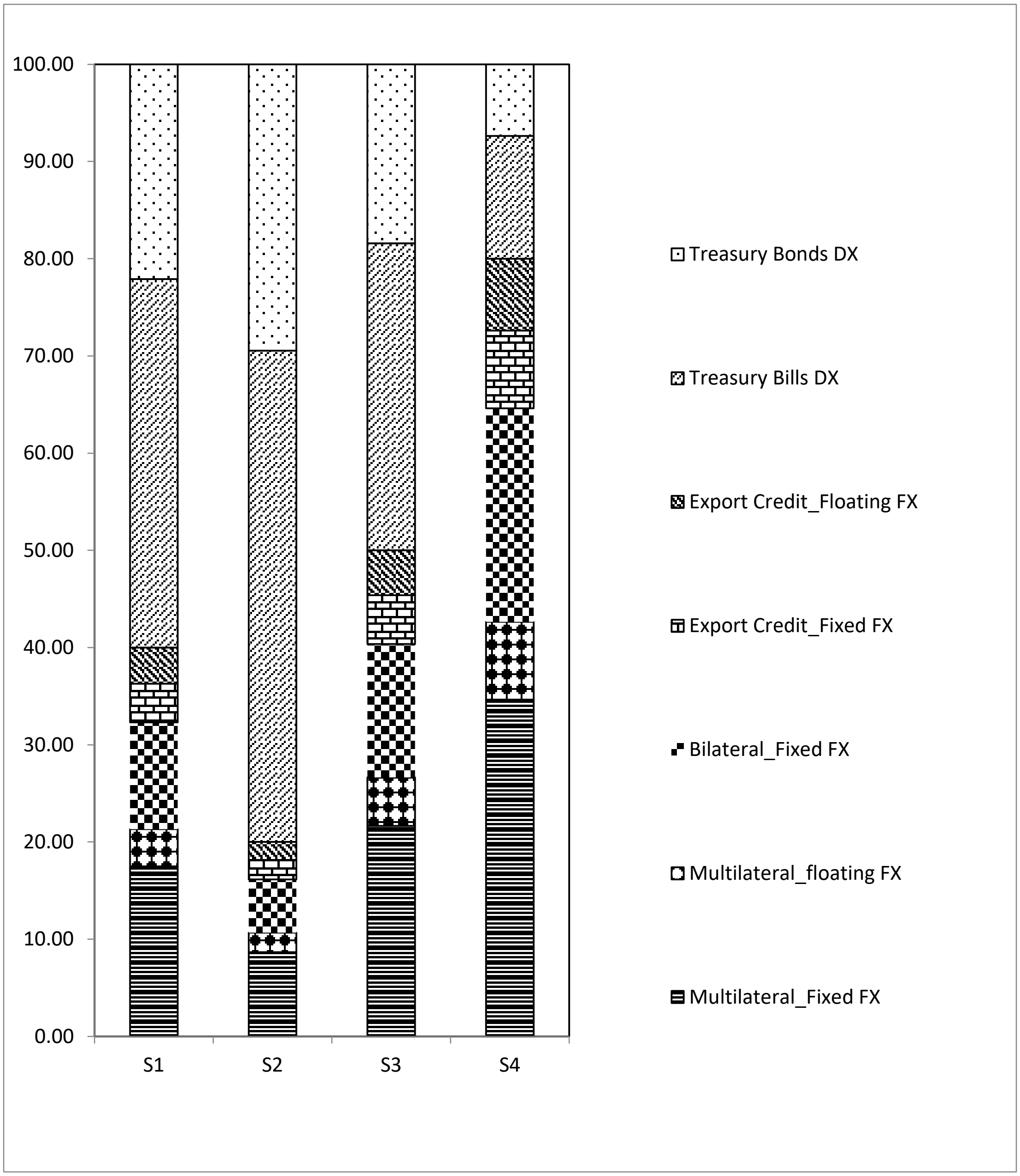
Strategy 4 (S4): External Oriented Financing Strategy

- 80% of External Debt and 20% of domestic debt
- Increase the total external borrowing seeking to raise additional funds from foreign sources with more reliance on external concessional loans
- Reduce the issuance of treasury bills

9.3 Percentage Distribution of Gross Borrowing

Figure 4 shows the percentage distribution of gross borrowing under the four contending strategies over the simulation period, in terms of source of financing debt instruments and percentage share under each strategy.

Figure 4: Percentage Distribution of Gross Borrowing for Each Strategies



9.4 The Cost and Risk Analysis of Each Strategy

Table 4 presents the four different debt management strategies and their corresponding cost-risk indicators. These indicators assess various aspects of debt sustainability, including nominal debt, present value debt, interest payments, refinancing risk, interest rate risk and foreign exchange (FX) risk.

Table 3: The Cost and Risk Analysis of Each Strategy

Risk Indicators		2024	As at end 2029			
		Current	S1	S2	S3	S4
Nominal debt as percent of GDP		98.3	77.3	71.2	80.4	89.5
Present value debt as percent of GDP		94.1	69.5	66.4	71.0	75.5
Interest payment as percent of GDP		7.4	4.6	4.9	4.4	3.8
Implied interest rate (percent)		7.5	5.8	6.9	5.4	4.1
Refinancing risk	Debt maturing in 1yr (percent of total)	19.1	9.4	11.3	8.5	6.4
	Debt maturing in 1yr (% of GDP)	17.6	7.3	8.0	6.9	5.7
	ATM External Portfolio (years)	9.8	9.8	8.9	10.0	10.5
	ATM Domestic Portfolio (years)	5.0	3.8	3.6	3.9	4.3
	ATM Total Portfolio (years)	6.7	7.8	6.7	8.2	9.2
Interest rate risk	ATR (years)	6.5	7.2	6.3	7.6	8.4
	Debt refixing in 1yr (percent of total)	21.4	17.7	17.4	17.8	18.2
	Fixed rate debt incl T-bills (percent of total)	97.3	91.1	93.5	90.1	87.4
	T-bills (percent of total)	13.9	4.6	6.7	3.7	1.3
FX risk	FX debt as % of total	37.5	53.3	40.7	58.8	73.2
	ST FX debt as % of reserves	29.2	24.3	19.5	26.7	33.9

ATM= Average Time to Maturity, ATR= Average Time to Refixing, FX= Foreign Currency, ST= Short Term

Debt Reduction (Nominal and Present Value Debt)

A lower nominal debt-to-GDP ratio is generally better as it suggests lower overall debt in relation to economic output, reducing the risk of fiscal stress. S2 (71.2 percent) offers the most favorable nominal debt-to-GDP ratio compared to others.

A lower present value debt-to-GDP ratio indicates that the Government has more sustainable debt, with lower real debt burden over time. S2 (66.4 percent) is the best scenario, indicating a more manageable debt load.

Interest Payments

The interest payment as a percentage of GDP is reflecting a reduction comparing to the current situation in all four strategies, while S4 is the most favorable Strategy, as it indicates the lowest proportion of GDP spent on interest payments.

Implied Interest Rate

S4 has the lowest Implied Interest Rate (4.1 percent), followed by S3 (5.4 percent), S1 (5.8 percent), and S2 (6.9 percent). A lower implied interest rate typically indicates that the Government is able to borrow at more favorable terms, which reduces the cost of servicing debt.

Refinancing Risk

S4 has the lowest refinancing risk, with the least amount of debt maturing in 2025 (6.4 percent). This suggests that the Government has a more manageable debt maturity schedule and is less vulnerable to refinancing pressures. However, all four strategies have a lower value than targeted.

Interest Rate Risk

S4 and S3 have relatively better Average Time to Refixing (ATR) at 8.4 years and 7.6 years, offering the best protection against rate volatility of the interest rate. S2 has a lower ATR of 6.3 years, indicating that debt will be subject to interest rate changes sooner.

Exchange Rate Risk

S2 has the lowest FX Debt as percentage of Total (40.7 percent), making it less vulnerable to currency fluctuations compared to S3 (58.8 percent) and S4 (73.2 percent). High external debt levels in foreign currencies, like those in S3 and S4, increase vulnerability to exchange rate risks, particularly if the domestic currency depreciates. S2 has the lowest short term FX Debt as percentage of Reserves (19.5 percent), indicating that it has relatively more reserve capacity to handle short-term foreign currency obligations compared to S3 and S4.

10. Preferred Strategy for 2025-2029 and its Implications

Based on the Cost and Risk analysis of the proposed four strategies, the Strategy 2 (S2) emerges as the most optimal Strategy for Sri Lanka in 2025-2029 to grab the maximum benefit from debt restructuring process and the undergoing macro fiscal reforms.

1) Lower Debt-to-GDP Ratios:

S2 significantly reduces both nominal and present value debt, making the debt burden more manageable over medium term. This implies S2 requires less debt servicing, reducing the fiscal pressure on the Government and providing more room for growth-oriented expenditures. Given the country context, lower debt-to-GDP ratios ensure fiscal sustainability, which can lead to better credit ratings and lower borrowing costs in the future.

2) Interest Payment Control:

While S2 has a slightly higher interest payment as a percentage of GDP compared to S1, it is still significantly lower than the current level and remains within the target. This implies that, over time, S2 still reduces the fiscal burden of servicing debt, freeing up resources for other economic needs. Reducing interest payments allows for more flexibility in budget allocation, helping the country to prioritize key investments without compromising fiscal health.

3) Refinancing Risk:

S2 minimizes refinancing risk by spreading debt maturities more evenly over time. This is crucial for avoiding the potential of a debt crisis may happen in a macro economic shock.

4) FX Risk Management:

S2 has lower FX debt exposure (40.7%) compared to S1 (53.3 percent). Lower FX debt reduces the country's vulnerability to currency fluctuations, minimizing the risk of increased debt servicing costs due to exchange rate volatility. This is especially important in uncertain global markets where currency depreciation can drive up the cost of foreign-denominated debt. The lower FX exposure of S2 enhances the country's financial stability and mitigates the possible risk of reserve depletion during periods of currency weakness.

S2 has a lower percentage of short-term FX debt relative to its foreign reserves (19.5 percent). This means the country is in a stronger position to meet its short-term foreign debt obligations, reducing the risk of a liquidity crisis. Lower short-term FX debt exposure relative to reserves means more cushion in case of a currency or financial shock, ensuring greater financial stability and reducing the likelihood of sudden funding issues.

In light of the above, Strategy 2 (S2) is the best strategy for achieving a balance between fiscal stability, debt sustainability, and risk mitigation in the medium term. In essence, S2 strikes the best balance between lower debt burden, reduced risk exposure, and long-term fiscal health, making it the most favorable strategy for the country for 2025-2029 as it paves the way for debt sustainability and fiscal health in the medium term. Accordingly, S2 is the optimal choice for sustainable debt management and fiscal stability in the present context where Sri Lanka is envisaging realizing a healthy macro fiscal environment.

The strategy also provides good avenue to realize the Government financing needs and undertake public infrastructure projects with long term, concessional multilateral and bilateral external financing. It also considers the objective of development of the domestic debt market in the long run.

11. Risks Associated with Preferred Strategy and Risk Mitigation Mechanism

Key Risk Factor	Mitigating Mechanism in Long Term
Debt maturing in the short term could lead to liquidity pressures	**Smooth Debt Maturity Profile** by issuing longer-term debt in future years and focusing on restructuring the maturity of debt to reduce heavy near-term maturities.
The increase in implied interest rates could lead to higher debt servicing costs over time	**Interest Rate Hedging:** Utilize derivatives (like interest rate swaps or forward rate agreements) to hedge against rising interest rates, especially if borrowing rates increase significantly in the future. **Increase Fixed-Rate Debt Issuance**: While S2 maintains a high percentage of fixed-rate debt, further increasing this proportion can help lock in lower rates and mitigate the risk of future rate hikes. **Diversify Debt Instruments** by exploring new debt instrument and modalities

FX debt as a percentage of total debt exposes the country to exchange rate fluctuations and the risk of increased debt servicing costs if the domestic currency depreciates	**Diversify FX Debt Sources:** Diversify the currency denominations of foreign-denominated debt. **FX Reserves Management:** Ensure that FX reserves are sufficient and strategically managed to meet the country's external debt obligations. **Hedge FX Exposure:** Use FX derivatives (such as forward contracts or FX swaps) to hedge against currency risks.
Liquidity Risk	**Build Liquidity Buffers**: Establish liquidity buffers to ensure that sufficient resources are available to meet debt obligations when they become due, especially in volatile conditions. **Cash Flow Forecasting**: Use detailed cash flow forecasting models to anticipate upcoming debt repayments and adjust fiscal policies to meet obligations without needing to refinance at unfavorable terms.
Despite the reduction in debt-to-GDP ratios, maintaining a sustainable debt path depends on overall fiscal health and future budget management.	**Pursue Fiscal Consolidation:** Ensure that fiscal deficits are reduced over time, with a clear path as outlined in MTFF. **Economic Growth Focus:** Support the implementation of pro-growth policies that increase GDP growth. **Debt Sustainability Analysis:** Periodically conduct debt sustainability analyses to assess whether the debt trajectory remains manageable.
Political instability, policy shifts, or poor institutional framework	**Institutional Strengthening:** Improve institutional frameworks related to debt management, fiscal policy, and public financial management. Fully operationalizing the Public Debt Management Office (PDMO) can help implement the strategy effectively and transparently. **Policy Commitment and Transparency:** Ensure that there is broad political consensus on the debt strategy and a strong commitment to maintaining fiscal discipline.

12. Conclusion

Sri Lanka's fiscal challenges, including high budget deficits and low revenue, led to a temporary suspension of debt servicing for an interim period pending an orderly and consensual restructuring of the debt in a manner consistent with an economic adjustment program supported by the International Monetary Fund (IMF). Accordingly, the Government successfully completed debt-restructuring process, securing USD 17 billion debt relief. In line with IMF-EFF programme, the Government aims to achieve key debt sustainability targets, such as reducing debt-to-GDP below 95 percent by 2032 and keeping annual gross financing needs below 13 percent of GDP.

With the intention of managing the public debt of Sri Lanka, the authorities enacted Public Debt Management Act No. 33 of 2024 (PDMA) as a single debt management law of the country and established the Public Debt Management Office to centralize public debt management operations. The preparation of Medium Term debt Management Strategy (MTDS) is one a legal requirement of PDMA. The MTDS 2025-2029 outlines strategies to manage the Government debt over the next five years, aiming to successfully realize the debt sustainability targets in the long run. Accordingly, the MTDS 2025-2029 intends to extend debt maturity, increase fixed-rate borrowings, and boost domestic borrowing.

The Debt Management Strategy for the period 2025-2029 focuses on more domestic oriented financing strategy maintaining 80:20 domestic to external financing ratio, while increasing the issuance of medium term to long term treasury bonds to address refinancing and borrowing cost and gradually reduce the reliance on treasury bills. It also focuses to manage the external borrowing to bilateral and multilateral concessional loans with fixed interest rates.

This debt management strategy effectively reduces the country's debt burden, easing fiscal pressure and providing more room for growth-oriented investments. The strategy also offers a balanced approach to interest payments, minimizing refinancing risk and reducing exposure to foreign exchange fluctuations, which enhances overall financial stability.

The proposed risk mitigation mechanisms strengthen its viability, ensuring that Sri Lanka can withstand economic shocks and avoid sudden liquidity crises. Additionally, the focus on fiscal consolidation and discreet monetary policies supports a sustainable economic recovery, while institutional strengthening and political stability are essential underlying factors for the long-term achievements of the strategy. Accordingly, Sri Lanka will successfully navigate its debt challenges and realize a prudent management of its debt in the coming years.

Annual Borrowing Plan 2025

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Annual Borrowing Plan (ABP) for 2025

1 Introduction

The Public Debt Management Office which was established on December 02, 2024 under the Public Debt Management Act No. 33 of 2024 shall prepare a borrowing plan for each financial year (Annual Borrowing Plan) to meet the aggregate borrowing requirement in accordance with the Appropriation Act for any given year. Such borrowing plan shall be reviewed at least half yearly. The Annual Borrowing Plan (ABP) for 2025 outlines the government's borrowing strategy and proposed borrowing mix which focuses on meeting the Government's financing requirements during the year while ensuring the reduction of cost of borrowings and management of risks associated with borrowings. The plan aligns with the Medium-Term Debt Management Strategy (MTDS) for 2025-2029 and the Medium-Term Fiscal Framework (MTFF) for 2025-2029.

2 Gross Financing Needs of the Government for 2025

Table 1: Gross Financing Needs -2025

	2025 Estimate	LKR. Bn
Primary Expenditure		**4,285**
Recurrent Expenditure	2,970	
Capital Expenditure	1,315	
Public Debt Servicing		**4,550**
Interest Payment	2,950	
Debt Repayment	1,600	
Total Expenditure		**8,835**
Total Revenue		**5,042**
Gross Financing Requirement		**3,800**
Domestic Financing	3,100	
External Financing	700	
Gross Borrowing Limit*		**4,000**

Source: Ministry of Finance, Planning and Economic Development

*Includes provisions for Advanced Account Operations & adjustment for book /cash value for Government Securities

Total estimated expenditure of the Government which is LKR 8,835 bn in 2025 to be financed through tax and non-tax revenues, grants and debt. Revenue and grants are projected at LKR 5,042 bn leaving a deficit of LKR 3,800 bn. This will be financed through external and domestic borrowings of LKR 700 bn and LKR 3,100 bn, respectively (See table 1). The external gross borrowing of LKR 700 bn relates to projected disbursements on already contracted loans and new borrowing from multilateral and bilateral lending agencies, while domestic gross borrowing of LKR 3,100 bn relates to new debt to be raised from the domestic market through issuances of Government securities in 2025. The gross borrowing limit is LKR 4,000 bn.

3 External Financing

In 2025, the Government intends to contract Gross External Financing (GEF) of LKR 700 bn, to finance the 2025 National Budget (see Table 1). The Government expects to disburse LKR 277 bn under the already contracted loans obtained from external multilateral and bilateral lending agencies. The Government plans to contract new debt with the multilateral and bilateral creditors amounting to LKR 115.4 bn and it is expected to receive LKR 307.6 bn as the 4th, 5th and 6th tranches of Extended Fund Facility through IMF.

4 Domestic Financing

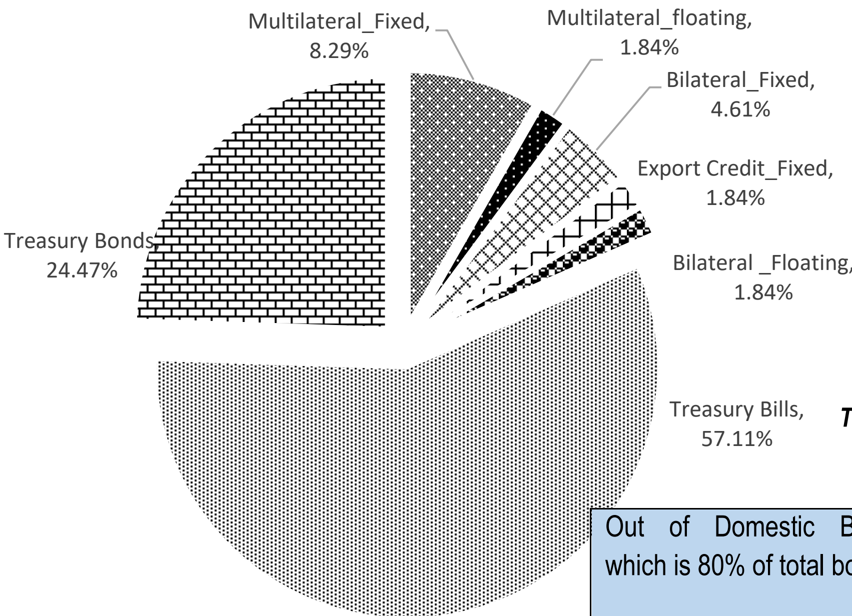
Gross Domestic Financing (GDF) requirement for the financial year 2025 is projected at of LKR 3,100 bn. Domestic financing will be raised through the issuance of Government securities in public auctions. Government bonds will constitute both medium and long-term domestic debt instruments to be issued during the year. The tenors on offer will be 2-years, 3-years, 5-years, 7-years, 10- years and 15-years. Treasury Bills will constitute short-term instruments with a maturity period of up to one year. The Government expects to issue LKR 2,170 bn of Treasury Bills and LKR 930 bn worth of Treasury Bonds to the domestic market as specified under MTDS. The auction calendar for the year 2025 will be developed and published for both Treasury Bills and Treasury Bonds by the Central Bank of Sri Lanka in coordination with Public Debt Management Office. The auction calendar will be based on the annual borrowing plan and the cash flow forecast for 2025.

5 Borrowing Strategy in 2025

To meet the financing needs in 2025, the borrowing strategy will focus on a domestic financing oriented approach, utilizing more domestic financing sources, such as Treasury bills and Treasury Bonds. The objectives of the strategy are to:

- Reduce the debt to GDP ratio and ensure the debt sustainability
- Minimize the cost of borrowing while managing risks related to interest rates, refinancing, and foreign exchange fluctuations.
- In view of addressing debt bunching effect, extend the maturity profile to reduce refinancing risks and increase the proportion of long-term debt.
- Diversify financing sources to include both traditional and non-traditional sources.
- Reduce external commercial borrowing with non-concessional terms and conditions

6 Proposed Borrowing Mix



The maximum limit of each instrument as a percentage of total annual borrowing, in line with the Medium Term Debt Management Strategy, is depicted in this chart

Table 2: Proposed Borrowing Mix-2025

Out of Domestic Borrowing which is 80% of total borrowing		Out of External Borrowing which is 20% of total borrowing	
Treasury Bills	70%	Multilateral Fixed	45%
Treasury Bonds	30%	Bilateral Fixed	25%
		Bilateral Floating	10%
		Export Credit Fixed	10%
		Multilateral Floating	10%

7 Monitoring and Reporting

The government will monitor the execution of the ABP throughout 2025, with quarterly reviews to ensure targets are met and any necessary adjustments are made.

8 Conclusion

Annual Borrowing Plan (ABP) for 2025 presents a strategic approach to meet the government's financing needs while ensuring debt sustainability. By focusing on domestic financing through Treasury Bills and Bonds and minimizing non-concessional external borrowing, the plan aims to reduce the debt-to-GDP ratio. It diversifies financing sources, including multilateral and bilateral fixed debt and sovereign bonds, to mitigate external risks. With quarterly monitoring and a commitment to optimizing borrowing costs, the ABP supports fiscal stability and risk management, fostering long-term economic robustness.