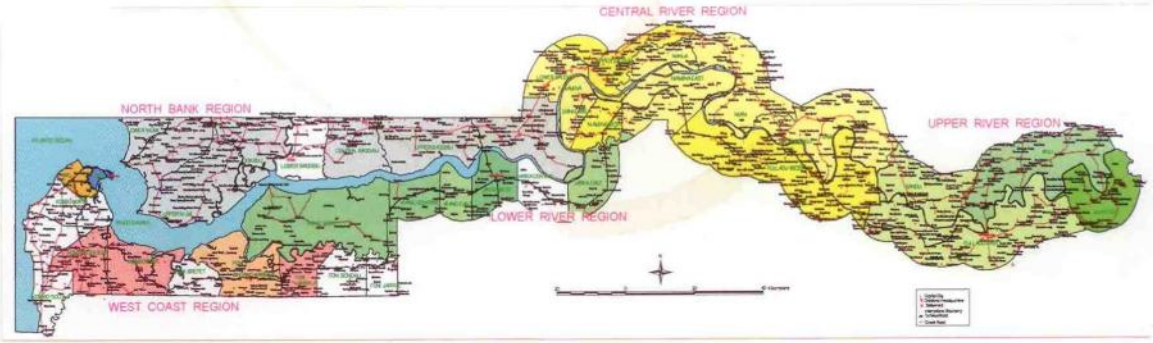
REPUBLIC OF THE GAMBIA

MEDIUM TERM DEBT STRATEGY (MTDS)

2011 — 2014



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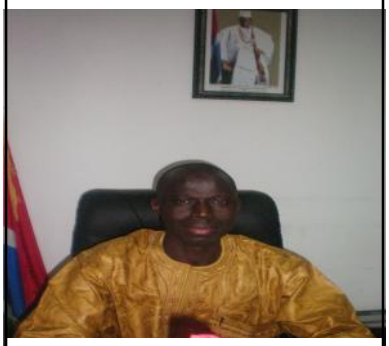

Hon. Abdou Kolley

In the quest to achieve national development aspirations as enshrined in the MDGs and Vision 2020, the Government of The Gambia maintains a stable macroeconomic environment with an average annual Real (GDP) growth rate of 4.5% (2007-2011), Hon. Abdou Kolley reduction/declining incidence of poverty among the population from 58% to 48% over the past decade, prudent fiscal and monetary policies which is quite outstanding in the region. These socio-economic gains are significant within the context of the current global economic crisis. This is a testimony of hard work and resilience of the Gambia Government and the commendable support of our development partners.

The Medium Term Debt Strategy (MTDS) covering the period 2011 - 2014, intends to secure Government's financing requirement, with the least cost possible within an acceptable limit of risk, in order to maintain a robust economic Development and meet the requirement of the Gambia's Priority Action Programmes (PAP) of the Programme for Accelerated Growth and Employment (PAGE). This MTDS builds up on the gains of the previous medium term debt strategy (2010-2012) and learnt lessons from the challenges experienced therein.

The Gambia's current debt challenges are characterized by high interest cost and high rollover risk in domestic debt. However, the external debt continues to enjoy low cost and risk due to the considerable low interest rates and elongated maturity profiles of the debt. The 2011 debt sustainability analysis (DSA) of the IMF reported that despite debt relief the Gambia remained at high risk of debt distress. It is important to note that as at end 2010, 74 percent of the domestic debt portfolio matures within the next 12 months, this exposes the domestic debt portfolio to high roll-over risk.

This is worrisome in light of the current financial and debt crisis in the euro zone and reduced demand in Asia. This has led to reduction in aid flows and foreign direct investment resulting to an upsurge in domestic borrowing with corresponding higher interest payments. In the year 2011 alone, domestic interest account for nearly 30% of total spending crowding out other priority spending.

The debt strategy therefore seeks to address maximally the major debt problems and issues confronting the Gambian economy which are the high interest cost and the high refinancing risk of the domestic debt and to explore new innovative ways of mobilizing external resources including non debt creating flows for long term debt sustainability.

Government will partner with the private sector and donors in putting in place a legal and regulatory framework for public private partnerships initiatives, embarked on a campaign of communication for attracting foreign direct investment and participation of the private investors in the program for accelerated growth and employment (PAGE). My Ministry is collaborating with the Gambia Investment and Export Promotion Agency (GIEPA), the Public Private Initiative Facility (PPIAF) and the PPP divisions of the World Bank in such endeavors.

We are aware of the challenges but we believe that if all stakeholders put-in their utmost best together we will succeed. There is the will and political commitment to embark on this path. This document fully receives the barking and support of His Excellency Sheik Prof. Dr. Alh. Yaya A.J.J Jammeh, President of the Republic of The Gambia and Government.

In light of this, government will continue to strengthen public financial management and capacity of debt management stakeholders to ensure successful implementation of the medium term debt strategy (MTDS).

Honourable Abdou Kolley

Minister of Finance and Economic Affairs.

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Executive Summary

The formulation and successful implementation of a credible and robust debt management strategy is anchored on key parameters such as broad based participation of all stakeholders, donors and the authorities. In the formulation process, the Directorate of Loans and Debt Management (DLDM) in collaboration with staff from the planning, Gambia Bureau of Statistics, fiscal and monetary authorities produced this MTDS Document covering the period 2011 to 2014. WAIFEM, IMF and the World Bank also provided considerable technical support in the exercise.

An in depth analysis that looks at cost-risk indicators of different strategies was considered and assessed under baseline assumptions on the macroeconomic; market risk scenairo and environment, consistent with the government's medium term development plan(PAGE). The scenerio building also took in to account borrowing policy limits agreed between The the International Monetary Fund (IMF) including the suggested net domestic borrowing reduction to half a percent of GDP by 2014; the 35% minimum grant element on external borrowing and CBG lending parameters to government; etc under the anticipated new Extended Credit Facility (ECF) expected to start in mid 2012. In addition, the quantum and type of instruments for use under each strategy was also reviewed to assess its feasibility and realism. This scenario development was also informed by the consequences for domestic debt market development.

Generally, it is difficult to have a particular strategy that out-performs the rest of the strategies across all the cost-risk indicators warranting for a focus on the indicators that are significantly affecting the economy. All the four strategies assessed show that the strategies bias towards external debt performs best in terms of cost and risk advocating for substantial international access of donor funds to finance Government fiscal deficit and Government development agenda.

This implies that more expensive domestic debt is effectively being refinanced by cheaper external debt. Although it may be true, multilaterals do not like to lend to refinance domestic debt.

The MTDS examines four alternative debt management strategies. These strategies are chosen to illustrate the impact of alternative mix of external and domestic financing sources, as well as alternative mix of short term and longer term domestic debt on The Gambia's public debt profile in the future.

The MTDS and its subsequent reviews are to address the major debt problems confronting the Gambia's debt portfolio and the decision is to seek concessional external financing and to lengthen the maturity profile of domestic debt to reduce the roll-over risk. Key to this strategy is reducing government's net domestic borrowing, which would ease pressure on yields and help make extending the maturity profile in a phased manner that will not lock in high costs upfront by extending the maturity too fast.

The strategy that seeks to address the current issues confronting the Gambia's debt portfolio in a non aggressive manner is strategy 4 (four). This strategy assumes a reasonable decrease in domestic borrowing to be matched with an upsurge in external borrowing maximally on an average of US$ 60 million per year. The remaining borrowing requirement will be sourced domestically introducing the 3-year nominal bond and the 5-year inflation linked bond in addition to treasury bill borrowing.

The Gambia Government is hereby adopting strategy 4 (four) and henceforth begins its implementation.

Government and Central Bank Officials at the MTDS Validation

1.0 Introduction

- The Government of the Gambia through the Ministry of Finance and Economics Affairs in collaboration with the IMF, World Bank and WAIFEM conducted a workshop to develop the Medium Term Debt Management Strategy (MTDS) in 2011. The objective of the workshop was to provide training on the MTDS tool for country officials especially debt managers and also to develop the MTDS for the country. The workshop brought together participants from key institutions responsible for managing the national debt (MTDS National Team); namely the Ministry of Finance and Economic Affairs, the Central Bank of the Gambia (CBG), the Gambia Revenue Authority (GRA) and the Gambia Bureau of Statistics (GBOS).

- Analysis of the cost-risk implications of a range of debt strategies was carried out. These strategies were assessed under baseline assumptions on the macroeconomic and market environment, consistent with the government's medium term macroeconomic program, and a set of market risk scenarios. The borrowing strategies took into account informal policy limits agreed between the Government and the IMF, including the net domestic borrowing limit of 3.1% of GDP for 2011, in anticipation of a new Extended Credit Facility (ECF) expected for 2012.

2.0 Objectives and Scope of the MTDS

- The debt management objectives are clearly stated in the legislations, the1970 Loans Act. It states that " An act to make provision for the raising of loans to finance development schemes and other

purposes connected therewith. The Minister of Finance and Economic Affairs, with the prior approval of the House of Representatives signified in that behalf by resolution thereof, raise outside the Gambia such loans as may be specified in such resolution". Other primary legislations covering debt management are the Government Budget Management and Accountability Act (GBMA Act) 2004 and the Central Bank Act. The Minister of Finance and Economic Affairs is the only government official entitled to borrow, lend, and issue guarantee for public resources. The policy and the Act are operationalized by the Ministry of Finance and the Central Bank acts as agent to the Government. Public enterprises and local authorities need to borrow from local and external sources through the MoFEA or, if permitted by the MoFEA, borrow directly. The 1997 Constitution (Section 155) establishes the requirement of ratification in the form of an Act from the National Assembly for (i) any guarantee by the Government, and (ii) any international business or economic transaction to which the Government proposes to become a party.

The Government eventhough has been pursuing a more refine set of objectives officially including minimizing cost and risk while helping domestic market development, this document suggests a refinement in the law by adding that it also tries to minimize cost and risk while helping domestic market development.

- The scope of the MTDS covers the central government external and domestic debt, and external guarantees. The scope also excludes external borrowing for balance of payments support, such as that received from the IMF under the Extended Credit Facility (ECF).

3.0 Existing Debt Management Strategy and Debt Portfolio

3.1 Debt Management Strategy

- The debt management strategy for 2010-12 has been to allocate the total gross borrowing requirement between 90 percent domestically and 10 percent externally. The external borrowing policy has been to maximize borrowing from multilateral and bilateral concessional sources, and to borrow from multilateral and bilateral semi-concessional sources at the margin. However, the strategy that had de facto been implemented implied a domestic borrowing of 93 percent and the residual from external sources.

- Reflecting the past de facto strategy, the existing debt portfolio is characterized by approximately equal proportions of domestic and external debt, and a high share of concessional debt within the external debt portfolio.

3.2 Structure of Existing Debt Portfolio

- while the large share of external debt makes the portfolio vulnerable to changes in the exchange rate, the annual repayments in FX are quite low relative to the stock of FX reserves (8.9% in 2011). Also, the low interest cost of external debt, on average, more than offsets the exchange

rate risk to the portfolio. Moreover, all external debt have fixed interest rate. The remainder of the overall debt portfolio is shielded from exchange rate fluctuations, because they are denominated in dalasi. However, as 74 percent of the domestic debt portfolio matures within the next 12 months, this exposes the portfolio to interest rate and roll-over risks. The remainder of the domestic portfolio has a fixed interest rate and consists of 3-year Treasury bonds (0.3 % of domestic debt) and debt instruments created by the consolidation of various overdraft facilities with the CBG (29%).

- Overall, the analysis of the existing debt portfolio suggests that the drivers of future strategies will be the cost and risk trade-off between contracting domestic debt with high interest rate cost and risk and high roll-over risk, as well as external debt which carries low interest cost and risk, but high exchange rate risk.

- Total public debt has been steadily growing since the receipt of debt relief through the HIPC and MDRI initiative. As at end December 2010, the total public debt was GMD 18,308million (Eighteen billion three hundred and eight million Gambian dalasis) equivalent to US$ 661.8million (Six hundred and Sixty one point eight million US dollars); this represents 62.5% of GDP as at end December 2010. Unlike many of the other Low Income Countries (LICs), the Gambia does not have external debt arrears, except for three loans from the People's Republic of China.i However, there are significant domestic arrears to suppliers (about 10 percent of GDP).The external debt was US$ 377.0 million constituting 57% of total public debt,

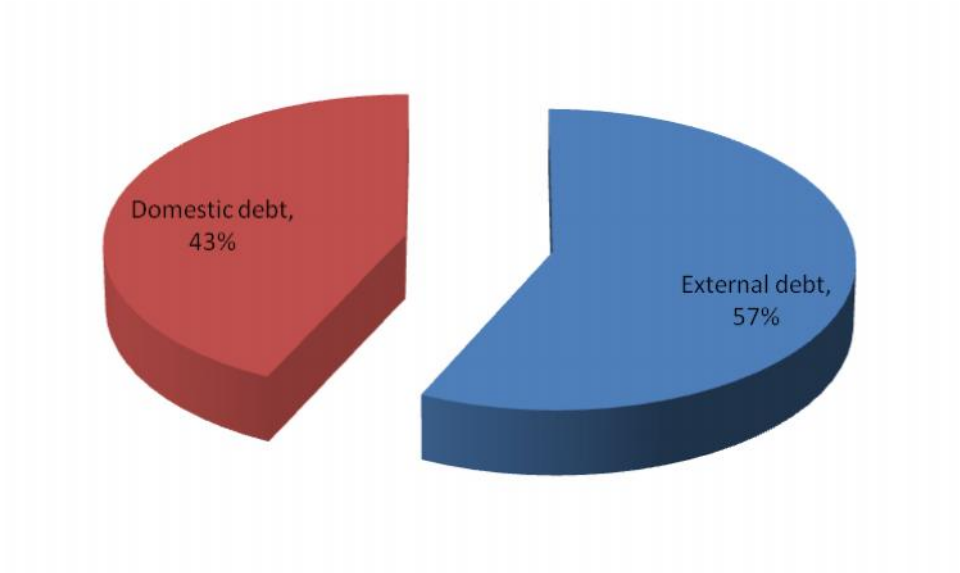
whereas domestic debt stood at US$ 284.7 million constituting 43% of total debt (Table 1&Chart 1):

Table 1. Composition of the debt portfolio, December 2010

	in GMD billions	**in USD million**	**as % of GDP**
External debt Domestic debt	10.4 7.9	377.0 284.7	35.6 26.9
Total:	18.3	661.7	62.5
Memo: Nominal GDP	29.3	1,059.0	
IMF ECF out-standing	0.8	31.1	2.7

Source: Ministry of Finance, Fund team macro projections, MTDS team

Chart 1: Total Debt Portfolio as at end of December 2010



Source: Gambian authorities and MTDS team

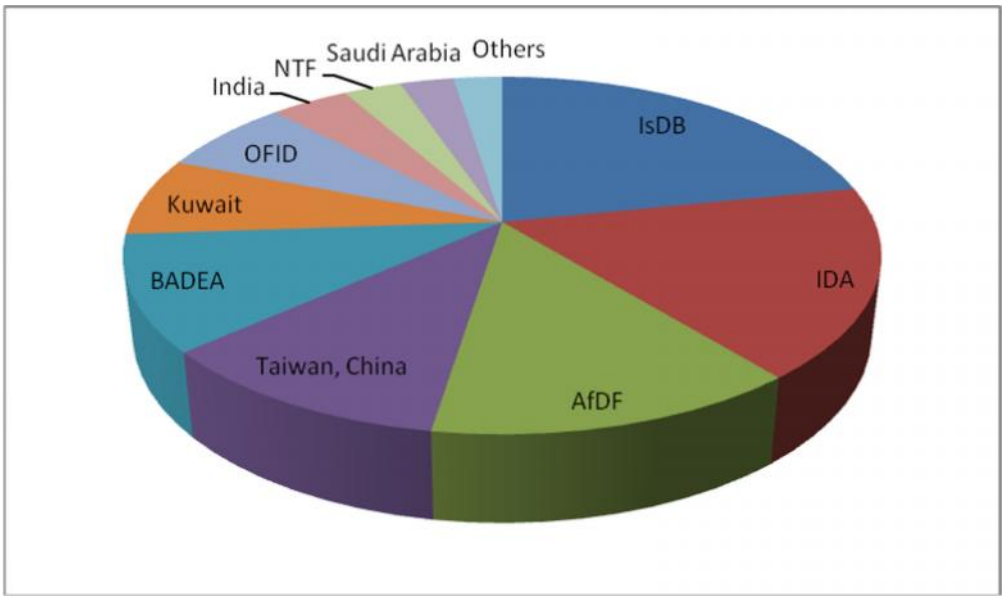
3.2.1 External Debt

- Throughout the history of the country in contracting loans dated back in the early 1970s, concessional financing windows have been the source of financing and hence resulting to the major share of the external debt, before the debt relief, to the multilateral concessional windows e.g. IDA of the World Bank Group and ADF of the African Development Bank Group.

- After the receipt of debt relief from mainly the World Bank and the African Development Bank groups, their proportion of the external debt was significantly reduced leading to the situation, as at end December 2010, where the Islamic Development Bank took charge of the greater share of the external debt followed by the International Development Association (IDA) and the African Development Fund (ADF).

- On the bilateral side, the republic of china on Taiwan constituted the largest proportion followed by the Kuwaiti Fund for Economic Development in Africa (KFEAD) and the Export Import Bank of India (EIBI) (chart 2):

Chart 2: External Debt Composition by Creditor Category as at end of December, 2010

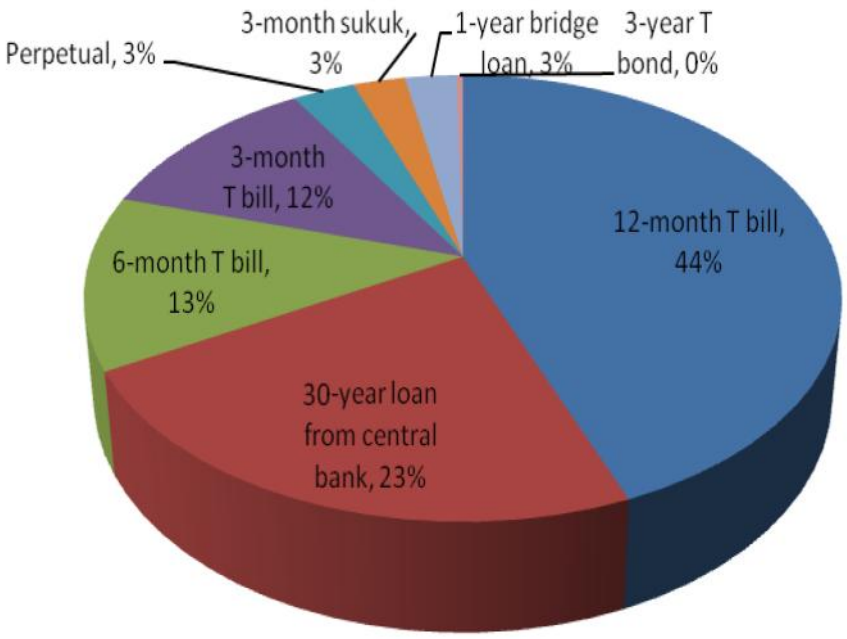


Source: Gambian authorities and MTDS team

3.2.2 Domestic Debt

- The Domestic debt comprises marketable and non-marketable securities. Marketable securities consist of Treasury bills (3, 6, 12-months) and Treasury bonds (3-years), whereas non-marketable securities comprise of the 1-year bridge loan, the perpetual loan and the 30-year loan from the central Bank. There is no clear distinction between the treasury bills issued for liquidity management and financing purposes (chart 3).

Chart 3: Composition of marketable and non marketable securities (Dec 2010)

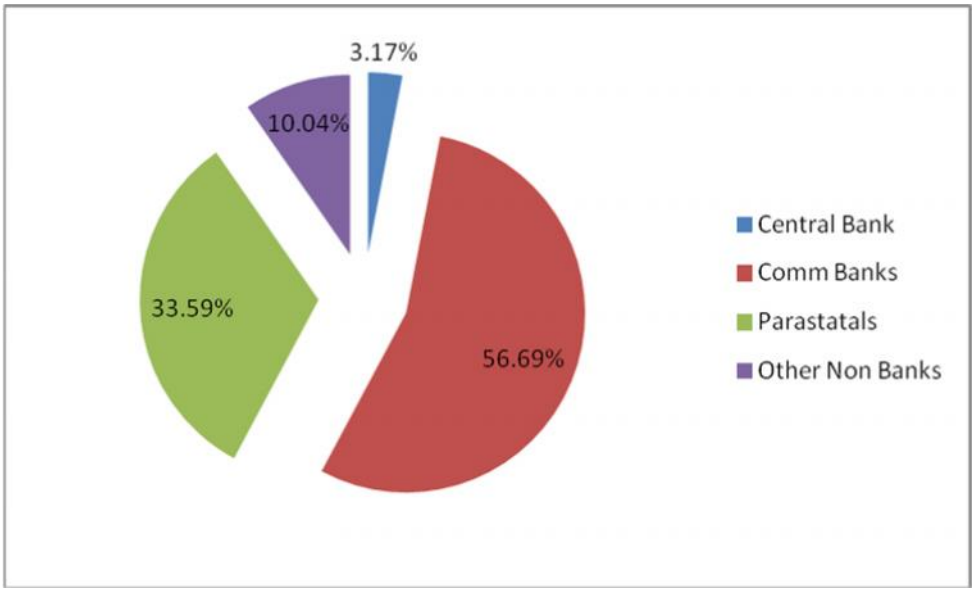


Source: Central Bank of the Gambia

The Gambia's domestic debt market is underdeveloped and is dominated by a few participants with commercial banks holding 56.69 per cent of the securitized debt. The relatively low risk in Government securities as compared to loans to the private sectors as well as the expansion of the banking sector explains the dominance of commercial banks in the securities market. In addition, the private sector is being crowded-out, i.e., Banks are not bothered to lend to the private sector because it is profitable to invest in government debt with low risk. Parastatals ranked the second holding with 33.59 per cent mainly by the

Social Security and Housing Finance Corporation's (SSHFC) holding. The non-Bank is ranked third with10.04% while the Central Bank of the Gambia is ranked the lowest holder with 3.17% (Chart 4).

Chart 4: Percentage of Interest bearing domestic debt by holder as at end Dec, 2010



Source: Central Bank of the Gambia

In the latest technical memorandum of understanding for economic and financial policies setting the parameters for central bank lending to government under the new enhanced credit facility (ECF) program, there is a semiannual amortization of the 30-year and 10-year bonds beginning 2012 over the bonds life. In the case of the perpetual bond, there is only interest

payment and no principal payment over the bond's life. The payment schedule for government securities held by the Central Bank for 2012 is shown in Table 2 below:

Table 2. The Gambia: Schedule of Payments on Government Securities held by the Central Bank of the Gambia for 2012. (GMD millions)

Due Date	**30-year bond**		**10-year bond**		**Perpetual bond**
	Principal	**Interest**	**Principal**	**Interest**	**Interest**
March 1, 2012	30.42	57.34			
June 30, 2012			10.42	5.63	6.25
September 1, 2012	30.42	56.35			
December 31, 2012			10.42	5.32	6.25

This repayment scheduled which now adds annually D258.3 million to interest on treasury bills (D873 millions) would increase debt service as a percentage of revenue well above the 30 percent sustainability limit. The fiscal authorities have been committed to this arrangement which will further impact on government priority spending, financing of page and long term sustainability.

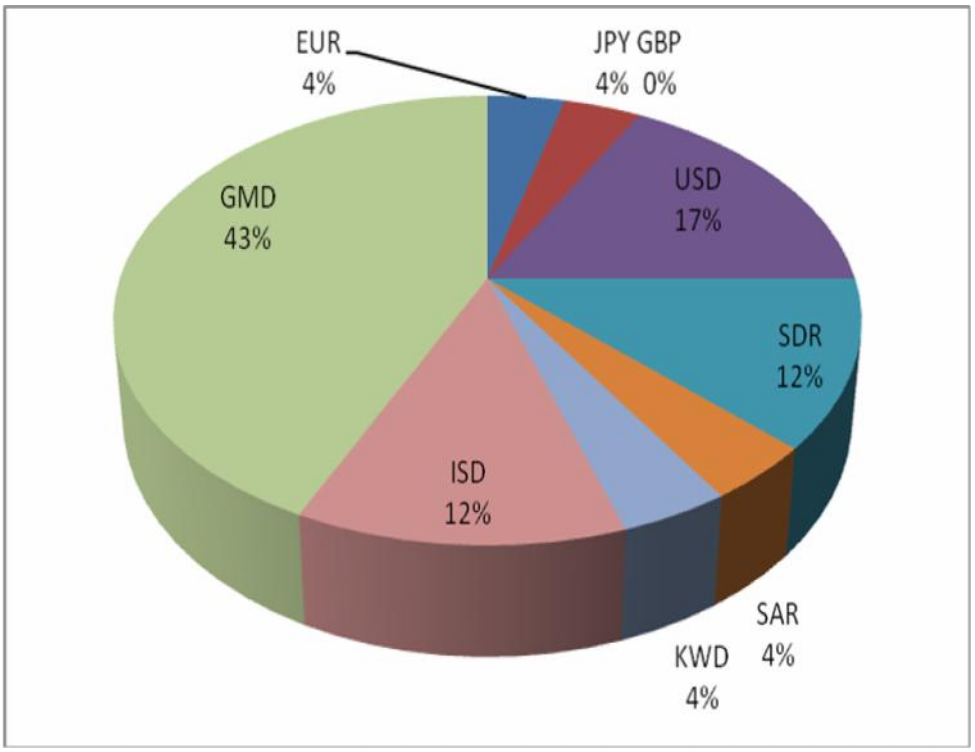
3.3 Cost and Risk of the Existing Debt Portfolio

- The current strategy slightly eased the pressure on refinancing risk by introducing the longer term 3-year bond, which was issued once and was considered a partial success. This trend of a bias towards and elongating the domestic debt was seen as crucial, since the high reliance on external debt exposes a small economy like the Gambia to significant financial vulnerability through the exchange rate, demand and commodity price shocks. Moving towards domestic debt would also have a positive effect on the external debt sustainability of the country, which has been highlighted as a problem area in the debt sustainability analyses (DSA) of the country.

- The public debt, in terms of the current currency composition, could be broadly categorized into two: the domestic debt portfolio, within its totality, is denominated in the local currency whereas, the external debt even though constitutes more than one foreign currency, is usually dollarized.

The currencies that constitutes the external debt portfolio are: United States Dollar (USD), Kuwaiti Dinar (KWD), Euro (EUR), Saudi Riyal (SAR), Japanese Yen (JPK), Special Drawing Rights (SDR) or (XDR) and Islamic Dinar (XID). See chart 5 below:

Chart 5: Currency Composition of Existing Debt Portfolio, by currency, as at end Dec, 2010.



Source: MOFEA

- The currency composition of the debt portfolio above is a true reflection of the past debt management strategy at the time, was biased towards domestic borrowing sources as means of reducing the portfolio's currency exposure.

3.3.1 Debt stock by actual exposure (consolidating SDR and ISD, and decomposing into EUR, JPY, GBP and USD)

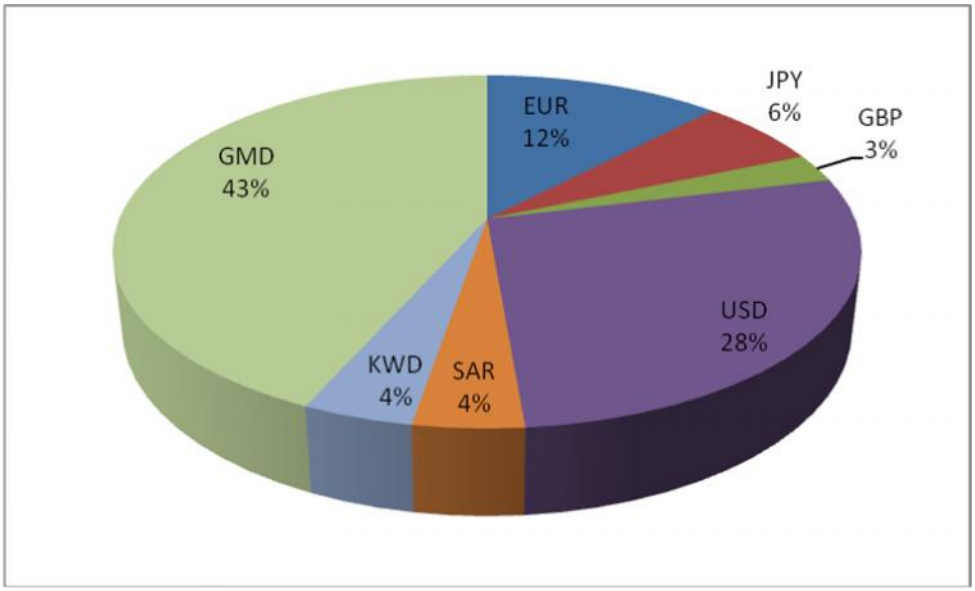
The SDR and XID (ISD) are currency baskets and are the same, and that the exposure is simply the sum of four currencies. 1 (one) SDR is equal to the sum of**: EUR 0.423**

JPY 12.10

GBP 0.111

USD 0.666

Chart 6: Debt stock by actual exposure (consolidating SDR and ISD, and decomposing into EUR, JPY, GBP and USD)



Source: MOFEA

From the consolidation of the SDR and XID (ISD) and decomposing into the four currencies constituting the basket, there is exposure to the GBP (3%), even though we have no loans that are expressed explicitly in GBP. The exposure to USD increased from 17% to 28%, EUR from 4% to 12%,

and JPY from 4% to 6%. Assuming that the KWD and SAR are fixed to the USD, the effective exposure to the USD increases further to 36%.

- The current debt portfolio has a nominal debt and the PV of debt as percentages of GDP, on the high side with 68.3% and 57.5% respectively. Whereas, the implied interest rate on the external debt portfolio is low at 1.4%, it is high on the domestic debt at 10.4%. The average time to maturity (ATM) and average time for refixing are the same for the portfolio, due to the fixed rates on the debt and are far better on the external side at 13.0 years than the domestic side at just 3.8, which could have been much lower excluding the perpetual loan. Furthermore, 74.4% of the domestic debt portfolio is subject to refixing in one year and 3.8% of external debt. See table 3 below:

3.4 Current Redemption Profile

- The current debt portfolio has a redemption profile through the years up to 2058. The external debt component has a uniform maturity within the redemption profile. However, on the domestic debt component, most of it is to be redeemed or rolled over in the first year. This shows the limited rollover risk associated with the external debt but the rollover risk is very high on the domestic debt. See chart and table below:

Chart 7: Current Redemption Profile

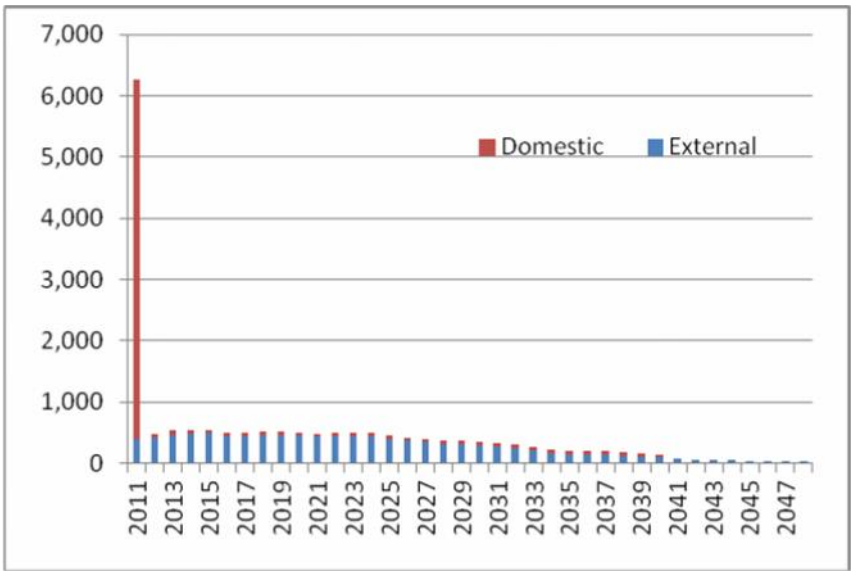


Table 3: Cost-Risk Indicators of the current strategy as at end 2010

Risk Indicators		**External debt**	**Domestic debt**	**Total debt**
Amount (in millions of USD)		377.0	284.7	661.8
Nominal debt as % GDP		38.9	29.4	68.3
PV as % of GDP		28.1	29.4	57.5
Cost of debt	Weighted Av. IR (%)	1.4	10.4	5.3
Refinancing risk	ATM (years)	13.0	3.8	9.1
	Debt maturing in 1yr (% of total)	3.8	74.4	34.2
Interest	ATR (years)	13.0	3.8	9.1

rate risk	Debt refixing in 1yr (% of total)	3.8	74.4	34.2
	Fixed rate debt (% of total)	100.0	100.0	100.0
FX risk	FX debt (% of total debt)			57.0
	ST FX debt (% of re-serves)			8.9

4.0 Sources of Financing

4.1 External Financing and Trend

- The government has been contracting debt from mainly concessional windows, such as the World Bank and the African Development Bank Groups. Evidence of their dominance could be traced back in the debt database prior to the country reaching HIPC completion point, where they were in-charge of the greatest proportion of the debt portfolio. However, the post HIPC completion era is marked with the greater proportion of the debt portfolio gradually shifting to the semi concessional windows mainly the Islamic development Bank (IsDB), Kuwaiti Fund for Economic Development in Africa (KFEAD) and BADEA.

- The commercial creditor windows and funding from the BRICS community are also potential sources of financing.

- Potential sources of external financing available to the country may be categorized into multilateral, bilateral and commercial. The multilateral loans are classified into concessional and semi-concessional. The IDA type loans are characterized with low fixed interest rate (0.75 per cent), long maturity (40 years or more) with grace period (10 years). The ADF also has low fixed interest rate (0.75 per cent), long maturity (50 years or more) with grace period (10 years). IDA and ADF have different amortization rules. Whereas, the latter has an average fixed interest rate of 2%, and maturity (25 years) with grace period between 5-7 years. Examples of such loans are from IsDB and BADEA etc.

- The bilateral loans, usually from Kuwaiti Fund, Saudi Fund etc, are generally semi-concessional in nature, with average fixed interest rates of 2%, and average maturity between 20-25 years including grace period between 5-7 years.

- It is however worth noting that the Government has not contracted debt from the commercial creditors in the past, but as the economy grows, concessional windows are expected to dry-up gradually, hence compelling the Government to tap possible funding from the commercial creditors.

Table 4: Potential External Sources of Financing

	Grace period	Maturity	Interest Rate	Cost	Principal Risk Exposure	Projected Disburse-ment Amount
IDA	10	40	Fixed	0.75 %	FX	$18 million
ADF	10	50	Fixed	0.75 %	FX	$15 million
IsDB	7	25	Fixed	2.5 %	FX	$10 million
Taiwan	7	23-25	Fixed	3%	FX	$5 million
Ku-wait/Saudi Fund	5	25	Fixed	1%	FX	$5 million
India	5	25	Fixed	1.75 %	FX	$5 million
Others						$2 million
Total						$60 million

Source: MOFEA

4.2 Domestic Financing

- As at end December 2009, the total domestic debt stood at 7.32 billion Dalasis equivalent to USD 271 millions and as at end December 2010, it stood at 7.9 billion Dalasis equivalent to USD 284.7 millions.
- The domestic debt management policies includes among others; rolling over maturing principal, while paying interest through domestic revenue; financing of the budget deficit through marketable instruments; and smoothening the redemption profile.

- To minimize crowding out private sector, the NDF is pegged at a lower percent of GDP. The main strategy is to lengthen the maturity of domestic instruments gradually by reducing the share of 3, 6 and 12 months T-bills and increasing the share of 3, 5-year and Inflation linked bonds. The proportion of Treasury bills is gradually being reduced. This strategy will be based on the following assumptions: financing will be through marketable instruments, T-bills will be rolled over using 3 or more-years and Inflation linked bonds. The buyers of the domestic debt are the commercial banks, which have the greater share than the parastatals and the non bank public.

4.3 Medium Term Financing Assumptions

- Going forward, the Government will continue to access concessional program and project loans from both multilateral and bilateral sources. However, concessional and semi-concessional financing are inadequate and

are subject to unpredictability of disbursements, financial conditionality, and are tied to specific projects and suppliers. Given such situation, the Government will consider semi-concessional and non-concessional financing including tapping funding from the BRICS community and other commercial windows. In addition, the Government of the Gambia will endeavor to elongate further, the domestic debt maturity by issuing more bonds and inflation linked bonds in substitution for the short dated maturity domestic debt.

- External sources will continue to finance a bigger proportion of the Financing needs in the medium term given the relatively low level of development in the domestic financial market and the policy to minimize crowding out the private sector.

5.0 Baseline Macroeconomic Assumptions and Key Risk Factors

5.1 Overall Development Strategy

- The Gambia just recently launched the country's development strategy in the medium term (2012-2015) called the PAGE succeeding the PRSP II which concluded in the last year. The MTDS for 2011 is consistent with the overall macroeconomic framework, and reflects the inter-linkages and feedback effects between the MTDS and the macroeconomic framework. This section describes the medium term baseline macroeconomic assumptions underlying the analysis.

- Determining the baseline assumptions was done in co-ordination across key institutions (Ministry of Finance and Economics Affairs and Central Bank of the Gambia). The newly launched PAGE, which highlights key areas in attaining economic growth and employment, formed the basis of the macroeconomic assumptions for the Gambian economy in the medium term.

5.2 Recent Macroeconomic Developments

- The Gambia's macroeconomic performance has been less affected by the recent global financial and debt crisis. The country's GDP had grown by around 6.5% yearly during 2008-2010. This was driven mainly by agriculture while, tourism and remittances were downwardly affected by the global crisis. In 2011, even though tourism is showing some recovery signs, GDP growth is projected to be slightly less at about 5.5% due to poor weather conditions that affected crop production. The medium term is projected to have a minimum growth rate of 5% annually.

- The 12-month inflation rate is very low at about 4% and is projected to remain below 5% at the end of 2011. The inflation rate in the medium term is expected to be a single digit annually.

- The Gambia has been experiencing large fiscal deficits in recent years which led to a significant increase in the domestic debt particularly short term T-bills requiring roll-over periodically. Given the above, the interest

rate on the domestic debt has assumed an increasing pattern and it is now consuming 18.5% of government revenues. Factoring also the interest on the external debt, total interest payment now consumes 22.5% of government revenue. In addressing this high cost and risk, government has started exercising strong fiscal discipline by significantly reducing domestic borrowing. This is evident in the 2011 net domestic borrowing expected to be just over 2.5% of GDP in 2011, compared to 20% in 2010. The government is continuing its efforts on easing its debt burden, by gradually reducing new domestic borrowing to about 0.5% of GDP by 2014. The government will also be pursuing highly concessional loans with soft terms from the external frontier.

- While measure and policies will be implemented to reduce the fiscal deficit, "the government is also observing strict limits on borrowing from the CBG, including the elimination of its overdrafts. This has allowed the CBG to implement a more consistent and proactive monetary policy. At a recent meeting of the Monetary Policy Committee, the CBG lowered its policy interest rate for the first time in 2011, by 1 percentage point, to 14 percent. If inflation remains subdued, there may be scope for further cuts in the policy rate going forward". The gross international reserves remain at a comfortable level at slightly under 5 months of import cover.

- The Government has been realizing a continuous fall in tax revenues relative to GDP since 2007, which is down to less than 12.5% of GDP in 2011. This compared to their peak in 2007 is 3.5 percentage points below.

The tax base eroded significantly resulting on high tax rate on the remaining tax payers. The government has embarked on tax reforms including and not limited to the introduction of a Value-Added tax (VAT) and further simplifies it to ensure tax compliance and improved tax administration.

- In addition, Government is being encouraged to immediately implement fully its fuel pricing formula, including a specific excise tax, and rigorously adheres to the monthly price adjustments going forward. Implicit fuel subsidies led to substantial tax revenue losses, which could have been used for other priority programs that more directly benefit the poor.

- It is believed that The Gambia's banking system as a whole is well capitalized and liquid. Banks' nonperforming loans have begun to fall, but they are still high, and some banks continue to incur losses. The CBG is making ongoing efforts to build capacity to conduct stress testing for the banking system. In addition, the CBG has taken immediate steps to improve the performance of the Credit Reference Bureau (CRB), which started operating in the year 2010.

- In 2012, the priority areas of public financial management include improving transparency in the budget process, strengthening budget execution, and building capacity in internal and external audit functions.

5.3 Principal Risks to the Baseline

5.3.1 Output Risks

- The economy is susceptible to natural disasters particularly droughts and floods. Droughts affect the agricultural sector significantly due to its subsistence in nature. Agriculture in the Gambia is rain fed and employs almost 70% of the work force. A negative impact on it means more than half the population of the country is affected. The agricultural sector can perform below expectations due to the unanticipated shortfall in rain. The diversification of financing sources, and deepening of domestic financial market are expected to enhance the flexibility of the government to respond to such shocks.

5.3.2 Balance of Payments Risks

- The resumption of increase in global food and oil prices poses risk to the Gambia's current account deficit. The primary exports of the country notably groundnut and cashew nuts are vulnerable to weak external demand and lower world prices. A worsening current account deficit could increase the need to contract additional external loans without an offsetting increase in FDI or from international reserves. Overall, this may imply a substantial increase in exchange rate risks which points to the need to explore more avenues of borrowing in domestic currency to mitigate such pressure. However, exchange rate depreciation is likely to be correlated with the increase in the domestic nominal interest rate, which could increase the costs of domestic financing.

5.3.3 Fiscal Risks

- The Government's fiscal position is vulnerable to many risks including those arising from the balance of payments and output risks. In addition, the country's dependence on domestic borrowing to finance budget deficits poses a risk to rising interest rates. There is a risk associated with increasing borrowing without scaling up investment particularly in infrastructure development. In overcoming these risks, the government will diversify the financing sources and increase market capacity to help absorb such shocks.

5.3.4 Monetary Risks

- The fluctuations in world oil and food prices pose risks to inflation. In addition, if the balance of payments risks materialize, a sharp depreciation of the exchange rate would lead to an increase in inflation. The occurrence of drought and/or floods in the country may lead to high inflation that cannot be contained by monetary policy.

- As the growth of bank credit recovers, there is a risk for interest rates to pick up, hence increasing the cost of Government borrowing from domestic sources in the medium term. In mitigating these risks, the Government will continue to implement prudent monetary policy with the aim of reducing the volatility in the exchange and interest rates.

5.3.5 Main Macroeconomic Projections

- The macro assumptions made are consistent with the PAGE and the new ECF agreed with the IMF. See table 5 below:

Table 5: Main Macroeconomic Projections

	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
National account and prices	Percentage change; unless otherwise indicated						
Nominal GDP (millions of dalasi)	26,811	29,445	32,542	35,961	39,746	43,932	48,551
Nominal GDP	10.6	9.8	10.5	10.5	10.5	10.5	10.5
GDP at constant prices	6.3	5.5	5.5	5.5	5.5	5.5	5.5
GDP per capita (US$)	560	564	567	573	589	605	624
GDP deflator	4.0	4.1	4.7	4.7	4.8	4.8	4.8
Consumer prices (average)	5.0	4.9	4.5	5.0	5.0	5.0	5.0
Consumer prices (end of period)	5.8	4.1	5.0	5.0	5.0	5.0	5.0
External sector							
Exports, f.o.b.	6.8	8.1	3.3	4.4	4.2	4.3	4.9
Of which: domestic exports	28.1	32.6	-0.3	6.4	5.4	5.8	9.1
Imports, f.o.b.	6.2	5.7	2.5	5.3	6.2	6.4	6.4
Terms of trade (deterioration -)	-0.2	-0.7	1.2	1.0	2.0	2.0	2.0

Central government budget	In percentage of GDP; unless otherwise indicated						
Domestic revenues	14.8	14.0	14.9	15.5	16.1	16.1	16.1
Grants	4.0	4.5	3.3	3.6	3.6	3.6	3.5
Total expenditure and net lending	24.8	22.2	21.6	21.4	21.5	21.3	21.0
Overall balance	-5.6	-3.6	-3.0	-2.4	-2.0	-1.5	-1.5
Basic balance	-3.3	-1.5	-0.8	-0.3	0.3	0.5	0.5
Net foreign financing	1.4	0.9	1.3	1.4	1.5	1.5	1.5
Net domestic financing	4.2	2.8	1.6	1.0	0.5	0.0	0.0
External sector							
Current account balance							
Excluding budget support	-16.7	-15.4	-15.5	-15.6	-15.5	-15.5	-15.4
Including budget support	-16.7	-15.4	-15.5	-15.1	-15.0	-15.0	-14.9
Gross official reserves (millions of dollars)	163.3	173.0	182.7	192.9	204.5	217.3	229.5
Gross FX reserves (months of imports)	5.3	5.3	5.5	5.5	5.5	5.5	5.4

6.0 Cost-Risk Analysis of Alternative Debt Management Strategies

6.1 Baseline Pricing Assumptions

6.1.1 External Sources

- For the purposes of the medium-term analysis, the following pricing assumptions were considered:

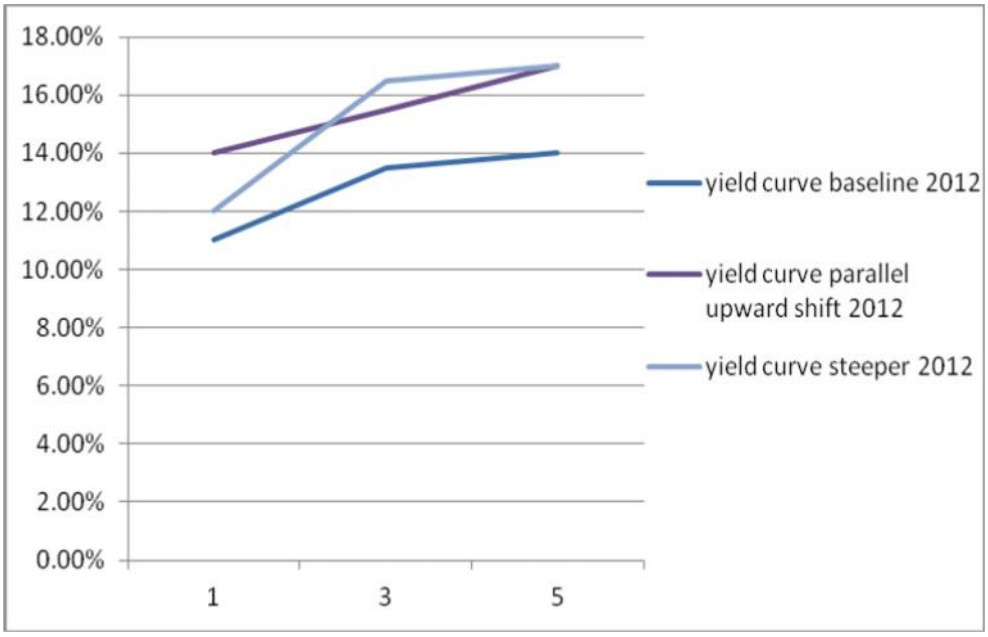
1) All future multilateral concessional loans are priced at a fixed rate of 0.75 per cent, with a 40-year tenor and 10-year grace period. The assumptions are in line with IDA and AfDF financing terms.

2) Semi-concessional financing, with fixed rate loans and have maturity of 20-25 years including 5-7 year grace period, are assumed to be sourced from both traditional (e.g. IsDB, BADEA and Saudi Fund), and emerging (e.g. China, India and Korea) multilateral and bilateral creditors.

6.1.2 Domestic Sources

- The absence of a well functioning secondary market means that the current Gambian Dalasis yield curve does not provide a robust basis for determining forward curves. Instead, the future Gambian Dalasis yield curves are determined based on the existing maturities of the Government securities. The resultant curve is then adjusted for a premium, which can be assumed to capture liquidity, inflation risk and other risks. See chart 8 below:

Chart 8: Yield curve



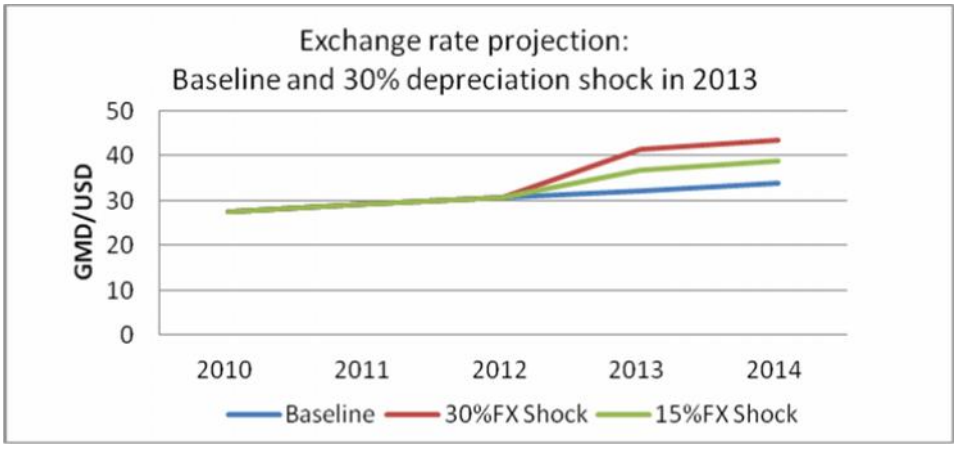
6.2 Description of Shock Scenarios

- The robustness of the alternative debt management strategies was assessed under four alternative stress scenarios based on interest and exchange rate shocks. The magnitude of the shocks was informed by the historical performance of the Gambia's interest and exchange rates over the years. It was assumed that, shocks will materialize in FY 2013, as years earlier do not have the full weight of the shocks' materialization, and that all shocks are sustained thereafter for the remaining period of the analysis.

Scenario 1: *Country-specific depreciation of the Gambian Dalasi.*

- Under this scenario the Gambian Dalasi will depreciate by 30% against the Dollar in 2013 and will be sustained for the reminder of the years. Refer to chart 9 below:

Chart 9: Exchange rate projection



Scenario 2: Yield curve parallel upward shift: Increase in domestic interest rates by 3 percent.

- Under this scenario, the cost of domestic borrowing will increases in 2013 and thereafter stagnant for the remaining period of the analysis. Refer to chart 8 above:

Scenario 3: Yield curve steeper:

- Under this scenario, the shock is applied in 2013 and only to the 3-year bond. Refer to chart 8 above:

Scenario 4: Yield curve parallel upward shift and a 15 per cent de-valuation of the domestic currency against the US dollar in 2013.

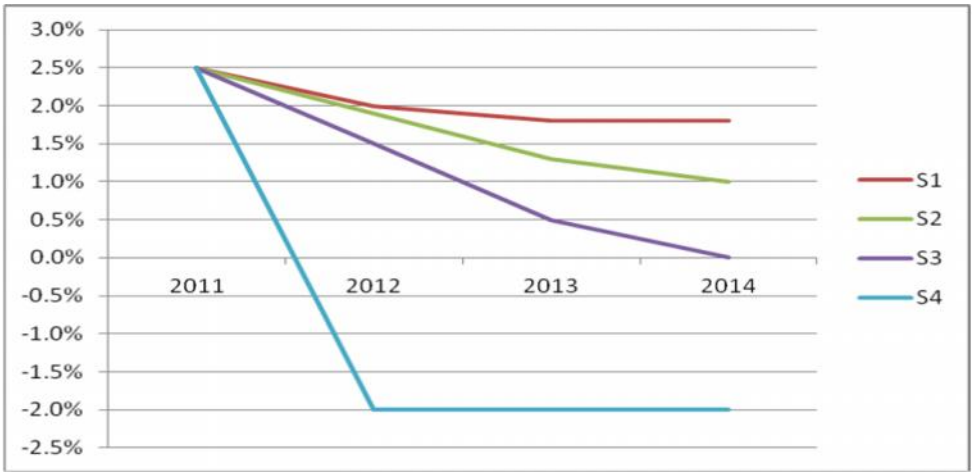
- Under this scenario, there is a combined shock from a yield curve parallel shift and a 15% devaluation of the Gambian dalasi against the US dollar. Usually devaluation is followed by higher inflation, so this shock captures more macro effects. Refer to chart 8 and 9 above:

6.3 Description of Alternative Debt Management Strategies

The Four alternative debt management strategies examined are chosen to illustrate the impact of alternative mix of external and domestic financing sources, as well as alternative mix of short term and longer term domestic debt, on The Gambia's public debt profile in the future.

The four strategies envisage different annual net issuance of domestic borrowing. The gross domestic financing need is the sum of domestic debt falling due and net domestic borrowing (NDB), while external gross financing is the gross financing requirement minus gross domestic financing (or vice versa). With regard to amounts available, which determine the feasible set of external financing, the analysis was based on past trends in commitments and information available on the multilateral and bilateral resource envelope for the Gambia over the next few years.

Chart 10: Net Domestic Borrowing (% of GDP) for each of the four strategies



6.4 Specific Assumptions for Financing Strategies

Strategy 1 – Status quo; Heavy domestic borrowing at short Maturity in the medium Term

This strategy assumes the status quo to continue in the medium term. The expected available foreign funding implies a Net Domestic Borrowing of 2.0 percent of GDP in 2012. Domestic gross financing is split in 99.7 percent T-bills and 0.3 percent 3-year bonds.

Strategy 2 – Continuous domestic borrowing with limited space to go long in the domestic debt market.

Net Domestic Borrowing is slightly reduced compared to Strategy 1 to 1.7 percent of GDP, reflecting the intended strategy described in the 2009 MTDS document, which funds 10 percent of the borrowing from external sources and 90 percent from domestic sources, while extending domestic maturities by reducing the share of T-bills in total gross domestic issuance to 85 percent, and increasing the share of 3-year bonds to 15 percent.

Strategy 3 – Reduction in domestic borrowing, some lengthening of domestic maturity.

Net Domestic Borrowing is reduced to 0 percent of GDP over the four-year time horizon, and extends the domestic maturities by reducing the share of T-bills in total gross domestic issuance to 85 percent, and increasing the share of 3 year bond to 15 percent.

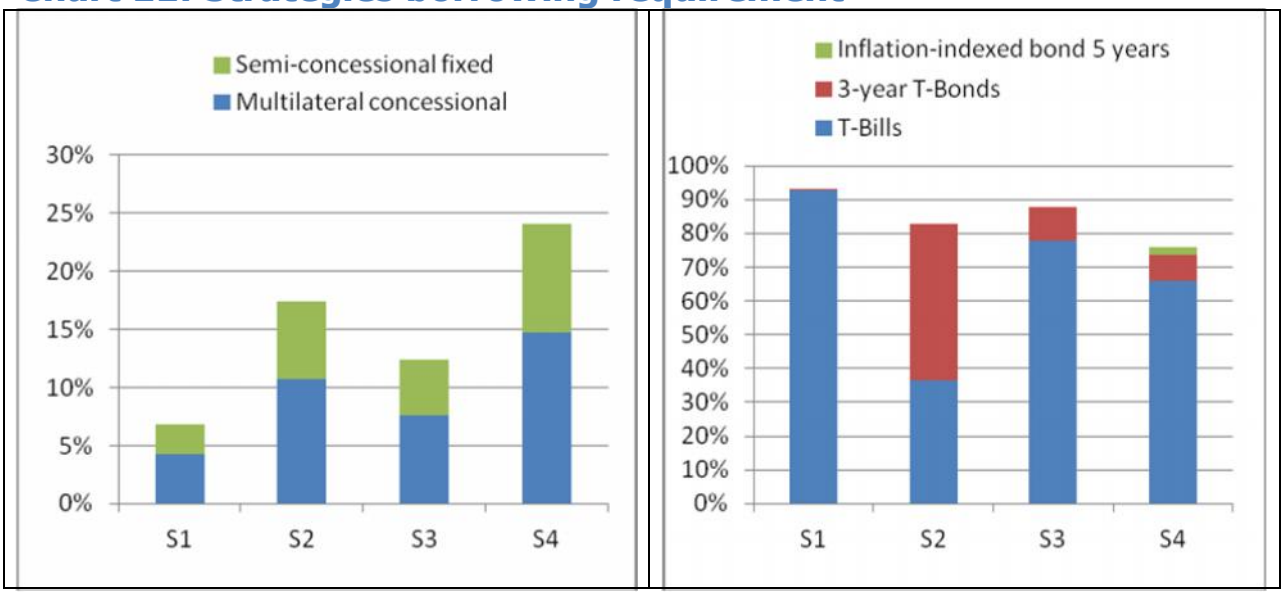
Strategy 4 – Maximize external borrowing

Net Domestic Borrowing is reduced to -2 percent of GDP over the four-year time horizon, reflecting the strategy envisaged in the 2010 Bank-Fund DSA for the Gambia. It is characterized by a domestic debt to GDP trajectory which falls from 21 percent in 2011 to 10 percent by 2014. 3-year bond and inflation indexed debt are introduced as domestic debt instruments in the strategy.

Table 6:Key characteristics of the four alternative strategies

Strategy	Key objective	NDB	Gross Domestic versus external financing	Net Domestic versus external financing	Domestic mix	External mix	Feasibility
1	Status quo strategy: Continue to borrow domestically	2.0 %	93% vs 7%	105% vs -5%	T-bill 99.7% T- bond 0.3%	Multi-concessional 66% Semi-concessional 34%	High domestic debt level and interest cost
2	Domestic 90%, External 10%	1.7 %	90% vs 10%	82% vs 18%	T-bill 85% - T-bond 15%	Multi-concessional 60% Semi-concessional 40%	Still too much pressure on domestic borrowing
3	Gradual reduction of NDB to 0% in 4 years. Also domestic lengthening	1.1 %	86% vs 14%	53% vs 47%	T-bill 85% - T-bond 15%	Multi-concessional 58% Semi-concessional 42%	Time to maturity lengthened, and rate of accumulation diminished
4	Reduce domestic stock by 10% GDP over 5 years (NDB=-2% of GDP)	-0.9 %	72% vs 28%	-60% vs 160%	T-bill 80% - T-bond 15% Inflation indexed bond 5%	Multi-concessional 63% Semi-concessional 37%	This shows the re-profiling and reduction of domestic debt stock

Chart 11: Strategies borrowing requirement



6.5 Analysis of results

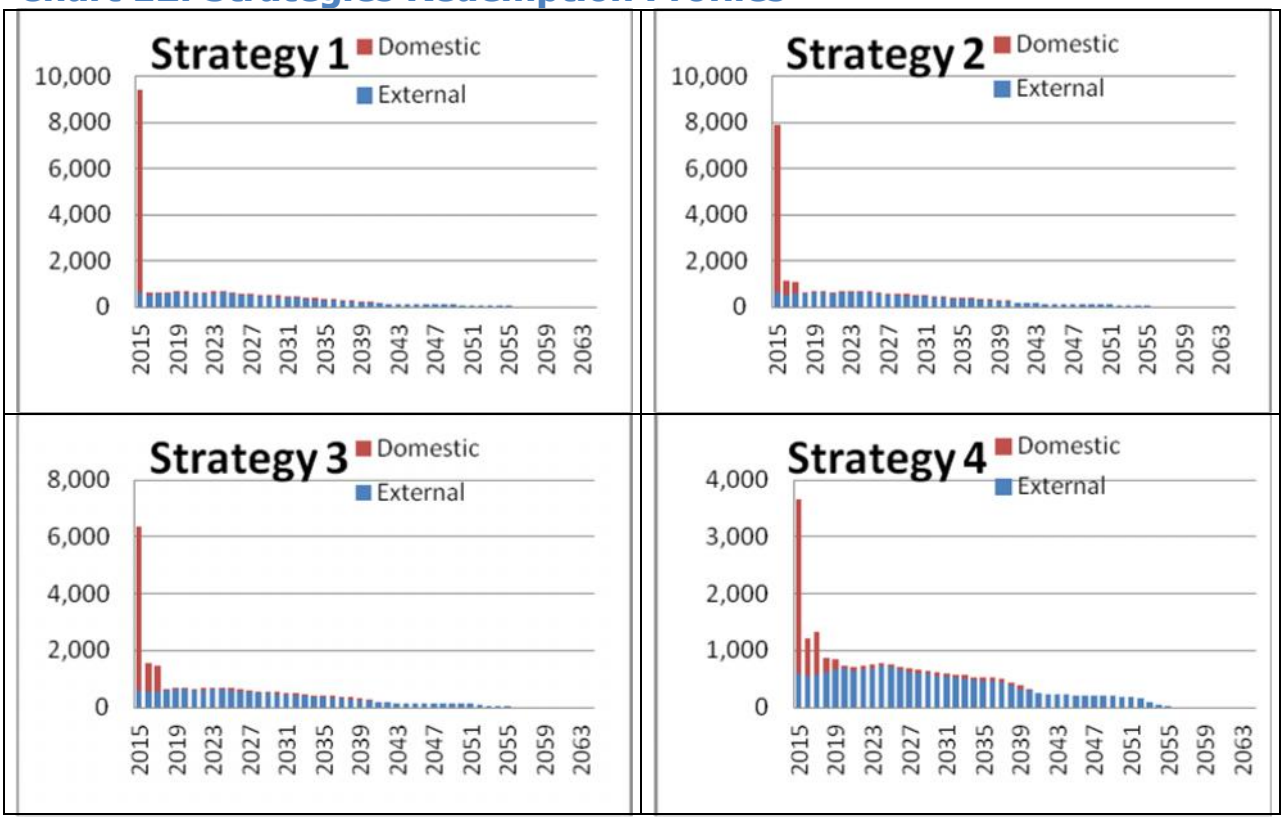
- Strategy 4 advocates for the maximum utilization of the available external sources of financing from both the multilateral concessional and semi-concessional fixed windows, whereas, the other strategies assume less external financing and are much less with strategy 3 and 1.

- On the domestic front, strategy 2 assumes for a slight reduction in domestic borrowing and massive graduation into 3-year Bonds while strategy 4 on the other hand, assumes more significant reduction on domestic borrowing and gradual graduation into 3-year bonds and inflation 5-year linked bonds.

6.5.1 Refinancing Risk

- Comparing strategy 1 with the original profile, there is no significant difference. However, Strategy 4 issues longer term debt, significantly less T-bill roll-over. See the charts below:

Chart 12: Strategies Redemption Profiles



6.5.2 Nominal Debt to GDP and PV of debt to GDP

- Level of debt quite similar across strategies, as the debt strategies mostly affect the composition rather than the level of debt

- On the PV of debt, S4 goes more into long-term external debt (more concessional).

6.5.3 Interest Cost of each strategy

- Strategy 4 emerged the lowest and the best. This is due to the fact that it is more longer term and concessional in composition.

6.5.4 Average time to maturity of the different strategies

- On the external side, strategy 4 is the best because it is more of a long-term external debt.

- On the domestic side, strategy 4 is the best due to more 3 and 5-year bonds followed by strategy 3 then 2 and 1 last.
- Overall, strategy 4 is the best because it is more long term, 3 and 5-year bonds, followed by strategy 3 then 2 and 1 last.

6.5.5 Average time to Refixing (ATR) of the different strategies

- ATR is higher with strategy 4 due to the long-term external debt, 3 and 5 year bonds, followed by strategy 3 and then 2.

6.5.6 Foreign exchange Risk (FX risk) of the different strategies

- The FX risk is high with strategy 4 with 72.7%, due to the significant exposure of the strategy into more external concessional borrowings.
- The strategy with the least FX risk is strategy 1 with 55.2%, which is very similar to the current strategy, focusing more on domestic borrowing.

Table 6: Summary of Risk Indicators

Risk Indicators		2010	As at end FY2014			
		Cur-rent	S1	S2	S3	S4
Nominal debt as % of GDP		68.3	59.7	60.7	59.8	59.5
PV as % of GDP		57.5	50.4	50.4	49.1	46.1
Implied interest rate (%)		5.3	5.2	5.9	5.1	4.2
Refinancing risk	ATM External Portfolio (years)	13.0	13.5	14.1	14.3	15.4
	ATM Domestic Portfolio (years)	3.8	2.9	3.1	3.4	4.6
	ATM Total Portfolio (years)	9.1	8.8	9.5	10.1	12.6
Interest rate risk	ATR (years)	9.1	8.8	9.5	10.1	12.6
	Debt refixing in 1yr (% of total)	34.2	39.7	32.8	26.8	15.4

	Fixed rate debt (% of total)	100.0	100.0	100.0	100.0	100.0
FX risk	FX debt as % of total	57.0	55.2	58.1	61.0	72.7
	ST FX debt as % of re-serves	8.9	8.4	8.4	8.4	8.4

6.5.7 Risk to the different Strategies

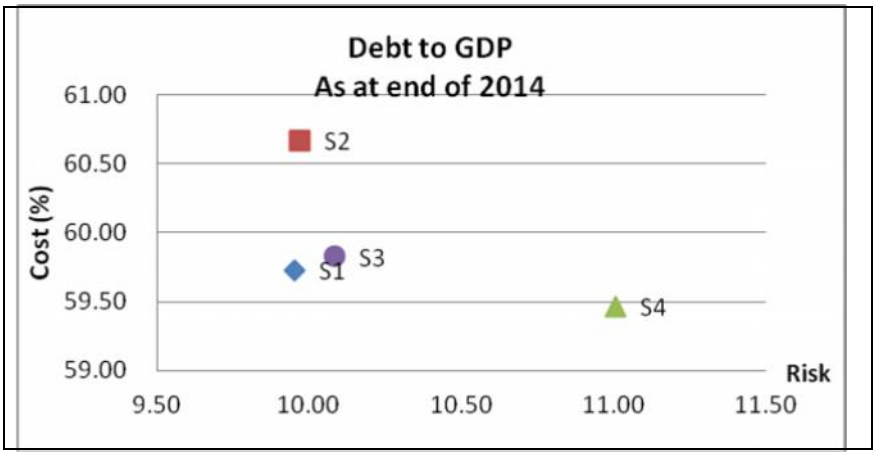
6.5.7.1 Nominal Debt to GDP and PV of debt to GDP

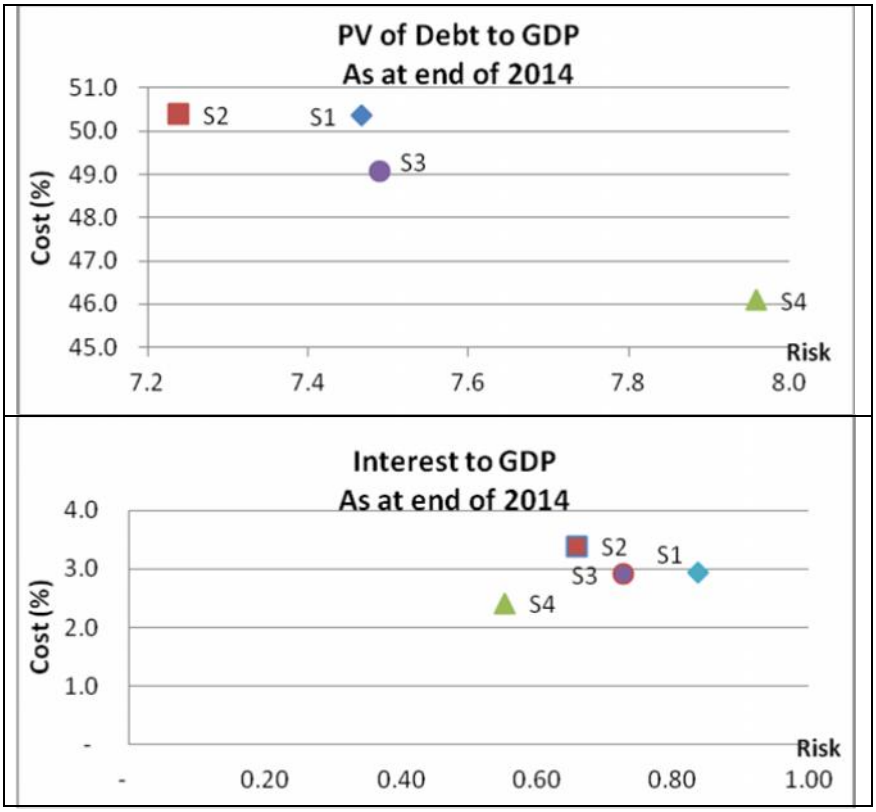
- The largest risk impact is when there is 30% devaluation, See annex for further details.
- Strategy 4 stands out to be more risky in term of both Debt to GDP and PV of debt to GDP due to the significant exposure to foreign currency risk, followed by strategy 3. Strategy 1 and 2 have almost the same risk level in the Debt to GDP chart and strategy 1 stands out more risky than strategy 2 in the PV of debt to GDP chart. See the charts below:

6.5.7.2 Interest Cost of each strategy

- S1 has the highest interest risk due to its huge share of domestic debt. However, strategy 4 has the lowest interest risk due to its larger share of external fixed debt.
- The largest impact is when there is a yield curve parallel up + 15% devaluation. See annex.

Chart 13: Debt Ratios





6.5.7.3 Average annual gross financing over 2012-14

- The average annual gross financing needs under the different strategies are all feasible. On the domestic side, the annual gross financing in 2011 was 7.45 billion dalasis equivalent to USD 276 million. All the alternative strategies examined fall below this level, showing the feasibility of the annual gross financing domestically in all the four strategies.
- On the external side, the sources of external financing show that all the four strategies are also feasible. Strategy 4 with the highest external annual gross financing of USD 55 million is still below the 2011 level of annual aggregate external sources of financing. See table below:

Table 7: Average annual gross financing over 2012-14

	S1	S2	S3	S4
Total domestic (GMD mn)	8,017	2,762	6,299	4,249
T-Bills	7,993	0	5,354	3,399
T-bonds	24	2,762	945	637

Inflation-indexed bond 5 years	0	0	0	212
Total external (USD mn)	15	23	28	55
Multilateral concessional	9	14	17	33
Semi-concessional fixed	6	9	11	22

7.0 Conclusion

The objective of the MTDS, as stated earlier, is to address the major debt problems confronting the Gambia's debt portfolio and the decision is to seek concessional external financing and to lengthen the maturity profile of domestic debt to reduce the roll-over risk. Key to this strategy is reducing government's net domestic borrowing, which would ease pressure on yields and help make extending the maturity profile in a phased manner that will not lock in high costs upfront by extending the maturity too fast.
From the Analysis, strategy 4 stands out to be the best in terms of being less costly and a smooth redemption/repayment profile of the debt portfolio. However, the strategy is more risky in terms of Debt to GDP and PV of Debt to GDP. It will also require more communication with the market as it projects issuance of 3-year nominal and 5-year inflation-indexed bonds.

Following strategy 4 implies that, given the budget deficit projection of 7.92 billion dalasi in fiscal year 2012, there is a need to finance part of the deficit through external funding. Since the government has to date contracted external loans only for project financing, the government should seek to mobilize external funding for budget support.

Being fully aware of the challenges that lie ahead, The Gambia Government is hereby adopting strategy 4 (four) and henceforth begins its implementation in addressing the major issues confronting its debt portfolio.

Annex

Debt Stock to GDP ratio as at end 2014

Scenarios	S1	S2	S3	S4
Baseline	59.7	60.7	59.8	59.5
Exchange Rate Shock (30%)	69.7	70.6	69.9	70.5
Interest Shock 1	61.6	62.1	61.6	60.9
Interest Shock 2	60.3	62.1	60.6	60.1
Combined Shock (15% depreciation and IR Shock)	66.6	67.1	66.6	66.5
Max Risk	10.0	10.0	10.1	11.0

Interest Payments to GDP Ratio as at end 2014

Scenarios	S1	S2	S3	S4
Baseline	2.9	3.4	2.9	2.4
Exchange Rate Shock (30%)	3.1	3.5	3.1	2.6
Interest Shock 1	3.7	3.9	3.5	2.9
Interest Shock 2	3.2	4.0	3.2	2.7
Combined Shock (15% depreciation and IR Shock)	3.8	3.9	3.6	3.0
Max Risk	0.8	0.7	0.7	0.6

PV of Debt to GDP Ratio as at end 2014

Scenarios	S1	S2	S3	S4
Baseline	50.4	50.4	49.1	46.1
Exchange Rate Shock (30%)	57.8	57.6	56.6	54.0
Interest Shock 1	52.2	51.6	50.6	47.3

Interest Shock 2	51.0	51.5	49.8	46.6
Combined Shock (15% depreciation and IR Shock)	55.9	55.2	54.4	51.3
Max Risk	7.5	7.2	7.5	8.0

Gross borrowing requirement

% of gross borrowing - Over Projection Period					
New debt		S1	S2	S3	S4
IDA	FX	4%	11%	8%	15%
AfDF	FX	0%	0%	0%	0%
Semi-concessional	FX	3%	7%	5%	9%
Semi-concessional	FX	0%	0%	0%	0%
0 0		0%	0%	0%	0%
0 0		0%	0%	0%	0%
T-Bills	DX	93%	37%	78%	66%
T-bonds	DX	0%	46%	10%	8%
Inflation-indexed bond 5 years	DX	0%	0%	0%	3%
Miscellaneous consolidated debt	DX	0%	0%	0%	0%
NA	FX	0%	0%	0%	0%
NA	FX	0%	0%	0%	0%
NA	FX	0%	0%	0%	0%
NA	FX	0%	0%	0%	0%
NA	FX	0%	0%	0%	0%
External		7%	17%	12%	24%
Domestic		93%	83%	88%	76%
		100%	**100%**	**100%**	**100%**

MATRIX OF BORROWING PARAMETERS

Indicators	Target
Real Growth	5-6%
Annual Inflation	5%
Net Domestic Borrowing	½% of GDP by 2014
International Reserve	5 or more months of import cover