بسم الله الرحمن الرحيم

Ministry of Finance
Male' Maldives

MEDIUM-TERM DEBT STRATEGY

2024-2026

31 July 2023

Content

1. Introduction

In accordance with the Fiscal Responsibility Act (Law Number 7/2013), the Government is obligated to present a Medium-Term Debt Strategy (MTDS) Statement to the Public Accounts Committee of the People's Majlis by the end of July each year. This strategy has been prepared in accordance with the requirements stipulated in Article 22. The information includes the following:

1. Targets for public debt.

2. Target for the ratio of total public debt to gross domestic product (GDP).

3. Target ratio of external and domestic debt.

4. Ongoing and planned measures to mitigate risks associated with public debt.

5. Specifics regarding the utilization of borrowed funds.

This report provides an overview of the risks associated with the government's debt portfolio as of 2022 and presents a forecast of the risks expected in the portfolio for 2023. It also covers the cost of debt servicing, the status of the international debt capital market, and outlines how the government intends to uphold and implement the MTDS while adhering to the parameters established by the government to manage the debt portfolio effectively.

1.1 Objectives for Debt Management

The primary goal of the MTDS is to effectively meet the government's financing requirements while minimizing costs and maintaining a prudent level of risk. Simultaneously, it aims to continue the development and diversification of the domestic debt market.

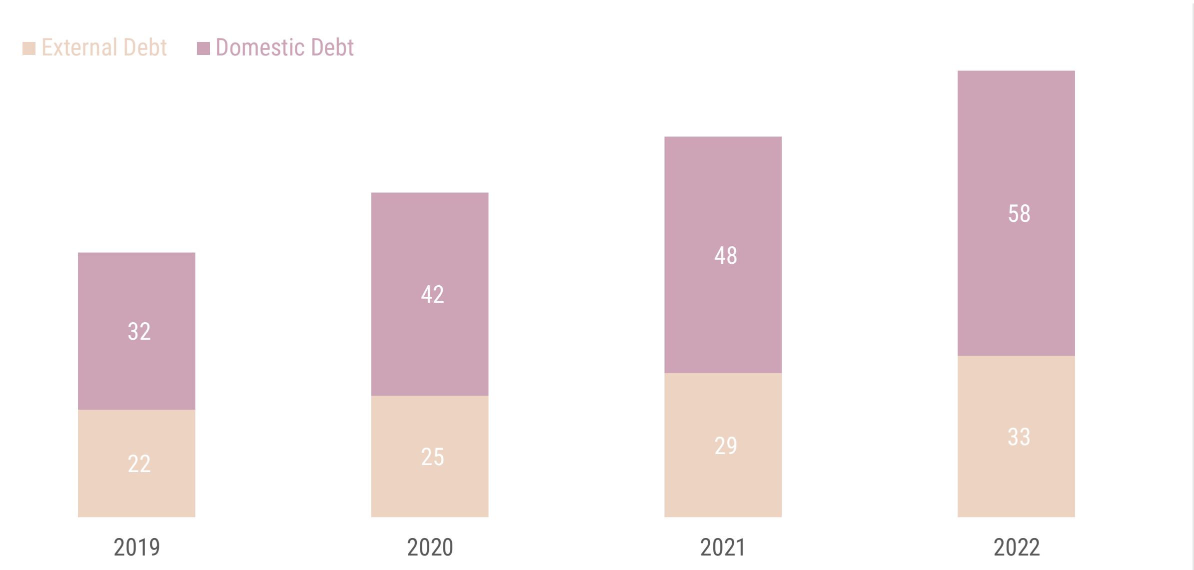
1.2 Scope of Coverage

The MTDS focuses on the government's total borrowing, as defined in section 40 (faafu) of the Public Finance Act (No. 7/2013). The definition of government debt excludes sovereign guarantees and other contingent liabilities. However, given that the sovereign guarantees pose risks to the debt portfolio, an evaluation of this risk is included in the report. The MTDS is a three-year strategy, and it is updated annually. To determine the most advantageous debt portfolio strategy, the MTDS is developed by assessing different approaches using a toolkit provided by the International Monetary Fund (IMF) and the World Bank Group.

2. Breakdowns of Government Debt

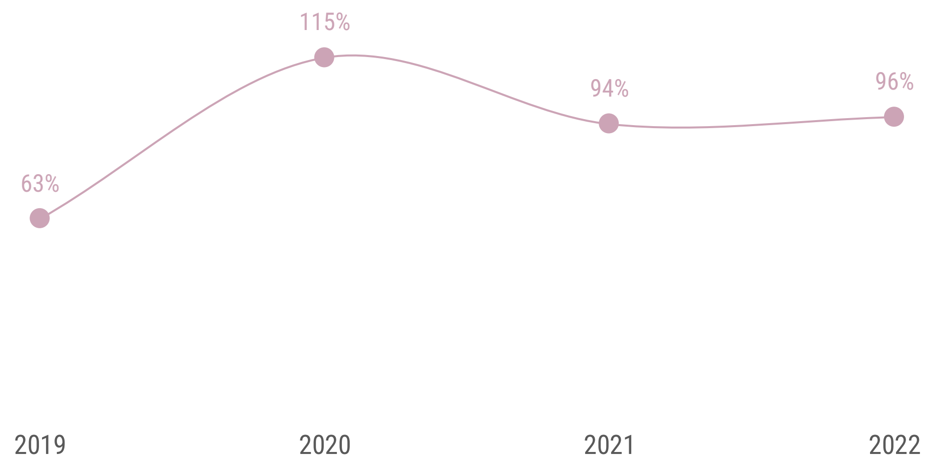
The total debt outstanding as of December 2022 was MVR 91.5 billion, which accounts for 96 percent of GDP.

Chart 1: Central Government Debt (in MVR Billions) and Debt as percentage of nominal GDP



Source: Ministry of Finance

Chart 2: Central Government Debt as percentage of nominal GDP

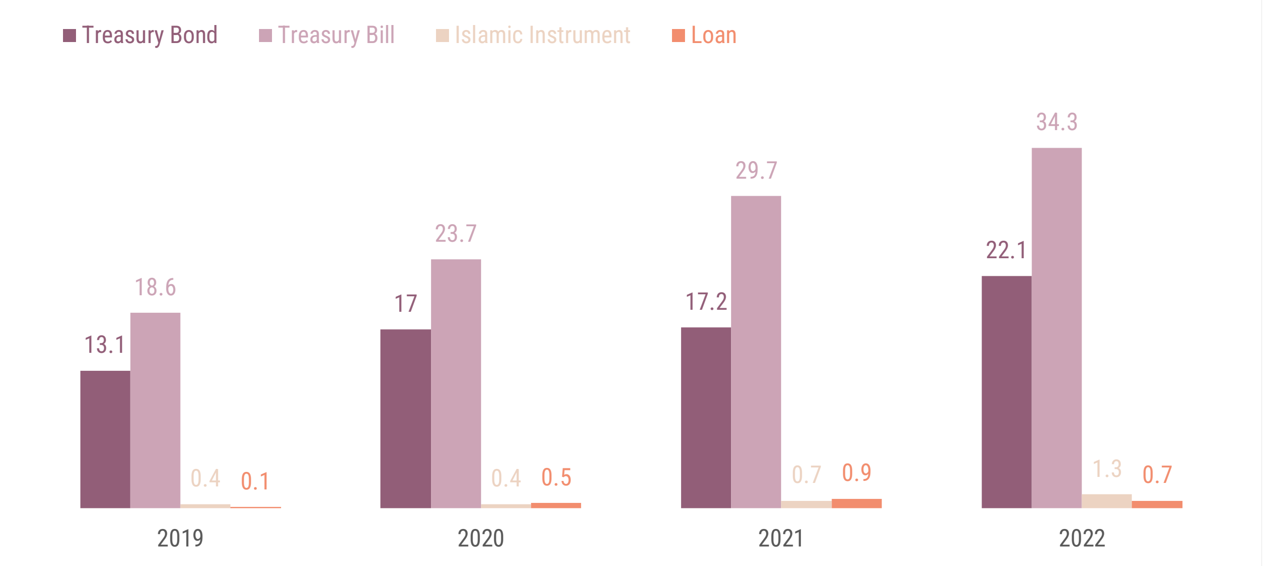


Source: Ministry of Finance

2.1 Domestic Debt

As of 2022, the domestic debt stood at MVR 58.4 billion, which accounts to 63.8 percent of the total Government debt. The largest share of domestic debt is held in treasury bills, representing 58 percent of the total domestic portfolio as of 2022.

Chart 3: Outstanding domestic debt by Instrument type (in MVR billions)

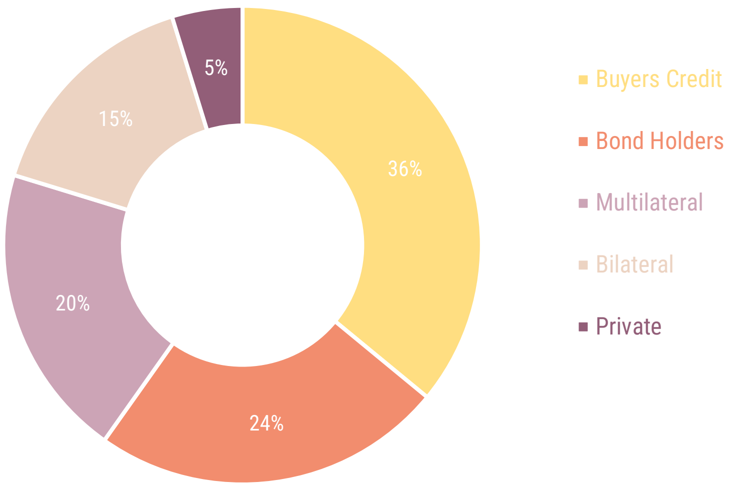


Source: Ministry of Finance

2.2 External Debt

The external debt stood at MVR 33.1 billion as of 2022, accounting for 36.2 percent of total Government debt. Debt outstanding under buyer's credit lenders held 36 percent of the external debt portfolio followed by Bondholders with 24 percent. Multilateral agencies held 20 percent, while 15 percent was held by bilateral agencies. The remaining 5 percent represents debt outstanding to Private creditors.

Chart 4: Share of External Disbursed Outstanding Debt by Creditor (as at 31 December 2022)

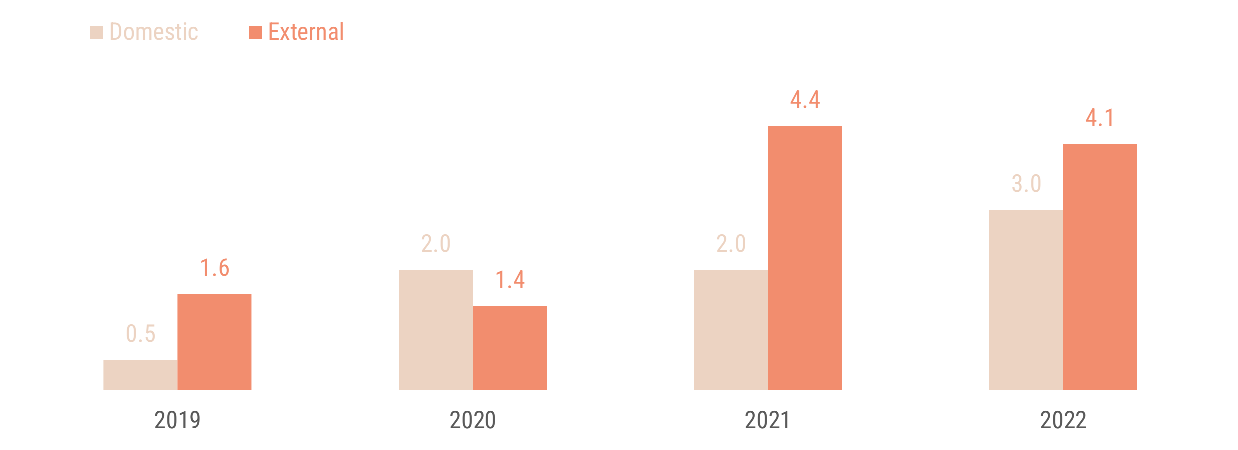


Source: Ministry of Finance

2.3 Debt Servicing

A total of MVR 7.1 billion was utilized for debt servicing during 2022, of which, MVR 3.0 billion was utilized for servicing of domestic debt. Of this, MVR 1.7 billion is for interest payments and MVR 1.3 billion is principal repayments. Out of the MVR 4.1 billion utilized for debt service of external debt, MVR 1.7 billion is for interest payments and the remaining MVR 2.4 billion is principal repayments.

Chart 5: Debt Service Cost from 2019 - 2022 (MVR billions)

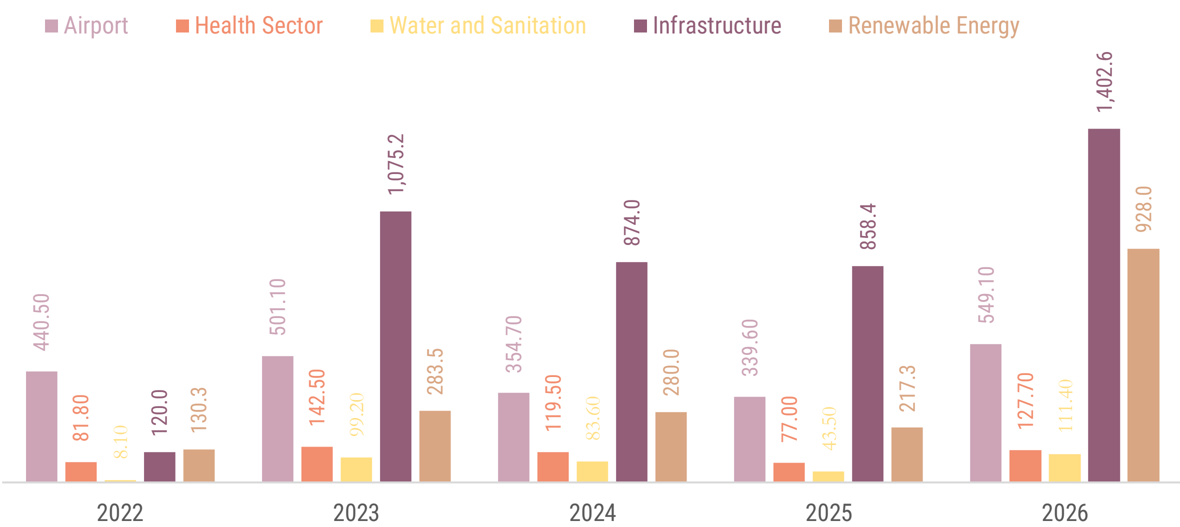


Source: Ministry of Finance

3. Utilization of Borrowed Funds

Loan disbursements were mainly utilized for projects carried out in sectors including infrastructure development and healthcare. These encompassed projects such as the development and expansion of several airports across the country, including the expansion of the passenger terminal building at the Velana Interntional Airport; construction of ports in various islands; water and sanitation initiatives; and renewable energy generation projects. Furthermore, the second phase of the Gulhifalhu land reclamation project is underway to address land shortages in the Maldives. Notably, a significant portion of the financing for these projects was secured at favorable terms, along with long-term repayment plans, contrasting with prevailing interest rates in the Debt Capital Market.

Chart 6: Consolidated Disbursement Snapshot (in MVR millions)



Source: Ministry of Finance

4. Risks in the Debt Portfolio

As of 2022, the primary risks of the government debt portfolio are (1) exchange rate risk, (2) refinancing risk, and (3) interest rate risk.

Table 1 illustrates key cost and risk indicators at the end of 2022 and forecast for the end of 2023

Indicator		2022	2023 (F)
Cost of Debt	Interest (as a % of GDP)	4.6	4.5
	Implied Interest Rate (%)	4.8	6.0
Refinancing Risk	Average Time to Maturity (Years)	6.3	5.3
	Debt Maturing in one year (% of total debt)	37.0	47.2
	Debt Maturing in one year (% of GDP)	39.5	42.4
Interest Rate Risk	Average Time to re-fixing (Years)	6.3	5.3
	Debt re-fixing in one year (% of total debt)	37.0	47.2
	Fixed Rate Debt (including Treasury Bills)	83.8	97.1
Exchange Rate Risk	Foreign Currency Debt (% of total debt)	40.4	43.1
	Short term Foreign Currency Debt (% of foreign reserves)	23.4	32.6

Source: Ministry of Finance

4.1 Exchange Rate Risk

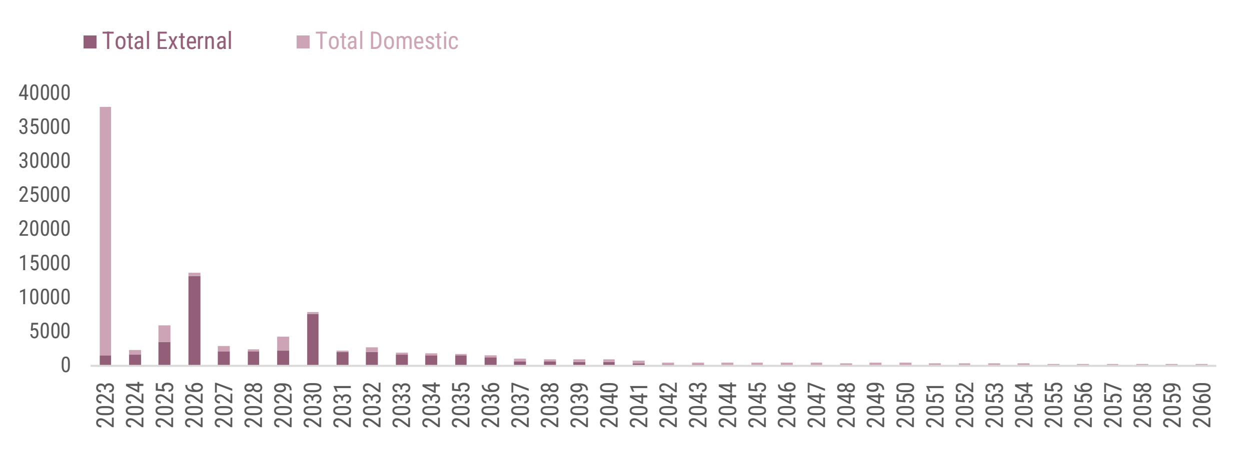
Exchange rate risk has become a significant risk to the government's debt portfolio. Despite a decline of 9.7 percent in the government's foreign currency borrowings in 2022 compared to 2021, given that a significant proportion of the debt portfolio is denominated in foreign currency, the exchange rate risk remains as one of the primary risks to the debt portfolio. As of 2022, 37 percent of the total direct borrowings were denominated in foreign currency. The decrease in foreign currency denominated debt in 2022 was due to the settlement of the remaining USD 58.0 million of the sunny-side bond upon maturity during the year. In addition, the securitization of Public Bank Account overdraft of MVR 4.3 billion to a long-term bond in 2022 resulted to an increase in the share of local currency denominated debt in the debt portfolio which also resulted to a change in currency composition of the debt portfolio. Even though foreign currency denominated debt decreased in 2022 when compared to 2021, there was an 11 percent increase in short-term foreign currency debt as a proportion of the government's foreign currency reserves. This poses a significant risk to the exchange rate in the short term.

A floating exchange rate band of 12.85 rufiyaa between ±20 percent was fixed between the Rufiyaa and the Dollar in 2011. However, over the past years, the exchange rate between Rufiyaa and Dollar has remained at the band's upper value of MVR 15.42. In the perspective of the risk, a 10 percent depreciation of Rufiyaa against the US Dollar will increase the country's total debt by approximately MVR 5 billion. This signifies the importance of monitoring and managing the exchange rate risk within the debt portfolio.

4.2 Refinancing Risk

Refinancing risk can arise from either (i) having to refinance at a higher interest rate or (ii) inability to refinance. The primary factors that signal potential risks associated with refinancing are the Average Time to Maturity (ATM) and the debt that will mature within one year. The ATM of the debt portfolio increased from 6.2 years in 2021 to 6.3 years by the end of 2022 and the debt maturing in one year decreased from 40.1 percent to 37.0 percent. The main reason for this is the settlement of the remaining outstanding sunny side bond of USD 58.0 million, which accounted for a large share of the debt maturing within one year. However, there are upcoming significant bullet payments in 2025 and 2026. This includes a USD 500.0 million Sukuk, and a USD 100.0 million privately placed bond invested by Abu Dhabi Fund for Development. Moreover, the likelihood of an increase in interest rates in the global financial market poses a potential risk of an increase in the implied interest rate, thus increasing the refinancing risk.

Chart 7: Budgetary Central Government Debt Redemption Profile 2023 –2060 (in MVR millions)

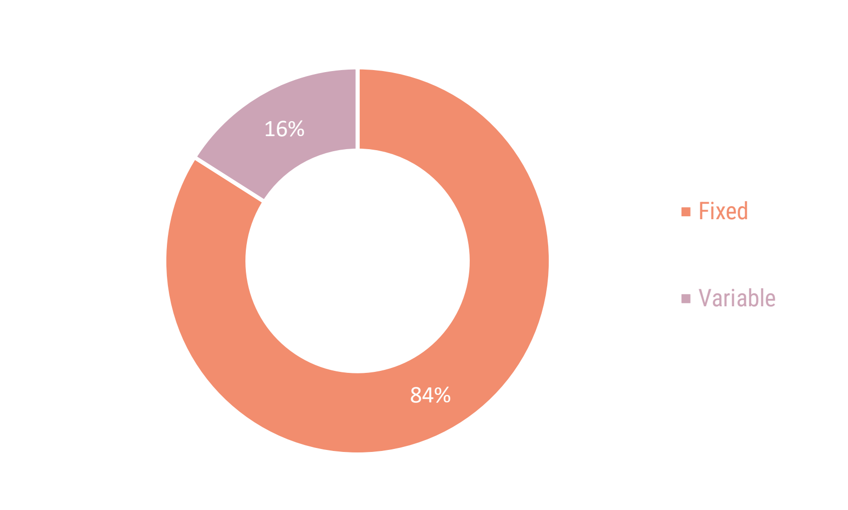


Source: Ministry of Finance

4.3 Interest Rate Risk

The key indicators to analyze the interest rate risk include the Average Time to Re-fixing (ATR), and the amount of debt that requires re-fixing within one year, the percentage of fixed-rate debt compared to the total debt, and the implied interest rate. As of 2022, the ATR of the debt portfolio was at 6.3 years. Debt required to be re-fixed within a year stood at 37.0 percent and the fixed-rate debt stood at 83.8 percent at the end of 2022. However, the implied interest rate of the debt portfolio increased to 4.8 percent in 2022. This increase can be primarily attributed to the high interest rates in the global financial market at the time of refinancing.

Chart 8: Fixed rate debt as a percentage of total debt (2022)

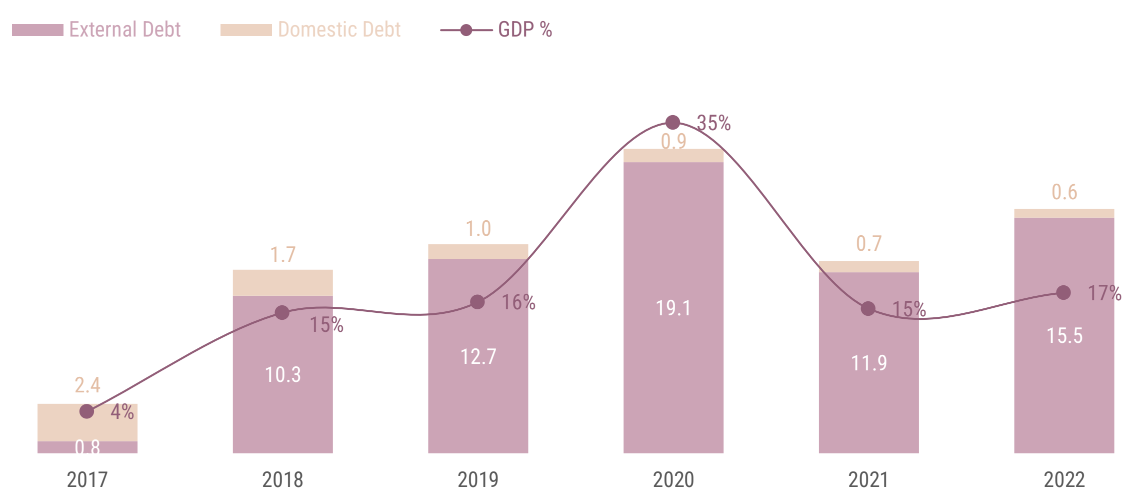


Source: Ministry of Finance

4.4 Contingent Liability Risk

As of 2022, the total sovereign guaranteed debt outstanding stood at MVR 16.0 billion, which is an increase of 27.0 percent when compared to 2021. This increase is mainly because of the utilization of currency swap facility by MMA for which a guarantee was issued to the Reserve Bank of India. This accounted for 20.0 percent of the total sovereign guaranteed debt outstanding as of 2022.

Chart 9: Outstanding Guaranteed Debt (2017-2022) in MVR billions



Source: Ministry of Finance

4.5 Operational Risk

Operational risk within the debt management function encompasses a wide range of potential risks that can disrupt debt service and overall debt management operations. These include systems and processes used to record and manage debt, as well as the risks associated with the debt portfolio. In line with the recommendations and guidance provided by international financial institutions such as the IMF and the World Bank, the Ministry has been actively working towards strengthening its debt management processes. To consolidate and streamline the debt management functions, a comprehensive front, middle, and back-office structure has been established within the Ministry. This structure aims to centralize debt management activities and ensure compliance with international standards. Furthermore, the Ministry is in the process of formulating a debt management law to provide a robust legal framework for effective debt management. In addition, the Ministry is actively undertaking measures to identify areas that require improvement within the realm of debt management. This includes conducting assessments to determine the necessary enhancements and implementing appropriate measures to address any identified gaps.

The Ministry is currently engaged in efforts to mitigate operational risks in day-to-day operations by updating standard operating procedures (SOPs) pertaining to debt management. Moreover, initiatives are being undertaken to enhance debt operations by automating approximately 90 percent of daily tasks through electronic means by the end of 2023. The aim is to leverage technology and improve efficiency in managing debt-related activities. The Ministry has recently migrated to Meridian, a new debt recording, and management system developed by the Commonwealth Secretariat. The focus is now on finalizing the implementation of the system and ensuring its smooth operation. The implementation of this system will revolutionize the debt management process, ushering in a contemporary approach that significantly enhances operational efficiency. It will enable seamless integration with the government's primary accounting software (SAP), facilitating streamlined reporting of debt-related information. Additionally, efforts are underway to establish an electronic trading platform and a central securities depository, both interconnected with the National Payment System. Upon successful implementation of these systems, their integration shall facilitate the development of a secondary market for debt instruments.

5. Medium-Term Financing Requirements and Sources

5.1 Financing Requirements

The projected amount of gross financing (excluding rollover of T-bills) required to cover fiscal deficits and debt repayments are anticipated to rise in the medium-term. As per the Medium-Term Fiscal Strategy (MTFS) 2024-2026, it is expected to increase from MVR 13.4 billion in 2024 to MVR 14.2 billion by 2026. Despite efforts to consolidate the primary balance, the expected growth in these financing needs is primarily driven by higher obligations for debt servicing, rising fuel prices and increased investment in development projects. As a result, in the baseline scenario, interest expenses are estimated to grow by 0.1 billion in 2026 compared 2024.

5.2 Potential Funding Sources

To achieve the primary focuses outlined in this strategy, the government intends to raise financing by prioritizing tapping into the most concessional facilities first, prior to engaging with other potential financing avenues. Additionally, as part of the government's strategy of diversifying the debt portfolio, the Ministry intends to explore innovative financing mechanisms in the medium term as well.

To secure budget financing, the government's focus is to secure loans from domestic sources, such as the securities market and money market, as these domestic creditors play a significant role in fostering liquidity within the domestic capital market. As such, in the progress to strengthen the relationships with the current investors, the government has planned to hold an investor forum in 2024. In 2022, the government has opened windows for the public to invest in short-term instruments. Consequently, in 2022, the government introduced new Shariah complaint instruments which enabled the investors to invest their excess funds and diversify the domestic capital market. Additionally, this measure aims to decrease dependence on external sources.

In the medium term, the government intends to list 5 –to 10-year bonds on the stock exchange instead of issuing privately placed bonds only. It is worth noting, the government has been closely working on the development of domestic securities market, by acquiring a central securities depository system and automating the government securities issuance and settlement function. As a result, this would help to increase the investor base and further develop and deepen the domestic capital market.

6. Debt Strategy 2024-2026

6.1 Description of the strategy

The preferred strategy was selected after comparing three strategies and assessing the relative costs and risks scenarios, financing sources, the measure of diversification required and the conditions of the international debt capital market. As such, the risks associated with the current debt portfolio remains unchanged from what was identified in the previous debt strategy for the period 2023-2025. Hence, the two major risks arising from exchange rate risk and refinancing risk from the previous strategy remain unaltered. Nonetheless, the current approach also details ways to mitigate these risks.

In addition, this strategy aims to reduce the share of external debt portfolio year by year. As a result, reducing the external debt and obtaining financing at a minimal cost would enable us to reduce the share of external debt in the medium term. The following section outlines the main assumptions and proposed activities for this strategy.

6.2 Key Assumptions

In the MTDS model, projections of the government's fiscal balances and macroeconomic factors from the MTFS are used to generate estimated baseline figures for the portfolio's cost and risk indicators, considering different financing strategies. The following section outlines the essential assumptions regarding the preferred mix of financing in this MTDS.

6.2.1 Financing assumptions

i. Optimize utilization of external concessional financing.
ii. To minimize the risks in foreign currency, the strategy aims to maintain a balanced ratio between domestic and external net financing throughout the strategy period, with a target ratio of 50:50.
iii. Based on the conduciveness of the international debt capital market, this strategy aims to issue securities with a maturity of 5 to 7 years.
iv. This strategy also aims to gradually shift 4.0 percent of Treasury Bills to MVR bonds with a maturity of 5 to 10 years.

6.3 Methodology and Strategy Analysis

Strategies were simulated using the MTDS Toolkit considering the above assumptions and the outcome of these strategies were evaluated. The analysis of these strategies was focused on cost indicators including interest/GDP and Debt/GDP, as well as risk indicators such as ATM, ATR, and redemption profile.

7. Expected Outcome from Strategy Implementation

Table 2: Expected changes to cost and risk indicators with the implementation of the Strategy

Indicator		2022	2023	2024	2025	2026
Debt to GDP		**95.2**	97.6	101.0	94.6	89.8
Cost of Debt	Interest rate (as a percent of GDP)	**4.6**	4.1	5.4	5.3	4.6
	Implied Interest rate (%)	**4.8**	6.0	5.8	5.2	5.5
Refinancing risk	Average time to maturity (years)	**6.3**				7.0
	Debt maturing in one year (% of total debt)	**37.0**	40.1	44.5	53.9	41.2
	Debt maturing in one year (% of GDP)	**39.5**	39.2	44.9	50.9	42.4
Interest Rate risk	Average time to re-fixing(years)	**6.3**				7.0
	Debt re-fixing in one year (% of total Debt)	**37.0**	40.1	44.5	53.9	47.2
	Fixed Rate Debt (Including T-Bills)	**83.8**	97.1	98.1	98.5	98.9
Currency risk	FX Debt (% of total debt)	**40.4**	43.1	43.4	42.6	36.7
	Short term FX debt (% of Gross International Reserves)	**23.4**	32.6	34.7	97.2	16.4

Source: Ministry of Finance

7.1 Analysis of cost and risk indicators

The baseline scenario of the MTDS is chosen based on the medium-term economic outlook and fiscal adjustments taken from the medium-term fiscal strategy 2024-2026. The strategy aims to reduce debt to GDP percentage from 95.2 percent to 86.4 per cent in 2026. However, given the government's interest expenditure on existing borrowings, it is projected that the debt interest expenditure as a percentage of GDP will maintain a level of 4.6 percent by the end of 2026. The implied interest rate on the debt portfolio is expected to rise from 4.8 percent in 2022 to 5.5 percent by the end of 2026, along with the refinancing risks posed by bullet repayments of foreign currency debt in 2026.

When considering refinancing risk indicators, the ATM of the government debt portfolio is anticipated to extend to 7.0 years by the end of 2026. The percentage of debt maturing in one year is expected to increase from 37.0 per cent at the end of 2022 to 41.2 per cent by the end of 2026. This is mainly due to the conversion of some short-term Treasury bills to long-term bonds over the next three years.

In terms of interest rate risk, the average time to re-fixing was 6.3 years at the end of 2022. It is expected to rise to 7.0 years by the end of 2026. Under this strategy, fixed-rate debt is expected to increase from 83.8 per cent at the end of 2022 to 98.9 per cent by the end of 2026 and the impact of variable-rate borrowing on total debt portfolio is expected to be minimal.

The outcomes of this strategy indicate a favorable effect on the exchange rate risk, which is recognized as a significant risk to the government's debt portfolio. Despite an anticipated increase in foreign borrowings compared to previous years, the strategy aims to reduce the proportion of foreign currency debt from 40.4 percent by the end of 2022 to 36.7 percent by the end of 2026.

7.2 Strategy Implementation

The proposed strategy is intended to achieve the government's debt management objectives and targets in the medium-term. The medium-term policies, aligned with the government's debt strategy as analyzed in the current MTDS, will play a vital role in the successful execution of this strategy. Therefore, despite existing challenges, the following factors are essential for the successful implementation of the government's MTDS.

- Development and publication of an Annual Borrowing Plan (ABP)
- Vigilantly monitoring primary market practices and fostering strong relationships with market participants
- Assessing new financing options in alignment with the MTDS targets
- Conducting annual reviews of the MTDS due to uncertainties in the global economic outlook.
- Continue implementation of debt management reform plan and other technical expert advice to enhance the quality of public debt management.
- Formulate and implement the Debt law

8. Conclusion

Aligned with the objectives of public debt management, this strategy focuses on reducing exchange rate risk, refinancing risk, minimizing interest costs and their impact on the budget, developing domestic debt market, and expanding investor relations.

Consequently, the expected outcomes of the MTDS by the end of the implementation period are as follows:

1. Assist in mitigating the refinancing risk associated with the maturity of the USD 500 million Sukuk in 2026.
2. Development of the domestic capital market.
3. Enhancing the domestic capital market liquidity thereby improving the government's financing capabilities.
4. Allow to implement debt strategies which would minimize the risks to the debt portfolio.
5. Diversify the debt portfolio.