Note: This document was submitted to the People's Majlis on 31st July 2019. The figures used in this document are subject to further changes as they were based on forecasts made as at end of June 2019.

بسم الله الرحمن الرحيم

Ministry of Finance
Republic of Maldives

Medium Term Debt Management Strategy 2020-2022

1. Introduction

This Strategy outlines the Government's debt position and the ongoing and planned activities to strengthen debt management. The Strategy details the Maldives' debt position as of 2018, the projected debt for 2019, the actions planned to be executed during the Strategy period with regard to debt management, and the changes envisioned to the debt position from the execution of these actions.

This Strategy is prepared in accordance with Article 20 of the Fiscal Responsibility Act (FRA; 7/2013). Article 22 of the FRA details the information required to be included in the Strategy, as follows:

1. Public debt targets
2. Total public debt to gross domestic product (GDP) target
3. Target ratio of external and domestic debt
4. Ongoing and planned actions to mitigate risks related to public debt, and
5. Details of utilization of borrowed funds.

Despite notable achievements in economic development, Maldives faces numerous economic challenges. It is imperative that the country seeks cost effective and low risk options to finance ongoing and proposed national development initiatives. In recent years, there has been an increase in the reliance on domestic and international debt markets to source financing for development projects.

The main purpose of this Strategy is to ensure that medium to long term risks are considered, and the most cost effective financing options are sought in order to maintain public debt at sustainable levels, and support the development of the domestic debt market.

This Strategy defines public debt in accordance with the FRA, incorporating explicitly guaranteed loans into the analysis.

2. Maldives Debt Position

In 2018 total public debt stood at MVR 60,634 million, equivalent to 73% of GDP. It is estimated that by the end of 2019 this amount would increase to MVR 71,486 million, 80% of GDP. Table 1 details the recent trend in debt levels.

Table 1: Total public debt (MVR millions), 2014-2019

in MVR millions	2014	2015	2016	2017	2018	2019 Forecast
Total debt	**32,459**	**34,687**	**43,299**	**46,898**	**60,634**	**71,486**
Domestic debt	20,578	23,093	26,402	27,108	27,664	30,409

External debt	10,746	10,204	11,727	16,674	20,357	23,249
Publicly guaranteed debt	1,136	1,390	5,171	3,117	12,613	17,828
Debt to GDP	57%	56%	67%	62%	73%	80%

Public debt is estimated to increase by 18% in 2019 compared to 2018. The largest contribution to debt in 2019 is expected to come from publicly guaranteed debt, as projects being implemented with guaranteed loans are near completion and the underlying loans are expected to be fully utilized in the short term.

Domestic debt is expected to increase by 10% in 2019, on account of treasury bill investments worth USD 150 million by State Bank of India (SBI). This investment is a result of bilateral friendly ties between the Government of India and Maldives. Although an addition to direct debt, it is agreed that the Government of India will service all payments related to this investment, effectively removing the debt burden and any fiscal imbalances that may arise from this investment to the Government of Maldives.

Domestic Debt

In 2018 total domestic debt stood at MVR 29,363 million and is expected to increase to MVR 30,047 million by the end of 2019. This includes the domestic debt guaranteed by the Government. Table 2 illustrates the breakdown of domestic debt.

Table 2: Domestic debt outstanding (MVR millions), 2014 -2019

(MVR millions)	2014	2015	2016	2017	2018	2019 Forecast
Total domestic debt	**21,124**	**24,043**	**29,456**	**29,554**	**29,363**	**30,819**
MVR treasury bills	10,421	11,661	12,796	12,889	13,512	14,042
Reverse dual currency treasury bills	354	601	935	664	767	840
USD treasury bills	-	-	-	-	-	2,313
Mudharabah	270	320	320	540	490	370
Reverse dual currency mudharabah	-	-	-	-	216	216
Murabaha	101	-	127	-	29	-
Wakalah bi al-isthithmar	-	-	278	-	-	-
Sukuk murabaha	-	116	58	-	-	-
Treasury bonds	9,335	10,332	11,862	12,594	12,632	12,611
Commercial loans	97	64	26	420	19	18
Guaranteed domestic debt	547	951	3,054	2,447	1,699	409

The largest share of domestic debt is held in treasury bills. 49% of domestic debt in 2018 was held in treasury bills and this amount is expected to be at 56% by the end of 2019. However, this expected increase does not signify an increased dependence on treasury bills, as treasury bill holdings is expected to decline to a level equivalent to 2018 when SBI's USD 150 million investment is settled in 2020.

External Debt

External debt stood equivalent to 38% of GDP, at MVR 31,271 million in 2018. This includes both direct and guaranteed external debt. The largest share of external debt is held by commercial banks with 40%. The remaining includes 27% buyers' credit facilities, 16% from multilateral financial institutions and 11% from bilateral creditors.
In 2018, the Maldives Monetary Authority utilized a USD 100 million currency swap facility from Reserve Bank of India (RBI). As this facility was guaranteed by the Government, the utilization of the facility increased external debt by USD 100 million, which constitutes 5% of the outstanding external debt in 2018. The facility was fully repaid during the first quarter of 2019. Table 3 illustrates the breakdown of external debt.

Table 3: External debt (MVR millions), 2014 -2019

(MVR millions)	2014	2015	2016	2017	2018	2019 Forecast
Total external debt	**11,335**	**10,644**	**13,844**	**17,345**	**31,271**	**40,668**
Multilateral	4,506	4,141	3,908	4,265	5,158	6,963
Bilateral	2,925	2,609	2,190	1,875	3,448	3,928
Buyers credit	2,824	3,077	5,343	6,486	8,483	10,802
Commercial loans	1,080	817	868	4,719	12,641	18,975
Reserve Bank of India facility	-	-	1,535	-	1,541	-

Debt Servicing

The total debt servicing cost was MVR 5,557 million in 2018, and is estimated to be at MVR 7,309 in 2019. This includes servicing cost of both direct and guaranteed debt. 45% of the debt servicing cost of 2018 and 63% of 2019 corresponds to guaranteed debt. Table 4 depicts the breakdown of debt servicing cost.

Table 4: Debt servicing cost (MVR millions), 2014 -2019

MVR Millions	2014	2015	2016	2017	2018	2019 Forecast
Total debt servicing cost	**3,334**	**3,088**	**2,876**	**6,062**	**5,557**	**7,308**
Domestic debt	626	1,235	1,213	2,148	1,466	1,262
External debt	1,183	1,109	1,190	1,356	1,618	1,603
Publicly guaranteed debt	1,525	743	473	2,557	2,473	4,444
As a % of total revenue	**22%**	**18%**	**15%**	**30%**	**25%**	**30%**

3. Utilisation of Borrowed Funds

Funds borrowed in 2018 and 2019 were utilised towards implementation of key development projects and for budget support. Table 5 illustrates the expenditure on key projects during this period.

Table 5: Funds utilized for key projects (MVR millions), 2018-2019

Project	Creditor	Type of Debt	2018	2019 Forecast
China Maldives Friendship Bridge project	Export Import Bank of China	Direct Debt	591	51
Development of Hulhumale Island	Saudi Fund for Development	Direct Debt	69	175
Velana International Airport Project	The OPEC Fund for International Development	Direct Debt	31	101
Dollar Credit Line Agreement	Exim Bank of India	Direct Debt	-	1027
Velana International Airport Project	Kuwait Fund for Arab Economic Development	Direct Debt	-	132
Velana International Airport Project	Export Import Bank of China	Direct Debt	1846	669
Velana International Airport Project	Saudi Fund for Development	Direct Debt	346	10
Outer islands water supply and sewerage facilities project	The OPEC Fund for International Development	Direct Debt	204	27
Provision for water supply, sanitation and waste management project	The OPEC Fund for International Development	Direct Debt	208	105
Seenu Hithadhoo regional hospital project	Saudi Fund for Development	Direct Debt	59	76
Velana International Airport Project	Abu Dhabi Fund for Development	Direct Debt	-	149
Development of 1500 housing units in Maldives	Export Import Bank of China	Publicly Guaranteed Debt	-	135
2500 Social Housing Units Project	Bank of China, London Branch	Publicly Guaranteed Debt	-	308
Construction of 7000 Housing Units in Hulhumale Phase II	Industrial and Commercial Bank of China	Publicly Guaranteed Debt	3406	1793
Construction and Development of the Seaplane Facilities at VIA	China Development Bank	Publicly Guaranteed Debt	-	382
Construction of 7000 Housing Units in Hulhumale Phase II	Credit Suisse AG, Singapore Branch	Publicly Guaranteed Debt	1003	-
Design and Construction of Electricity System and Open Access Network of Hulhumale' Phase II	Browns-CMEC	Publicly Guaranteed Debt	-	593

Design and Construction of the Link Road Connecting Hulhule and Hulhumale'	Industrial and Commercial Bank of China	378	98
Greater Male' Grid Connection Phase I	Dongfang Electric International Corporation	-	600
Development of 1530 Housing Units in Hulhumale	China Development Bank	1294	1094
Hulhumale Phase II Road Development	Exim Bank of India	305	-
Irufen Island Resort Project	Export Import Bank of China	837	422
Design and Construction of Electricity System and Open Access Network of Hulhumale Phase II	Seylan Bank Plc	258	-
Purchase of Refined Petroleum Products	International Islamic Trade Finance Corporation	3204	1413
Purchase of Refined Petroleum Products	International Islamic Trade Finance Corporation	-	2312
STELCO 5th Power Development	Export Import Bank of China	650	53
USD Swap Arrangement	Reserve Bank Of India	1538	-

Priority areas for public sector investment through debt financing during the Strategy period are establishment of five regional urban centres, connecting Male' and Gulheefalhu via a bridge, and relocation of Male' Port to Gulheefalhu. Social housing, improving health care services and building water and sewerage infrastructure in outer islands will also be key sectors that require financing via debt.

4. Risks in the Debt Portfolio

Three main risks monitored in debt management in addition to the cost of financing are refinancing risk, interest rate risk and currency risk. Refinancing risk is the risk that debt cannot be rolled over or will have to be rolled over at higher cost, interest rate risk is the risk associated with increase in the cost of financing due to rising interest rates, and currency risk is the possibility for increased debt burden from a change in exchange rates.

The main risk in the current debt portfolio of the Government is currency risk due to high exposure to foreign currency denominated debt. Therefore, this Strategy aims to outline the policies that will be implemented to minimise this risk. Table 6 illustrates the cost and risk indicators for 2018 and the estimates for 2019.

Table 6: Debt cost and risk indicators, 2018 -2019

Indicator		2018	2019
Cost of debt	Interest (as a % of GDP)	3	3
	Weighted average interest rate	4	4
	Average time to maturity (years)	7	

Refinancing risk	Debt maturing in one year (% of total debt)	33	11
	Debt maturing in one year (% of GDP)	23	8
Interest rate risk	Average time to re-fixing (years)	7	
	Debt refixing in one year (% of total debt)	48	39
	Fixed rate debt (including treasury bills)	80	70
Currency risk	Foreign currency debt (% of total debt)	57	81
	Short term foreign currency debt (% of foreign reserves)	43	47

In addition to the risks illustrated in Table 6, other macroeconomic challenges to the broader economy will pose further risk to debt portfolio. While the weakening global growth, the trade war between USA and China, and uncertainty associated with Brexit are economic challenges at the global level, in the medium term these are probable to have some negative impacts on the local economy as well, via its impact on foreign investments and tourism sector performance. Any decline in the tourism sector revenue will lead to an increase in fiscal deficit, pushing debt to higher levels, and further increasing the currency risk.
Strengthening public finance management and reducing the fiscal deficit are important steps to maintaining debt at sustainable levels.

5. Debt Strategy 2020-2022

In formulating the debt strategy 2020–2022, the cost and risk inherent in the existing debt portfolio was considered. As the major challenge in the current debt portfolio was identified to be the currency risk due to the increase in foreign currency denominated debt, the main policies under the Strategy are geared towards more reliance on the domestic debt market. The Government intends to do so by further developing and strengthening the domestic market and seeking cost effective financing from domestic sources.
The main activities proposed to be undertaken under this Strategy are:

1. **Introduce more participants into the primary market**

   Due to limited investors in the domestic market, the Government has been increasingly reliant on external financing. While this limitation in the domestic markets results in the Government being unable to raise the desired level of financing from domestic sources, this is also a lost opportunity for investors active in the domestic market to be part of the development efforts of the country. To address this issue, Government is currently working towards facilitating the opening of new branches of foreign banks in Maldives within the next two years. Plans are also ongoing to further diversify the current investor base, by facilitating the participation of large and medium scale private companies and individuals active in tourism and other economic sectors, as well as the general public in the domestic market. The government aims to achieve this by reducing the face value of treasury bills, in order for them to be more affordable for a broader pool of investors.

2. **Increase longer term investments in the primary market**

   Government intends to introduce some long term debt instruments with the aim of increasing the maturities in the domestic market. Discussions have been held with potential investors to seek their appetite for such instruments, with the response being positive. Hence, plans to issue bonds with tenures between 8 and 20 years within the next 5 years are currently underway.

3. **Increasing Islamic financial instruments in the market**

   The demand for shariah-compliant instruments have been steadily increasing in recent years. Due to the limited use of such instruments in the domestic market, investors have not had the opportunity to participate in the market. To address this issue, Government plans to introduce longer term sukuks within the next 5 years.

Although the Strategy is focused towards developing the domestic market, important measures are planned to effectively manage external debt as well. Notable of these are:

1. A Maldives Partnership Forum was held in 2019, with the aim of strengthening the engagement with the international community and minimising the reliance on borrowed funds.
2. Government plans to focus more on seeking grants and technical assistance from development partners in order to maintain the public debt at a sustainable level.
3. In order to be prepared to mitigate any financial risks that may arise from a potential natural disasters, Government is working towards concluding a catastrophe drawdown option with the World Bank. This will allow the Government an immediate financial relief package at disposal in case of a disaster.
4. A "samurai" bond will be issued in the Japanese financial market.
5. New financial instruments such as Green Bond, Blue Bond, and Sustainable Development Goals Programmatic Bond, are being explored.
6. Promoting the engagement of private sector in development programs initiated by the Government.
7. Strengthening the Sovereign Guarantee Issuance Guideline in order to minimise the risks associated with loan guarantees.
8. A sovereign development fund has been established to act as a buffer in case of increased fiscal burden from increase in debt servicing cost.

It is expected that the development of the domestic market will enable the reduction of the risks in the existing debt portfolio, especially the currency risk. Thus, if borrowing activities could be implemented according to this Strategy, cost and risk is expected to follow the trend as shown in Table 7.

Table 7: Expected changes to cost and risk indicators with the implementation of the Strategy

Indicator		2020	2021	2022	2023	2024
Debt to GDP		**73**	**76**	**74.8**	**74.4**	**71.9**
Cost of Debt	Interest rate (as a percent of GDP)	3	3	3	3	2
	Weighted Average Interest rate (%)	4	4	4	4	4
Refinancing risk	Average time to maturity (years)					9
	Debt maturing in one year (% of total debt)	7	11	8	6	11
	Debt maturing in one year (% of GDP)	5	8	6	4	8
Interest Rate risk	Average time to re-fixing(years)					8
	Debt to be re-fixed in one year (% of total Debt)	34	39	36	32	37

	FX Debt (Including T-Bills)	70	70	71	72	73
Currency risk	External Debt (% of total debt)	83	84	85	85	83
	Short term external debt (% of total foreign reserves)	30	66	49	34	81

6. Improvement in Debt Management

In addition to the Strategy, which addresses the costs and risks inherent in the debt portfolio, the Government is further introducing measures to strengthen the legal and institutional framework, and update the processes, that would enable effective public debt, as detailed below:

1. **World Bank Debt Management Performance Assessment and Reform Plan**
   In March 2019 a World Bank team conducted a Debt Management Performance Assessment for the Maldives. This Assessment identified the strengths and weaknesses in the current debt management practices. The World Bank is currently formulating a Reform Plan which will guide the proposed activities and timelines for addressing the core weaknesses identified.
2. **The Public Finance Act and the Fiscal Responsibility Act**
   As part of its legislative agenda, the Ministry of Finance is reviewing the Public Finance Act and the FRA. The aim is to address conflicting clauses within these Acts, as well as to reconsider the fiscal limits stipulated in the FRA to determine their alignment with international best practices and country context.
3. **Public Debt Audit**
   The public debt audit conducted by the Auditor General's Office (AGO) as part of their annual financial statement audit has been significantly delayed in recent years due to administrative challenges at AGO. However, efforts have been made to reduce the backlog, and the audit for 2016, 2017, and 2018 are now close to completion and expected to be finalised during 2019. It is further expected that debt audits will be conducted without delays moving forward, and this is a significant step to further strengthen public debt management.
4. **Debt Recording and Management System**
   The Government of Maldives uses the Commonwealth Secretariat Debt Recording and Management System for recording and managing debt. Although the System is widely used internationally, there are some limitations within the System, which a new version recently released is expected to address. The Ministry of Finance intends to start working on the migration to the new version in 2020. Further, the Maldives Monetary Authority (MMA), who acts as an agent for the government in the domestic securities market, is also currently in the process of developing their systems to record and manage the issuance of treasury instruments. These developments will enable both the Ministry and MMA to reduce the administrative burden through automation, and further reduce the operational risks in public debt management.
5. **Institutional arrangements for debt management**
   The World Bank's Assessment identified several gaps in the debt management processes, some of which can only be resolved with a reorganization of functions within the Ministry of Finance. Therefore, the Ministry plans to restructure and reorganise the institutional setup for debt management, so as to ensure more focused and proactive debt management.
6. **Information disclosure**
   To ensure transparency in public debt statistics, the Ministry of Finance has recently increased the dissemination of debt data to the public. Further efforts will be made to increase transparency.

7. Conclusion

The Ministry of Finance, through the World Bank funded Public Finance Management Systems Strengthening Project, and through other external assistance, has taken several steps to strengthen the overall public finance and debt management, and will work towards developing the domestic market to further support its efforts.

However, it is imperative that the Government makes effort to strengthen the financial management and governance of state owned enterprises, reduce the fiscal deficit, and ensure macroeconomic stability. These are essential steps to be taken in order to increase the debt carrying capacity of the country.

****