Medium Term Debt Management Strategy 2021 - 2023

1. Introduction

This Strategy outlines the current debt portfolio of the government along with the ongoing and planned activities to strengthen debt management. The Strategy will focus on (i) the debt portfolio as of 2019 including major highlights in 2019, (ii) the projected debt portfolio for 2020, (iii) the strategic actions for the next three years, and (iv) the main changes to the debt portfolio envisioned by the strategic actions.

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

1. Public debt targets
2. Target ratio of total public debt as a percentage of gross domestic product (GDP)
3. External & Domestic debt targets
4. Strategic actions to manage risks of the debt portfolio, and
5. Details of utilization of debt financing

In 2019, several measures were taken to strengthen public debt management. A Debt Management and Performance Assessment (DeMPA) had been conducted with the World Bank's assistance. As per the recommendations from this assessment, the Resource Mobilization and Debt Management Department (RMDMD) of the Ministry of Finance has been restructured with debt management functions consolidated into the debt division. Furthermore, the transparency of debt has improved with the regular publication on debt related statistics. These measures have been well recognized by both domestic and international community. In order to strengthen the legal framework for debt management, a more comprehensive debt law is being formulated with the help of technical assistance from external partners.

As a result of the ongoing Covid-19 pandemic, there are significant economic challenges faced by Maldives. While the Government expenditure on health sector has increased due to Covid-19, the Government revenue has declined causing an increase in budget deficit. This has led to an increase in the financing gap which in turn led to an increase in financing through debt instruments. To revive and to build a more resilient economy, the Government critically requires concessional financing for developmental projects However, due to the credit rating for Maldives being downgraded, it has been challenging to obtain low cost financing from our development partners.

The objective of this Strategy is to ensure the Government's financing needs and payment obligations are met, at the lowest possible cost, with a prudent level of risk and support the development of the domestic debt market, in order to maintain public debt at sustainable levels.

The scope of public debt in this strategy is in accordance with the FRA with the inclusion of explicit guaranteed debt. The debt forecasts in the "Fiscal Strategy 2021-2023" does not include Government guaranteed loans thus will differ with this Strategy.

2. Debt Portfolio

In 2019, total public debt was MVR 67,961 million, which is equivalent to 78 percent of GDP. It is estimated that by the end of 2020, public debt will increase to MVR 85,530 million, which is148 percent of GDP. The significant increase in debt as a percentage of GDP compared to 2019 is due to the decline in GDP and due to the increase in financing need. GDP is estimated to contract by 29 percent due to the negative impacts of Covid-19; compared to previous estimates in the 2020 budget. Table 1 illustrates the recent development of the total public debt.

Table 1: Total Public Debt (MVR Millions), 2016-2020

In Millions of MVR	2016	2017	2018	2019	2020 Forecast
Total Public and Publicly Guaranteed (PPG) Debt	**43,425**	**47,196**	**60,257**	**67,961**	**85,530**
External Debt	11,852	16,863	20,546	22,030	29,960
Domestic Debt	26,402	27,108	27,664	32,227	40,409
Publicly Guaranteed External Debt	2,117	778	10,348	12,727	14,675
Publicly Guaranteed Domestic Debt	3,054	2,447	1,699	977	486
PPG Debt as a percent of GDP	67%	65%	73%	78%	148%

Public debt is estimated to increase by 26 percent in 2020 compared to 2019, with a larger portion expected to accumulate from external debt. This increase was from the projects financed by direct and Government guaranteed debt in recent years being completed, and loan disbursements for some of the mega projects increased significantly. Meanwhile, reliance on external debt has also increased due to difficulties in raising finance from the domestic market.

Furthermore, USD 150 million has been disbursed in 2020 from the USD 400 million currency swap facility under a guarantee issued to the Maldives Monetary Authority (MMA) in 2019, for reserve management.

This swap facility has been used to manage the balance of payment (BoP) deficit and to maintain the Maldivian Rufiyaa currency value. This will be serviced by MMA.

3. Domestic Debt

In 2019, total domestic debt stood at MVR 33,204 million and is expected to increase to MVR 40,895 million by the end of 2020. This includes the domestic debt guaranteed by the Government. Table 2 illustrates the breakdown of domestic debt.

Table2: Domestic Debt Outstanding (MVR Millions)-2016-2020

In Millions of MVR	2016	2017	2018	2019	2020 Forecast
Total Domestic Debt	**29,456**	**29,555**	**29,364**	**33,204**	**40,895**
Treasury Bills	13,731	13,553	14,279	18,615	22,723
Islamic Instruments	783	540	735	350	350
Treasury Bonds	11,862	12,595	12,632	13,115	16,986
Commercial Loans	26	420	19	147	350
Publicly Guaranteed Domestic Debt	3,054	2,447	1,699	977	486

The largest share of domestic debt is in treasury bills (T-bills). In 2019, 55 percent of domestic debt consisted of treasury bills and this is expected to be at 56 percent at end of 2020. The guaranteed domestic debt is expected to reduce by 50 percent by the end of 2020 in comparison to 2019. It is estimated that the guaranteed domestic debt will account for 1.2 percent of the total domestic debt by the end of 2020.

4. External Debt

External debt is estimated to be MVR 44,635 million by the end of 2020. This is 28 percent higher compared to 2019 and is equivalent to 77 percent of GDP. This includes both direct and guaranteed external debt. The largest share of external debt is guaranteed debt.

It is estimated that by the end of 2020 bondholders will account for 22 percent and buyer’s credit loans will hold 21 percent of the total external portfolio. The rest of the composition of creditor category consists of 17 percent being held by multilaterals and 8 percent being held by bilateral creditors. Table 3 illustrates the breakdown of external debt.

Table 3: External Debt (MVR Millions), 2016-2020

Millions of MVR In	2016	2017	2018	2019	2020
Total Public and Publicly Guaranteed External Debt	**13,969**	**17,641**	**30,894**	**34,757**	**44,635**
Multilateral	3,905	4,270	4,474	4,868	7,366
Bilateral	2,318	2,059	3,631	4,150	3,733
Buyers credit	5,343	6,486	8,483	9,152	9,177
Commercial banks	286	195	105	15	-
	-	3,853	3,853	3,845	9,684
Total Guaranteed External Debt	**2,117**	**778**	**10,348**	**12,727**	**14,675**
Currency swap	1,535	-	1,541	-	2,310
Others	582	778	8,807	12,727	12,365

5. Debt Servicing

The total debt servicing cost for total PPG debt was MVR 9,792million in 2019 and is estimated to be MVR 7,645 million in 2020. This includes debt servicing cost of both direct and guaranteed debt. 73 percent of the debt servicing cost of 2019 and 63 percent of 2020 corresponds to guaranteed debt. Table 4 shows the breakdown of total debt servicing cost of PPG debt.

Table 4: Total Debt Service Cost of Public and Publicly Guaranteed (PPG) Debt (MVR Millions), 2016-2020

In Millions of MVR	2016	2017	2018	2019	2020
Total PPG Debt service cost	**2,876**	**6,061**	**5,557**	**9,792**	**7,645**
Domestic Debt	1,213	2,148	1,466	1,045	1,191
External Debt	1,190	1,356	1,618	1,620	1,656
Publicly Guaranteed Debt	473	2,557	2,473	7,127[1]	4,799
Risk Indicators:					
Total PPG Debt Service Cost as a percentage of revenue	15%	30%	25%	44%	61%
Direct Debt Service Cost as a percentage of revenue	13%	17%	14%	12%	23%
Publicly Guaranteed Debt Service Cost as a percentage of revenue	2.5%	13%	11%	32%	38%

[1] The national budget does not cover the full cost incurred on servicing publicly guaranteed debt as these are serviced by the Borrowers directly.

Total debt servicing cost as a percentage of revenue has been on an increasing trend each year. In 2020, Government revenue is expected to fall by 49 percent, thus considerably increasing debt servicing as a percentage of revenue. Debt servicing of direct debt of the Government is estimated to be 25 percent of revenue in 2020, which is an increase of 12 percent compared to 2019.

In April 2020, the G20 countries announced the Debt Service Suspension Initiative (DSSI), which will defer the debt service payments to G20 Official Creditors from May – December 2020. The Government has also proposed to participate in the DSSI which will ease debt servicing in 2020

6. Utilization of Debt Financing Proceeds

Funds disbursed in 2019 and 2020 were utilized towards the implementation of key development projects and for budget support. Table 5 illustrates the disbursements on key projects in 2019 and estimated disbursements in 2020.

Table 5: Funds Utilized for Key projects (MVR Millions), 2019-2020

Project	Creditor	2019	2020 Forecast
Direct Debt of GOM			
Small Scale Waste to Energy Project	Abu Dhabi Fund for Development	35	1
Velana International Airport Project	Abu Dhabi Fund for Development	44	34
COVID-19 Active Response and Expenditure Support Program	Asian Development Bank	-	385
South Asia Sub-regional Economic Cooperation National Single Window Project	Asian Development Bank	-	14
Covid-19 Rapid Response to Maldives	European Investment Bank	-	345
Maldives Sustainable Energy Project	European Investment Bank	153	35
Dollar Credit Line Agreement	Export Import Bank of India	-	85
Covid-19 Emergency Income Support Project	International Development Association	-	60
COVID-19 Emergency Response and Health Systems Preparedness Project	International Development Association	-	57
Development Policy Financing with a Catastrophe Deferred Drawdown Option	International Development Association	77	-
First Fiscal Sustainability and Budget Credibility Development Financing	International Development Association	155	77
Maldives Urban Development and Resilience Project	International Development Association	-	168
Development Of Water Supply And Sewerage Facilities Project in Fuvahmulah	Kuwait Fund for Arab Econ. Development	15	6
Expansion and Upgrading of Ibrahim Nasir International Airport	Kuwait Fund for Arab Econ. Development	140	100
Fuvahmulah Eastern Coastal Protection Project	Kuwait Fund for Arab Econ. Development	-	10

Development of Hulhumale' Island Phase 2	Saudi Fund for Development	169	65
Fisheries Sector Development Project	Saudi Fund for Development	-	33
Ibrahim Nasir International Airport Upgrade Project	Saudi Fund for Development	39	96
Seenu Hithadhoo Regional Hospital Project	Saudi Fund for Development	36	2
Affordable Housing Scheme Project	Saudi Fund for Development	-	32
Development of 1500 housing units in Maldives	Export Import Bank of China	135	-
Expansion and Upgrading of INIA Airport in Hulhule of Maldives Project	Export Import Bank of China	782	189
Development of the Ibrahim Nasir International Airport Project	The OPEC Fund for International Development	103	117
Outer Islands Water Supply and Sewerage Facilities Project	The OPEC Fund for International Development	42	-
Provision for Water Supply, Sanitation and Waste Management Project	The OPEC Fund for International Development	180	60
Public Sector Investment Program Budgetary Support Loan	The OPEC Fund for International Development	-	308
Seenu Hithadhoo Regional Hospital Project	The OPEC Fund for International Development	27	2
Covid-19 Emergency Response and Health Preparedness Project	Asian Infrastructure Investment Bank	-	13
Emergency Response to Covid-19 Pandemic Phase 2	Islamic Development Bank		168
Civid-19 Amendment to Istisna Agreement	Islamic Development Bank		6
Publicly Guaranteed Debt			
Development of 2,500 Housing Units	Bank of China, London Branch	307	-
Design and Construction of Electricity system and Open Access Network in Hulhumale’ Phase 2	Browns-CMEC	-	1,036
Seaplane Terminal Development Project	China Development Bank	547	108
Development of 1530 housing units	China Development Bank	284	874
Greater Male’ Grid Connection Phase 1	Dongfang Electric Corporation	115	276
Development of 7,000 housing units	Industrial and Commercial Bank of China	929	399
Purchase of Staple food and Medicine	Industrial and Commercial Bank of China	-	231
USD Swap Facility	Reserve Bank of India	2,313	-
STELCO 5th Power Development Project	Export Import Bank of China	118	232
Irufen Island Resort	Export Import Bank of China	807	318

Some of the priority projects for public sector investments through debt financing for the next three years include the development of the Velana International Airport and regional airports, reclamation of Gulhifalhu and the Greater Male’ Connectivity project connecting Male’ and Gulhifalhu, relocation of Male’ Commercial Port to Gulhifalhu, and establishment of five regional urban centres. Social housing, improving health care services, and building water and sewerage networks and other infrastructure projects will also be key sectors that require debt financing. In addition to the above, proceeds from debt financing will be used for the economic recovery of Covid-19, to strengthen the health sector and for budget support.

7. Risks in the Debt Portfolio

There are three main risks monitored in debt management in addition to the cost of financing, which include the (i) refinancing risk, (ii) interest rate risk and (iii) currency risk. Refinancing risk refers to the possibility of not being able to roll over the debt or to refinance the debt at a higher cost. Interest rate risk is the risk associated with increase in the cost of financing due to rising interest rates. Currency risk is the possibility for increased debt burden due to a change in exchange rates.

The main risks in the current debt portfolio of the Government is the currency risk due to the high exposure to foreign currency denominated debt and the refinancing risk of short-term debt. It is estimated that by the end of 2020, the total public debt maturing in 1 year will be 14 percent. Comparatively, in 2019, the total debt maturing in 1 year was 35 percent of total debt. This reduction is attributed to the measures that Government is taking to address the refinancing risks.

Therefore, this Strategy aims to outline the policies that will be implemented to sustain these risks. Table 6 illustrates the cost and risk indicators for 2019 and the forecasts for 2020.

Table 6: Debt Cost and Risk Indicators, 2019-2020

Risk Indicator		2019	2020
Cost of Debt	Interest cost as percent of GDP (percent)	3	4
	Weighted Average Interest Rate (percent)	4	3
Refinancing risk	Average time to maturity (years)	7	7
	Total Debt Maturing in 1 year (percent of total PPG Debt)	35	14
	Debt Maturing in 1 year (percent of GDP)	26	14
Interest rate risk	Average Time to re-fixing (years)	5.8	5.8
	Total PPG Debt Re-fixing in 1 year (percent)	51	51
	Total Fixed Rate Debt Portfolio (including T-bills)	70	81
Exchange Rate risk	FX Debt as percent of total PPG debt(percent)	58	82
	Short Term FX Debt as percent of Reserves (percent)	58	75

In addition to the risks mentioned in table 6, an adverse macro-economic situation poses significant risks in debt management. As such, the negative impacts to the Maldivian economy due to the global economic recession caused by Covid-19 is significant. In light of the challenges faced by the tourism industry, experts in the industry believe that it will take at least two years for revenue from tourism sector to recover even in the best-case scenario. The budget deficits caused by decline in tourism receipts lead to an increase in reliance on external debt financing and resulted to an increase in the foreign exchange risk. Hence, it is crucial to decrease Government expenditure to reduce fiscal deficit and to maintain debt at sustainable levels. Moreover, with unfavorable changes to sovereign rating, it is likely that cost of borrowing from development partners will be higher. As the sovereign ratings for Maldives downgraded in 2020, the value of Euro bonds issued in 2017 in international financial markets fell and it became challenging to obtain external financing at a lower cost from the development partner's institutions and the market. Therefore, the government had limited access to concessional financing; and as a result, had to resort to a higher cost of borrowing from the domestic market to finance its short-term financing requirement.

8. 2021–2023 Debt Strategy

In formulating the 2021–2023 Strategy, the costs and risks inherent in the existing debt portfolio were considered. Two major challenges in the current debt portfolio were identified to be the currency risk due to the increase in foreign currency denominated debt and increase in short-term debt. The main policies under the Strategy are geared towards more reliance on the domestic debt market by introducing more domestic financial instruments. The risk from short-term debt can be reduced by introducing domestic and external longer term instruments. In addition to this, the Government is reviewing the non-concessional debt in the portfolio.

The main activities proposed to be undertaken under this Strategy are given below. The results of these proposed activities are given in table 7.

Table7: Expected Changes to Cost and Risk Indicators with the Implementation of the Strategy

Risk Indicator		2020	2021	2022	2023
Cost of Debt	**PPG Debt to GDP**	148 %	129 %	116 %	114 %
	Interest cost as Percent of GDP (percent)	4	3	3	3
	Weighted Average Interest Rate (percent)	3	3	3	3
Refinancing risk	Average time to maturity (years)	7	7	7	10
	Total Debt Maturing in 1 year (percent of total PPG Debt)	14	10	5	6
	Debt Maturing in 1 Year (percent of GDP)	19	12	5	6
Interest rate risk	Average Tine to Re-fixing (years)	6	6	6	8
	Total Debt Re-fixing in 1 year (percent)	46	44	41	40
	Total Fixed Rate Debt Portfolio including T-bills (percent of total PPG debt)	67	63	63	62
Exchange Rate risk	FX debt as percent of total (percent)	82	78	78	78
	Short Term FX debt as percent of Reserves (percent)	75	53	18	34

a. Introducing Longer Term Debt Securities

The Government has proposed to introduce longer term securities in both the domestic and international markets. Domestic investors are likely to be interested to invest in longer-term instruments as well. Hence, plans to issue treasury bonds and Sukuk with tenures between 8 and 20 years within the next 3 years are currently underway.

b. Increasing Islamic Financial Instruments in the Domestic Market

It is important to develop Islamic financial market, as investors' demand for sharia-compliant instruments has been increasing. However, there have been limited instruments that are available in the domestic market to date, and have only been used to provide financing for state-owned enterprises (SOEs). Due to the limited use of such instruments in the domestic market, investors have not had the opportunity to utilize this option. To further develop the domestic market, the Government plans to increase its participants and to introduce more Islamic Financial Instruments during the next 3 years.

c. Introduce More Participants into the Primary Market

Due to the limited investors in the domestic market, the Government has been increasingly reliant on external financing. While this limitation in the domestic market results in the Government being unable to raise the desired level of financing from domestic sources, this is also a lost opportunity for potential investors who may engage in the market, if given the opportunity to be part of the development efforts of the country. To address this issue, the Government is currently working towards facilitating the opening of new branches of foreign banks in Maldives within the next few years. Plans are also ongoing to further diversify the current investor base, by facilitating the participation of medium and large 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 denomination of the face value of securities sold by the Government, in order for them to be more affordable for a broader pool of investors.

d. **Debt Restructuring**

With the introduction of the Maldives Retirement Pension Scheme in 2009, accrued pension rights of Government employees have been transferred to the employee's retirement savings account under a recognition bond. The compound interest paid for this bond is raising the Government's outstanding debt and debt servicing each year. Hence, the Government has proposed to restructure this bond, with the change in computation of interest without compounding, which will result in reduction of debt accumulated and debt servicing every year.

9. Strengthening Debt Management Operations

In addition to the above strategies 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 improve its debt management procedures, that would enable effective public debt management, as detailed below.

a. Strengthening Governing Laws Related To Debt

As part of its legislative agenda, the Ministry of Finance is reviewing the Public Finance Act and the Fiscal Responsibility Act. The aim is to align international best practices on debt management to country context. Furthermore, Government is drafting a separate comprehensive law on debt management

b. Debt Recording and Management System

The Government of Maldives uses the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) for recording, analysis and management of public and publicly guaranteed debt. A new version of the system has now been introduced and the Ministry of Finance intends to start working on the migration to the new version in 2021 Further, the Maldives Monetary Authority (MMA), acting 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.

c. Information disclosure

To ensure transparency in public debt statistics, the Ministry of Finance has recently increased the dissemination of debt data to the public. In future, as part of the Government's efforts to further increase its transparency of debt related and improve its quality, the Government has become a part of the World Bank's Public Sector Debt Statistics (PSDS) Database; and plans to publish an annual borrowing plan.

d. Strengthening Institutional Arrangements for Debt Management and Capacity Building

The plans to strengthen the institutional arrangement of debt management are detailed below:

1. Establishment of a Front Office in the Debt Department and Capacity Building

A Debt Management Performance Assistance (DeMPA) has been conducted with the World Bank's assistance in 2019. As per its recommendations, the RMDMD of the Ministry of Finance has been restructured and the debt management and resource mobilization functions have been separated. Furthermore, the front office of the debt management department has been established and is now functional The Ministry is working on obtaining consultancy services under World Bank assistance to further strengthen the capacity of the Front Office and the department as a whole.

2. Strengthening the Guidelines for Sovereign Guarantees

In order to revise the existing guidelines for sovereign guarantees issuance and to strengthen fiscal and risk management, capacity building of employees has been planned through international experts. Further, the Government will strengthen the existing sovereign guarantee guidelines and introduce a more robust framework to assess the feasibility studies and overall fiscal risks when issuing sovereign guarantees.

3. Improvement of Relationship with Investors and Rating Agencies

The Government recognizes the importance of maintaining strong relationships with its investors. Strengthening relationships, especially with external investors, will assist in obtaining financing from the international financial markets easier. In addition to this, the Government is working together with sovereign rating agencies to improve the credit rating of the Maldives, with the purpose of this being to secure lower cost and lower risk financing at the most favourable terms.

4. Reviewing the Medium-Term Debt Strategy

Prior to formulating the Medium Term Debt Management Strategy of 2022-2024, it will be important to generate a report assessing the current debt strategy and monitor its results. The challenges faced in implementing the actions of the current debt strategy will also have to be included in this report.

10. Conclusion

The Ministry of Finance, through the World Bank funded Public Finance Management Systems Strengthening (PFMSS) Project, and through other external assistance, has taken several steps to strengthen the overall public finance and debt management functions, and will work towards developing the domestic market to further support its developmental efforts. Furthermore, it is imperative that the Government strives to obtain financing at the most favourable terms and forecast the impact on the ability of debt servicing in the short, medium and long term, since debt is estimated to increase as a result of the increase in budget deficit due to Covid-19. In addition to introducing longer term instruments, the Government aims to increase financing opportunities using innovative financing models. Further, it is vital to strengthen and improve the relationship between the general public and investors by increasing transparency in debt related information.

The Government must also increase its efforts to strengthen the financial management and governance of its 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.