Debt Management Department

Medium Term Debt Management Strategy

2022-2024

MINISTRY OF FINANCE
REPUBLIC OF MALDIVES

Contents

2022/24 Debt Management Strategy – at a glance

The primary objective of the Debt Management Strategy is to ensure that the Government's financing needs and payment obligations are met, at the lowest possible cost, consistent with a prudent degree of risk, while supporting the development of domestic debt market.

Strategy targets

FX debt as % of total debt

Maintain within 500bsp of current ratio

Weighted average interest rate (%)

Reduce by 100bsp

Average time to maturity

Increase the ATM to 8 years

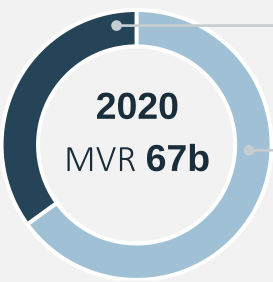
Debt maturing in 1 year (% of total debt)

Maintain within 30% of total debt

Central Government's Debt Portfolio

as at 31 December 2020

Outstanding Debt

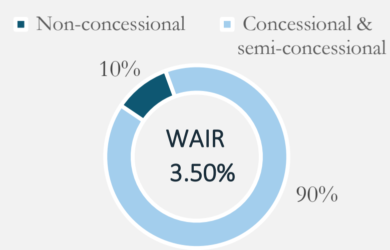


Portfolio composition

MVR **44b**
66% in Foreign Currency

MVR **23b**
34% Local Currency

External Portfolio



2022/24 Focus

- **Reduce annual external financing ratio to 50% by 2023**
- **Issue 5 – 7-year bond/ Sukuk to the international market**
- **Maximum utilization of concessional financing**
- **Diversify portfolio by introducing innovative financing instruments**
- **Introduce longer term instruments in the domestic market**
- **Gradually shift domestic t-bills portfolio to longer term bonds**
- **Introduce new sharia compliant instruments to the domestic market**

1. Introduction

The Fiscal Responsibility Act (Law Number 7/2013) requires the Government to submit a Medium-Term Debt Strategy Statement to the Public Accounts Committee of the People's Majlis before the end of July every year. Therefore, this statement is prepared in accordance with the requirement as per Article 20 of the FRA and contains the information required under Article 22, as follows:

1. Central Government's debt targets
2. Total Central Government 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 Central Government debt, and
5. Details of utilization of borrowed funds.

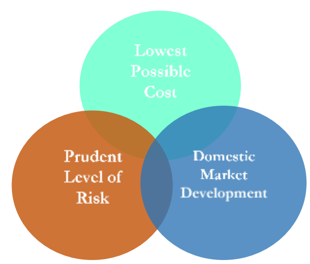
In particular, this Debt Strategy Statement provides an overview of the Government's debt position at the end of 2020 and outlines the forecasted debt position for 2021. The Strategy discusses how the Government intends to borrow and manage its debt to achieve the desired portfolio that reflects its cost and risk preferences in the medium term. The Strategy also includes, an action plan for strategy implementation and highlights the changes envisioned to the debt position from the execution of these actions.

The global economy has entered the deepest contraction in many decades due to the Covid-19 pandemic. Despite notable achievements in economic development in the recent years, the Maldives has experienced an unprecedented 32 percent contraction in GDP in 2020 due to the global pandemic and containment measures. The Government's revenue was hit hard and the fiscal deficit has widened significantly. As a result, the budget deficit rose to 22.6 percent of GPD by end of 2020. Consequently, leading to an expanded financing gap which was predominantly filled by raising debt.

It is imperative that the country seeks cost effective and low risk options to finance ongoing and proposed national development initiatives.

1.1 Objectives for Debt Management

The primary objective of the Medium-Term Debt Management Strategy (MTDS) is to ensure that the Government's financing needs are met, at the lowest possible cost, consistent with a prudent level of risk, while supporting the development of domestic debt market. Through the MTDS, the Government aims to achieve an optimal composition of the debt portfolio over the medium term, while managing the risk exposures arising from external debt and potential variation in the debt servicing costs and refinancing risk.



1.2 Scope of coverage

This MTDS covers the total debt of the central Government as defined in the FRA. As per the FRA, total State debt includes all the direct borrowings of the State, sourced externally and domestically. In this regard, guaranteed debt of the Government is excluded from the quantitative analysis of the MTDS. However, details of existing guaranteed debt and associated risks are outlined in this strategy. The MTDS is a three-year rolling strategy, which is reviewed and published on an annual basis. The MTDS derives its quantitative assessment of alternative strategies and key risk indicators, using the IMF/World Bank MTDS toolkit.

2. Central Government Debt Portfolio

In 2020, total central government debt stood at MVR 67 billion, which is equivalent to 115 percent of GDP. It is estimated that by the end of 2021, Central Government debt will increase to MVR 79 billion, which will be 128 percent of GDP. The ongoing Covid-19 pandemic has resulted in the contraction of the GDP due to the significant decline in revenue and contraction of the GDP in 2020, which caused the Debt to GDP ratio to increase. However, the GDP is estimated to improve by 15 percent in 2021, as the economic conditions of Maldives improves. Chart 1 illustrates the recent trends in the total Central Government debt.

Chart 1: Disbursed Outstanding Debt of Central Government (MVR billions), 2017-2021

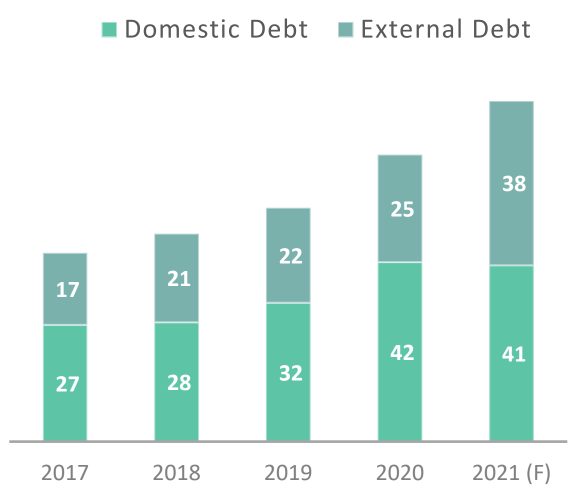
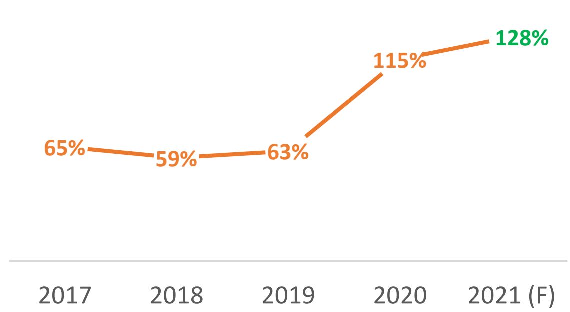


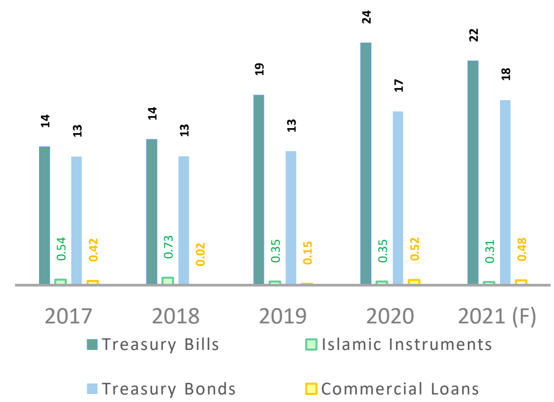
Chart 2: Debt to Nominal GDP Ratio, (2017-2021)



2.1 Domestic Debt

In 2020, total direct domestic debt stood at MVR 42 billion and is expected to decrease to MVR 41 billion by the end of 2021. The largest share of domestic debt is in treasury bills. In 2020, 57 percent of domestic debt consisted of treasury bills and it is expected that this percentage will remain within this level through 2021.

Chart 3: Domestic debt outstanding (MVR billions), 2017 -2021



2.2 External Debt

External Debt stood at MVR 25 billion at the end of 2020. 38 percent of the current external DOD are to buyer's credit borrowings, while 25 percent and 21 percent of the portfolio is towards loan borrowings from multilateral financial institutions and bilateral agencies respectively. Commercial borrowings account for 15 percent of the portfolio. External Debt is expected to increase by 21 percent by the end of 2021.

Chart 4: Share of External Disbursed Outstanding Debt by Creditor, Dec 2020

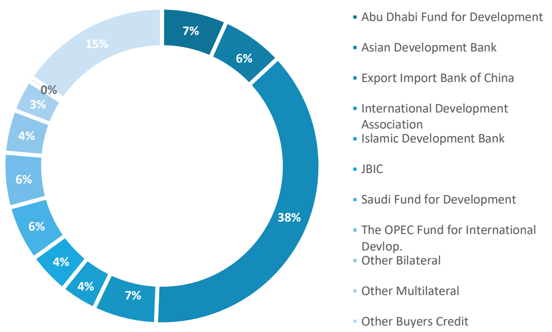
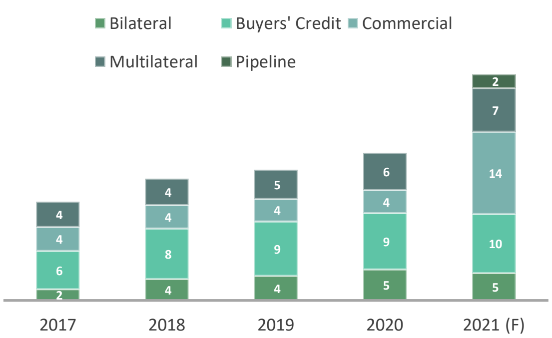


Chart 5: External DOD by Creditor Category (MVR billions) 2017-2021

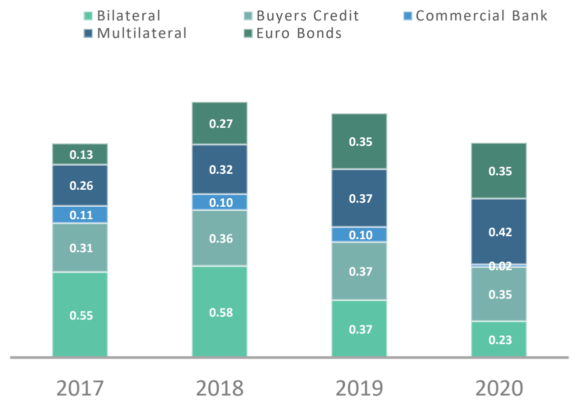


2.3 Debt Servicing

Total debt servicing cost of the Central Government's external debt for the year 2020 was MVR 1.36 billion. The Chart below shows the composition of direct/Central Government external debt service cost for the year 2020.

Under the G20 Debt Service Suspension Initiative (DSSI), approximately MVR 370 million was deferred from the debt service payments due between May to December 2020.

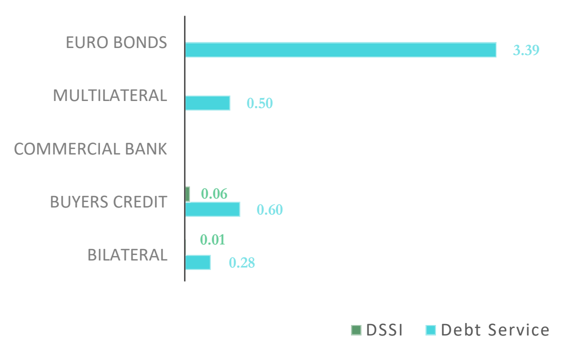
Chart 6: Total Debt Service Cost by Creditor Category (MVR billions), 2017 -2021



The G20 DSSI was extended up to December 2021 and GoM has requested to extend its participation in the extension. Chart 6 shows the debt service forecasts for 2021 and the expected amounts which will be deferred for the year.

As part of a liquidity management exercise carried out by the Government, 76.79% of the Euro bond maturing in 2022 was settled in April 2021 under a Tender Offer. This has resulted in increased debt service cost of Euro Bonds for 2021, which at the same time has significantly reduced the short-term refinancing risk.

Chart 7: 2021 Forecasted Debt Service Cost and DSSI (MVR billions)



3. Utilisation of Borrowed Funds

In 2020, the funds disbursed were mainly utilized in response to the Covid-19 crisis and mitigation of future setbacks and to stimulate economic activities. The increased spending on health care, emergency response borrowings to fund economic relief measures increased the Debt to GDP. However, these targeted policy expenditures on healthcare and economic stimulus added significant improvement to the economic cycle of the country.

The key priority projects for public sector investments through debt financing for the next three years includes, the expansion and development of the Velana International Airport, Greater Male' Development Project which includes the Greater Male' connectivity project, relocation of Male' Commercial Port to Gulhifalhu, and reclamation of Gulhifalhu island; Social housing projects, improving health sector and services, and building water and sewerage networks and other key infrastructure projects.

The disbursement from debt financing is projected to significantly increase country's economic growth in the medium term. As such, it is projected that by 2024, the GDP will increase to MVR 104.9 billion; an increase of 80.5 percent when compared to 2020. Government's revenue is also expected to increase to MVR 27.3 billion in 2024 (75 percent increase compared to 2020). With the development of tourism sector and expansion of airport infrastructures, tourist arrival is expected to increase by 275 percent in the medium term.

These macroeconomic projections do not include contributions of some of the key large-scale infrastructure projects to be completed in the medium term. Successful completion of these projects will further increase growth, revenue and generate employment.

The chart below illustrates the actual disbursements on key projects in Years 2019 to 2020 and estimated disbursements in Year 2021 to 2023.

Chart 8: Consolidated Disbursement Snapshot (2019 - 2023)

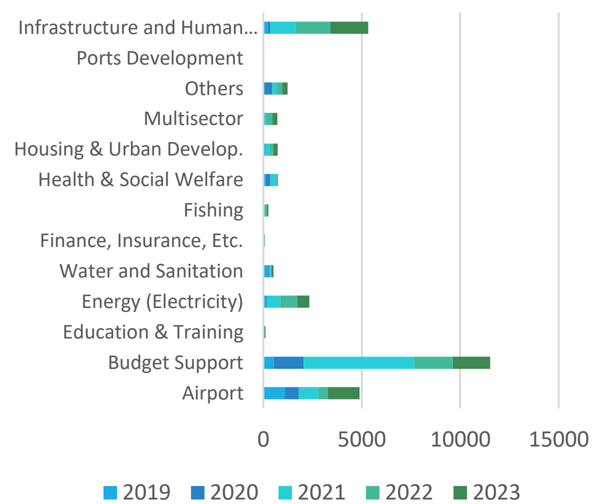


Chart 9: Airport Development Project (2019 - 2023)

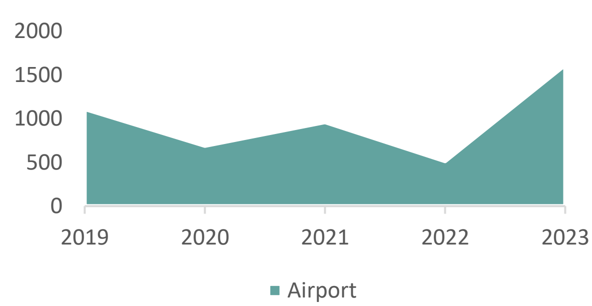
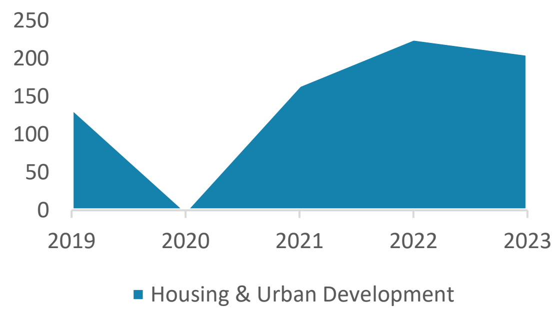


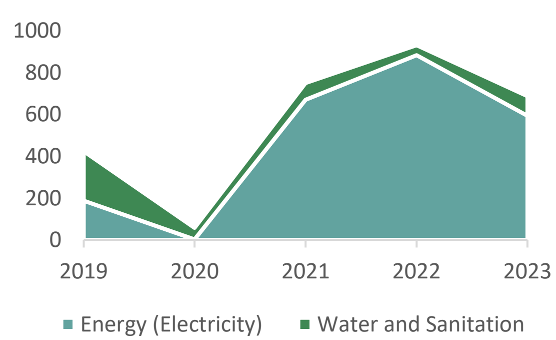
Chart 9 shows that, in 2019 and 2020, approximately MVR 1.8 billion is utilized for the development of the VIA, which is 31.78 percent of the total funds disbursed in the Year 2019 and 2020. For the Year 2021 to 2023, an estimated total disbursement of 13.50% is to be realized for the expansion and development of Velana International Airport.

Chart 10: Housing and Urban Development (2019 - 2023)



In Years 2019 and 2020, MVR 135.4 million was utilized for housing and urban development projects and disbursements are expected to increase to an approximate MVR 680 million for the next three years period for urban development projects.

Chart 11: Energy, Water and Sanitation (2019 - 2023)



In 2019 and 2020, approximately MVR 482.1 million were utilized for the implementation of energy, water and sanitation programs, which is 8.51% of the total funds disbursed in the Year 2019 and 2020. For the Year 2021 to 2023, an estimated total disbursement of 10.35% or MVR 2.4 billion is to be disbursed for energy, water and sanitation programs.

Chart 12: Infrastructure & Human Development (2019 - 2023)

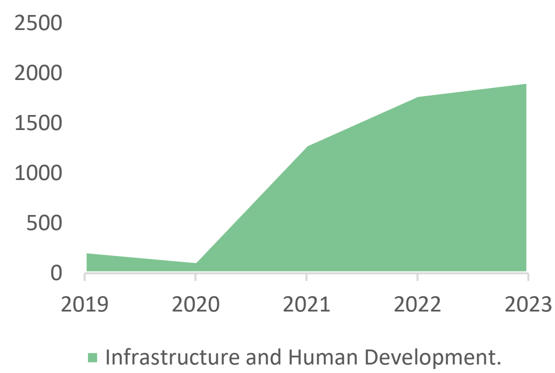


Chart 12 Shows that, in Years 2019 and 2020, MVR 343.30 million was utilized for rural, infrastructure and human development projects.

It is projected that an estimated total MVR 4.98 billion will be disbursed for rural and infrastructure and human development projects from 2021 to 2023.

4. Risks in the Debt Portfolio

The assessment of relative costs and risks in the existing debt portfolio is an integral part of the Government's debt management strategy. The debt portfolio of the Government is predominantly exposed to refinancing risk[1], interest rate risk[2], exchange rate risk[3], operational risk and risk arising from contingent liabilities. In terms of quantitative analysis, the Government monitors key refinancing risk and market risk indicators associated with the debt portfolio. In addition, assessment of operational risks and risk from contingent liabilities are continuously monitored and incorporated in the overall debt management strategy. Table 6 illustrates key cost and risk indicators at the end of 2020 and forecast for 2021.

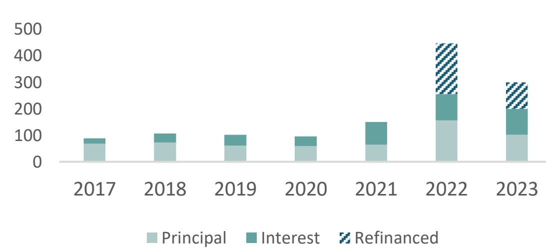
Table 1: Debt cost and risk indicators, 2020 -2021

Indicator		2020	2021 Forecast
Cost of debt	Interest (as a % of GDP)	4	3
	Weighted average interest rate (%)	4	3
Refinancing risk	Average time to maturity (years)	7	7
	Debt maturing in one year (% of total debt)	39	22
	Debt maturing in one year (% of GDP)	45	24
Interest rate risk	Average time to re-fixing (years)	7	7
	Debt refixing in one year (% of total debt)	41	24
	Fixed rate debt (including treasury bills)	98	98
Exchange rate risk	Foreign currency debt (% of total debt)	65	69
	Short term foreign currency debt (% of foreign reserves)	61	58

4.1 Refinancing risk

The refinancing risk captures the exposure of the debt portfolio to unusually elevated redemption profile and high interest rates. One of the major refinancing risks in the Government's debt portfolio is related to the USD 250 million Eurobond maturing in mid-2022. As a proactive measure to address the refinancing risk, the Government carried a Liability Management Exercise through an any-and-all tender offer where 76.76% of the Eurobond was tendered and settled from a 5-year Sukuk issued under a Sukuk Issuance Program. This is also reflected in the Average Time to Maturity (7 years) of the portfolio forecasted for end of 2021. In addition to the refinanced Eurobond maturing in 2022, the maturity of USD100 million bond originally maturing in 2023 has also been extended by 3 years as illustrated in the chart below.

Chart 13: External Debt Redemption Profile (2017 - 2023)



[1] Refers to the uncertainty that debt may have to be rolled over at an unusually high interest cost or cannot be rolled over at all.

[2] Risk of increase in debt servicing cost due to unfavourable changes in the interest rates.

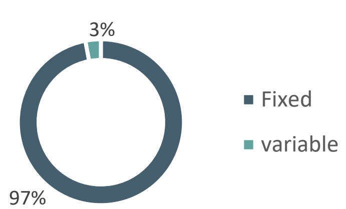
[3] Risk of increase in debt outstanding and debt servicing cost due to fluctuations in exchange rate

Nonetheless, with 39 percent of the total portfolio set to mature in the next 12 months, the short-term refinancing risk still remains prevalent. Therefore, the refinancing risk is deemed critical and the Government will continue its efforts to proactively manage this risk.

4.2 Interest rate risk

The interest rate risk reflects the volatility in various interest rates structures in Government's debt portfolio. The key indicators used to measure interest rate risk are; Average Time to Refixing (ATR), Debt refixing in 1 year, split between fixed and variable rate debt and Weighted Average Interest Rate (WAIR). The ATR describes time taken in years to fix the interest rates; therefore, a shorter ATR implies that the portfolio is more exposed to variable interest rate shocks. The ATR of the portfolio as at end of 2020 was 7 years. This implies that the Government has adequate time to refix the interest rate in terms of interest rate shocks. Table 1 also shows that 41 percent of total debt portfolio is subject to interest rate refixing in less than one year. However, around 90 percent of debt subject to refixing represent fixed rate treasury bills issued to domestic market. As such, considering the growing demand for treasury bills (6 percent average annual growth in the past 5-year), the risk of interest rate refixing remains minimal.

Chart 14: Fixed rate debt as percentage of total debt (2020)

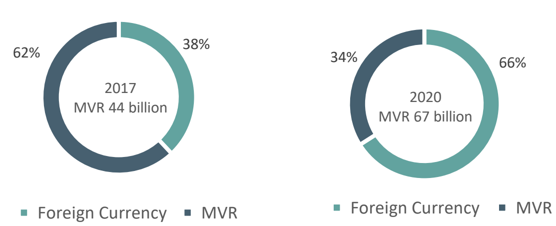


In terms of average interest rate, the WAIR at the end of 2020 was 4 percent and it is expected to drop to 3 percent by the end of 2021. This is mainly due to increased concessional borrowings obtained through multilateral and bilateral partners in 2020. In addition, considering the fact that almost 98 percent of portfolio consists of fixed rate debt, the exposure to adverse interest rate shocks remains low.

4.3 Exchange rate risk

In terms of exposure to foreign exchange risk, at the end of December 2020, approximately 65 percent of the Government's debt portfolio is denominated in foreign currency. Although foreign currency debt portfolio comprises of several currencies including United States dollar (USD), Chinese Yuan (CNY), Saudi Riyal (SAR), Euro (EUR), Japanese Yen (JPY), the predominant exposure is towards USD. This is due to the current exchange regime in which USD cross exchange rate is applied for all foreign currency debt service payments of the Government.

Chart 15: Foreign Currency debt as a percentage of total debt as at end of 2017 and as at end of 2020.



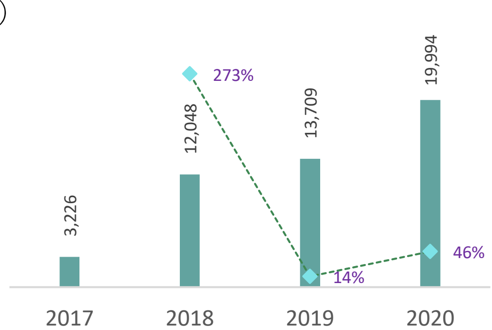
Given the uncertainty over the tourism recovery and deteriorated foreign currency reserve position, the Government considers exchange rate risk as the most critical risk facing the country in the medium to long term, Therefore, this Strategy outlines the policies that will be implemented to minimise this risk.

4.4 Contingent Liabilities

Government's contingent liabilities include, government guaranteed debt of State-owned entities, statutory authorities' debt and guaranteed debt of private companies where Sovereign Guarantees (GS) are granted for their borrowings. As such, total guaranteed debt at the end of 2020 stood at MVR 19.9 billion (34 percent of GDP), an increase of MVR 16.7 billion when compared guaranteed debt at the end of 2017.

This poses significant risks for the government if a beneficiary of guaranteed debt defaults and a call on the guarantee is made by the lender resulting a settlement to be made by the Government to avoid any sovereign default.
However, it is worth noting that the Government has never defaulted on its obligations to pay its debt The Government continues to monitor the financial soundness and debt repayment capacity of the beneficiaries of the SGs. The proactive monitoring enables the Government to provide assistance to SOE's and other beneficiaries when they are faced with difficulties in servicing the debt in a timely manner.

Chart 16: Outstanding Guaranteed Debt (2017 - 2020)



4.5 Operational Risk

Operational risk refers to a wide variety of risks faced by the Debt Management Office (DMO) that can disrupt debt service and debt management operations. Several operational gaps in the current debt management operation were identified in the DeMPA carried out in 2019 by the World Bank. Findings from the assessment led to recommendations to further strengthen the institutional structure and to implement a centralized debt office within the Ministry of Finance. In this regard, the implementation of traditional FO/MO/BO model debt office with robust internal procedures and enhanced staff capacity has assisted the Government in achieving some of the key operational reform tasks identified by the assessment. tasks

Furthermore, as detailed in this MTDS, the Debt Management Department of the Ministry of Finance will continue the reform work to ensure that operational risks related to debt management operations are mitigated to the maximum possible extent.

5. Debt Management Targets

Table 2: Medium Term Debt Management Targets

FX debt as % of total debt	**Average time to maturity**
$	
Maintain within 500bsp of current ratio	Increase the ATM to 8 years
Weighted average interest rate (%)	**Debt maturing in 1 year** **(% of total debt)**
Reduce by 100bsp	Maintain within 30% of total debt.

6. Debt Strategy 2022-2024

6.1 Description of the Strategy

The Government's debt strategy for 2022-2024 is derived from a quantitative assessment of alternative strategies geared towards meeting Government's medium-term debt management objectives and targets set for key risk indicators, using the IMF/World Bank MTDS toolkit.

The MTDS 2022-2024 was formulated by considering the inherent costs and risks in the existing debt portfolio of the Government. In particular, the risk of increasing foreign currency denominated debt and potential refinancing risks were considered. Although, it is worth noting that with the accelerated disbursements of the externally financed project loans, the external debt outstanding is projected to increase in the medium term. These are mainly mega infrastructure development projects for which external financing was secured on favourable terms in 2019 and 2020.

Despite the existing constraints, the strategy is geared towards gradual decrease of external financing in the medium term. The successful implementation of the MTDS will assist the Government in reducing portfolio exposure to foreign currency debt by controlling the growth of external debt while ensuring its financing needs are met at lowest possible cost, consistent with a prudent degree of risk. The following section discusses the key assumptions and proposed activities for this strategy.

6.2 Key Assumptions

The modelling of MTDS utilizes forecasts of the Government's fiscal balances and macroeconomic projections in the Fiscal Strategy to produce baseline estimates for portfolio cost and risk indicators under alternative financing strategies. The key assumptions of the desired financing mix under this MTDS are discussed below.

6.2.1 Financing assumptions

i. Financing sources: Gradual decrease of external to domestic financing ratio from 70 percent in 2021 to 50 percent in 2024 is assumed.
ii. Maximum utilization of external concessional financing is assumed based on projected disbursements of existing financing facilities.
iii. Residual external financing will be sourced through semi-concessional/blended financing sources and by issuing 5–7-year bond or sukuk to the debt capital market.
iv. Domestic financing strategy aims to gradually decrease the reliance on short term treasury bills and increase stock of long-term treasury instruments in the medium term.
v. In addition to the existing 10-year t-bond tenure, the strategy assumes introduction of 10-20-year t-bonds to the domestic market from 2022. This will assist the Government to reduce it refinancing risk by lengthening the debt portfolio's ATM.

6.3 Methodology and Strategy Analysis

The strategies have been simulated in MTDS Toolkit under the assumptions discussed above. Discussions focused on performance of each strategy under the cost indicators of interest/GDP and Debt/GDP. The interest to GDP ratio is relevant as it indicates the resources that is required to service the debt and not available for other uses. A number of other risk indicators are considered; such as ATM and ATR, which give indication of rollover risk and interest rate risk. The redemption profile is also considered since it gives indication of cash flow profile or liquidity pressure on the budget. Overall, it is envisaged that the methodology applied and the cost-risk indicators considered will assist in obtaining the desired portfolio mix.

7. Expected Outcome from Strategy Implementation

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

Indicator		2020	2021	2022	2023	2024
Cost of Debt	Interest rate (as a percent of GDP)	3.6	2.9	1.5	1.1	0.9
	Weighted Average Interest rate (%)	3.9	3.4	3.4	3.2	
Refinancing risk	Average time to maturity (years)	6.9	6.9	6.9	6.9	8.4
	Debt maturing in one year (% of total debt)	39.0	35.1	35.0	32.3	30.4
	Debt maturing in one year (% of GDP)	44.7	35.3	30.0	28.5	26.3
Interest Rate risk	Average time to re-fixing(years)	6.6	6.6	6.6	6.6	8.4
	Debt refixing in one year (% of total Debt)	41.2	37.7	37.1	35.3	32.4
	FX Debt (Including T-Bills)	97.8	98.1	98.3	98.5	98.6
Currency risk	FX Debt (% of total debt)	65.3	68.5	70.8	71.9	72.5
	ST FX debt (% of Gross International Reserves)	39.4	58.2	36.9	39.8	41.2

7.1 Analysis of cost and risk indicators

The elected strategy will assist the Government in achieving its medium-term debt management targets which is aligned to addresses portfolio risks arising from exposure to foreign currency and hikes in redemption profile. In particular, the strategic reduction of annual external borrowings' ratio over the medium term and increasing the issuance of longer-term instruments will help achieve the set targets. It is also worth noting that despite the large disbursement expected from committed external loans, FX debt as a percentage of total debt will be at a sustainable level over the medium term. As depicted from the above table, by the end 2024, the ATM of the debt portfolio will reach 8.4 years; which is a significant improvement that mainly reflects introduction of new longer-term instruments in both the domestic and international markets.

Similarly, significant reduction in debt maturing in one year can be observed over the medium term. The debt maturing in one year as a percentage of total debt will be reduced from 39 percent at the end of 2020 to approximately 30 percent by the end of 2024.

7.2 Risk to Baseline Macroeconomic Projections

The robustness of the analysis is based on the resilience of the macro fundamentals and typically the baseline assumptions for the interest rates, exchange rates and the fiscal stance. The overall budget balance assumption is also anchored on a very optimistic GDP growth, propelled by the strong fiscal stance which is enhanced by the revenue from taxation. In view of the main macro postulations above, the following may post material risk to the macroeconomic fundamentals that could impede the implementation of this strategy.

- Further worsening of the Covid-19 pandemic could slow down the recovery thereby adversely impacting the GDP growth assumptions.

- Tax revenue may not materialize as envisaged in the baseline assumptions, if the pandemic further worsens or recovery is prolonged. This could widen fiscal deficit and budget financing gap.
- Deterioration in economic outlook could lead to a further downgrade in Sovereign Credit Ratings. This affects pricing of government securities as the markets reassesses the credit quality of government and likely to apply credit premiums. This will in turn increase future borrowing costs and depending on the magnitude of downgrade.
- Increase in debt to an unsustainable level could pose challenges in obtaining additional debt on favourable terms. Depending on the severity of debt sustainability, the Government may not be able to secure the required financing, particularly from external sources.
- Disruptions in the international financial markets such as a credit crunch and interest rate hikes could impede the Government's ability to secure financing from debt capital markets as envisaged in this strategy.
- Depletion of Gross International Reserve poses significant devaluation risk. Devaluation of Maldivian Rufiyaa against USD will inflate value of the Government's debt portfolio and increase cost of debt service.
- Further, the contingent liabilities could also pose additional fiscal risk and restrict Government's ability to successfully implement the MTDS.

7.3 Strategy Implementation

The proposed strategy aims to fulfil the Government's debt management objectives and its debt management targets in the medium term. However, the successful implementation of the proposed strategy could be challenging given the heightened uncertainty around the Covid-19 pandemic and its effects on the economy. In spite of these challenges, the activities proposed below will play a critical role in supporting the successful implementation of the Government's Medium-Term Debt Management Strategy.

- Development of an associated Annual Borrowing Plan.
- New financing will be evaluated against the MTDS targets.
- Given the uncertainty associated with the Covid-19 pandemic, MTDS will be reviewed semi-annually during the strategy period.
- Continue implementation of DeMPA reform plan to enhance the quality of public debt management.

8. Conclusion

In line with the Government's debt management objectives, the MTDS aims to reduce portfolio's exposure to foreign currency debt in the medium term. As such, the selected strategy will allow the Government to control the growth of external debt while meeting the financing requirements from the domestic sources through avenues proposed in this strategy. Nonetheless, it is imperative for the Government to strengthen the financial management system and governance to ensure macroeconomic stability and increase the debt carrying capacity of the country.

In this regard, by the end of the implementation period; the MTDS is expected to achieve the following;

(i) Reduce the reliance on external financing;
(ii) Establish deep and liquid domestic debt capital market;
(iii) Increase average time to maturity of the debt portfolio and;
(iv) Reduce the weighted average interest rate of the debt portfolio.