Ministry of Fiance

Medium-Term Debt Management Strategy

2025–2027

31st July 2024

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1.0 Introduction

The Fiscal Responsibility Act (Law Number 7/2013) mandates 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. The strategy has been formulated in accordance with the Article 22 of the Fiscal Responsibility Act and includes the following components:

- Public debt targets
- Total public debt to gross domestic product (GDP) target
- Target for external and domestic debt
- On going and planned measures to mitigate risks related to public debt
- Details of utilization of borrowed funds

This report was prepared by the Debt Management Department of the Ministry of Finance. This report takes into account the cost-risk profile of the existing debt portfolio, as well as the anticipated market conditions, macroeconomic trends, and fiscal objectives in the medium-term. It also covers the debts servicing costs, the status of the international debt capital market, and outlines government's approach to implementing the MTDS 2025-2027 strategy. Due to the COVID-19, on 26 April 2020 Ministry of Finance submitted to People's Majilis and got approval for the suspension of Article 32 (Clause haa, raa & baa) of the Fiscal Responsibility Act. The impact of this suspension on domestic and external debt are analyzed in this report.

1.1 Objectives for Debt Management

The main 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 fostering the growth of the domestic capital market.

1.2 Scope & Coverage

The MTDS is a three-year strategy that is updated annually. MTDS is formulated by assessing various strategies using a toolkit formulated by the International Monetary Fund (IMF) and the World Bank Group, and the most feasible strategy for the debt portfolio is selected based on the analysis. The MTDS focuses on the government's total borrowings as defined in clause 40 (Faafu) of FRA (No.7/2013). As such total state debt refers to all direct debt of the government including sovereign guaranteed debt.

2. Breakdowns of Government Debt

At the end of 2023, the public and publicly guaranteed (PPG) debt amounted to MVR 125.5 billion, which is equivalent to 124.1% of the GDP. Implementation of fiscal reform measures set for the year 2024 is expected to decrease the debt accumulation and ensure fiscal and debt sustainability. By the end of 2024, the PPG debt of government is forecasted to reach MVR 137.0 billion which is equivalent to 126.7 percent of GDP.

Chart 1: Composition of Government Debt 2019 – 2024 (In MVR billions)

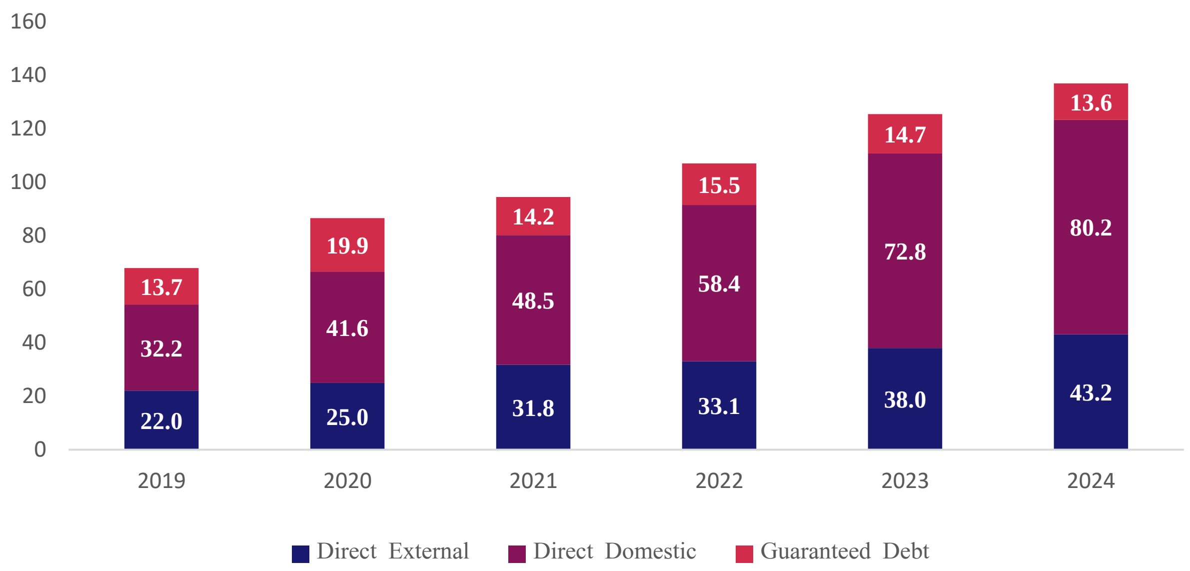


Chart 2: PPG Debt as a percentage of GDP 2019 – 2024

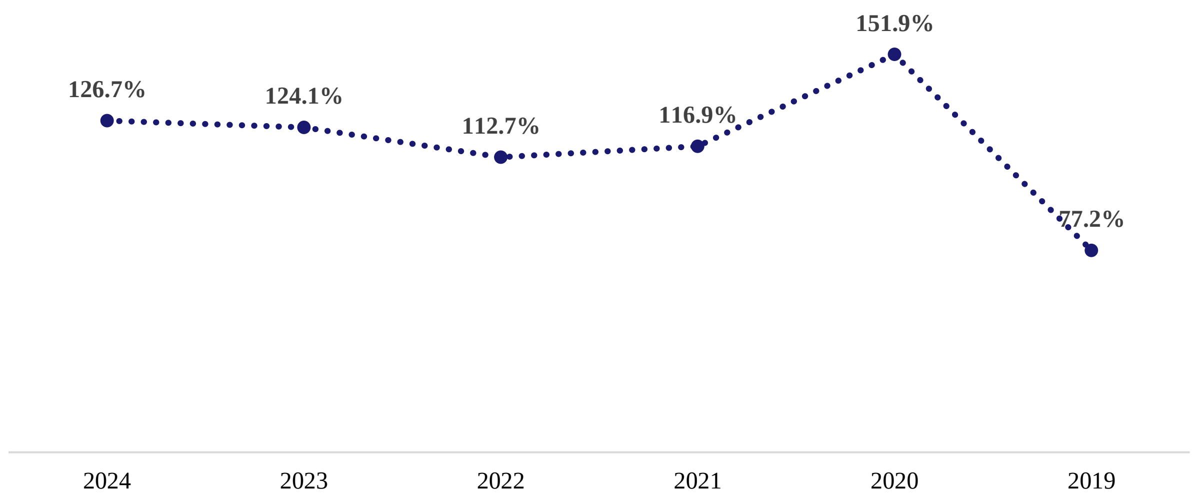
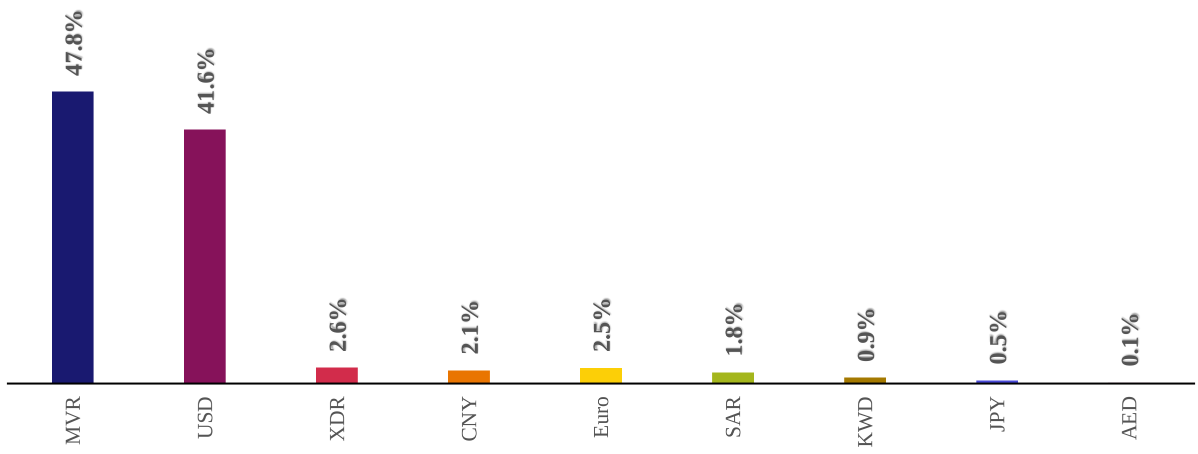


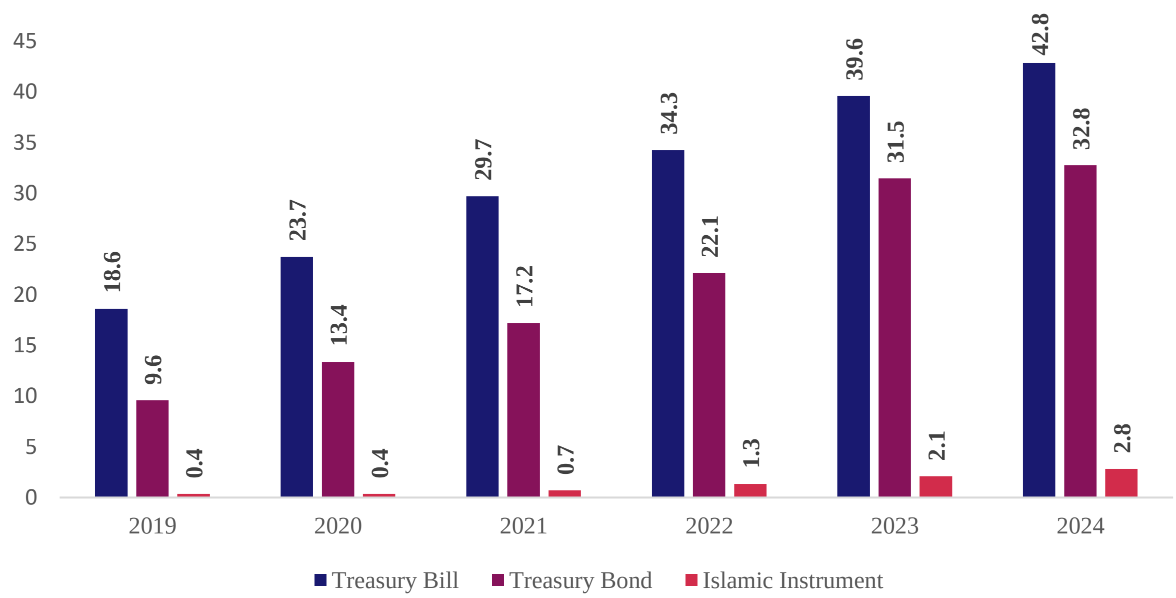
Chart 3: Currency Composition of PPG Debt as of 2023



2.1 Direct Domestic Debt

By the end of 2023, the government's direct domestic debt stood at MVR 72.8 billion and is projected to rise to MVR 80.2 billion by the end of 2024. Short-term Treasury bills issued by the government account for 54 percent of direct domestic debt. The suspension of Clause 32 (haa, raa & baa) of the Fiscal Responsibility Act from 2020 to 2023 resulted in Overdraft of Public Bank Account, subsequently casuing economic challenges and a significant rise in direct domestic debts.

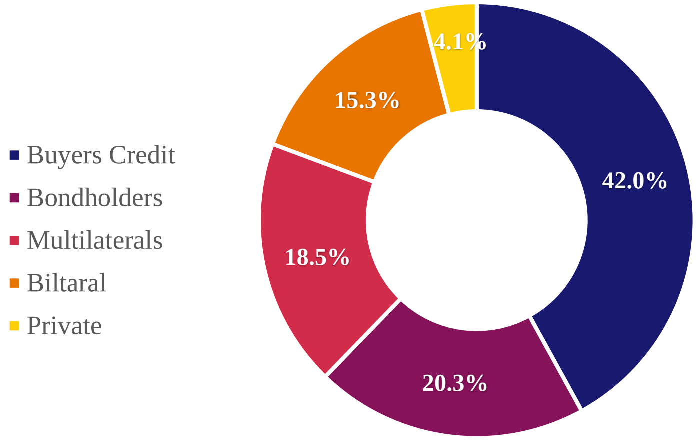
Chart 4: Breakdown of Direct Domestic Debt 2019 – 2024 (In MVR billions)



2.2 Direct External Debt

By the end of 2023, the government's direct external debt stood at MVR 38.0 billion. Chart 5 illustrates the breakdown of external debt by creditor categories. External debt is projected to rise by 13.6 percent by the end of 2024 compared to 2023, primarily driven by increased disbursements aimed to expedite ongoing major projects including Development of Velana International Airport and the Greater Malé Development Project.

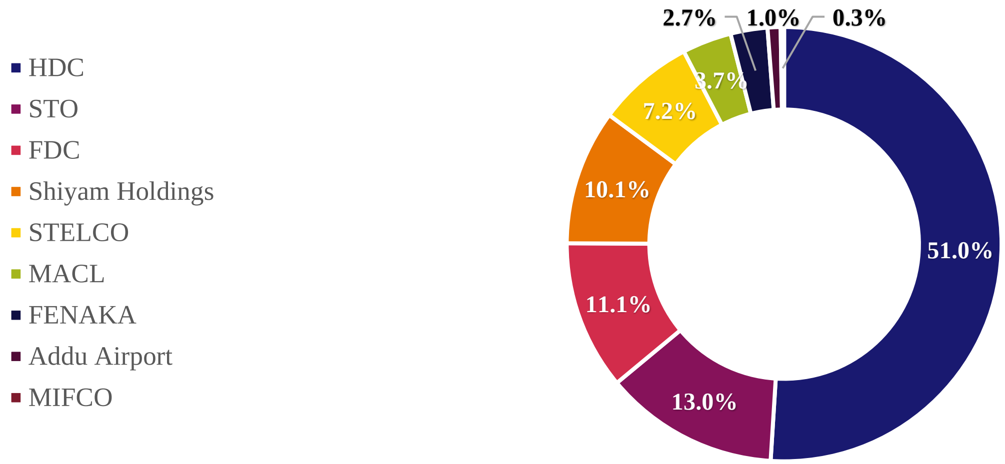
Chart 5: Creditor category of direct external debt as of 2023



2.3 Sovereign Guaranteed Debt

Government's guaranteed debt amounted to MVR 14.7 billion by the end 2023 which is equivalent to 14.5% of GDP. Among this, MVR 13.7 billion was guaranteed to external creditors, while MVR 917.2 million was issued to domestic creditors. The guaranteed debt includes MVR 1.5 billion outstanding from the sovereign guarantee issued to Ahmed Siam Holdings Pvt Ltd. The remaining MVR 13.1 billion consists of guarantees provided for debt incurred by State-Owned Enterprises. Composition of government guaranteed debts is illustrated in Chart 6.

Chart 6: Composition of government guaranteed holders as of 2023

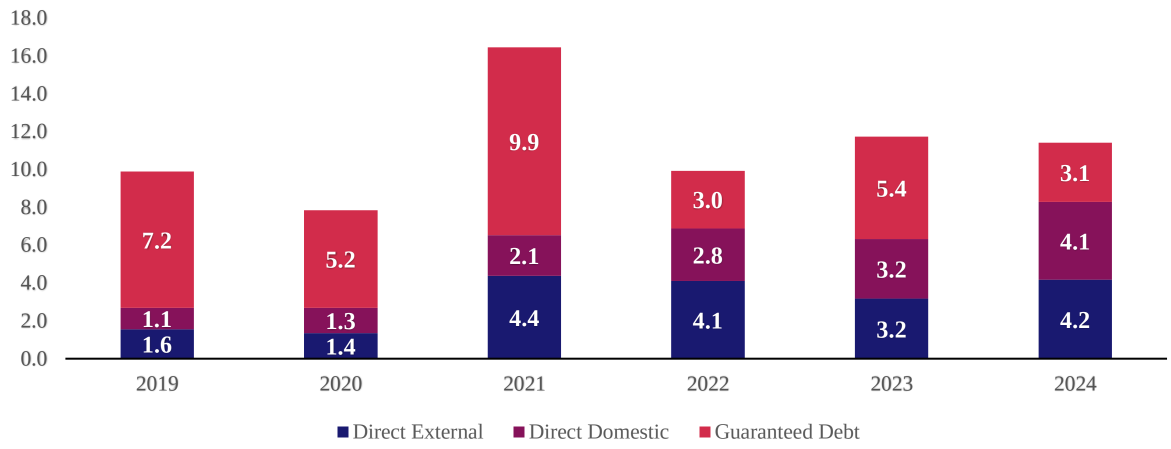


2.4 Debt Servicing of PPG Debt

Debt servicing of direct debt (including interest, other payments, and principal repayments) reached MVR 6.4 in 2023. This amount was evenly split between domestic and external debt, with MVR 3.2 billion used for each. Debt servicing costs for direct government debt are projected to rise to MVR 8.3 billion by the end of 2024, primarily due to higher refinancing costs.

In 2023, MVR 5.4 billion was incurred on servicing sovereign guaranteed debt, while MVR 516.5 million allocated to domestic creditors and MVR 4.9 billion was for external creditors. Debt servicing cost for sovereign guaranteed debt is projected to decline to MVR 3.1 billion during 2024. Details of debt service costs are shown in Chart 7 below.

Chart 7: Debt Service cost from 2019 – 2024 (MVR billions)



2.5 Breakdown of Net Financing

The financing requirement for 2023 budget amounting to MVR 19.3 billion was raised as debt, of which 75 percent was secured from domestic sources. Among this, long term treasury bonds accounted for 65 percent, which includes bonds worth MVR 6.2 billion issued to the Maldives Monetary Authority (MMA) to securitize the Public Bank Account overdraw resulting from the suspension of the Public Finance Act, 2023.

Compared to 2022, net financing of external debt increased significantly in 2023, mostly due to loans obtained from buyer's credit lenders. The decline in financing from buyer's credit in 2022 was mainly due to the resumption of debt service on suspended loans under the G-20 Debt Service Suspension Initiative and the decline in disbursements of projects funded by these facilities relative to debt service obligations. The surge in 2023 was contributed by the disbursement of budget support loans from a Buyers Credit Facility and the Gulhifalhu Reclamation Project. Additionally, the rise in net financing from bilateral sources was largely due to the increase in disbursements of loans taken for the development of Velana International Airport.

Table 1: Net Financing from 2021 – 2024 (In MVR millions)

	2021	2022	2023	2024
Domestic Sources				
MVR Conventional Treasury Bills	5,307	4,088	3,012	3,554
RDC/USD Treasury Bills	667	459	1,443	1,703
MVR Shariah Compliant Instruments	350	553	610	720
USD Shariah Compliant Instruments	-	92	157	185
Total financing from Treasury Bills	**6,323**	**5,192**	**5,221**	**6,162**
MVR Treasury Bonds	174	2,548	8,561	439
USD Treasury Bonds	(5)	2,390	770	860
Total financing from Treasury Bonds	**169**	**4,937**	**9,331**	**1,299**
Domestic MVR Loans	(37)	(3)	(3)	(2)
Domestic USD Loans	371	(166)	(189)	(56)
Total raised from domestic loans	**334**	**(169)**	**(192)**	**(58)**
Net Financing from Domestic Sources	**6,826**	**9,961**	**14,360**	**7,403**
External Sources				
Bilateral Loans	(197)	(49)	757	1,657
Buyers Credit	2,166	734	3,588	2,089
Multilateral Loans	148	(62)	574	1,421
Foreign Bonds	4,736	(888)	-	-
Commercial Loans	-	1,540	-	-
Net External Financing	**6,852**	**1,275**	**4,919**	**5,167**
Total Net Financing	**13,677**	**11,236**	**19,279**	**12,570**

3.0 Use of proceeds

The borrowed funds are mainly utilized to finance budget deficit and to fund various projects related to infrastructure development, healthcare and public services. This includes projects such as Velana International Airport, development of airports across various regions of the Maldives, construction of ports on several islands, water and sewerage initiatives and renewable energy projects. Additionally, the second phase of the Gulhi Falhu land reclamation project was commenced to address the land shortage in the Maldives. A significant portion of debt obtained to fund these projects were secured at lower interest rates compared to current market rates, with extended repayment periods. However, the interest rate on the financing obtained for budget support is higher than the market rate.

4.0 Risks to the Debt Portfolio

The most prominent risks to the debt portfolio as of 2023 are:

(1) Exchange Rate Risk,

(2) Refinancing Risk, and

(3) Interest Rate Risk

Table 2: Risk Indicators 2022 - 2023

Risk Indicators		2022 Actuals	2023 Actuals
Cost of Debt	Total debt (as a percentage of GDP)	112.7	126.7
	Interest Payments (as a percentage of GDP)	3.5	3.7
	Implied Interest Rate (%)	4.1	4.1
Refinancing Risk	Average Time to Maturity (ATM)	6.3	6.6
	Debt Maturing in 1 year (as a percentage of total debt)	37.0	39.4
	Debt Maturing in 1 year (as a percentage of GDP)	39.5	42.9
Interest Rate Risk	Average Time to Refixing (ATR)	6.3	6.6
	Debt refixing in 1 year (as a percentage of total Debt)	37.0	39.4
	Fixed Rate Debt (including short term instruments)	83.8	97.6
Exchange Rate Risk	Debt denominated in foreign currencies (as a percentage of total debt)	48.5	46.5
	Short Term FX debt (as a percentage of reserve)	23.4	20.7

4.1 Exchange Rate Risk

The increase in short-term foreign currency debt as a percentage of foreign currency reserves and the percentage of debt denominated in foreign currencies as a percentage of total debt poses a significant risk to the debt portfolio in the shortterm. Short-term foreign currency debt as a percentage of foreign currency reserve decreased by 2.7 percent from 2022 to 2023. Also, debt denominated in foreign currency as a percentage of total debt declined by 4.1 percent from 2022 to 2023. This decline was primarily due to the securitization of the public bank account overdraft worth MVR 6.2 billion, which increased the share of MVR-denominated debt in the portfolio. Despite this, exchange rate risk is considered as one of the key risks to the debt portfolio.

4.2 Refinancing Risk

Another significant risk in the debt portfolio is refinancing risk. The main indicators for assessing refinancing risk are average time to maturity (ATM) and proportion debt maturing in 1 year as a percentage of total debt. The ATM of the debt portfolio increased slightly from 6.3 years in 2022 to 6.6 years in 2023. Meanwhile, debt maturing in 1 year as a percentage of total debt has risen from 37 percent in 2022 to 39.4 percent in the year 2023. Furthermore, there are substantial bullet repayments due in the year 2025 and 2026, which includes USD 500 million sukuk and USD 100 million bond held by the Abu Dhabi Fund for development. Amid rising global interest rates and heightened refinancing risk, the significant upcoming maturities requiring refinancing in the medium term further increase the implied interest rate of the portfolio.

4.3 Interest Rate Risk

The key indicators used to measure interest rate risk include average time to re-fixing (ATR), Debt refixing in one year, the ratio of fixed-rate debt and the implied interest rate. In 2023, ATR of the debt portfolio was 6.6 years. The proportion of Debt re-fixing in one year stood at 39.4 per cent, while the fixed-rate debt accounted for 97.4 per cent at the end of 2023. The implied interest rate of the debt portfolio declined to 4.2 per cent in 2023. This was mainly due to significant loan disbursements for projects in 2023 and issuance of long-term bonds worth MVR 4.3 billion and MVR 1.9 billion to MMA to securitize the amount overdrawn from public bank accounts in 2023. Details are illustrated in Chart 8 and 9.

Chart 8: Fixed vs Variable debt as a percentage of total debt (2023)

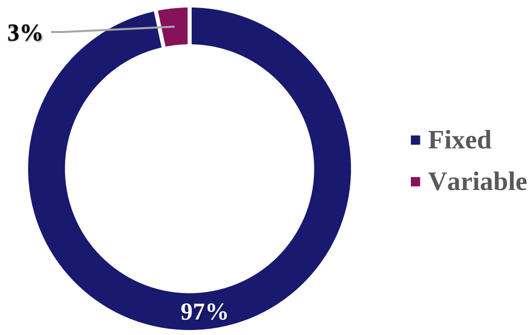
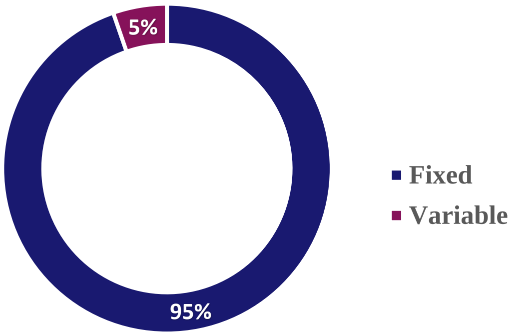


Chart 9: Fixed vs Variable debt as a percentage of total debt excluding Treasury Bills (2023)



4.4 Operational Risk

Operational risk refers to the risk of rise in cost of managing debt due to operational challenges of debt management. In accordance with the recommendations and guidance of international financial institutions such as the IMF and the World Bank, the ministry is working to enhance debt management processes. Thus, the ministry's debt management department has initiated the process of conducting a self-assessment to assess the need to improve debt management in line with the Debt Management Performance Assessment Methodology developed by the World Bank. Currently, over 80 per cent of the daily tasks has been automated to streamline the debt management process. Moreover, a Public Debt bill has been submitted to parliament this year to strengthen the legal framework for debt management.

5.0 Debt Management Environment

5.1 Macroeconomic, Policy & Market Environment

Although Maldives has recovered from the adverse economic impacts of COVID-19 pandemic, the rise in global market rates to counter the inflationary pressures from the increase in oil prices, presents significant challenges to Maldives in securing external financing. Moreover, the government is facing challenges in raising funds from the domestic capital market due to high domestic borrowing in past through excessive cash injections. Consequently, this has adversely affected the investor exposure and market liquidity, thus limiting potential financing which can be obtained from the domestic capital market. it is estimated that a maximum of MVR 4 billion can be obtained from domestic capital market per year. Furthermore, high risk related to fiscal and debt sustainability coupled with lack of implementation of measures to address these, could impede government's ability to secure financing from international markets.

However, reduction in government expenditure and implementation of the medium-term fiscal strategy and debt strategy will improve the current situation and facilitate access to external financing. Additional information on the economic performance has been included in the fiscal strategy.

5.2 Financing Requirement

Fiscal reforms set to be implemented between 2024 and 2028 are expected to lower the gross financing needs (excluding the rollover of Treasury bills) required for budget execution in the medium term. The gross financing requirements are anticipated to decline from MVR 15.5 billion in 2025 to MVR 7.8 billion by 2027. Meanwhile, debt service expenditures are expected to rise from MVR 9.5 billion in 2025 to MVR 10.5 billion in 2027.

5.3 Potential sources of finance

The government secures financing from both domestic capital market and foreign sources. Domestically, the government primarily raise financing by issuing short-term and long-term debt securities, such as Treasury bills, Treasury bonds, and Islamic instruments. The main purpose of external borrowings is for implementation of development projects through loans and the issuance of long-term bonds and sukuk.

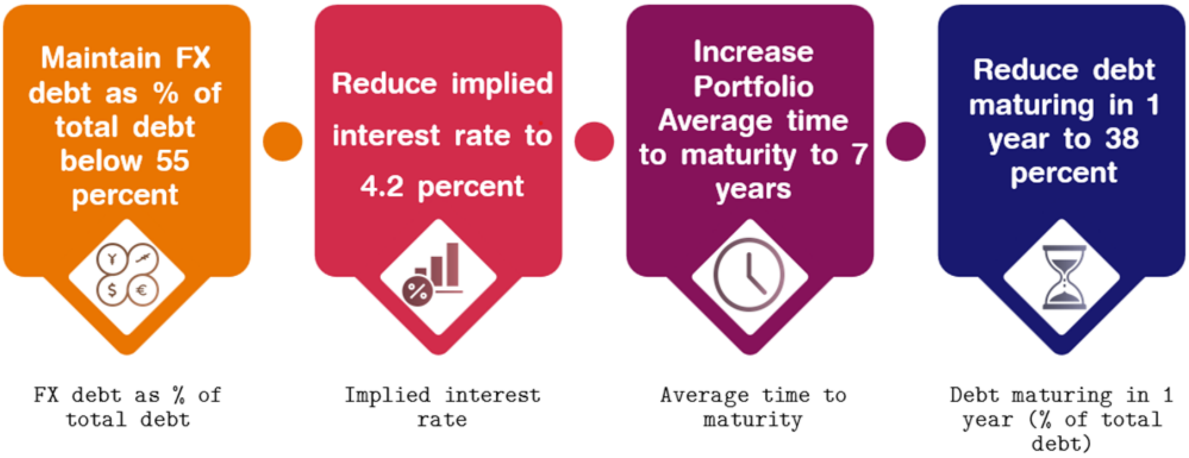
5.3.1 Project Financing

The government aims to maintain strong relationships with multilateral agencies, bilateral entities, and other development partners, with a focus on securing concessional financing. Currently, several major government projects have been financed through bilateral agreements with various countries.

5.3.2 Budget Support

Domestic sources intended to raise financing for budget support in the medium term are through commercial banks, state-owned enterprises, institutional investors such as pension funds, private companies, and eligible private individuals. For external financing, the government plans to secure budget support from international financial institutions and other countries.

6.0 Medium term Debt Management Strategy Targets by 2027



7.0 Medium Term Debt Management Strategy 2025-2027

7.1 Introduction

Given that the risks to debt portfolio and its significance remained unchanged, the Medium-Term Debt management Strategy for 2025 – 2027 has been formulated in alignment with the previous year's strategy. The strategy has been formulated after due consideration to the borrowing costs, risks to portfolio, sources of financing, extent to which the debt portfolio needs to be diversified, currentfiscal situation of the government, and changes in international financial markets. The Medium-Term Debt Management Strategy is to coordinate with international financial institutions to reduce public expenditure and to obtain financing for the budget.

The strategy is planned to be implemented by:

- Securing the medium-term external financing requirement at concessional terms through multilateral and bilateral institutions
- Refinancing USD 300 million from the USD 500 million Sukuk which is set to mature in 2026 in 2025 through a market friendly approach and repaying the remaining USD 200 million of the Sukuk by utilizing the Sovereign Development Fund (SDF)
- Developing the domestic capital market by introducing longer term securities including Shariah compliant instruments
- Converting a portion of the treasury bill stock into treasury bonds

7.2 Assumptions

- The implementation of the home-grown reform plan laid out in the medium-term fiscal strategy
- Market rates are expected to remain stable, with a decline in the medium-term, enhancing market access and lowering the borrowing costs for the Maldives

7.3 Methodology and Strategy Analysis

The assumptions outlined above were evaludated using the medium-term debt management strategy formulation toolkit. Each strategy was evaluated by analyzing its impact on the cost-risk indicators such as debt servicing costs as a percentage of GDP, projected total debt levels and refinancing risk indicators such as ATM and ATR.

8.0 Strategy Results

Table 3: Projections of cost and risk indicators in the medium- term

Risk Indicators		2022 Actuals	2027 Forecast
Cost of Debt	Total debt (as a percentage of GDP)	126.7	96.4
	Interest Payments (as a percentage of GDP)	3.7	4.3
	Implied Interest Rate (%)	4.1	4.2
Refinancing Risk	Average Time to Maturity (ATM)	6.6	7.0
	Debt Maturing in 1 year (as a percentage of total debt)	39.4	38.0
	Debt Maturing in 1 year (as a percentage of GDP)	42.9	38.0
Interest Rate Risk	Average Time to Refixing (ATR)	6.6	8.3
	Debt refixing in 1 year (as a percentage of total Debt)	39.4	35.3
	Fixed Rate Debt (including short term instruments)	97.6	98.0
Exchange Rate Risk	Debt doneminated in foreign currencies (as a percentage of total debt)	46.5	55.0
	Short Term FX debt (as a percentage of gross reserve)	20.7	36.2

8.1 Analysis of Cost and Risk Indicators

The baseline scenario for the Medium-Term Debt Management Strategy 2025 – 2027 is formulated based on the medium-term economic outlook and home-grown fiscal reforms outlined in the Medium-Term Fiscal Strategy 2025 – 2027. The strategy aims to reduce direct debt as a percentage of GDP to less than 95 percent by 2026.

8.1.1 Refinancing Risk

To mitigate the refinancing risk posed from the sizeable repayments due in the year 2026, this strategy aims to refinance USD 300 million of the Sukuk in the year 2025 through market friendly approaches with remainder settled by utilizing the Sovereign Development Fund (SDF). As a result, ATM of the portfolio is forecasted to increase to 8.3 year while debt maturing in 1 year as a percentage of total debt is expected to decline from 39.4 percent in 2023 to 38.0 percent by 2027.

8.1.2 Interest Rate Risk

In terms of interest rate risk, the average time to refixing stood 6.6 years at the end of 2023 and is projected to increase to 8.3 years by the end of 2027. In the medium-term, the proportion of debt obtained at fixed interest rates is expected to increase to 98.0 percent, thus minimizing the interest rate risk associated with variable rate borrowing.

8.1.3 Exchange Rate Risk

As per the risk indicators in Table 3, exchange rate risk is the most significant risk to the debt portfolio. The proportion of debt denominated in foreign currency (as a percentage of total debt) is anticipated to grow from 46.5 per cent at the end of 2023 to 55.0 per cent by the end of 2027. This increase is driven mainly due to the rise in foreign currency debt to support the implementation of medium-term budget. In the medium-term, short-term foreign currency debt (as a percentage of reserve) is expected to increase to 36.2 percent.

9.0 Conclusion

Aligned with the objectives of public debt management, this strategy focuses to minimize risks to the debt portfolio, reduce debt service costs and lower its adverse impacts on the budget while developing domestic capital market and maintaining investor relations. The expected outcomes of the MTDS by the end of the implementation period are as follows:

1. Facilitate to secure medium term external financing requirement at a low cost
2. Facilitate the refinancing of the USD 500 million-dollar Sukuk maturing in 2026
3. Foster development of the domestic capital market
4. Enhance domestic capital market liquidity thereby improving the government’s financing capabilities
5. Enable the implementation of financing strategies to reduce risks in the debt portfolio
6. Diversify the debt portfolio
7. Enhance country’s credit rating and boost investor confidence

Attainment of the goals of the medium-term debt management strategy depends on the implementation of the recommendation outlined in the fiscal strategy which has been formulated to achieve debt sustainability in the medium term.