Medium- Term Debt Management Strategy 2023 - 2025

Debt Management Department

MINISTRY OF FINANCE
REPUBLIC OF MALDIVES

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2023/25 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 FX debt as % of total debt below 60%

Weighted average interest rate (%)

Reduce Weighted Average Interest Rate to 3.5%

Average time to maturity

Increase Portfolio Average Time to Maturity to 7 years

Debt maturing in 1 year (% of total debt)

Maintain Debt Maturing in 1 year within 40% of total debt

Central Government's Debt Portfolio

as at 31 December 2021

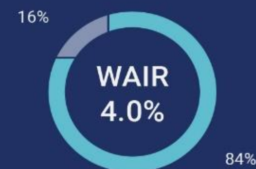
Outstanding Debt

Portfolio composition

MVR 40.1b
50.1% in Foreign Currency

MVR 39.9b
49.9% Local Currency

External Portfolio



weighted average interest rate - 4.0%

■ Non-concessional ■ Concessional & semi-concessional

2023/25 Focus

1. Maximum utilization of concessional financing
2. Diversify portfolio by Introducing innovative financing instruments such as ESG in 2023/24
3. Reduce annual external financing ratio to 40% by 2025
4. Issue 5-7 year bonds to the international markets
5. Gradually shift from T-bills to longer term bonds
6. Develop the Government securities market by Introducing longer term instruments and new Shariah complaint 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. 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.

The Medium-Term Debt Management Strategy (MTDS), sets out the Government's debt strategy over the medium-term, with respect to funding the gross financing needs through borrowing from a range of domestic and external sources, as well as through the use of internal reserves. The challenges and constraints that the Government faces require a strategic approach which is well identified through an overall vulnerability assessment of the debt position.

In particular, the MTDS 2023-2025 will assist the Government in funding medium-term financing requirements on sustainable basis, and to diversify the investor base while simultaneously catalyzing development of the domestic capital markets. Liability management operations will be considered as a means to provide opportunities to streamline borrowing costs, reduce refinancing risk in the near term, and foster favorable pricing of new debt issuances. The debt strategy supports the Government in implementing the National Budget and the Medium-Term Fiscal Framework (MTFF) by setting the guidelines for Government financing actions in such a way as to bring greater resilience to economic shocks. The preferred debt strategy formulated in this MTDS Report gives due consideration to the cost-risk profile of the existing debt portfolio, as well as to the anticipated market conditions, macroeconomic trends, and fiscal objectives in the medium-term. The MTDS 2023-2025 also includes an action plan for strategy execution and presents the expected outcome to the debt position from implementing these actions.

1.1 Objectives for Debt Management

The main objective of the Medium-Term Debt Management Strategy (MTDS)'s 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 debt market. The Government seeks to attain an ideal composition of the debt portfolio over the medium-term through the MTDS while addressing the refinancing risk associated with external debt as well as prospective changes in the cost of debt servicing.

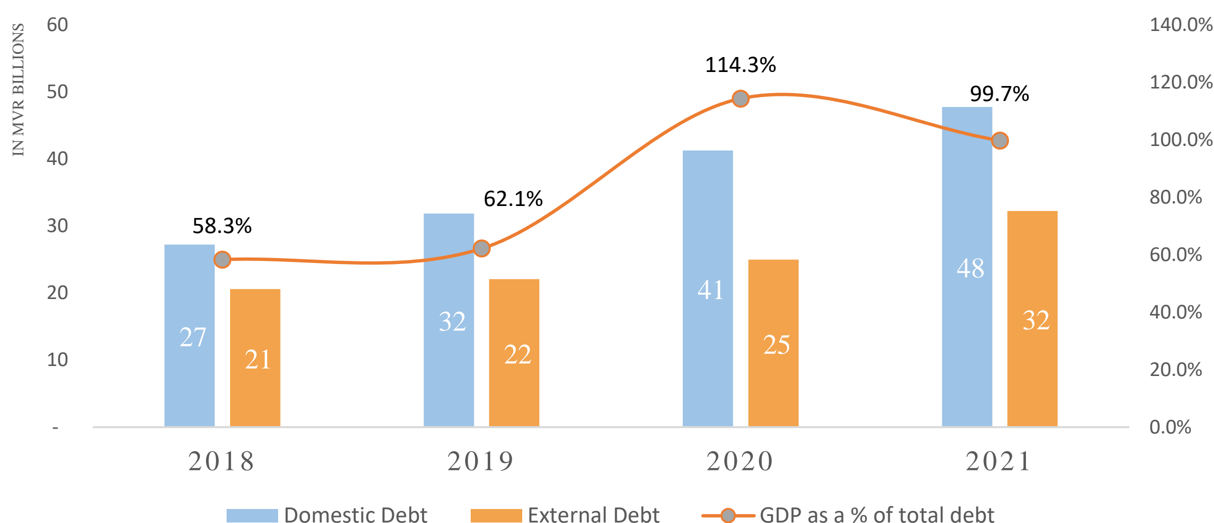
1.2 Scope of coverage

The scope of the MTDS covers the total debt portfolio of the Central Government as stated in the FRA. According to the FRA, total state debt refers to all the direct borrowings of the Government which are obtained externally and domestically. Therefore, the analysis consisting key cost and risk indicators of the MTDS excludes all guaranteed debt. 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

At the end of December 2021, total Central Government debt stood at MVR 80 billion, which is equivalent to 99.7 percent of nominal GDP.

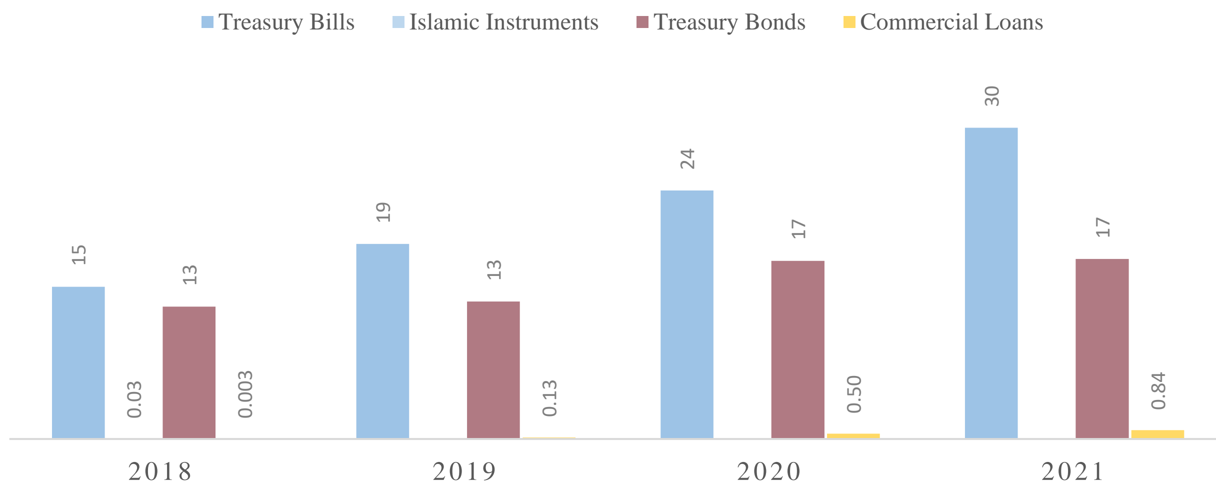
Chart 1: Central Government Debt (in MVR Billions) and Debt as percentage of nominal GDP



2.1 Domestic Debt

As at 31 December 2021, total central government domestic debt stood at MVR 48 billion. The largest share of the domestic debt is held in treasury bills, holding 62 percent of total domestic debt as of December 2021. This is an increase of 4 percent compared to the end of December 2020.

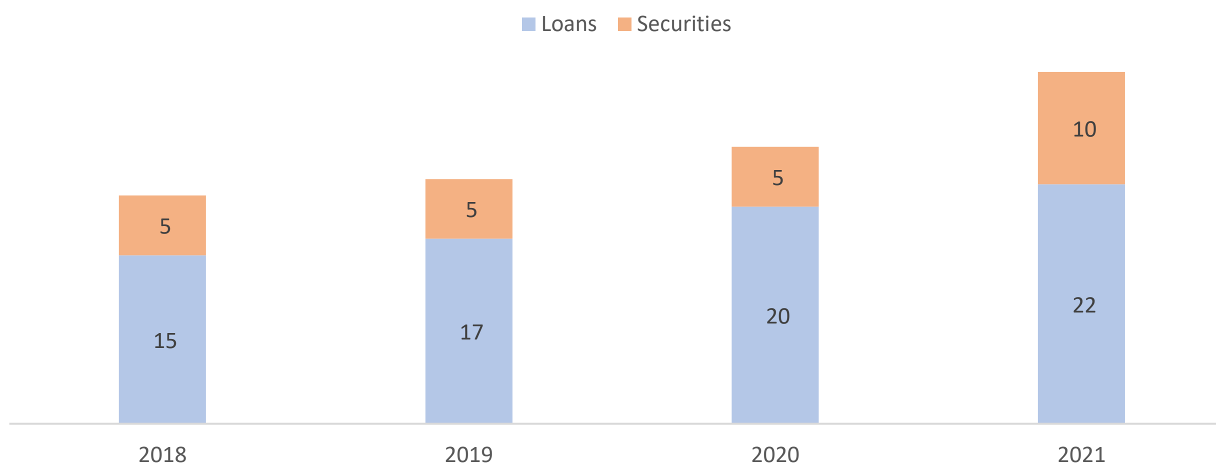
Chart 2: Outstanding domestic debt by Instrument type (in MVR billions)



2.2 External Debt

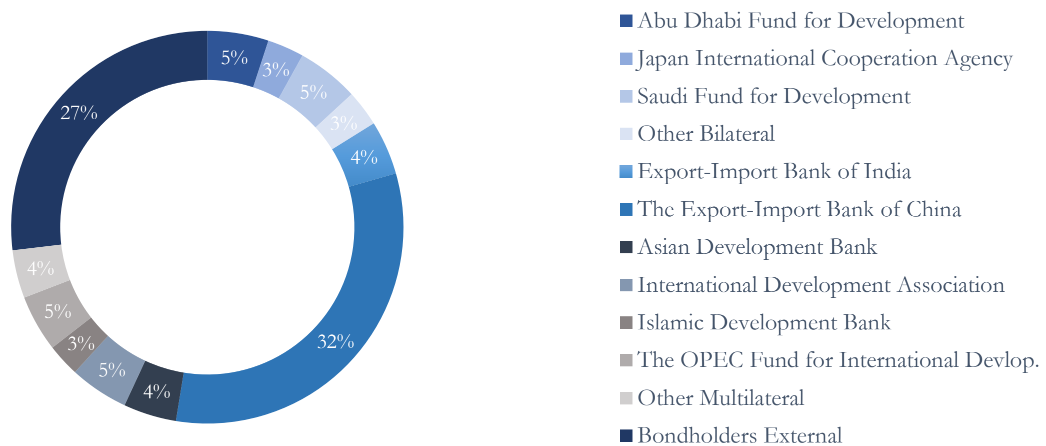
As of December 2021, central government external debt stood at MVR 32 billion. This is a 28 percent increase compared to December 2020. The increase in external debt is mainly driven by the issuance of the debut Sukuk in the international Debt Capital Market and due to disbursements under previously contracted loans. Chart 3 shows the Central Government external debt outstanding by type of instrument.

Chart 3: Central Government External Debt Outstanding (in MVR billions)



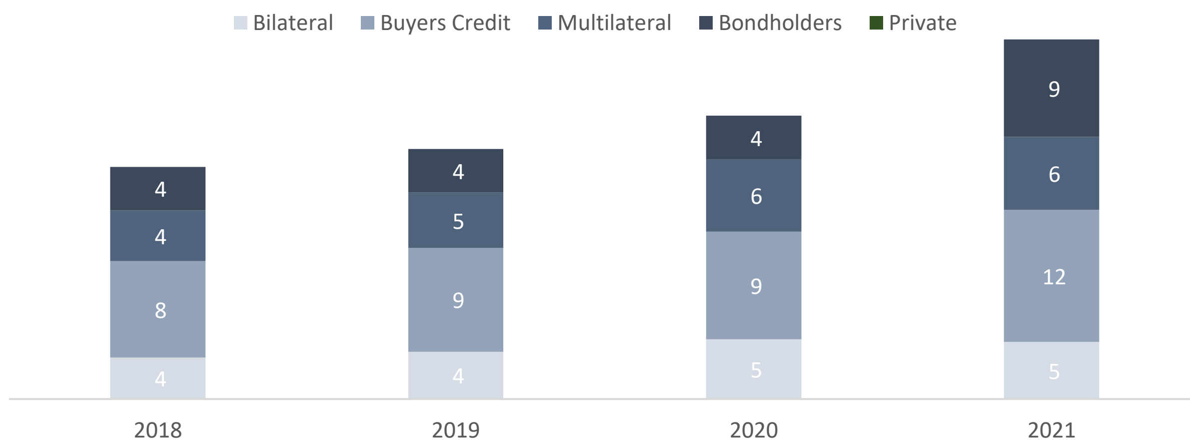
As illustrated in chart 4 the of the distribution of external debt outstanding at the end of 2021, 37 percent is accounted for borrowings through Buyer's Credit facilities, followed by 20 percent and 16 percent towards borrowings from multilateral financial institutions and bilateral agencies, respectively.

Chart 4: Share of External Disbursed Outstanding Debt by Creditor (as at 31 December 2021)



In terms of debt outstanding by creditor, EXIM China holds the largest share amounting to 32 percent of total external debt outstanding as of Dec 2021, followed by External Bondholders with 27 percent. ADFD, SFD, IDA and OFID holds 5 percent each. It is to note that the USD 100 million bond which was privately placed in 2018 is shown under ADFD, as it was a private placement with the Fund. Chart 5 below shows the central government debt outstanding of external creditors by creditor category from 2018 to 2021.

Chart 5: Central Government External Debt Outstanding by Creditor Category (in MVR billions)

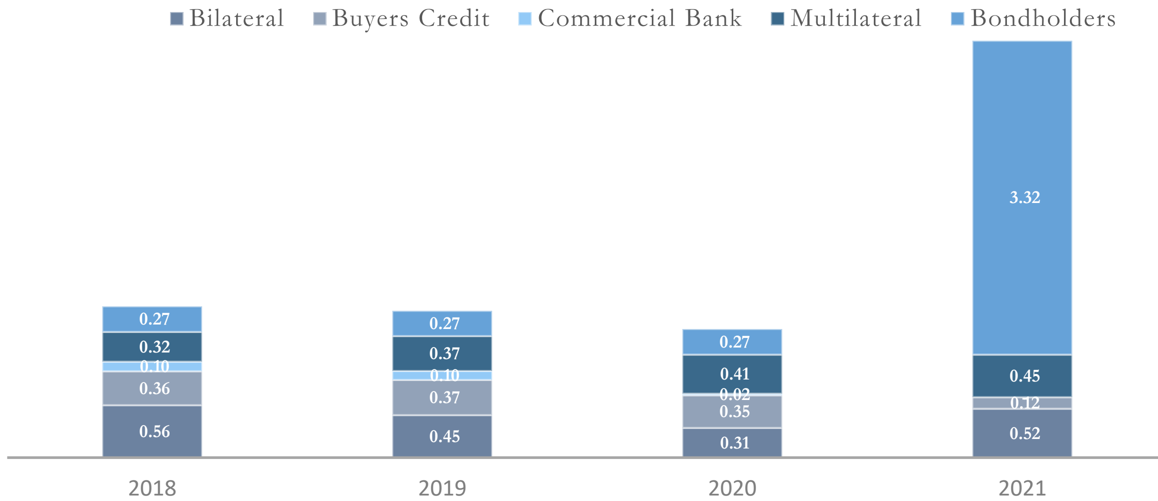


2.3 Debt Servicing

The total debt servicing cost of the central government's external debt in 2021 was MVR 4.37 billion. Under the G20 Debt Service Suspension Initiative (DSSI), approximately MVR 1.03 billion was deferred from the debt service payments during the year 2021.

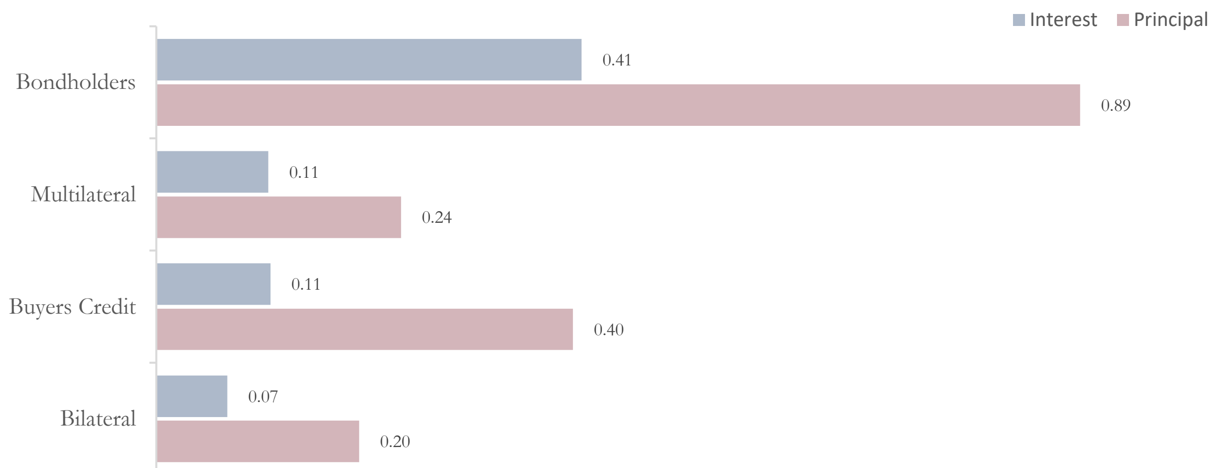
The deferred amount is to be repaid within 3 to 5 years with the same interest rate as the initial loan. This allowed in creating fiscal space, to utilize the savings from DSSI on much needed expenditure on protecting lives and livelihoods of citizens due to adverse effects of the Covid-19.

Chart 6: Central Government External Debt Service Cost by Creditor Category (in MVR billions)



In 2021, through a market friendly any-and-all tender offer, a proactive LME was conducted for the Eurobond maturing in 2022, and 76.7 percent had been prepaid causing the debt servicing cost to increase significantly in 2021. The remaining sum of the Euro Bond has been repaid at maturity in June 2022.

Chart 7: Forecasted Debt Service Cost for the year 2022 (MVR billions)



3. Utilization of Borrowed Funds

Major investments from 2019 illustrate that most of the funds disbursed are utilized for the development of infrastructure and health sector related activities. These investments will enhance the economic recovery of the country that has experienced the greatest economic contraction in our history, with real GDP declining by 33.5 percent in 2020. Major share of these borrowings have been contracted at concessional and semi-concessional terms which includes the Line of Credit Facility from the Indian EXIM Bank of USD 800 million and USD 400 million financing facility for the Greater Male' bridge connectivity project which comprises of USD 100 million grant from the Government of India.

Over the medium term, the Government will continue investing in economic stimulus activities towards the development of key infrastructure projects including the development and expansion of the Velana International Airport development, Greater Male' connectivity project which includes the reclamation of Gulhifalhu island to relocate the existing Male' commercial port to Gulhifalhu; and social housing projects to cater the housing need of the greater Male' region. Successful completion of medium to long-term development projects would further prosper the economic outlook of the country and will increase the Government revenue significantly.

Chart 8: Consolidated Disbursement Snapshot (in MVR millions)

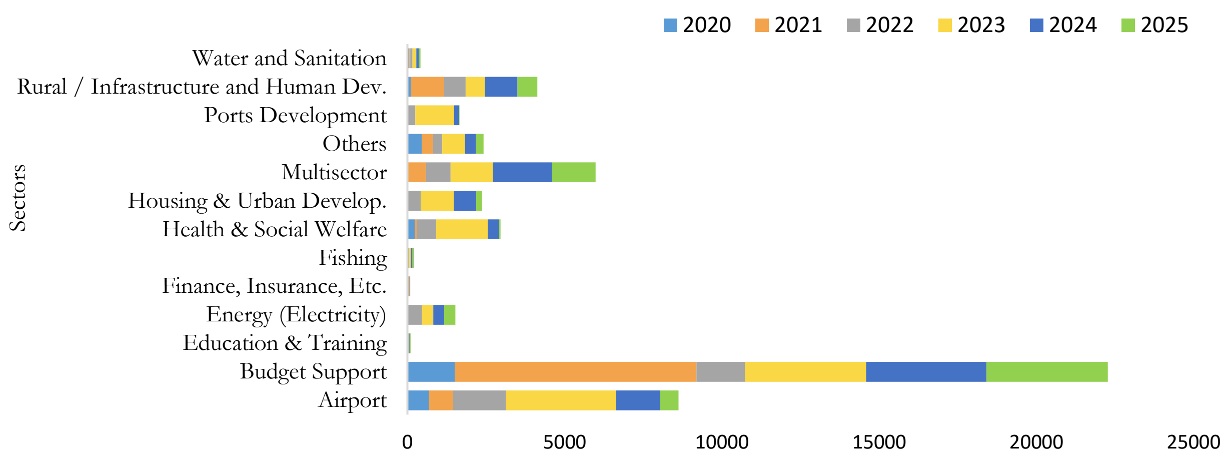
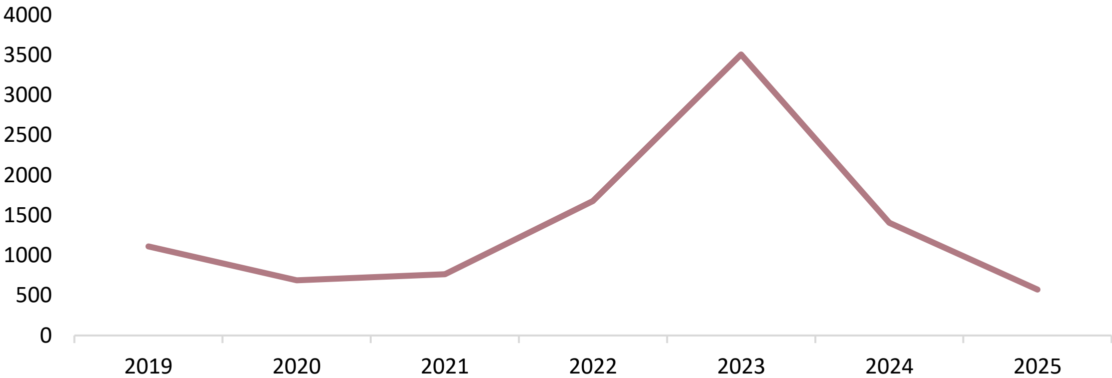


Chart 8 illustrates the actual disbursements on key projects for the period from 2019 to 2021 and estimated disbursements from 2022 to 2025. In medium term, key infrastructure projects are expected to complete and would lead the economic development of the country increase the Government revenue significantly and relieve poverty and deliver public services.

Apart from the ongoing infrastructure projects, the Government is working towards accelerating the transition to renewable energy for power generation to increase the share of renewable energy used for power generation and exploring alternative solutions to reduce the carbon dioxide emissions through various financiers like World Bank Group, IDB, AIIB, ADFD, etc. The Government has also set out targets to achieve the Sustainable Development Goals (SDGs) in its recent Strategic Action Plan 2019-2023, aligning the ESG policies and strategies to become a net-zero country by 2030.

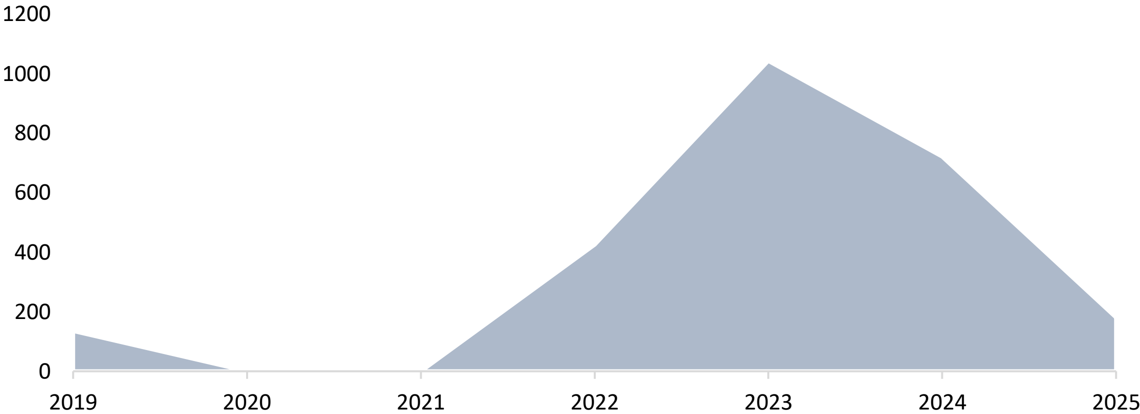
In 2021, the Government issued a total of USD 500 million Sukuk to the international debt capital market. As a proactive measure, part of the sukuk proceeds were utilized for the liability Management (LM) exercise where 76.8 percent of the USD 250 million Eurobond maturing in June 2022 were settled and the remaining proceeds had been used for budget financing requirement. During the pandemic, the Government spent money to keep people in jobs and to subsidize expenditure for basic necessities during these times of profoundly diminished incomes that impacted the livelihood of our people.

Chart 9 Airport Development Project (in MVR millions)



The graph above illustrates, from the Year 2019 to 2021, approximately MVR 2,563.9 million had been utilized for the development of the VIA, which is 15.8 percent of the total funds disbursed for the period from Year 2019 to 2021. The estimated total disbursement from Year 2022 to 2025 will raise to 18.3 percent which is an amount of MVR 7,164.47 million. The VIA development project, which would approximately cater 7.2 million arrivals per year, is scheduled to complete by December 2023. In parallel, the Government is expanding the development of domestic airports and enhancing other airport facilities throughout the Maldives, to cater the expected incoming demand following the expansion of the main airport, VIA.

Chart 10: Housing and Urban Development (in MVR millions)



The graph above illustrates, from Year 2019 to 2021, MVR 135.40 million was utilized for housing and urban development projects. As shown in the graph, Government was forced to delay all its housing and urban development projects to cater the national emergency responses including for urgent health equipment, testing labs and procurement of medical supplies. However, with the positive rebounding of the economy, the Government has been able to proceed and bring up to pace the projects to completion. Hence, the disbursements are expected to increase to an approximate MVR 2,370 million from Year 2022 to 2025.

Chart 11: Energy, Water and Sanitation (in MVR millions)

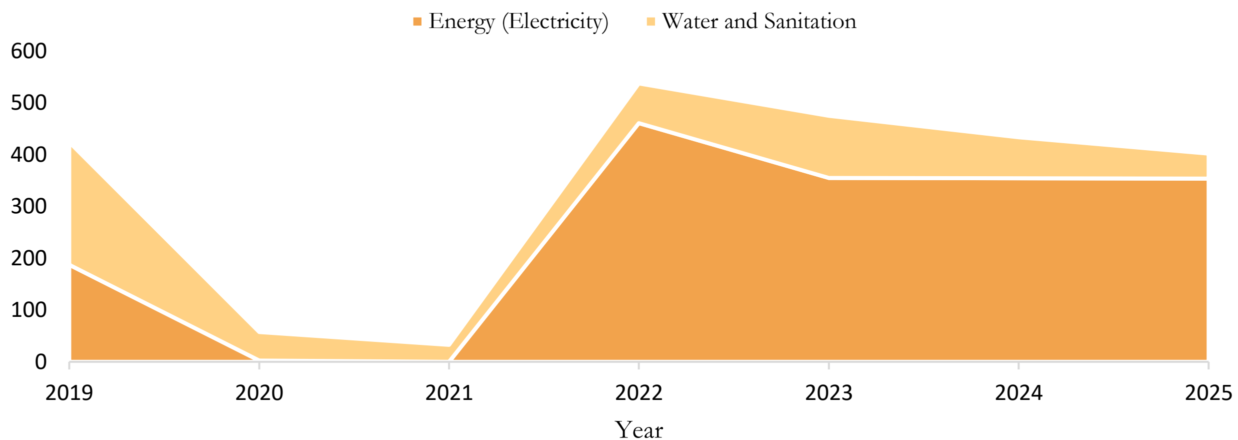
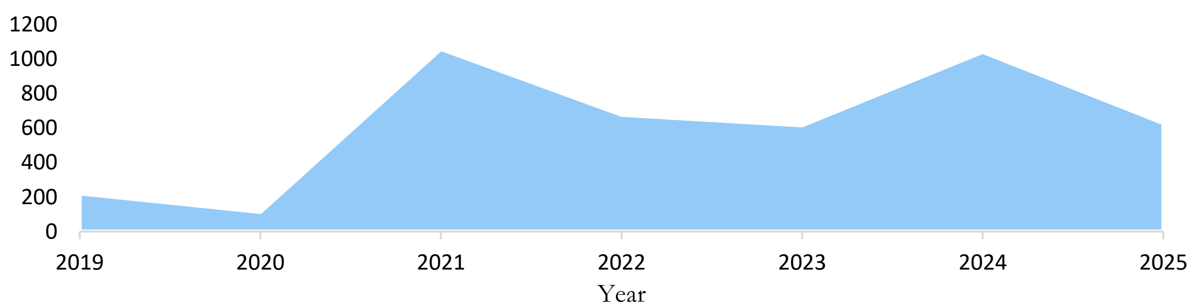


Chart 11 illustrates, from the Year 2019 to 2021, around MVR 514.70 million were utilized for the implementation of energy, water and sanitation programs, which is 3.2 percent of the total funds disbursed during the period. From the Year 2022 to 2025, an estimated amount of MVR 1,849.50 million will be disbursed for energy, water and sanitation programs. This is to achieve the Government's target to provide clean water and sanitation to all the inhabited islands by the end of 2024.

Chart 12: Infrastructure & Human Development (in MVR millions)



Graph 12, illustrates an amount of MVR 1,389.90 million was utilized for rural, infrastructure and human development projects from the Year 2019 to 2021. A total disbursement MVR 2,959.60 million is expected to be disbursed for rural and infrastructure and human development projects from the Year 2022 to 2025. This is mainly expected from the Greater Male' Area development project including the Gulhifalhu-Thilafushi –Male Connectivity Bridge.

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. At present, 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. At present, the prevalent risks in the Government debt portfolio are exchange rate risk, refinancing risk and interest rate risk. However, in addition to above mentioned risks, the Government continues to monitor portfolio risks such as operational risk and risks from contingent liabilities.

Table 1 illustrates key cost and risk indicators at the end of 2021 and forecast for end 2022.

Indicator		2021	2022 (F)
Cost of debt	Interest (as a % of GDP)	3.9	3.5
	Weighted Average Interest Rate (%)	4.0	4.2
Refinancing risk	Average time to maturity (years)	6.1	6.8
	Debt maturing in one year (% of total debt)	42.3	40.8
	Debt maturing in one year (% of GDP)	42.1	41.5
Interest rate risk	Average time to re-fixing (years)	6.1	6.1
	Debt refixing in one year (% of total debt)	42.3	52.9
	Fixed rate debt (including treasury bills)	97.8	96.1
Exchange rate risk	Foreign currency debt (% of total debt)	50.1	47.9
	Short term foreign currency debt (% of foreign reserves)	16.3	19.2

4.1 Refinancing risk

The key indicators for refinancing risks are Average Time to Maturity (ATM) and the debt maturing in one year (as a percentage of total debt). Existence of unusually high peaks in the redemption profile of the debt portfolio is reflected in these indicators. At the end of December 2021, the ATM of the total debt portfolio was 6.1 years (Table 1) which is a slight reduction in ATM of 7 years reported for end of December 2020. Similarly, total debt maturing in 1 year increased from 39 percent at the end of 2020 to 42.3 percent at the end of December 2021. The increase is primarily attributed to the increased short-term borrowings from T-bills to finance the budget deficit for 2021. Total debt maturing in 1 year includes all short-terms liabilities such as T-bills and the amortization of the USD 58.0 million of the debut USD 250 million Eurobond issued by the Government in 2017 as well as other external and domestic loans.

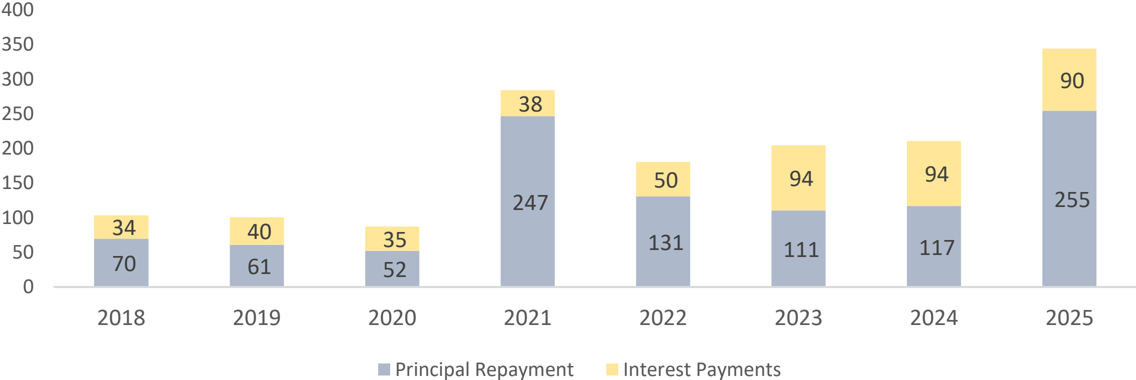
[1] Refers to the uncertainty that debt may have to be rolled over at an unusually high interest cost or cannot be rolled over at all

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

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

The refinancing of the USD 250 million debut Eurobond issued in 2017 remained the most significant risk for the Government in 2021. However, as part of its proactive approach in liability management, the Government refinanced USD 191.9 million in April 2021 through a market friendly "any-and -all" tender offer from the proceeds of the country's debut international Sukuk. And with the repayment of outstanding USD 58.0 million in June 2022, the Government has largely minimized the short-term refinancing risks in the debt portfolio. As illustrated in the Chart 13, the external redemption profile remains at a sustainable level in the medium term. However, the USD 500 million 5-year Sukuk and USD 100 million privately placed bond falling due in 2026, the external redemptions will increase significantly.

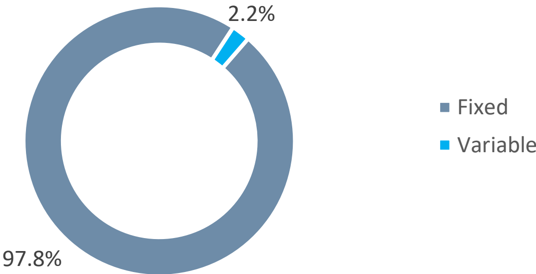
Chart 13: External Debt Redemption Profile from 2018 – 2025 (USD Millions)



4.2 Interest rate risk

The majority of the Government's debt portfolio comprise of a fixed interest rate debt. Key indicators for interest rate risk are the Average Time to Re-fixing (ATR), the debt re-fixing in one year, the fixed-rate debt (the latter two as a percent of total debt) and Weighted Average Interest Rate (WAIR). The ATR for the total debt portfolio was 6.1 years as at 31 December 2021. Debt re-fixing in 1 year represented 42.3 percent of the total debt as at end 2021, while the share of fixed-rate debt was 98.9 percent (Table 1). The Government is subject to interest rate re-fixing despite holding a major percentage of its debt (37 percent of the entire debt portfolio) in T-bills that mature within 12 months.

Chart 14: Fixed rate debt as a percentage of total debt (2021)



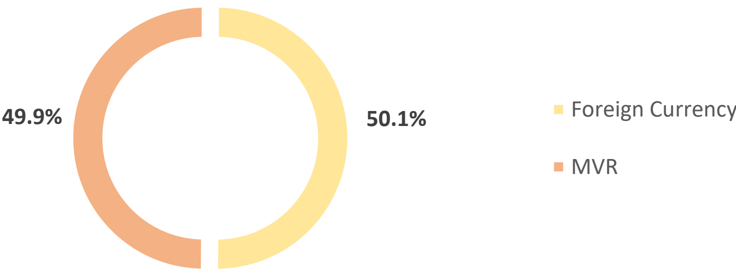
Despite the large share of short-term T-bills in the portfolio, it is worth noting that the interest rate risk from T-bills is relatively low. This is due to the existing Tap System of issuing T-bills that allows Government to issue T-bills at a fixed interest rate. And with the growing demand for investments from domestic investors, the risk remains minimal. This was evident from the 24.9 percent growth in T-bills' net issuance which recorded to total MVR 5.2 billion for the year 2021. Similarly, the small share of variable-rate debt in the total debt portfolio (98.9 percent as at 31 December 2021) limits exposure to higher interest rates over the near term. However, the exposure to interest rate risk will be more significant over the medium-term as a result of the redemptions of domestic and external debt to be refinanced in the next few years.

4.3 Exchange rate risk

In terms of foreign exchange risk, at the end of December 2021, approximately 50 percent of the Government's outstanding debt is denominated in local currency while the remaining 50 percent is denominated in a diverse set of currencies including United States dollar (USD), Chinese Yuan (CNY), Saudi Riyal (SAR), Euro (EUR), Japanese Yen (JPY). The foreign currency debt as a share of total debt has decreased by around 15 percent in the past 1 year ending 31 December 2021. Majority of the foreign-currency debt is in the USD (35 percent of total debt), to which the Maldivian Rufiyaa is permitted to fluctuate within a band between MVR 10.28 and MVR 15.42 since 2011, after having a fixed exchange rate of MVR 12.85 for a decade. Therefore, in a scenario whereby MVR depreciates against USD by 5 percent, the disbursed outstanding debt as at 31 December 2021 will increase by MVR 2.01 billion or 2.50 percent of the GDP and vice versa if it were to appreciate. In such a scenario, the debt to GDP ratio will fluctuate between 102 percent to 97 percent.

Despite the exchange rate regime allowing the MVR to float within this ±20% band, MVR has remained constant around 15.4 MVR/USD historically. The exchange rate peg is an appropriate policy anchor and provides stability to monetary policy. Hence, despite having 50 percent of the debt portfolio denominated in foreign currencies, the exchange rate risk is to some degree mitigated under the current regime.

Chart 15: Foreign Currency debt as a percentage of total debt as at end of 2021.

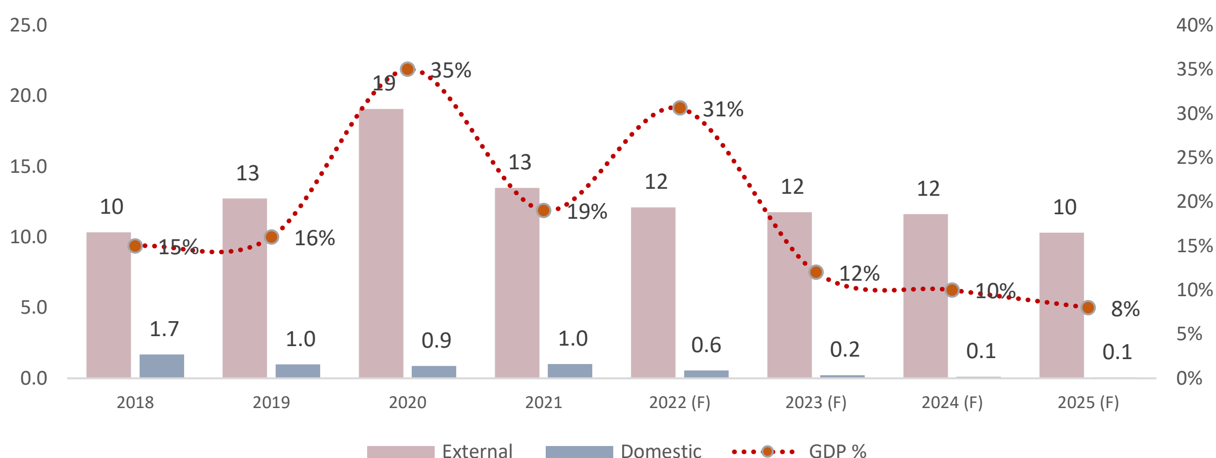


4.4 Contingent Liabilities

Contingent liabilities can be either implicit or explicit. The Government has issued sovereign guarantees, primarily to State Owned Enterprises (SOEs), exposing the Government to an explicit contingent liability risk. As illustrated in the below chart, the stock of outstanding debt guaranteed by the Government has decreased by nearly 15 percent when compared to end of December 2020. The stock of total guaranteed debt at the end of December 2021 stood at MVR 14.9 billion (19 percent of GDP).

Despite the reduction in guaranteed debt, the uncertainty of future events such as a deterioration in the financial health of a beneficiary of sovereign guarantees leading to crystallization of existing sovereign guarantee poses fiscal risks for the Government. The Government continues to monitor the financial stability and debt repayment capacity of sovereign guaranteed beneficiaries. Also, the Ministry has enhanced the credit risk assessment of sovereign guarantee applicants that allows the Government determine the creditworthiness of the applicants and make informed decision on issuing sovereign guarantee. The proactive monitoring also allows the Government to assist SOEs and other beneficiaries to ensure they are able to service their debt on time.

Chart 16: Outstanding Guaranteed Debt (2018 – 2021)



4.5 Operational Risk

Operational risk refers to a wide variety of risks faced by the debt management office that can disrupt debt service and debt management operations. The Debt Management Department (DMD) faces a wide range of operational risks that can disrupt the debt management operations. However, with the guidance of 2019 DeMPA and other technical expert recommendations, the Ministry has implemented the traditional FO/MO/BO model with enhanced FO capabilities. The Ministry has also set out internal procedures and guidelines for DMD operations with appropriate distribution of staff roles and responsibilities.

As a part of the Government's legislative agenda, drafting of the Public Debt law and reviewing of the existing Public Finance Regulation and Fiscal Responsibility Act is underway in order to align them with the international best practices on debt management. This would further strengthen the legal framework governing debt management.

The Government is working towards implementing the Commonwealth Secretariat's Meridian Software, which is the latest version of the Commonwealth Secretariat's Debt Recording and Management System (CS-DRMS). This will better equip the debt department with the most up to date tools to manage and analyze the debt portfolio. As a result, this will reduce the operational risks associated with debt recording and reporting. Furthermore, to mitigate operational risks associated with domestic Government securities operations, the Government is currently working with the MMA to bring the necessary automation and integration into the process. In this regard, establishment of an electronic trading platform and a central securities depository that integrates to Government's payment system is currently underway. The successful implementation of this project will ensure that the Government securities operations are carried out prudently and in line with the international best practices.

5. Medium-Term Financing Requirements and Sources

5.1 Financing Requirements

Gross financing needs generated by fiscal deficits and debt redemptions (excluding T-bills) are expected to increase over the medium term, from MVR 11.7 billion in 2023 to MVR 12.5 billion by 2025. Despite the fiscal consolidation in the primary balance, the expected rise in GFNs is led by an increase in the debt service obligations. Under the baseline scenario the interest costs are projected to increase from MVR 3.9 billion in 2023 to MVR 4.4 billion by 2025.

5.2 Potential Funding Sources

Multilaterals and Bilateral Creditors

As part of accessing and utilizing maximum available concessional financing, the Government intends to continue to approach multilateral and bilateral agencies and other partners/donors for financing through strengthened bilateral and multilateral relationships. Therefore, in medium-term, the Government will closely work on obtaining financing through bilateral and multilateral agencies mainly for the developmental projects such as basic infrastructure, healthcare and social projects which are essential for the development of the atolls and enhance the lives and livelihoods of the citizens of the country.

Other External Creditors

The Government maintains a good relation and have access to several concessional funding agencies, such as Export Credit Agencies, foreign banks, and many international financial agencies. Hence, the Government intends explore and raise financing through these development partners and creditors for the financing requirements of the Government and manage the fiscal risks arising from these financing operations. With these sources of financing, the Government would be able to expand and reach more diversified creditor base and would be able to choose the best financing option for the priority projects.

International Capital Markets

The Government carried out its first international debt capital market operation in June 2017 with the issuance of its debut USD denominated 5-year euro bond. As part of its proactive debt management, the Government refinanced USD 191.97 million of the USD 250 million Eurobond in April 2021 through a market friendly "any-and-all" tender offer from the proceeds of the debut international sukuk which assisted the Government reduce the near-term refinancing risk. Since then, the Government has the Government has tapped the existing sukuk twice where the last issuance carried out in September 2021 was oversubscribed by threefold.

The overwhelming support from the market in the last issuance is testament of the confidence in the development trajectory of the Maldives. The Government continues to maintain strong relationship with investors and intends to remain active in the debt capital market over medium term. The international debt capital market remains a potential avenue for the Government to raise financing and the Government will utilize the option based on the funding requirement subject to market conduciveness and evaluation of other financing options.

Under the existing USD 1 billion Sukuk program which was established in 2019 with the ICD, the Government intends to utilize the remaining USD 500 million over the medium-term based on the market conditions and the fiscal and macro situation of the economy keeping in view of the cost and risk considerations. In parallel, the Government will continue to engage with investors and broadcast investor information. Government also intends to explore and issue, innovative and sustainable financing instruments such as green and blue bonds, in medium term.

Domestic Creditors

Government's priority is to borrow from domestic sources including the securities market and money market, as domestic creditors play an important role in creating liquidity in the domestic market. The Government intends to raise finance through short-term and long-term instruments. Term loans, demand loans and other innovative instruments will be utilized to raise financing through domestic creditors to diversify the investment portfolio and across instruments. In doing so, the government would reduce its reliance on external financing to meet budget financing requirements.

Domestic Capital Market

Domestic capital market will remain a key funding avenue for the Government to finance the budget deficit and refinance the existing domestic securities. As part of the Government's effort to develop the domestic market and strengthen the relationship with existing investors through continuous

engagement, from 2023 onwards, the Government will publish Government securities issuance calendar and update the key changes to the Government borrowing plan to the domestic investors.

The Government will also introduce new Sharia compliant treasury instruments to the domestic market. This will create an avenue for Shari'ah compliant investors as there are few investment avenues to diversify their investment portfolio. In addition, these new instruments will allow investors to diversify their excess funds and assist the development of the domestic capital market.

The Government will introduce longer term securities, including 5 to 10 year and 10-to-20-year bonds to the domestic market during the MTDS horizon. Additionally, the Government is currently working on the development of domestic securities market, by acquiring Central Securities Depository system and enable the automating the Government securities issuance and settlement function. In addition, new revisions to the legislations will assist to create a liquid secondary market for the Government securities.

6. Debt Strategy 2023-2025

6.1 Description of the Strategy

The Government's debt strategy for 2023–2025 is selected on the basis of the cost-risk profile of alternative debt instruments, the diversification of sources of financing, and the market absorption capacity. The preferred strategy has been selected after comparing against alternative options to evaluate their relative performance in various scenarios, including a baseline outlook and risk scenarios. The quantitative analysis identifies a total of 19 Representative Debt Instruments (RDI) to represent the structure of the existing debt portfolio as at 31 December 2021 and instruments designed to reflect future financing sources of alternative strategies. These instruments are used in the MTDS analysis to summarize the main features of the many securities and loans included in the public debt portfolio, i.e., their cost-risk profile, financing terms, and debt servicing obligations. In addition, these instruments are utilized as the potential future sources of financing assessed in the MTDS analysis and to identify how the gross borrowing requirements are to be met in 2023-2025.

The preferred strategy acknowledges the inherent cost and risks in the existing debt portfolio. Particularly, the risk of growth in foreign currency denominated debt and potential refinancing risks primarily associated with external debt maturities. Despite the present limitations, 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. Proposed strategy assumes to maintaining the mix between domestic and external net financing ratio between 60:40 during the strategy horizon.
ii. Maximum utilization of external concessional financing is assumed based on the projected disbursement of external financing facilities.
iii. Based on disbursement forecasts of the existing financing facilities, an expected amount between MVR 3.5 - 4.5 billion annually is used for the analysis.
iv. 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.
v. It is assumed that domestic treasury bills will be continuously rolled over during the 3-year horizon. However, the strategy envisages to steadily diminish the reliance on short term treasury bills and refinancing the maturing t-bills stock to long-term treasury instruments in the medium term.
vi. The strategy envisages financing the domestic net financing requirement by raising funds with: i) 80 percent with Treasury-Bills in MVR, ii) 10 percent with a 5-10-year domestic MVR bonds, and iii) 10 percent with a 10-20-year domestic MVR bond. This will assist the Government to reduce it refinancing risk by lengthening the debt portfolio's ATM.

6.3 Methodology and Strategy Analysis

The Medium-term Debt Strategy 2023-2025 is formulated in line with the MTDS Framework and the MTDS Analytical tool developed by the IMF and the World Bank Group. 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. 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 requirement 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		2021	2022	2023	2024	2025
Debt to GDP		**99.7**	104.6	102.0	99.4	96.8
Cost of Debt	Interest rate (as a percent of GDP)	**4.1**	3.5	4.2	4.1	3.8
	Weighted Average Interest rate (%)	**4.0**	4.5	4.1	3.9	3.5
Refinancing risk	Average time to maturity (years)	**6.2**	6.2	6.2	6.2	6.0
	Debt maturing in one year (% of total debt)	**40.1**	46.3	36.2	35.7	41.7
	Debt maturing in one year (% of GDP)	**40.6**	48.5	40.0	38.3	43.6
Interest Rate risk	Average time to re-fixing(years)	**6.2**	6.2	6.2	6.2	5.3
	Debt refixing in one year (% of total Debt)	**40.1**	46.3	36.2	35.7	41.7
	Fixed Rate Debt (Including T-Bills)	**96.1**	97.1	98.1	98.5	98.9
Currency risk	FX Debt (% of total debt)	**50.1**	43.8	48.9	48.3	43.4
	Short term FX debt (% of Gross International Reserves)	**12.3**	23.1	19.9	34.9	97.0

7.1 Analysis of cost and risk indicators

The baseline scenario is defined by the macroeconomic assumptions, fiscal-adjustment path, and market and pricing conditions in the period 2022-2025 derived from the Medium-term Fiscal Strategy 2023-2025. Given this macro-fiscal scenario which assumes a determined fiscal-adjustment path, the four financing strategies deliver a very similar reduction in the public debt-to-GDP ratio over the medium term. The Government's preferred debt strategy is expected to reduce the gross public debt from 99.7 percent of GDP in 2021 to around 96.8 percent of GDP by 2025. With regard to interest payments, it is observed show that interest payment as percentage of GDP will decrease from 4.1 in at the end of 2021 to 3.8 by 2025. Similarly, this strategy will result the WAIT of the portfolio to decline from 4.0 percent in 2021 to 3.5 percent by end of 2025 allowing the Government to meet its medium-term debt management target.

In terms of refinancing risk, under the selected strategy, ATM of the portfolio remains at a steady level over the next two year before recording a decline to 6 years by end of 2025. Similarly, the percentage total debt maturing in 1 year increases from 40.6 percent at the end of 2021 to 41.7 percent by end of 2025. This is primarily due to increase in share of short-term T-Bills during the three-year horizon.

As for the interest rate risks, ATR slightly reduces from 6.2 years at the end of 2021 to 5.3 years by the end of 2025. Under this strategy, fixed rate debt increases from 96.1 percent at the end of 2021 to 98.9 percent by end of 2025 which potentially minimizes the adverse effects of high interest rates that variable rate debt would face under the current environment, especially given the current volatility and uncertainty in the global market.

Lastly, the selected strategy shows a favorable outcome in terms of exchange rate risk which remains a critical risk in the Government's debt portfolio. Under this strategy, despite the sizeable disbursement anticipated from committed foreign loans, the foreign currency denominated debt is expected to decline from 50.1 percent at the end of 2021 to 43.4 percent by end of 2025.

7.2 Risk to Baseline Macroeconomic Projections

The success of the selected debt strategy depends on prudent implementation and a sustained commitment to the fiscal consolidation program, supported by a sound macroeconomic environment and continued flexible and pro-active Government policies to mitigate the pandemic's impact over the medium-term. Similarly, 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 strong growth in revenue including new revenue measure from taxation. In view of the macroeconomic fundamentals above, the following may pose material risk that could impede the implementation of the MTDS 2023-2025.

- Macroeconomic shocks that impact the Government revenue and expenditure that could result widening of fiscal deficit and financing requirement.
- Deterioration in Sovereign Credit Rating due to worsening of fiscal position and macroeconomic outlook. This will impact pricing of Government securities since markets are more likely to impose risk premiums with the weakening of credit quality. Consequently, future borrowing costs may rise, and depending on the severity of the downgrading, borrowing options may be limited.
- Unsustainably high debt levels could make it difficult to obtain new financing on favorable terms. In such instances, the Government may not be able to secure the required financing, particularly from external sources
- Volatilities in the international financial markets due to rise in global interest rates or credit crunch and interest 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 risk of currency devaluation. Devaluation of Maldivian Rufiyaa against USD will inflate value of the Government's debt portfolio and increase cost of debt service.
- Delays in the implementation of projects where financing has been contracted will incur additional debt cost in servicing debt due to incurrence of commitment fees.
- Implementation of unbudgeted projects require additional fiscal space and increases the gross borrowing requirement and need to undertake additional debt.
- Risk from contingent liabilities such as crystallization of sovereign guarantees could also pose additional fiscal risk and restrict Government's ability to successfully implement the MTDS.

The Government's Medium Term Fiscal Strategy presents a detailed analysis of macroeconomic and fiscal risks to the implementation of Medium-term Fiscal Strategy.

7.3 Strategy Implementation

The proposed strategy is aimed towards fulfilling the Government's debt management objectives and its debt management targets in the medium term. The medium-term policies designed consistent with the Government's Debt Strategy from the current MTDS analysis will assist in the successful implementation of this strategy. Therefore, despite present challenges, the following will be crucial to the successful implementation of the Government's Medium-Term Debt Management Strategy.

- Development and publication of Annual Borrowing Plan.
- Close monitoring of primary market practices and strengthening relationship market participants.
- New financing being evaluated against the MTDS targets.
- Given the uncertainties in the global economic condition, MTDS will be reviewed semi-annually during the strategy period.
- Continue implementation of DeMPA reform plan and other technical expert advice to enhance the quality of public debt management.

8. Conclusion

In line with the public debt management objectives, the MTDS for 2023-2025 is focused on minimizing refinancing risk, interest costs and their budgetary impact, improving debt sustainability, developing the domestic debt markets and expanding investor relations. The key debt portfolio risks identified in the MTDS are refinancing and interest rate risks, the former especially for the foreign currency denominated debt. Hence, the ATM of the total debt portfolio, and the debt maturing in 1 year as a share of total Government debt were selected as the key cost and risk indicators to be improved by end of 2025. Although, since the existence of pegged exchange rate regime provides to Government stability, the foreign exchange risk may not be as significant at analyzing cost-risk indicators. However, it is important to keep the foreign-currency debt exposure under control and to continue developing the local-currency debt market. In this regard, by the end of the implementation period; the MTDS is expected to achieve the following;

(i) Reduce short to medium-term foreign currency risk of the debt portfolio;
(ii) Establish deep and liquid domestic debt capital market;
(iii) Reduce the weighted average interest rate of the debt portfolio;
(iv) Reduce refinancing risk by lengthening the maturity profile of the debt portfolio;
(v) Diversify the debt portfolio both across investor base and instruments.