DEBT SUSTAINABILITY ASSESSMENT

1. **Maldives' public and publicly-guaranteed (PPG) debt stood at 76.9% of gross domestic product (GDP) in 2019.** Half of public debt is domestic and denominated in local currency. Domestic debt is held largely by the national pension (42%), commercial banks (36%), and the central bank (21%). The most recent staff report for Rapid Credit Facility (RCF) request by the International Monetary Fund (IMF) published in April 2020 finds Maldives' public debt to be sustainable, albeit with a weak debt-carrying capacity and at a high risk of debt distress.[1] Debt sustainability depends critically on the government's commitment to medium-term fiscal consolidation and active debt management, including accumulation of liquid assets in the Sovereign Development Fund (SDF).

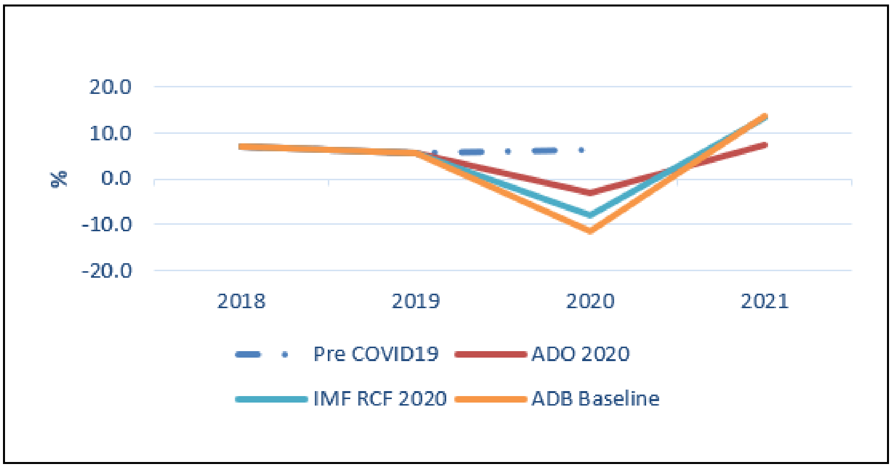
2. **External debt was 54.2% of GDP in 2019, of which external PPG debt was about 38.3%.** As the authorities ramped-up infrastructure investment, an elevated current account deficit was increasingly financed by external debt, making the country more susceptible to changes in global financial conditions. A little over a half of external PPG debt was owed to the People's Republic of China, followed by commercial debt that includes the two international sovereign bonds of $350 million in total. While bilateral debt is contracted largely on semi-concessional terms, multilateral debt is more concessional. The increase in external PPG debt in 2019 was mostly associated with finalizing existing public housing projects carried out by the Housing Development Corporation (HDC), a state-owned enterprise (SOE). The remainder of the increase in external debt was with the airport expansion project and infrastructure projects related to electricity and sanitation. These projects are to fill the large infrastructure needs of the Maldives and will contribute positively to growth in the medium to long term.

3. **COVID-19 pandemic has severely impacted the growth outlook for 2020.** Assuming borders to reopen by July 2020, the government projects growth to contract by 11.3% in 2020 from its pre COVID-19 estimate of 6.3% before rebounding to 13.7% in 2021 (Figure 1). This assumes that borders may reopen only in July 2020 with tourism arrival growth expected to decline by 40% in 2020. Growth is projected to rebound sharply in 2021 as tourism can be expected to make a strong comeback as pent-up demand is released. The latest IMF RCF report projects growth to contract by 8.1% before rebounding to 13.2% in 2021. The Asian Development Outlook 2020 had projected growth to fall in the range of -1.9% to -10.9% in 2020.

4. **PPG debt is expected to rise in 2020 due to adverse impact of COVID-19.** The ADB baseline (Table 1) follows the official estimates for 2020 and 2021 and assumes growth in the medium term to follow the path projected by the IMF RCF report. The primary deficit is projected to widen significantly to 11.1% in 2020 due to a sharp decline in revenue and despite reductions in some non-priority current expenditure as well as large cuts in capital expenditure compared with the original budget. With fiscal consolidation, the primary deficit is likely to fall rapidly in the medium term. Under these assumptions, the debt to GDP ratio is projected to increase to 96.5% in 2020 before falling gradually to 78.8% by 2025. Due to a large economic contraction and a bigger primary deficit, the ADB baseline PPG debt path is 2.6 percentage points higher than the IMF RCF projection in 2020 with the difference declining to 0.7 percentage points by 2025 (Figure 2).

[1] IMF. April 2020. *Request for disbursement under the rapid credit facility*. IMF Country report 20/133.

Figure 1: Growth Projections



Notes: Pre-COVID19 estimates correspond to Asian Development Outlook supplement (December 2019). The International Monetary Fund (IMF) Rapid Credit Facility 2020 are the latest projections by the IMF.
Source: Asian Development Bank estimates, Asian Development Outlook 2020, and International Monetary Fund Rapid Credit Facility Staff report (April 2020).

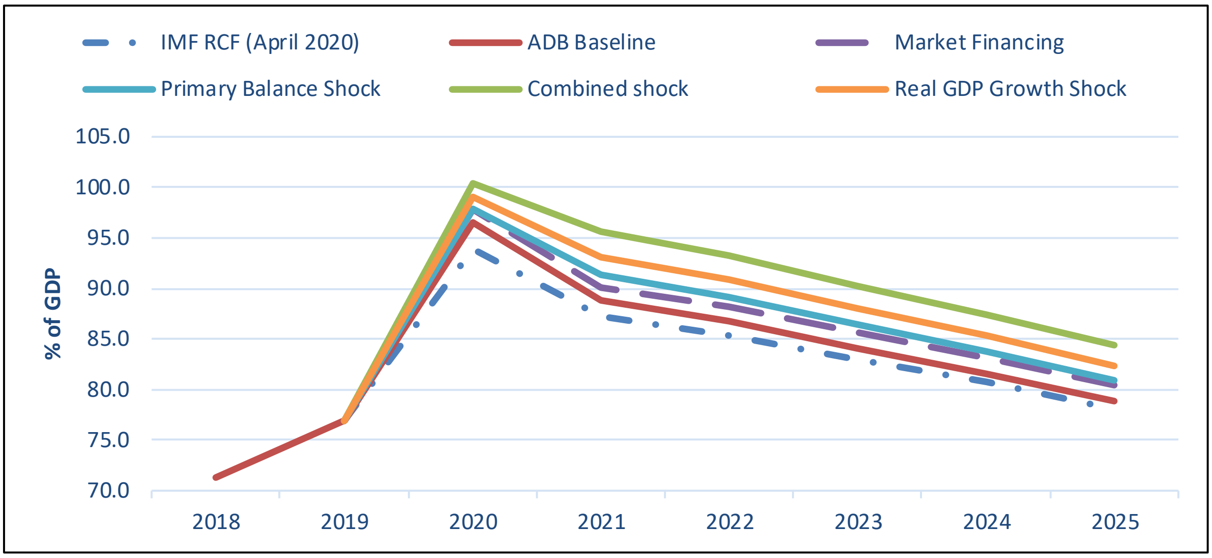
Table 1: Key Macroeconomic Assumptions

	2020	2021	2022	2023	2024	2025
IMF RCF (April 2020)						
Real GDP growth	-8.1	13.2	6.4	5.9	5.4	5.4
GDP deflator	2.4	2.5	2.0	2.0	2.0	2.0
Effective interest rates on total debt	2.0	2.2	2.3	2.4	2.4	2.4
Effective interest rate on total external debt	1.6	2.3	2.2	2.1	2.2	2.3
Primary balance % of GDP	-10.1	-4.4	-3.1	-1.9	-1.4	-1.1
Nominal GDP growth	-5.9	16.0	8.5	8.0	7.5	7.5
Non-interest current account deficit	22.2	10.5	7.9	7.8	8.1	7.8
Net FDI inflows	-6.0	-8.5	-8.7	-8.7	-8.7	-8.7
ADB Baseline						
Real GDP growth	-11.3	13.7	6.4	5.9	5.4	5.4
GDP deflator	3.7	2.5	2.0	2.0	2.0	2.0
Effective interest rates on total debt	2.0	2.2	2.3	2.4	2.4	2.4
Effective interest rate on total external debt	1.6	2.3	2.2	2.1	2.2	2.3
Primary balance % of GDP	-11.1	-4.4	-3.1	-1.9	-1.4	-1.1
Nominal GDP growth	-8.0	16.5	8.5	8.0	7.5	7.5
Non-interest current account deficit	22.2	10.5	7.9	7.8	8.1	7.8
Net FDI inflows	-6.0	-8.5	-8.7	-8.7	-8.7	-8.7

ADB = Asian Development Bank, FDI = foreign direct investment, GDP = gross domestic product, IMF = International Monetary Fund, RCF = Rapid Credit Facility.
Source: Asian Development Bank estimates and International Monetary Fund Rapid Credit Facility Staff report (April 2020).

5. **Maldives's PPG debt path is highly vulnerable to shocks, particularly growth shocks.** A one standard deviation (2.0 percentage points) negative growth shock in the first two years (Table 2) will increase debt to GDP to 99.1% in 2020 (2.5 percentage points higher than the baseline). Debt will remain elevated in the medium term reaching 82.3% in 2025. Failure to keep the commitment of medium-term fiscal consolidation could pose a threat to debt levels. A one-half standard deviation negative shock (1.3 percentage points) to the primary balance in the first 2 years of projection will cause debt to GDP to rise to 97.9%, slightly below the real GDP growth shock. A combined macroeconomic shock will cause debt to GDP to remain elevated by 5.6 percentage point by 2025 (Figure 2).

Figure 2: Public Debt Sustainability Assessment Stress Tests



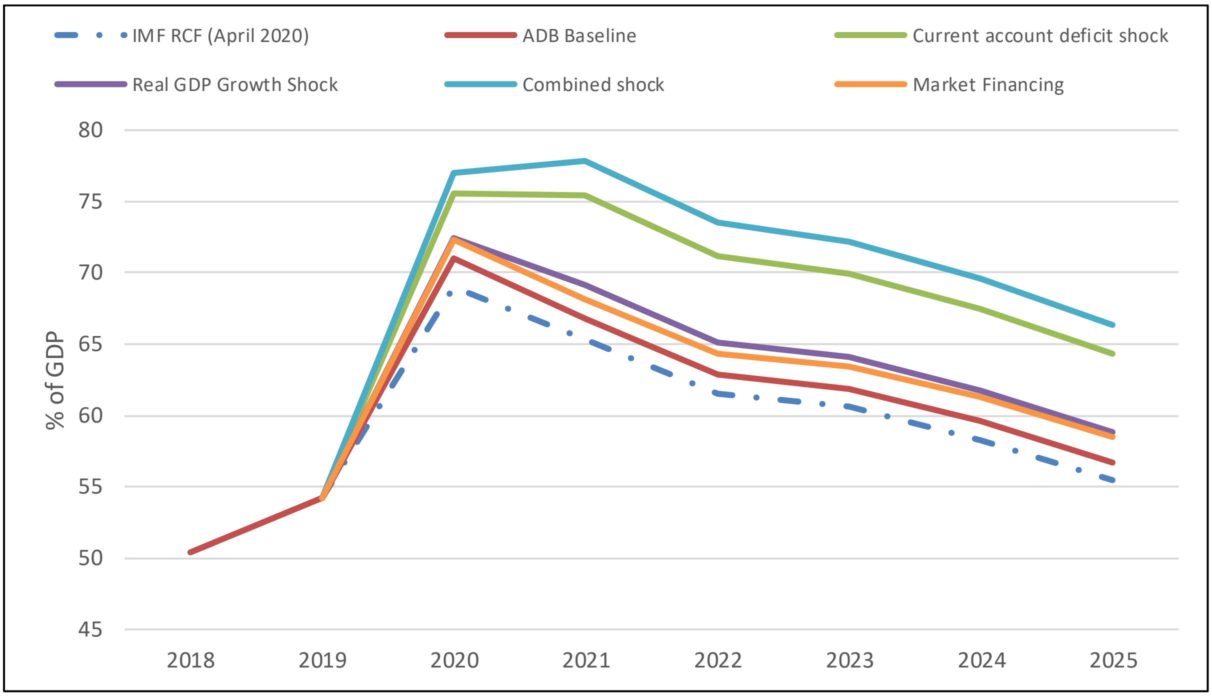
Notes: International Monetary Fund (IMF) Rapid Credit Facility (RCF) (April 2020) corresponds to the IMF Rapid Credit Facility report (April 2020). Market financing corresponds to a scenario where multilateral loans and grants are not available and Maldives has to raise funds from international markets.
Source: Asian Development Bank estimates and International Monetary Fund Rapid Credit Facility (April 2020).

6. **External debt will also rise but is sustainable in the medium term.** The external debt to GDP ratio will increase to 71.0% in 2020, of which external PPG debt is expected to rise to 51.4% of GDP, as the country borrows more externally than domestically to finance its fiscal deficit. The external debt path is about 2 percentage points higher than the IMF RCF one because of more adverse growth assumptions (Figure 3). External debt will gradually fall to 56.7% by 2025, while external PPG debt will also fall below 40% of GDP, both of which are marginally higher than those in the IMF RCF report. The IMF RCF report projects both total external debt and external PPG debt to fall below 30% by 2040.[2] Rollover risks from the repayment of two outstanding international sovereign bonds are mitigated by accumulation of foreign exchange resources in the SDF. The risk of high external debt distress will be further mitigated by an effort to obtain the most concessional terms available for contracting external debt and to seek grant financing to the extent possible.

7. **The external debt path is highly vulnerable to shocks to the current account deficit.** A half standard deviation shock to current account deficit (an increase of 4.5 percentage points) in the first two years (Table 2) will cause external debt to GDP to increase to 75.6% in 2020 and remain elevated at 64.3% in 2025 (Figure 3). A negative growth shock will also raise the external debt path, but not as much as the current account shock. The combined shock will push external debt to 77.8% of GDP in 2021 before falling to 66.4% in 2025. In the medium term, the debt levels under these shocks will continue to fall owing to favourable debt dynamics of strong growth prospects and loan terms which are usually semi-concessional, as confirmed by the IMF RCF report.

[2] For weak debt-carrying capacity countries, the threshold is 30% for present value of external debt as a percent of GDP and 35% for present value of total public debt to GDP. As Maldives' debt is largely semi-concessional, the present values of its debt will be lower than its nominal values.

Figure 3: External Debt Sustainability Assessment Stress tests



Notes: International Monetary Fund (IMF) Rapid Credit Facility (RCF) (April 2020) corresponds to the IMF Rapid Credit Facility report (April 2020). Market financing corresponds to a scenario where multilateral loans and grants are not available and Maldives has to raise funds from international markets.
Source: Asian Development Bank estimates and International Monetary Fund Rapid Credit Facility (April 2020).

8. **Multilateral financial assistances will help ease debt distress.** To help Maldives respond to COVID-19, international financial institutions have provided or proposed emergency assistances. IMF approved an RCF disbursement of $28.9 million in late April and other proposed assistance include from ADB ($50 million with a half in grant and a half in concessional loan), JICA ($20.0 million loan on concessional terms), the World Bank ($50.1 million of which $35.05 million is grant), OPEC Fund for International Development (OFID) ($20 million concessional loan), Islamic Development Bank ($46.2 million loan), the Asian Infrastructure Investment Bank ($7.3 million loan), and International Fund for Agriculture Development ($4.5 million loan). Together, these proposed grants and loans constitute 3.8% of GDP and will help finance the fiscal deficit in 2020, They are already reflected in the ADB baseline debt paths. If these proposed grants and concessional loans were unavailable, Maldives would have to borrow from international markets to raise the funds. Without the grants (about 1.1% of GDP) and concessionary interest rates, the government would have to borrow more and the effective interest rate would increase.[3] The absence of multilateral grants and loans would cause the public and external debt paths to increase by between 1.3 to 1.7 percentage points throughout the projection period (Market Financing Scenario in Figure 2 and 3). In other words, the proposed assistance from multilaterals is equivalent to a reduction of debt-to-GDP ratios by 1.3 to 1.7 percentage points.

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[3] Maldives rating was downgraded from B+ to B on 30 March 2020. Assuming a market interest rate of 7%, the effective interest rate would increase by 0.2 percentage points as the new market borrowing to replace the proposed multilateral assistance is about 3.9% of total debt. The effective interest rate for external debt analysis would increase by 0.3 percentage points due to higher external financing.

Table 2: Underlying Assumptions for Stress Tests

Shocks	2020	2021	2022	2023	2024	2025
Real GDP Growth Shock						
Real GDP growth	-13.3	11.7	6.4	5.9	5.4	5.4
GDP deflator	3.0	1.8	2.0	2.0	2.0	2.0
Primary Balance Shock						
Primary balance % of GDP	-12.5	-5.7	-3.1	-1.9	-1.4	-1.1
Current account deficit shock						
Non-interest current account deficit	26.7	15.0	7.9	7.8	8.1	7.8
Combined Shock						
Real GDP growth	-13.3	11.7	6.4	5.9	5.4	5.4
GDP deflator	3.0	1.8	2.0	2.0	2.0	2.0
Primary balance % of GDP	-12.5	-5.7	-3.1	-1.9	-1.4	-1.1
Non-interest current account deficit	26.7	15.0	7.9	7.8	8.1	7.8
Marketing Financing						
Effective interest rate on total PPG debt	2.2	2.4	2.5	2.6	2.6	2.6
Effective interest rate on total external debt	1.9	2.5	2.5	2.4	2.5	2.5

GDP = gross domestic product, PPG = public and publicly-guaranteed.
Source: Asian Development Bank estimates.