

Fiscal Position & Outlook

1 Medium Term Fiscal Objective

The Budget for 2017 was developed with the aim of overcoming the challenges faced by the Maldives economy and creating new economic opportunities, through the development projects initiated by the government. As such, the budget is compiled with a focus on reducing expenditure and moulding the fiscal policy in a way that the expenditure is sustained through the revenue received. It would also focus on increasing the rate of economic growth and improving standard of living.

Therefore, the budget for 2017 gives a special focus on public sector infrastructure projects (PSIP). The aim of the government is to expand economic activities and enhance economic growth through these public investments.

The basic characteristic of becoming a self-sufficient business or a family is managing their expenditure within their earnings. It is no different for a State; to achieve fiscal sustainability it is necessary for the State to meet their recurrent expenditures with their income. Reducing expenditure has become especially important since the budget has been running a chronic deficit continuously for a number of years now. Reducing the budget deficit is also crucial in solving structural issues in the economy. The government aims to reduce the deficit while prioritizing economic progress and raising the standard of living in the medium term.

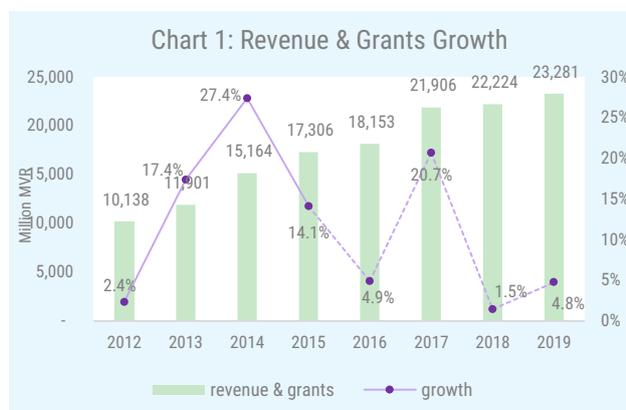
2 Government Revenue

Government revenue is an important component of the fiscal policy. In order to strengthen the economy and the government's fiscal policy, it is important to implement revenue-related policies in a sustainable manner.

Government receipts mainly consists of tax revenue and non-tax revenue. In addition, the government receives revenue from trust funds and grants.

2.1 Changes in Revenue

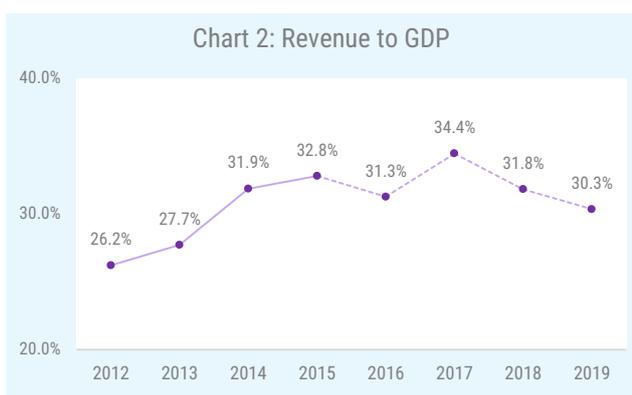
The revenue of the government has been increasing from year to year over the past five years. On average, the revenue growth from 2013 to 2016 was 16% (chart 1). The main reason for this is the consistent growth in tax revenue as the tax system has matured over time with the introduction of a modern tax system. This growth also reflects the results of additional non-tax revenue measures taken by the government.



Source: Ministry of Finance & Treasury

2.2 Revenue to GDP ratio

Since the introduction of the tax system, the government revenue as a percentage of GDP has been increasing consistently. The contributors to this revenue growth include the introduction of new taxes, increasing the tax rates and the broadening of the tax base over the years. However, since 2014 the revenue to GDP ratio has stabilized at around 30% and is expected to continue in the medium term (Chart 2).



Source: Ministry of Finance & Treasury

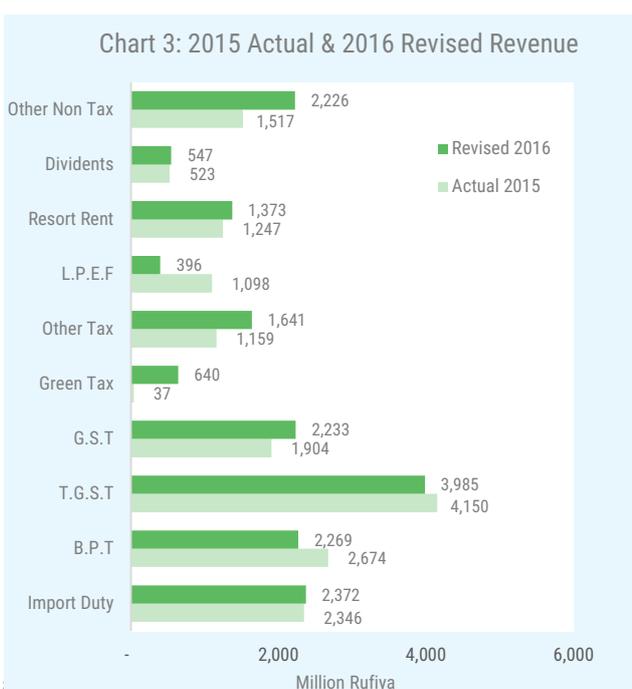
2.3 Government Revenue for 2016

2.3.1 Revenue for 2016 in comparison to 2015

The revenue realization for the year 2015 was MVR 17.3 billion, and it is estimated that the revenue for 2016 would increase by 4.9% to MVR 18.2 billion. The expected increase in revenue for 2016 is mainly due to the introduction of the Green Tax and the Remittance Tax during the year.

It is estimated that by the end of 2016 the revenue received from taxes would increase by 7.1% and non-tax revenue would increase by 3.6%.

When looking at the revenue from taxes, it was initially estimated that revenue from Green Tax would be MVR 654.2 million in 2016. However, the amount is now estimated to be at MVR 640.0 million by the end of the year.



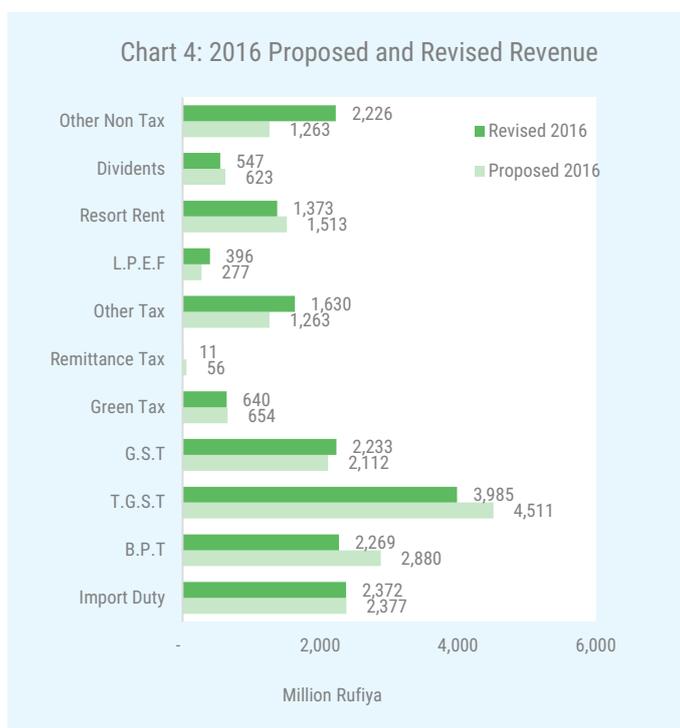
A notable change in the non-tax revenue is the Lease Period Extension Fee (LPEF). Since the LPEF is being paid in 8 quarterly instalments from 2014, the last instalment was to be paid in February 2016. Hence a large portion of the fee, totalling MVR 1.1 billion was received during the year 2015. It is estimated to receive MVR 396.3 million in 2016.

2.3.2 Actual revenue compared with budgeted revenue

The approved budget for 2016 includes total revenue of MVR 22.8 billion; including MVR 4.0 billion in new revenue measures. The budgeted revenue¹ for 2016 consists of MVR 13.1 billion in tax

¹ Total revenue includes receipts from offices (tax, non-tax and capital receipts), income from trust funds and grants. Subsidiary loan repayments are not included.

revenue, MVR 4.5 billion in non-tax revenue, MVR 107.5 million from trust funds and MVR 1.2 billion from grants (Chart 4).



The actual turnout is estimated to fall short of the budgeted revenue by 3.1%. This amounts to MVR 18.2 billion. The actual outturn is made up of MVR 13.1 billion in tax revenues, MVR 4.5 billion in non-tax revenues, MVR 132.1 million and MVR 478.9 million from trust funds and grants respectively.

The revenue shortfall compared to the budgeted revenues is because a significant share of MVR 4 billion in estimated revenue from new revenue measures has still not been realised for various reasons and because the economic growth is now expected to be 2.6% lower than originally projected.

Among the new revenue measures proposed with the 2016 budget, as of now, only remittance tax has been implemented. Effective from 1st October 2016, Remittance tax of 3% is imposed on money transferred out of the Maldives by “foreigners employed in the Maldives” as per the amendment to Employment Act². MVR 11.2 million is expected to be received as revenue from remittance tax during this year.

2.3.3 Main components of 2016 Revenue

Import Duty

It was initially estimated that the revenue from import duty would be MVR 2,376.7 million. However, the revenue is now estimated to decrease by 0.2% and is expected to stand at MVR 2,372.1 million by the end of this year. The main reason for this is the decline in the prices of imports due to the decline in global commodity prices. Furthermore, the exemption of import duty for goods imported for large public infrastructure projects and resort construction has also been a contributing factor.

Business Profit Tax (BPT)

The current projection for BPT revenue is MVR 2,268.6 million by the end of the year, which is 21.1% lower than the initial estimates. As BPT for 2016 is paid based on the previous year’s profits of businesses, this reduction also reflects the slowdown of the economy during the year 2015.

² As per 5th amendment to Act no 2/2008 (Employment Act) ratified by the president on 25 August 2016

General Goods & Services Tax (GST)

The revised revenue estimate from GST for the end of 2016 is MVR 2,233.2 million. This is an increment of 5.7% compared to the initial projection, which is mainly driven by the anticipated growth in nominal GDP in the current year.

Tourism Goods & Services Tax (TGST)

The expected revenue from TGST was initially MVR 4,510.9 million, however this value has now been revised down to MVR 3,984.6 million. This downward revision of 11.7% is due to the fact that both the number of tourists and total bed nights has not performed as initially estimated.

Resort Rent

The initial projection for revenue from Resort Land Rent was MVR 1,512.8 million. However, by the end of this year MVR 1,373.4 million is expected to be realized. This discrepancy of 9.2% is mainly due to the delays in payments from the resorts.

Interests & Dividends from SOEs

It is now estimated that the revenue from the transfer of dividends from SOE's would be 12.2% lower than it was initially estimated. This is primarily due to the lower than expected dividend pay-outs by some SOEs.

Trust Funds

The approved budget for 2016 includes a projected amount of MVR 107.5 million to be received from trust funds. However, it is now expected that by the end of this year this amount would be 22.9% lower.

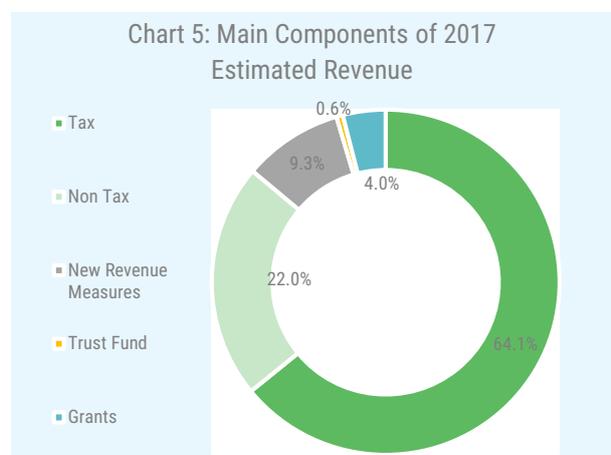
Grants

The approved budget for 2016 includes a projected amount of MVR 33.6 million to be received as cash grants and MVR 1.1 billion to be received as project grants. Current estimate is that by the end of this year receipts from cash grants would be MVR 52.1 million and project grants would be MVR 426.8 million.

2.4 Government Revenue for 2017

The total revenue for 2017 is expected to be MVR 21.9 billion, including new revenue measures of MVR 2 billion.

The revenue for 2017 is comprised of MVR 14.1 billion as tax revenue, MVR 4.9 billion as non-tax revenue, MVR 130 million from trust funds and MVR 0.9 billion from grants.



Source: Ministry of Finance & Treasury

2.4.1 Main components of 2017 Revenue

Import Duty

It is estimated that MVR 2.4 billion would be received from import duties in 2017. This is an increment of 4.7% compared to 2016. The effects of the proposed Free Trade Agreement (FTA) with China has been considered in forecasting the import duties. It is assumed that there will be no major trade diversion towards China as a result of the FTA in 2017, but there will be some impact in 2018 and 2019.

Business Profit Tax (BPT)

MVR 2.4 billion is expected to be received from business profit tax in 2017. The main reason for the rise in the projected revenue is due to higher economic growth in 2016 compared to the previous years. As a result, the businesses are expected to generate higher profits, leading to higher BPT payments.

General Goods & Services Tax (GST)

The revenue from GST is expected to be MVR 2.4 billion in 2017. This is 8% higher than the revised estimate for 2016. Since GST projections are prepared based on nominal GDP growth rates, the GST revenue is expected to increase with the 9.5% increase in nominal GDP projected for 2017.

Tourism Goods & Services Tax (TGST)

The expected revenue from TGST for 2017 is MVR 4.3 billion. This is an increase of 7.8% compared to 2016 revised figure, as tourist arrivals and bed nights are expected to recover from the slowdown in 2016. As such the number of tourist arrivals and bed nights are expected to grow by 4% and 3.9% respectively.

Resort Rent

The estimated revenue from Resort Land Rent is MVR 1.7 billion. As several new resorts are expected to be opened in 2017, it is projected that Resort Land Rent would increase by 25.7%.

Interest & Dividend from SOEs

It is estimated that dividends from SOEs would be MVR 1.6 billion in 2017. This increase is the result of a policy decision to mandate a dividend pay-out ratio of 60% for all SOEs. This change will increase the revenue from interest & dividend of SOEs by 198.2%. The dividends from Maldives Airports Company (MACL) will be transferred to the newly created Sovereign Development Fund.

Trust Fund

The budget for 2017 includes estimated revenue of MVR 130 million from trust funds. This is a 0.2% decline from the revised figure for 2016.

Grants

The budget for 2017 estimates MVR 50 million to be received as cash grants and MVR 825 million to be received as project grants. The project grants for 2017 is expected to be higher than 2016, due to the expected disbursements in 2017 on the China-Maldives Friendship Bridge project, Thilafushi incinerator project and the construction of a new national stadium project in Hulhumale'.

2.5 Changes in revenue policy

The estimated revenue for 2017 includes the additional revenue to be received from changes to the revenue policy or “new revenue measures”. It is estimated that these new revenue measures would generate MVR 2 billion in revenues in 2017. (This excludes the additional revenue generated from the proposed changes to the dividend policy).

New revenue measures are proposed in the budget to strengthen the fiscal position of the government and establish sustainability in the revenue. Furthermore, increasing revenue is also important in cash flow management as well as in attaining financial assistance from international financial institutions.

2.5.1 New Revenue Measures

Airport development fee

It is proposed to charge a fee of US\$ 25 per passenger departing from Velana International Airport. It is estimated that a revenue of MVR 565.8 million would be collected as airport development fee. This figure is estimated primarily based on the growth in tourist arrivals.

Sale of land

It is expected that recently reclaimed land in various parts of the country could be leased on a long-term basis to develop economic activities, including guesthouses and industries. The revenue is estimated based on an acquisition fee of MVR 1,000 per square feet and designated land area of 500,000 square feet. Hence, it is estimated that MVR 500 million could be generated through the sale of land in 2017.

Congestion charge for Male’ region

The Male’ region is highly congested with a large number of vehicles currently on the roads. This has led to high traffic volume and major inconveniences to the public. To mitigate the congestion in the region this measure proposes to charge a fee on 2-wheeled and 4-wheeled vehicles registered in the Male’ region. It is estimated that MVR 261 million would be generated from the collection of a congestion charge. Such fees are charged in many other countries and big cities with high population and traffic density.

Revise Import duty rates on cigarettes

There are numerous activities currently being carried out by the government to protect the community from the adverse effects of tobacco consumption. This measure proposes to increase the import duty rates for cigarettes to MVR 1.75 per cigarette. The purpose of this change is to discourage the consumption of cigarettes by raising the market price of cigarettes. It is estimated that MVR 200 million could be generated from this measure.

Revise Import duty rates on fizzy drink & energy drinks

This is another measure to discourage the consumption of products with negative health impacts. The proposal is to charge an ad valorem tax on fizzy and energy drinks at 20%. Additional revenue of MVR 9 million is expected to be received from increasing the rate.

Issuance of additional permits for taxi & pickup services

It is estimated that revenue of MVR 12 million could be generated from the issuance of new permits for taxi & pickup service in 2017. Around 400 new permits are expected to be issued at a rate of MVR 30,000 per vehicle.

Revising dividend policy of SOEs

The 2017 budget proposes to revise the dividend policy applied to SOEs, including a minimum pay-out ratio of 60%. An estimated amount of MVR 1.4 billion is expected to be generated from this revision.

Acquisition fee from SEZs

As per Special Economic Zones (SEZ) Act, the investor is required to pay an acquisition fee for the investment in SEZ. It is estimated that MVR 500 million would be received from SEZ acquisition fees in 2017.

Table 1: Proposed New Revenue Measures

	2017	2018	2019
Airport Development Charge	565,827,477	588,460,576	611,998,999
Income from sale of land	500,000,000	250,000,000	250,000,000
Congestion charge for Male' Region	261,000,000	261,000,000	261,000,000
Import duty on cigarettes	200,000,000	200,000,000	200,000,000
Import duty on fizzy drinks & energy drinks	9,000,000	9,000,000	9,000,000
Issuance of additional permits for taxi & pickup services	12,000,000	12,000,000	12,000,000
Acquisition fee from SEZs	500,000,000	-	-
	2,047,827,477	1,320,460,576	1,343,998,999

If the new revenue measures are realized during the year, an estimated revenue of MVR 2 billion would be received during the year. It is important for new revenue measures to be implemented during the year so that the expenditure is met through the government revenue so as to reduce the need to borrow.

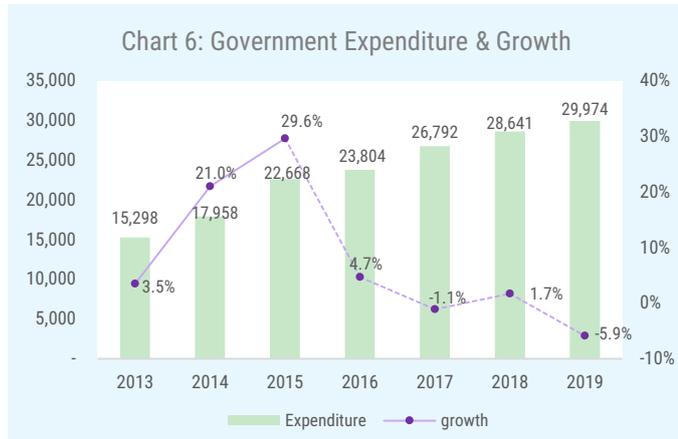
3 Government Expenditure

Government expenditure policy is one of the cornerstones of fiscal policy. The government expenditure primarily goes towards public services, social protection and public infrastructure development. Government expenditure is the main tool for implementing government policies, as well as a tool for regulating the economy and instituting structural changes in the economy.

Government expenditure is categorized as recurrent and capital expenditure. Recurrent expenditure includes, among others, expenditure on public administration, public services, social security and subsidies. Capital expenditure primarily includes development and infrastructure projects.

3.1 Changes in Government Expenditure

The government expenditure has expanded over the recent years with the changes in government policy. From 2013 to 2015, expenditure on average increased by 15% per annum. This increase has been due to a number of factors such as the establishment of new government institutions, increase in public sector employees, increase in administrative expenses, the introduction of new subsidies and the changes in the pension system.



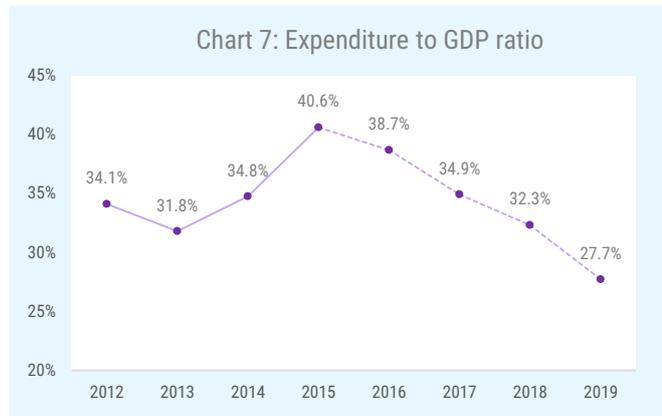
Source: Ministry of Finance & Treasury

Furthermore, government expenditure on public infrastructure projects has expanded rapidly in recent years.

Nevertheless, with measures taken to reduce recurrent expenditures in 2016, the rate of growth in expenditure is expected to fall in 2016. Some of the measures enacted in 2016 includes targeting subsidies and a public sector hiring freeze (Chart 6).

3.2 Expenditure to GDP ratio

Government expenditure as a ratio of nominal GDP has been increasing over the recent years; primarily as a result of the institutional changes in government administration, due to the enactment of a new constitution. This trend is likely to be reversed in 2016, with the ongoing efforts to reduce recurrent expenditure, the drop in prices in the global market in recent years, and the continuous growth of the Maldives economy. The downward trend in the expenditure-to-GDP ratio is expected to continue in the

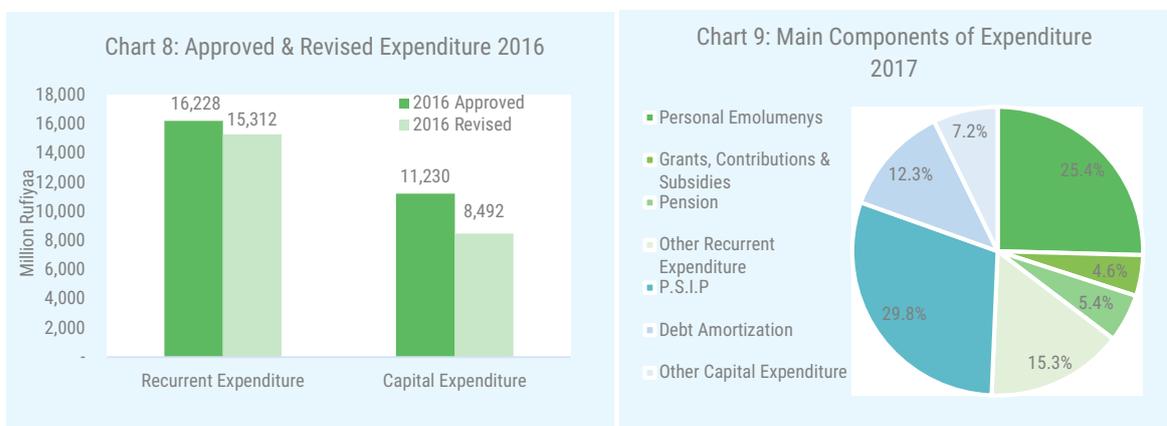


Source: Ministry of Finance & Treasury

medium term, as a result of the measures enacted to rationalize recurrent expenditure (Chart 7).

3.3 Government Expenditure 2016

The approved expenditure for 2016 was MVR 27,457.4 million, of which 59.1% was allocated for recurrent expenditure and 40.9% (MVR 11,229.8 million) for capital expenditure. Based on the capital expenditure patterns so far this year, capital expenditure has been revised down to 24.4% (Chart 8).



Source: Ministry of Finance & Treasury

Source: Ministry of Finance & Treasury

3.3.1 Main Components of Recurrent Expenditure

Personal Emoluments

Personal emoluments consist primarily of salaries & wages, overtime expenses and other allowances. Personal emoluments constitutes the biggest share of government expenditure in the approved budget of 2016. Around 43% of the approved budget for 2016, amounting to MVR 6,820.7 million, was allocated for personal emoluments. As per the spending patterns within the year, it is estimated that the expenditure on personal emoluments would reach MVR 6,930.3 million by the end of 2016. This is a 2% increase from the actual expenditure on personal emoluments in 2015. The government has taken measures to stem the growth in expenditure on personal emoluments by instituting a freeze on public sector hiring and promotions.

Pension, Retirement benefits and Gratuities

Expenditure on pension, retirement benefits and gratuities include contributions to the retirement pension scheme (deduction of 7% from employee salaries), redundancy payouts for retirees and the old age pension (MVR 5,000 for people above 65 years). The total expenditure on pension, retirement benefits and gratuities by the end of 2016 is expected to be MVR 1,439.7 million, which is less than the budgeted figure of MVR 1,793.4 million. Nevertheless, this is still a growth of 1.2% compared to the actual expenditure on this category in 2015.

Grants, Contributions & Subsidies

A significant portion of the government expenditure on grants, contributions & subsidies, goes towards the national health insurance scheme and on food and electricity subsidies. MVR 2,370 million was budgeted for grants, contributions & subsidies in 2016, which constitutes for 8.6% of the total approved budget. However, based on the expenditure in this category so far this year, expenditure on grants, contributions & subsidies are expected to fall by 12.3% by the end of this

year compared to 2015. This expenditure has reduced substantially in 2016, due to the revisions to the electricity subsidies in March 2016 and the targeting of foods subsidies.

Other Recurrent Expenditure

Other recurrent expenditure include operational expenses, expenditure on supplies and requisites for service provision, travel expenses, training expenses and interest expenses. Among these, interest expense constitutes the main expenditure item in 2016. The expenditure on T-bills and T-bond interest in 2016 is expected to be 18% higher than the budgeted figure. Expenditure on supplies and requisite for service provision constitutes the second largest component of other recurrent expenditures category.

3.3.2 Main Components of Capital Expenditure

Public Sector Investment Program (PSIP)

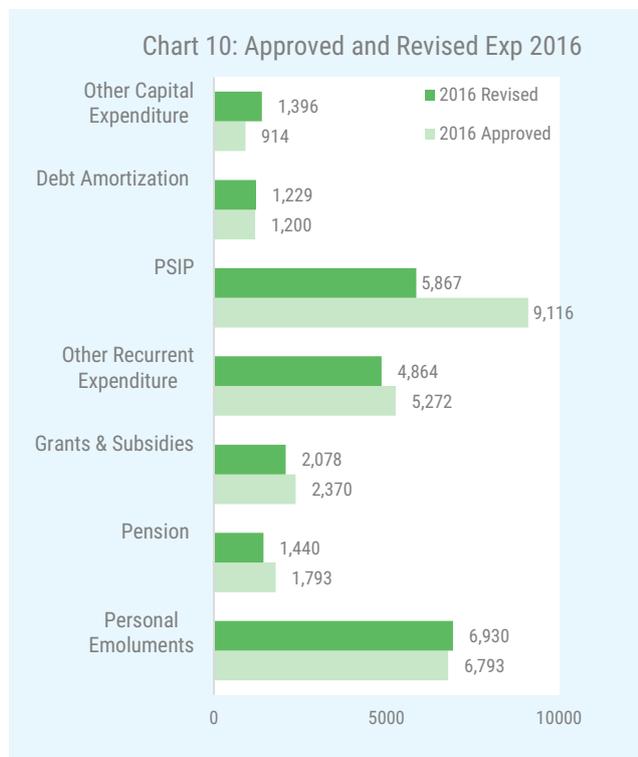
Of the approved budget for capital expenditure in 2016, 33.2% was allocated for PSIP. Based on the trend so far in 2016, it is now estimated that MVR 5,867.1 million would be spent on PSIP by the end of the year. This is an increase of around 88.2% compared to 2015. However, this only amounts to 64.4% of the approved PSIP budget for 2016. The disbursement for PISP is lower than expected because projects are not being completed at the desired pace due to supply chain difficulties, and the decision to slow down some projects to contain the budget deficit, as the revenue realization in the year has been lower than expected.

Debt Repayment

The expenditure on debt repayment under the approved budget for 2016 was MVR 1,200.2 million. However, it is now revised to MVR 1,229.1 million. This is a growth of 4.9% compare to 2015. The main reason for this growth is the higher repayments year by year, as the loan portfolio of the government has expanded.

Other Capital Expenditures

Other capital expenditure includes expenditure on capital equipment, expenditure on development projects, investment outlays and loan outlays. It is estimated that the expenditure on these items would be much higher than the initial projection for 2016. Among these loan outlays is notable; which includes loans for Small and Medium Sized enterprises and Housing loans.

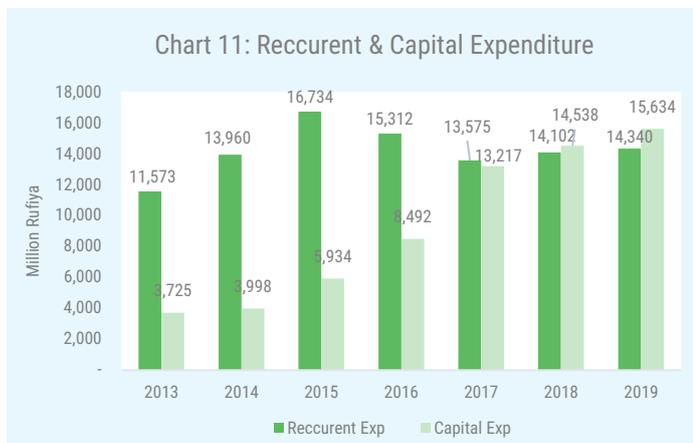


3.4 Government Expenditure 2017

The proposed budget for 2017 is MVR 26,791.5 million. This includes MVR 22,209.4 million as expenditure

The proposed expenditure for 2017 is 1.1% higher than the revised expenditure for 2016, and 15% lower than the approved expenditure for 2016. The expenditure for 2017 is proposed to be reduced through the measures to be enacted in the year to contain the growth of recurrent expenditures.

The proposed expenditure for 2017 comprises of 49.3% as recurrent expenditure and 50.7% as capital expenditure.

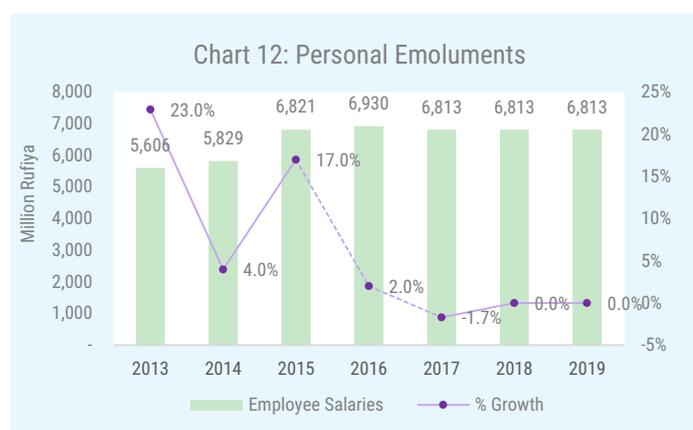


Source: Ministry of Finance & Treasury

3.4.1 Main Components of Recurrent Expenditure 2017

Personal Emoluments

A major portion of recurrent expenditure goes towards personal emoluments. As such 50.2% of recurrent expenditure is to be spent on personal emoluments. This constitutes a decrease of 1.7% compared to the revised figures for 2016. In order to maintain the expenditure on personal emoluments within the budgeted figure for 2017, no new allowances and posts have been included in the estimates.

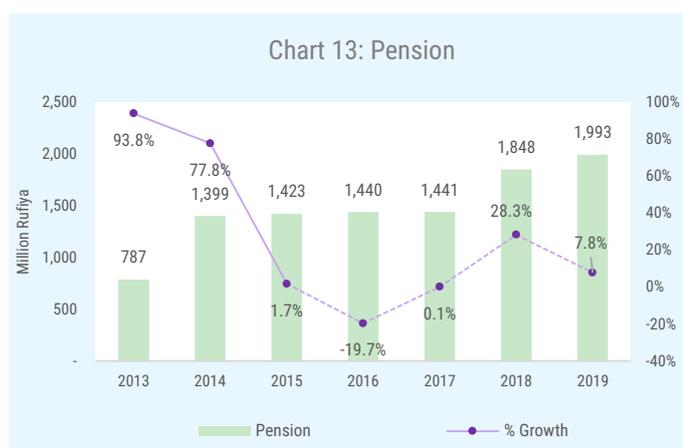


Source: Ministry of Finance & Treasury

Work will commence in 2017, through “National Pay Commission” to harmonize compensation within the government. Furthermore, measures would be taken to increase the productivity of public sector employees by incorporating new technologies and innovative methods.

Pension, Retirement benefits and Gratuities

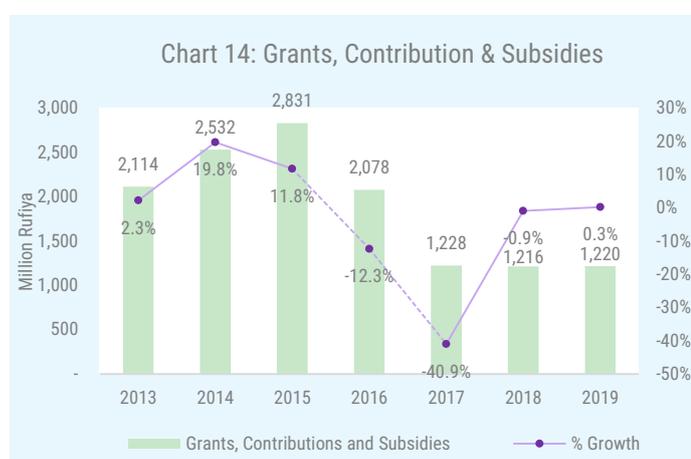
The proposed budget for pension, retirement benefits and gratuities for 2017 is estimated at MVR 1,441 million. This constitutes 10.6% of recurrent expenditure. This includes MVR 215.8 million as contribution to the retirement pension scheme.



Source: Ministry of Finance & Treasury

Grants, Contributions & Subsidies

A significant portion of the recurrent expenditure goes towards grants, contributions & subsidies. This figure for 2017 is estimated to be MVR 1,227.8 million, which is 40.9% lower than the revised figure for 2016. The decrease in estimated expenditure on grants, contributions & subsidies are expected to be brought through measures to target subsidies and bring reforms to the national health insurance system, Asandha.



Source: Ministry of Finance & Treasury

Other Recurrent Expenditure

Among other recurrent expenditure, the largest portion is estimated to be spent on interest payments.

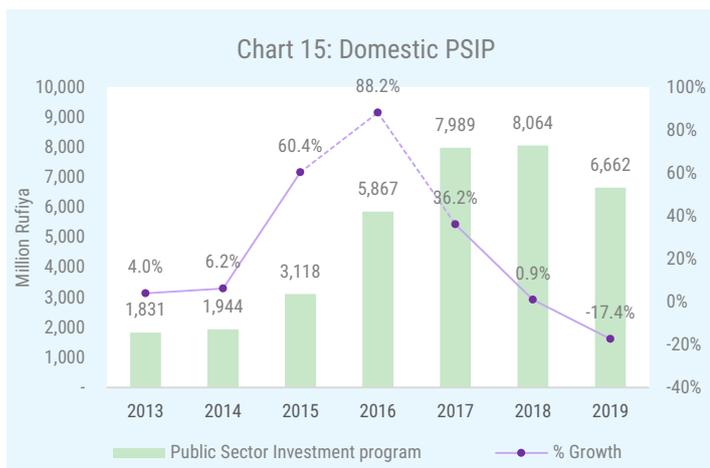
Compared to 2016, the expenditure on interest payments for 2017 is expected to decrease by 14.9%. This is due to a decrease in interest payments as deficit financed through T-bills and T-bonds is estimated to be lower for the year. In addition to this, other recurrent expenditure for 2017 is expected to be kept at 2016 levels.

3.4.2 Main Components of Capital Expenditure 2017

Public Sector Investment Program (PSIP)

Of the proposed budget for 2017, 50.2% is allocated for capital expenditures. Among capital expenditures, the highest proportion is expected to go towards PSIP. This is 60.4% of total capital expenditures.

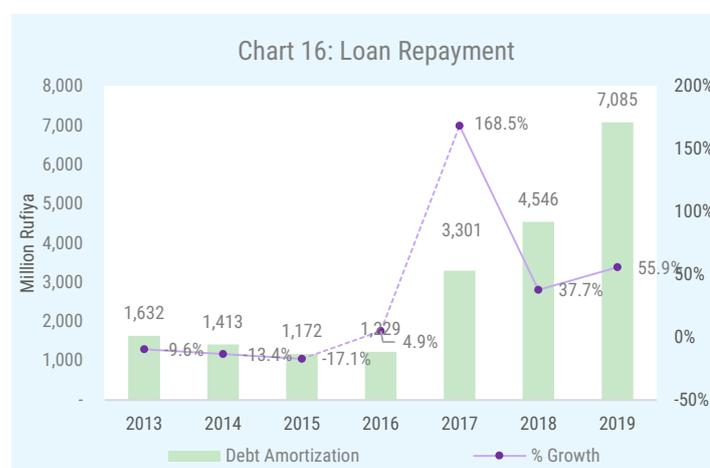
The proposed expenditure on PSIP for 2017 is MVR 2,121.9 million higher than the revised figure for 2016. It is estimated that 54.6% of PSIP would be financed through the domestic budget and 45.4% would be financed through loans, grants and other funding sources.



Source: Ministry of Finance & Treasury

Loan Repayment

The proposed expenditure for loan repayment in 2017 is MVR 3,300.7 million. This is a growth of 168.5% from the revised figure for 2016, as a significant portion of loan repayments are expected to fall due in the year.



Source: Ministry of Finance & Treasury

Other Capital Expenditure

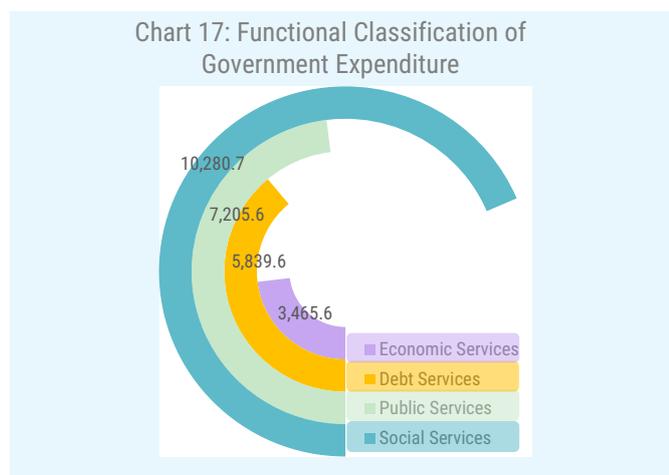
Among other capital expenditures, the expenditure on loan outlays is expected to be 61.5% lower than in 2016. The MVR 1,127.8 million in transfers to the Sovereign Development Fund is also included in this category. Expenditure on capital equipment is proposed to fall by 139.4% in 2017, compared to the 2016 revised figures.

3.5 Functional Classification of Government Expenditure

Government expenditure can be classified under 4 main functional categories; expenditure on public services, economic services, social services and debt service.

The highest expenditure is allotted towards social services which is proposed at MVR 10,280.7 million. Next is expenditure on public services, which is proposed at MVR 7,205.6 million. Expenditure on economic services is proposed to be MVR 3,465.6 million and debt service is expected to be MVR 5,839.6 million. Debt service includes the expenditure of MVR 1,127.5 million proposed as transfers to the Sovereign Development Fund. Sovereign Development Fund is a fiscal

reserve established to service debt incurred for the development of infrastructure projects while maintaining intergenerational equity in government borrowing.



Source: Ministry of Finance & Treasury

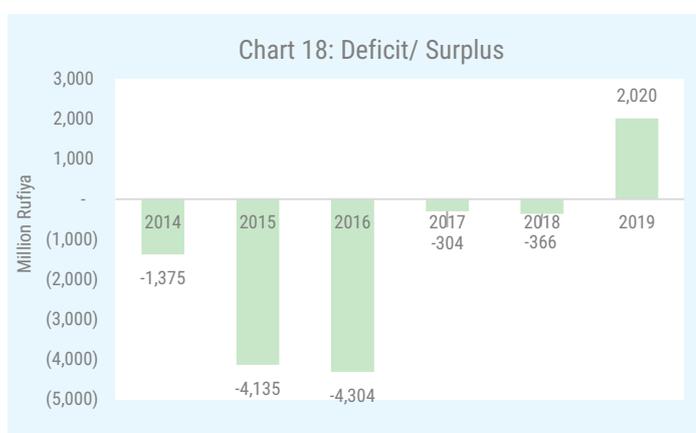
Rationalizing government expenditures is imperative for maintaining a healthy fiscal balance and economic sustainability. As such, this would enable the government to reduce its financing through treasury bills and bonds, and reduce the fiscal risk associated with the expansion of debt. With the government taking a step back in financing through treasury bills and bonds, it would create space for banks to increase lending to the private sector, which could in turn reinvigorate the private sector. Reducing recurrent expenditures would also create the fiscal space to boost the investment in public infrastructure from the domestic budget.

4 Budget Deficit/Surplus

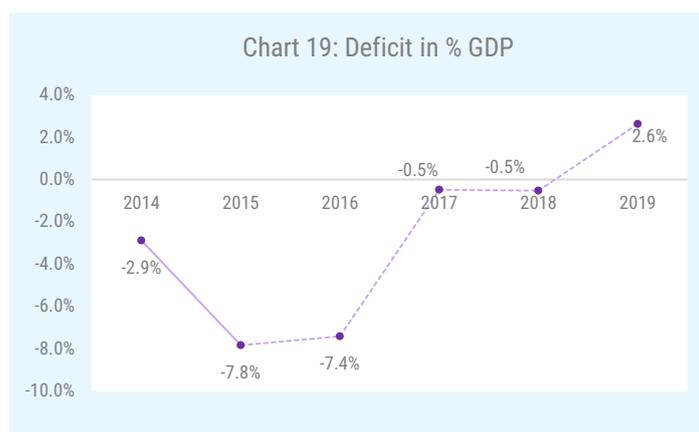
4.1 Budget Deficit 2016

The budget deficit projected for 2016 approved budget was MVR 3,356.6 million or 6% of the GDP. After considering the realization rates of revenue and expenditure so far in the year and the macroeconomic outlook, the budget deficit figure for 2016 has now been revised to MVR 4,304.1 million by the end of this year. This is a deficit to GDP ratio of 7.4%.

The reason for the gap in the deficit between the approved and revised budget is primarily the result of new revenue measures proposed with the 2016 budget not materializing as planned in the year. Also contributing to the widening of the deficit is the fact that expenditures has exceeded the budgeted amount, while the realization of tax revenue has been below forecasts, with the economy performance being slower than expected.



Source: Ministry of Finance & Treasury



Source: Ministry of Finance & Treasury

4.2 Budget Deficit 2017

The 2017 Budget targets to reduce the budget deficit by reducing expenditures. The objective of the government is to enact measures to reduce the budget deficit without hindering the progress of ongoing development projects, ensuring macroeconomic stability and achieving a balanced budget in the medium term.

The budget deficit projected for 2017 is MVR 303.7 million. This is 0.5% of GDP. The primary balance is projected to be a surplus of MVR 1,107.6 million or 1.7% of GDP.

A primary balance surplus means the discretionary expenditure policies proposed under the 2017 budget would produce a surplus balance. However, the overall balance of the budget for 2017 is a deficit as this includes repayment of loans taken for expenditures that occurred in previous budget years.

Reducing the budget deficit in the medium-term would be a step towards achieving a key pledge of the government's manifesto of attaining a surplus budget.

5 Financing

The deficit for 2017 would be primarily financed through external borrowing. This includes loan disbursement on projects of MVR 1,408.8 million and proceeds from a sovereign bond/sukuk of MVR 1,435.2 issued in the international market. This would be the first time that the government of Maldives would issue a sovereign bond/sukuk in the international financial markets. This would be an important step in strengthening the financial sector of Maldives, diversifying the financing and investment products in the domestic financial market, and would open the door for the public and private sector to source financing in international markets. The bond proceeds are expected to go primarily towards the construction of the National Diagnostic Center being built adjacent to IGMH. The bond proceeds are also expected to go towards the financing of other development projects.

The decision to source financing from external sources is also guided by the fact that the infrastructure scale up that the government envisions would create additional demand for foreign

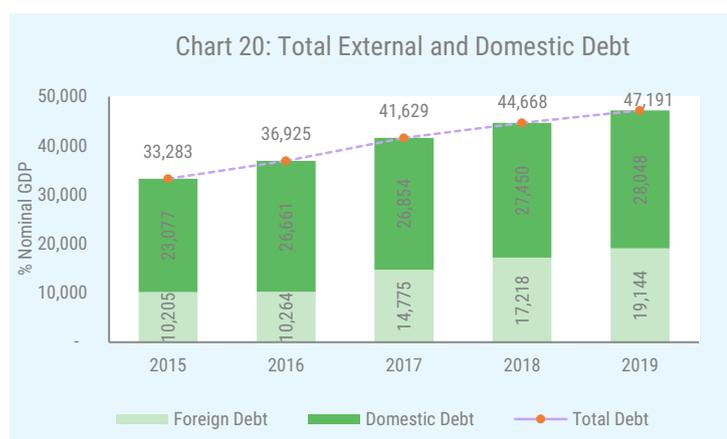
currency for purchasing machinery and equipment and construction material. External financing for such projects would relieve the potential pressure on the exchange rate and foreign exchange reserves.

Financing the deficit through external sources, would give the flexibility to the government to reduce domestic financing. Although a total of MVR 787.4 million treasury bills has been budgeted for cash flow management, it is expected that the current T-bills stocks would be reduced in 2017. Furthermore, measures are being taken to convert more of the short-term T-bills to longer term T-bonds to mitigate the fiscal risks associated with the buildup of shorter maturity T-bills stock. Taking into account the total financing needs and the external borrowings projected, MVR 2.2 billion in T-bills and t-bonds are expected to be repaid in 2017.

6 Government Debt

6.1 Total Debt

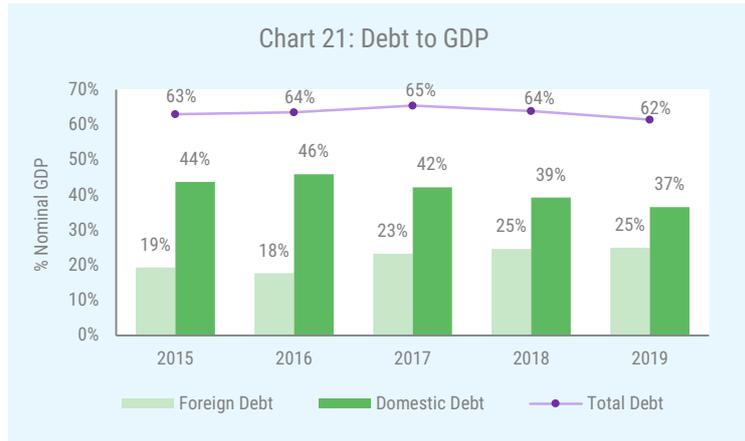
Government debt is expected to be at MVR 36,925 million by the end of 2016. This is 11% higher than the level of debt at the end of 2015. Government debt is expected to increase up to MVR 41,629 million by the end of 2017.



Source: Ministry of Finance & Treasury

Looking at the composition of expected total debt at the end of 2016, 72% is estimated to be domestic debt, while 28% is estimated to be external debt. Although total debt is projected to increase by 13% in 2017 in comparison to 2016, the composition of the debt is expected to remain similar.

Total debt to GDP ratio was 63% in 2015. In 2016, total debt to GDP ratio is expected to increase to 64% and is expected to be maintained at 65% in 2017.



Source: Ministry of Finance & Treasury

6.2 External Debt

A large share of the total external debt for the year 2017 is expected to be held by international financial institutions. That is 28% of total external debt. In addition to this, 31% is expected to be held by bilateral creditors, 27% as buyer's credit, and 1% as debt from commercial banks. Looking at the currency composition of external debt, 82% of total external debt is held in United States Dollars, Chinese Yuan Renminbi, and Euro.

While total external loan disbursements for 2015 stood at MVR 761 million, it is expected that by the end of 2016 MVR 997 million will be disbursed. It is further expected that due to the expenditure on government's mega projects, disbursements will increase to MVR 2,844.1 million in 2017. The main projects for which funds are expected to be disbursed are to the Velana International Airport Upgrade and Expansion Project, Hulhumale' Development Project and the China Maldives Friendship Bridge Project. These three projects would accounts for 39% of the funds expected to be disbursed in 2017.

6.3 Domestic Debt

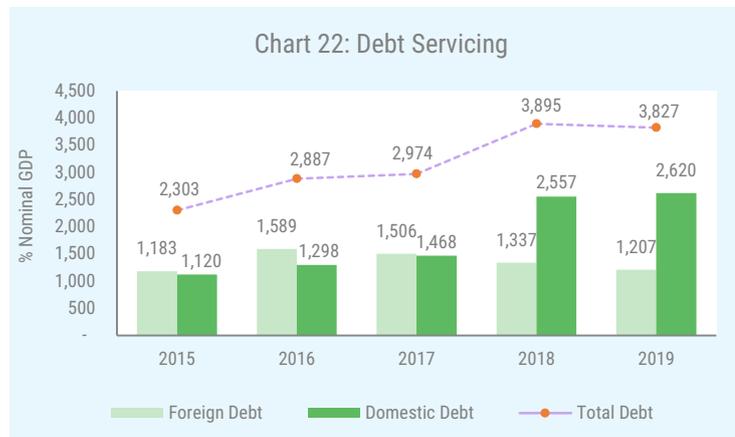
Treasury bills take up a large share of the domestic debt. In addition to this, some long term bonds and Islamic instruments are included in the domestic debt. Short term debt accounts for 47% of domestic debt.

Looking at the holdings of domestic debt, a large share is held by commercial banks operating in the Maldives, and long terms bonds invested by investment funds such as the Pension Fund. In addition to this, domestic debt also includes debt held by the Central Bank of Maldives.

6.4 Debt Servicing

A total of MVR 2,303 million was spent on debt servicing in 2015, and MVR 2,887 million is expected to be spent in 2016. In 2017, debt servicing is expected to be MVR 2,974 million.

The breakdown of debt servicing shows that MVR 1,183 was spent for domestic debt and MVR 1,120 was spent for external debt in 2015. Debt servicing for domestic debt for 2016 is expected to be MVR 1,589 million and debt service for external debt is expected to be MVR 1,298 million. For 2017, domestic debt servicing is forecasted to be at MVR 1,506 million and external debt servicing at MVR 1,468 million.



Source: Ministry of Finance & Treasury