

Maldives

The tourism sector has been hit hard by the slowdown in China and Russia and domestic unrest. The medium-term fiscal plan includes large public investment projects, which will move the risk of external debt distress to high. Fiscal consolidation and more sequencing of the investment projects is needed to contain the level of public debt. A particular concern is youth unemployment with skill mismatch and lack of local economic opportunities being reported as the main cause for unemployment.

2015

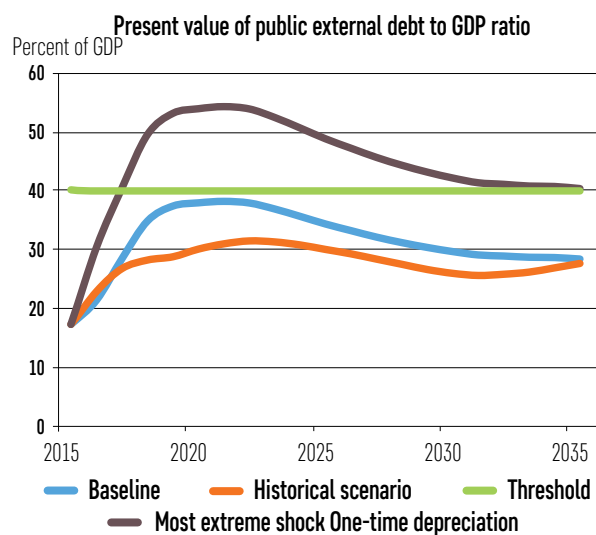
Population, million	0.4
GDP, current US\$ billion	3.1
GDP per capita, current US\$	7630.9

Sources: World Bank, WDI

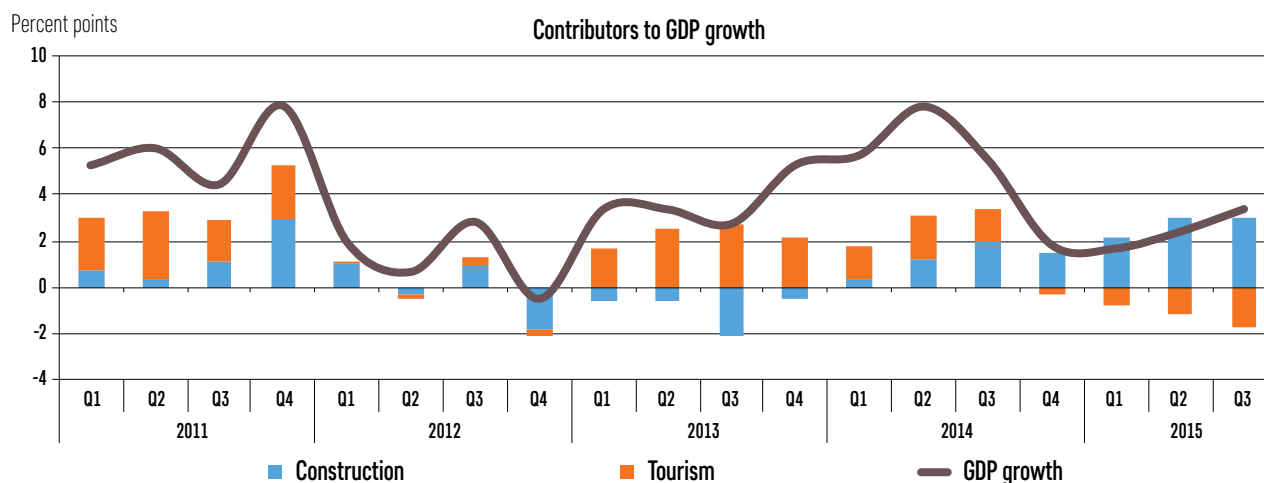
Recent Developments

GDP growth in Maldives has moderated in recent years. After dipping to 2.5 percent in 2012, GDP growth recovered in 2013-2014, reaching an estimated 6.5 percent. Staff estimates that growth fell to 1.9 percent in 2015, dragged down by a slowdown in tourism arrivals, especially from China and Russia and a number of cancellations of tourism reservations following the state of emergency in November. Construction has overtaken tourism as the most important driver of growth in 2015.

Following the global decline in commodity prices, CPI inflation has slowed down in 2014 and 2015. Annual average inflation in Malé reached 2.4 percent in 2014,



Sources: Ministry of Finance, World Bank staff calculations, Joint Bank-Fund Debt Sustainability Analysis



Source: Central Statistics Office and World Bank staff calculations



Table: Maldives

(annual percent change unless noted otherwise)

	2013	2014	2015 e	2016 f	2017 f	2018 f
Real GDP growth, at constant market prices	4.7	6.5	1.9	3.5	3.9	4.6
Private Consumption	...	...	...	...	...	...
Government Consumption	...	...	...	...	...	...
Gross Fixed Capital Investment	...	...	...	...	...	...
Exports, Goods and Services	...	...	...	...	...	...
Imports, Goods and Services	...	...	...	...	...	...
Real GDP growth, at constant factor prices	4.2	5.9	...	...	...	...
Agriculture	5.1	0.2	...	...	...	...
Industry	-7.6	12.9	...	...	...	...
Services	6.4	5.0	...	...	...	...
Inflation (Consumer Price Index)	4.0	2.4	1.4	1.3	2.5	2.8
Current Account Balance (% of GDP)	-4.3	-4.1	-8.0	-7.7	-14.7	-17.3
Financial and Capital Account (% of GDP)	9.2	11.8	6.7	9.8	19.6	20.3
Net Foreign Direct Investment (% of GDP)	12.9	12.1	10.6	10.0	10.9	10.8
Fiscal Balance (% of GDP)	-7.4	-9.1	-8.4	-13.3	-18.1	-18.9
Debt (% of GDP)	64.8	66.6	73.1	83.1	96.5	109.0
Primary Balance (% of GDP)	-4.9	-6.3	-5.5	-10.8	-14.7	-14.4

Source: Maldives Monetary Authority, Ministry of Finance and Treasury, World Bank staff projections

Note: e = estimate, f = forecast

and fell further to 1.4 percent in 2015, dragged down by food, transport and communication prices.

Maldives' high levels of fiscal deficits and public debt pose a significant risk, as the country is structurally spending beyond its means. Even though high costs of public service delivery can logically be expected in a multi-island country with a scattered population, high levels of public spending in recent years have been primarily driven by the increasing costs associated with the country's redistributive model, including the high public sector wage bill, pensions, universal health insurance and subsidies for food and electricity, and transfers to state-owned enterprises.

Continuing trends from previous years, staff estimates that public spending reached 44.4 percent of GDP in 2015, leading to a fiscal deficit estimated at 8.4 percent of GDP despite a high and increasing level of revenue (35.9 percent of GDP in 2015). In this context, management of the constrained cash flow has become an increasing challenge, leading to the build-up of arrears and costly domestic borrowing. Heavy reliance of domestic sources of financing have also contributed to

increase the exposure of the domestic banking system to sovereign risk.

The 2016 budget is expansionary with large public investment projects and one-off revenue measures. Staff projects revenue to reach 35.6 percent of GDP and expenditure 48.9 percent of GDP driven by public investment. Wages are projected to be frozen in nominal terms, while the budget foresees strong cuts in electricity and food subsidies. The budget includes a number of large multi-year investment projects: airport expansion, a bridge between the capital Malé and Hulhumalé island and housing construction in Hulhumalé island.

Balance of payment pressures have attenuated somewhat in recent months, and the exchange rate has remained stable. Loose fiscal policy and recourse to monetary financing of the deficits have contributed to substantial balance of payment pressures in recent years. Nevertheless, the decline in global commodity prices, and the associated decrease in the import bill (notably for diesel), together with continued FDI inflows in the tourism sector have offset this somewhat.



As a result, gross official reserves increased from USD 368 million at the end of 2013 to USD 564 million at the end of 2015. However usable reserves (net of short-term foreign liabilities to the banking sector) remain low, at only USD 194 million, covering only about 1.2 months of imports of goods and services. Nevertheless, the exchange rate of MVR 15.4 per USD has remained stable. In practice the tourism industry appears to be supplying sufficient quantities of foreign exchange at a stable premium over the official exchange rate.

Data constraints continue to prevent poverty monitoring since the last survey conducted in 2009-10. However, the recent release of Census 2014 data provides interesting insights on inter-censuses labor market trends. Overall, labor market participation of Maldivian resident population improved, with a notable increase in the share of women actively participating in the labor market, which went from 41.4 percent in 2006 to 47.6 percent in 2014. Unemployment rate among Maldivian resident population remains low at 5.2 percent, although much higher rates prevail among youth. Of particular concern, youth unemployment increased from 9.3 percent in 2006 to 12.4 percent in 2014, with skill mismatch and lack of local economic opportunities being reported as the main cause for unemployment.

Outlook

In the near term, growth is expected to be driven by construction, fueled by both private sector construction and large public investment projects, while tourism growth is likely to remain subdued because of a slowdown in China, the recession in Russia and, the appreciation of the MVR (pegged against the USD) against major currencies. Inflation is projected to remain subdued as long as global commodity prices remain low, with positive impacts on the current and fiscal accounts.

The large increase in capital investment will return the risk of external debt distress to high. Driven by a fiscal deficit reaching close to 20 percent of GDP by 2018, public debt would rise fast and could exceed 120 percent of GDP by 2020, while external public debt would breach the policy-dependent thresholds defined under the Low-Income Country Debt Sustainability Framework (LIC-DSF).

A sequenced implementation of investment projects with a more limited fiscal deficit could mitigate this risk to some extent. This scenario would limit the fiscal

deficit and could keep the public debt-to-GDP ratio below 100 percent.

In March 2016, the National Statistics Bureau has started the field work operations for a new Household Income and Expenditure Survey (HIES 2016) which is expected to be completed by the end of the year. The availability of new household survey data will allow the production of new estimates and an updated poverty assessment in 2017.

Risks and Challenges

The immediate macroeconomic challenge is the fiscal and external imbalances driven by high and rising public spending. The projected fiscal consolidation is not enough to bring public debt-to-GDP on a declining path and fiscal consolidation by raising revenue and reducing expenditure will be needed. Limited reserves, a high level of public debt and the short maturity of domestic debt adds additional vulnerability.

Meanwhile, continued domestic political unrest and a slowdown in major tourism-providing countries (China and European countries) might lead to further reductions in tourism visits, which could put pressure on growth, revenue and the balance of payments.

There are limited investment opportunities in the private sector outside tourism, and banks prefer to park their available assets at the central bank and abroad.

