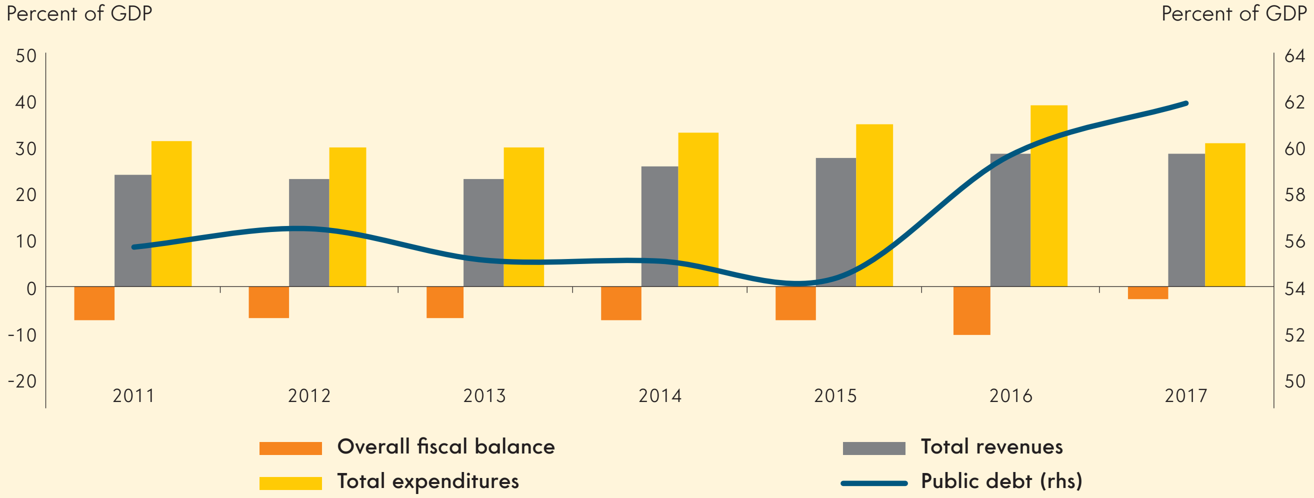
Maldives

Growth and a pick-up in tourism are expected to continue to drive growth. The government has succeeded in containing current fiscal expenditure to create space for capital expenditure, but the level of public debt is projected to rise further and foreign exchange reserves recovered slightly but are still low. A 45-day state of emergency from February 5 to March 22 led to arrests, protests and widespread travel advisories. While the impact on tourism is not yet clear, it may have a negative impact on growth, fiscal revenue and the current account. Meanwhile, Presidential elections in September will add further uncertainty.

	2017
Population, million	0.4
GDP, current US$ billion	4.6
GDP per capita, current US$	10468

Source: World Bank WDI.

Fiscal balance and debt level



Source: Ministry of Finance and Treasury and World Bank estimates.
Note: (rhs) = right hand side.

Recent economic developments

Construction has been the main driver of growth, growing at an average of 19 percent in 2015-17. After peaking at 10.1 percent growth in 2013, the tourism sector slowed down between 2014 and 2016, due to a slowdown in tourist arrivals especially from China and Russia. Tourism bed night growth started to recover in 2016 and reached 10.8 percent in 2017. Bank staff estimates that real GDP growth in 2017 remained around 6.2 percent as in 2016, below the government's projection of 6.9 percent.

CPI inflation increased from below 0.5-1 percent in 2015 and 2016 to 2.8 percent in 2017, reflecting the partial removal of food subsidies and the pass-through of rising electricity prices. It is expected that fast price rises of food and beverages (5.6 percent in 2017) and of rents (4.6 percent) has hit Maldivian households particularly hard. Inflation was higher in the atolls, with food prices rising even more significantly. This may have affected poor households even further, since the uptake of the cash transfer to compensate for the partial removal of the food subsidies was limited so far.

The current account deficit widened sharply from 3.2 percent in 2014 to an estimated 21.4 percent of GDP in 2017, driven by the large increase in investment-related

imports, with FDI inflows reflecting investment into opening 13 resorts in 2017, and project loan disbursements into large infrastructure projects. Thanks to a USD 250 million sovereign bond issuance, gross official reserves recovered from USD 467 million at end-2016 to USD 586 million at end-2017, although usable reserves (after netting out short-term foreign currency liabilities to domestic banks) are only USD 206 million, equivalent to 1.1 months of goods imports.

The government has made progress in rebalancing fiscal expenditure to accommodate increased capital expenditure. The fiscal balance shifted from a 10.6 percent of GDP deficit in 2016 to a 2.5 percent of GDP deficit in 2017, driven mainly by a reduction in public investment from 10.9 percent of GDP in 2016 to 8.2 percent of GDP 2017, and a reduction in spending on food subsidies and on the Aasandha health care system. Excluding the Public Sector Investment Program, the underlying current fiscal balance went from a deficit of 2.0 percent of GDP in 2015 to an estimated surplus of 5.7 percent of GDP in 2017, reflecting revenue increases and current expenditure reforms.

Public debt excluding guarantees is estimated to have reached 61.9 percent of GDP, an increase from 59.7 percent of GDP in 2016, driven by external projected-related borrowing and the sovereign bond, while domestic T-bills were redeemed.

Outlook

In the baseline scenario, growth is expected to be driven by construction and by tourism arrivals, facilitated by the opening of new resorts in 2017. The current account is projected to narrow gradually to 19.3 percent of GDP by 2020 as new capital investment projects are gradually tapering off. Reserve coverage is projected to remain weak. Despite the one-off impact of promised civil service wage increases, the fiscal deficit is projected to narrow gradually as public investment projects are tapering off. Public debt is projected to rise to 2020 and peak soon after. The recent World Bank-IMF Debt Sustainability Analysis assessed Maldives' risk of external debt distress as high, due a widening current account deficit, low international reserves, pipeline of guarantees, and rapid debt buildup.

However, the immediate outlook is highly uncertain given the probable impact of the February-March state of emergency on the tourism and non-tourism sector, which may not be visible in the data immediately. Widespread travel advisories may lead to cancellations affecting the tourism sector. If a significant negative shock to tourism bed nights materializes, it may lead to a reduction in fiscal revenue, tourism exports and activity in the tourism and ancillary sectors. This may require a fiscal adjustment to rebalance the fiscal accounts and the balance of payments.

A reduction in tourism may also likely have a negative impact on employment, as Maldivians face strong competition from a relatively cheaper foreign workforce for low-skilled jobs and a relatively better educated foreign workforce for high-skilled jobs. The Maldives face other risks that may impact macroeconomic stability. Other risks stem from exogenous factors such as a downturn in global economy, concerns about global terrorism, health pandemics, or natural disasters that may also impact tourism. Another is a risk of increasing global commodity prices (for example, fuel prices) that can impact the economy given its heavy reliance on imports. There is also a concern about fiscal slippages, especially due to delays in controlling current expenditure and the realization of contingent liabilities through guarantees.

Risks and challenges

The immediate challenge is dealing with the macro-fiscal impact of the state of emergency and travel advisories. Structural challenges include improving medium-term fiscal sustainability by addressing key expenditure drivers in the budget. These include increasing the efficiency of spending on Aasandha and replacing the electricity subsidies by a targeted cash transfer to help poor families pay electricity bills. It is also important to improve budget credibility by making ministry and agency budget ceilings binding.

The recent public-sector employment freeze was positive from a fiscal perspective. However, it may put pressure on the absorption capacity of the Maldivian labor market, since public sector employment is the main sector of employment of 25 to 64-year-old Maldivians, and the working age population is increasing. It is critical to foster private sector job creation, since the main drivers of growth, construction and resort tourism, are highly reliant on foreign labor.

In this context, the consolidation of population from vulnerable islands and atolls to larger islands in Greater Malé, while also reducing pressure on Malé, is a country priority. If successful, it may eventually allow for new forms of economic activity in line with the aspirations of Maldivian youth and provide employment, improve the quality of public services such as health and education, and make the country more resilient to climate change.

	2015	2016 (est)	2017 (f)	2018 (f)	2019 (f)	2020 (f)
Real GDP Growth, at Constant Market Prices	2.2	6.2	6.2	5.5	4.5	4.9
Real GDP Growth, at Constant Factor Prices	2.8	6.0	6.2	5.5	4.5	4.9
Agriculture	-0.5	1.4	0.6	0.2	0.0	0.1
Industry	16.5	15.1	10.4	17.3	15.3	13.5
Services	1.4	5.2	5.9	4.1	3.0	3.6
Inflation (Consumer Price Index)	1.0	0.5	2.8	2.8	3.0	3.0
Current Account Balance (percent of GDP)	-7.6	-24.4	-21.3	-19.8	-19.5	-19.3
Net Foreign Direct Investment (percent of GDP)	7.5	10.8	15.8	8.6	6.8	6.5
Fiscal Balance (percent of GDP)[a]	-7.1	-10.6	-2.5	-5.2	-4.8	-4.0
Debt (percent of GDP)[a]	54.4	59.7	61.9	63.3	64.7	65.0
Primary Balance (percent of GDP)	-4.9	-8.8	-0.8	-3.1	-2.7	-2.0

Source: World Bank.
Note: (est) = estimate, (f) = forecast.
(a) A large volume of expenditure was recorded in 2016, but the bills were settled with funds borrowed in 2017, which has led to a significant discrepancy been fiscal and debt numbers. It has been recorded as an additional positive financing item of 2.4 percent of GDP in 2016 (bills and arrears carried over) and a negative financing item of 3.1 percent of GDP in 2017 (bills and arrears clearance).