Maldives

Recent Economic Developments

Real GDP grew by 3.7 percent in 2013, driven by tourism and related sectors. Though a lackluster performance, it was something of a rebound from the precipitous dip to 1.3 percent in 2012, from an average of 6.5 percent over the preceding five years.

Tourism, the mainstay of the Maldives economy, has lost momentum, growing at 9.7 percent y-o-y in Q1 2014—almost 5 percentage points slower than in Q1 2013. This gives cause for concern as tourism, with linkages across sectors such as transport, communications, and construction, accounted for an estimated 60 percent of the economy in 2013. The tourist composition has undergone a structural shift from mainly European to Chinese and Middle Eastern tourists. The average length of stay and spending has fallen steadily since 2008.

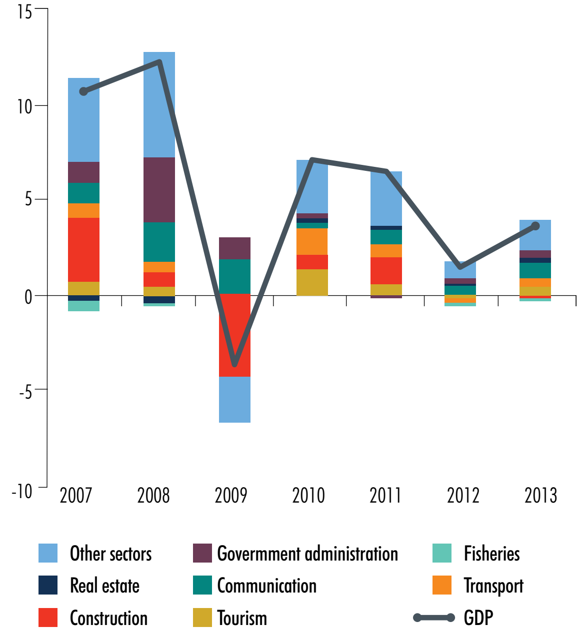
Growth has been less inclusive, since the agriculture and fisheries sector, which provide the majority of employment in the outer atolls, are only weakly linked to the tourism sector. These sub-sectors employ the largest proportion of Maldivians in the outer atolls, but contributed only 3.2 percent of GDP in 2013.

In the services sector, communications (10.3 percent of 2013 GDP) grew by 7.6 percent; transport (9.3 percent of GDP) grew by 5.1 percent. Manufacturing declined by 5.3 percent and construction by 2.1 percent, resulting in a 1.2 percent contraction in the secondary sector.

Inflation moderated to 4 percent of GDP in 2013, from 10.9 percent in 2012, and continued to fall in the first quarter of 2014, driven by the decrease in the government controlled price of fish and vegetables.

The fiscal deficit was around 10 percent of GDP in 2013, and the trend continued in Q1 2014 with expenditure outgrowing revenue by a wide margin. Although Maldives has the highest revenue-to-GDP ratio in South Asia, it is spending beyond its means, leading to persistent fiscal imbalances. The government has resorted to extraordinary means to finance the

GDP Growth Breakdown (% & share of total)



deficit, such as building up arrears, monetization, and ad hoc borrowings from the banking and private sectors at high interest rates.

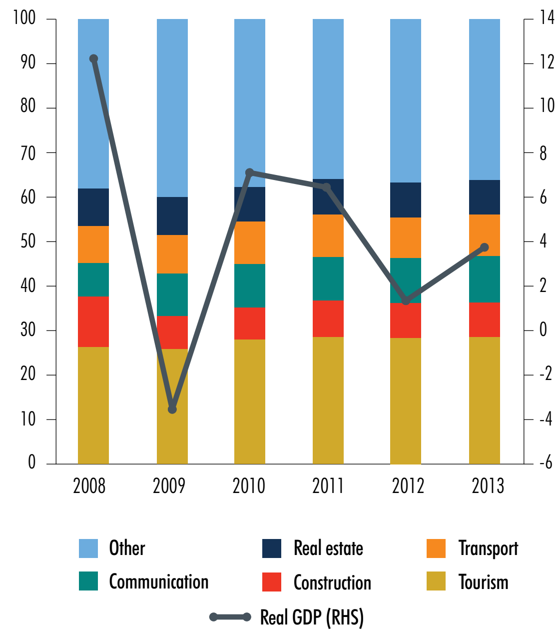
The current account has been persistently in deficit around 20 percent of GDP (despite the authorities having lowered it to a still-high 10 percent of GDP). Although the goods trade deficit is roughly offset by tourism revenue, net income outflows (such as dividends and interest payments on external debt) and remittance outflows lead to an overall structural current account deficit.

The Maldives is considered to be at high risk of external debt distress with the total public and publically-guaranteed debt level reaching 78 percent of GDP at end-2013. A large share of this is in Treasury bills yielding 7 percent.

While Maldives has reduced poverty over the past two decades, poverty and inequality are on the rise again in Male, the capital island city. With improved living conditions other atolls have been more successful in reducing poverty and vulnerability.

Maldives has made great progress in primary and lower-secondary education access and gender parity. Improving the quality of education remains a major challenge, especially in the context of providing technical, management and soft skills. The lack of these skills has contributed to high youth unemployment.

Tourism and Related Sectors (% of total and %)



The overall business environment ranks highly against other South Asian countries, but performance in uneven with low ranks, particularly in registering property, trade logistics, and access to electricity.

The Maldives remains vulnerable to environmental threats such as climate change and solid waste management.

Outlook and Policy

GDP growth is projected to rise to 4.5 percent in 2014 with likely improved performance by construction and the transport industry compensating for the slowdown of tourism. Inflation is likely to remain moderate due to stable international prices.

The immediate macroeconomic challenges for Maldives are the fiscal and external imbalances driven by high and rising public spending that lead to high debt, limited fiscal space and depleted reserves, and an undiversified economy, primarily dependent on tourism and fisheries. The path towards fiscal and debt sustainability will require short-term measures to address the current cash crunch, as well as long-term structural measures that are important but will entail political and social costs. An array of measures could be combined in a policy package accompanied with a communication strategy to sensitize the public on the need to adopt and implement these reforms.

The current account is at risk of further deterioration owing to the large remittance outflows. This is indirectly related to the public spending structure of the government that focuses largely on wages, benefits, and transfers that raise reservation wages, and fails to invest in quality education—policies that both lead to increased reliance on expatriates.

Inflationary pressures are expected to remain subdued in 2014 because of high dependence on imports (58 percent of the CPI basket) in a relatively stable international price environment. While the deficit on goods is projected to be sufficiently compensated by the service account surplus, particularly tourism receipts, the current transfers balance is projected to be in deficit due to the large outflow of remittance. An improvement of the trade balance seems unlikely following the import expansion by 15.6 percent, y-o-y, between January and July and a dramatic contraction of exports by 13 percent.

With the rise of private credit growth, increased demand looks likely to further pressure the trade balance through an increase in imports. Exports on the other hand, dominated by fish exports and re-export of jet fuel, are highly seasonal, and with the 13 percent contraction, y-o-y, in both domestic and re-exports between January and July 2014, the external sector does not display an optimistic outlook.