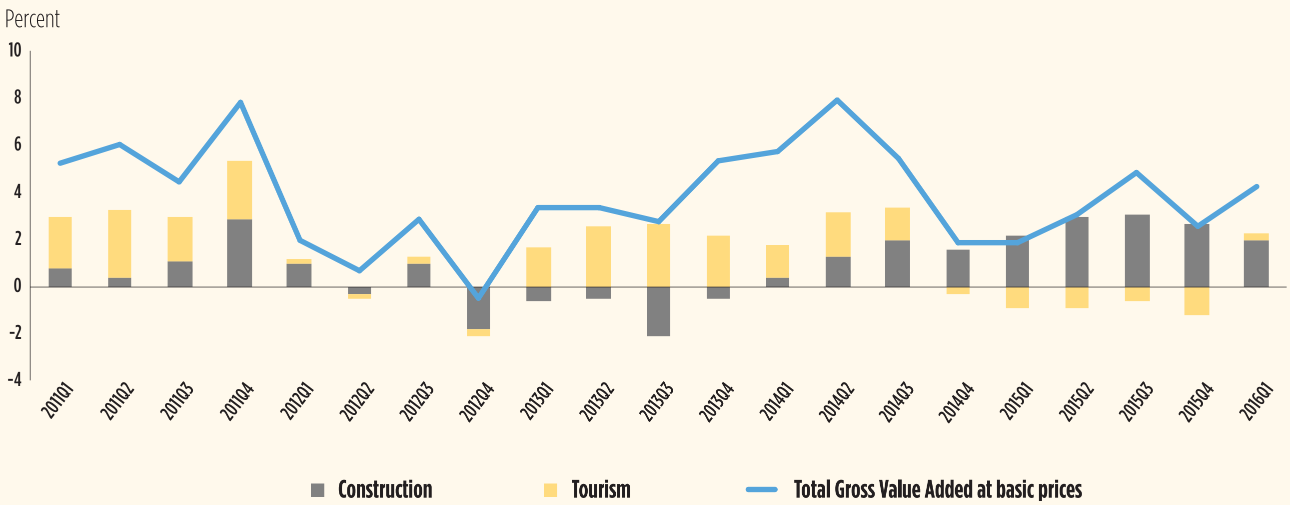
Maldives

Construction has taken over tourism as the main driver of growth since late 2014, the latter affected by a decline in tourist arrivals from Russia and China. The medium-term fiscal plan is anchored by large multi-year public investment projects. Given the lag between infrastructure spending and its growth impact, public debt situation is expected to deteriorate in the medium-term—raising the risk of external debt distress to high. A more gradual fiscal expansion and prioritization of investment projects are needed to lift growth to a moderate level while maintaining macroeconomic stability.

	2015
Population, million	0.4
GDP, current US$ billion	3.1
GDP per capita, current US$	7630.9

Sources: World Bank WDI and Macro Poverty Outlook.

Contributions to GDP Growth



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

Recent Developments

After peaking at 6.5 percent in 2014, growth is expected to decelerate to 1.9 percent,[1] dragged down by a slowdown in tourist arrivals, especially from Russia and China. While tourism is still the single largest sector, construction has overtaken tourism as the most important driver of growth, fueled by a surge in both public and private investments.

Following the global decline in commodity prices, CPI inflation has trended downward since 2013, and became negative in April 2016 (year-on-year), dragged down by food (mainly fish) prices, housing, water, electricity, gas and other fuel prices and transport 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 the high costs of public service delivery is inevitable in a multi-island country with scattered population, high levels of public spending in recent years have been primarily driven by 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.

Based on current trends, staff estimates that revenue and public spending have increased to 36 and 44 percent of GDP respectively in 2015, resulting in a fiscal deficit of 8.4

1 Staff projections. The official final macroeconomic numbers for 2015 are not yet available. The Maldives Monetary Authority monthly bulletin of August 2016 published preliminary estimates for GDP growth, the fiscal deficit and the current account deficit for 2015. Until these numbers are final, staff estimates for 2015 are used in this analysis.

percent of GDP. While, net external financing has been negative in 2014 and 2015, heavy reliance of domestic sources of financing has increased the exposure of the domestic banking system to sovereign risk. In response to fast rising domestic interest rates, Treasury bill auctions were replaced by a "tap system" fixing interest rates at low levels in mid-2014.

2016 fiscal policy is expansionary with large public investment projects. Staff projects revenue to reach 35.6 percent of GDP and expenditure 48.9 percent of GDP. Wages are projected to be frozen in nominal terms, while the budget foresees significant reduction 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.

The slowdown in tourism in 2015 has led to a decline in net service exports. While the import bill of petroleum products declined thanks to low global commodity prices, it was partially offset by increased imports of transport equipment and building materials driven by the construction boom. The current account deficit is estimated at 8.8 percent of GDP, financed by strong FDI inflows into the tourism sector. Gross official reserves reached USD 623 million by July 2016, although usable reserves[2] are only USD 209 million—equivalent to 1.2 months of imports of goods and services. But this is less of a concern than it may appear, since the tourism industry has been able to supply sufficient quantities of foreign exchange at a stable premium over the de facto fixed exchange rate of 15.4 rufiyaa per dollar.

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, 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.

2 Net of short-term foreign liabilities of the central bank to the banking sector.

Table: Maldives (annual percent change unless noted otherwise)

	2013	2014	2015 p	2015 e	2016 f	2017 f	2018 f
Real GDP growth, at constant market prices	4.7	6.5	2.1	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	3.5	...	...	...	...
Agriculture	5.1	0.2	-2.9	...	...	...	...
Industry	-7.6	12.9	26	...	...	...	...
Services	6.4	5	-0.1	...	...	...	...
Inflation (Consumer Price Index)	2.3	2.1	1.0	0.4	1.3	2.5	2.8
Current Account Balance (% of GDP)	-4.6	-3.9	8.8	-8.0	-7.7	-11.7	-14.6
Financial and Capital Account (% of GDP)	2.6	17.8	11.4	6.7	9.7	16.8	17.7
Net Foreign Direct Investment (% of GDP)	13.0	10.9	9.6	10.6	10.0	10.9	10.8
Fiscal Balance (% of GDP)	-7.4	-9.1	-6.9	-8.5	-13.0	-13.8	-11.9
Debt (% of GDP)	64.8	66.6	63.9	72.1	81.9	91.0	96.9
Primary Balance (% of GDP)	-4.9	-6.3	-4.4	-5.5	-10.5	-10.5	-7.7

Source: Maldives Monetary Authority, Ministry of Finance and Treasury, World Bank staff estimates for 2015 and forecasts for 2016-2018.
Note: p = preliminary estimate published in MMA bulletin, e = World Bank estimate, f = World Bank forecast

The planned large increase in front-loaded capital investment has increased the risk of external debt distress to high according to the most recent Debt Sustainability Analysis.[3] A more gradual implementation could mitigate this risk but without additional expenditure and revenue measures this could still lead to fiscal deficit of close to 14 percent of GDP with the public debt-to-GDP ratio approaching 100 percent.

Risks and Challenges

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

Meanwhile, political risks and a slowdown in countries important for tourism could lead to further reductions in tourism visits, which will 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. .

3 Joint World Bank-IMF Debt Sustainability Analysis, included in the IMF Article IV report of May 2016.