

# Maldives

*Economic growth continued its recovery from the 2012 dip, while inflation has slowed down, although recent political developments present a downside risk. The dominant tourism industry is operating on an enclave model of development, while fisheries, with largest share of employment, is only weakly linked. The challenges are fiscal and external imbalances driven by large and rising public spending leading to high debt, limited fiscal space and depleted reserves, and an undiversified economy, which primarily depends on tourism and fisheries.*

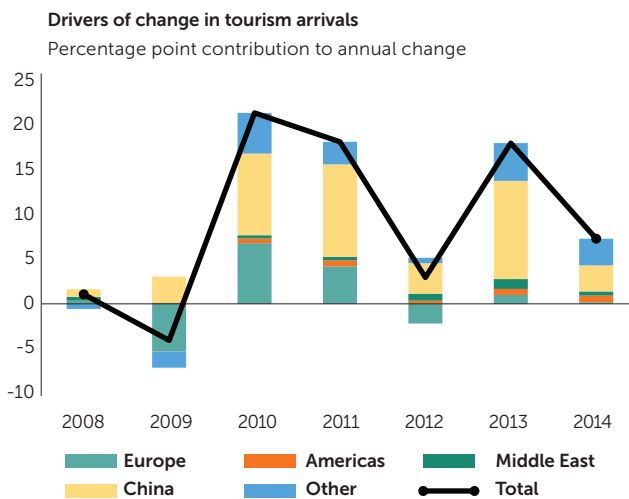
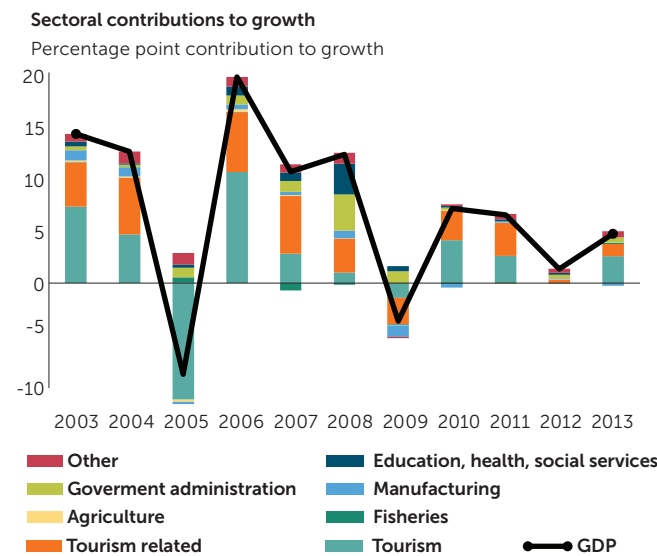
## Recent economic developments

Economic growth in 2014 is estimated to amount to 5.0 percent,<sup>1</sup> continuing the recovery in growth since hitting 1.3 percent in 2012. This is lower than the government's provisional full-year estimate of 6.8 percent, which was published in October. The main determinant of this estimate is the sharp slowdown in the growth in tourism bed-nights in November and December 2014, partly caused by the water crisis in Malé. Most other service sectors are estimated to have grown as well in 2014, while the industrial sector expanded by 13.2 percent in 2014. However, the agriculture and fisheries sector is estimated to have contracted by 2.1 percent in 2014 vis-à-vis a growth of 5 percent recorded in 2013.

Annual average inflation moderated even further in 2014, falling to 2.4 percent in 2014, down from 4.0 in 2013 driven by low food prices and international crude prices. The fall is particularly steep considering the double digit 10.9 percent inflation recorded only in 2012. As measured by the overall consumer price index (CPI) inflation in Malé has been unstable since 2009 with fluctuations large in magnitude. This decline was primarily driven by a slow growth of food and non-alcoholic beverages which grew at a slow pace of 1 percent in 2014 as opposed to 7.5 percent in 2013. During the second half of 2014, inflation fell even further driven largely by the drop in food prices.

In 2014 the fiscal deficit widened further to projected 11.6 percent of GDP in 2014. Despite high revenue of 32.4 percent of GDP, Maldives is spending beyond its means reaching 44 percent of GDP, leading to persistent fiscal imbalances. Driven by expenditure the

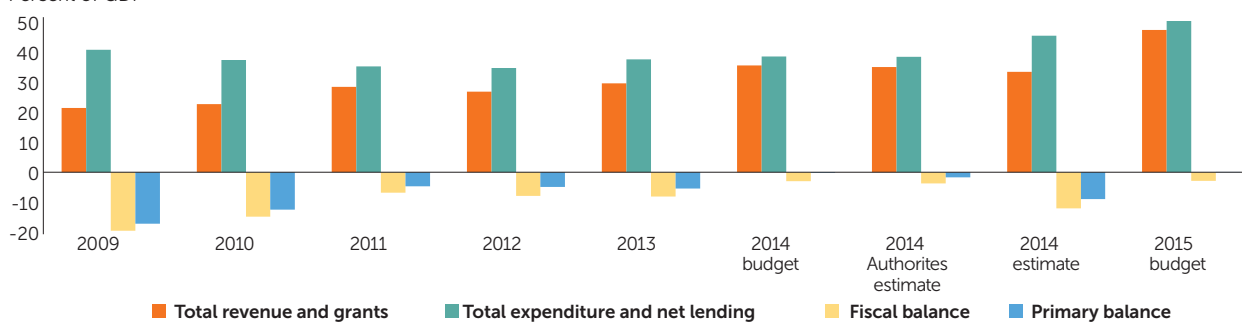
<sup>1</sup> Data for 2014 and projections are in line with the projections in the joint Bank-Fund LIC-DSA and the IMF Article IV of January 2015; World Bank staff estimates.



Source: National Bureau of Statistics, MMA, staff calculations

Fiscal accounts, actuals, budget and estimates

Percent of GDP



Source: MoFT, MMA, IMF, staff calculations

fiscal deficit has been on an upward trajectory since 2011 and is estimated at 11.6 percent of GDP in 2014 from 7.8 percent of GDP in 2013, despite a budgeted deficit of only 2.8 percent of GDP. Subsidies, transfers and social welfare payments contributed substantially to the expansive spending. It should be noted that the authorities project the fiscal deficit in 2014 at only 3.4 percent of GDP.

**Although the country's risk of external debt distress has been reduced from high to moderate, overall public debt is high at 74.6 percent of GDP in 2014, and subject to vulnerabilities.** Meanwhile, the persistent current account deficit has led to an increasing level of external debt. Thanks to data revisions and a more favorable outlook, the country's risk of external debt distress has been reduced from high (2013 DSA update) to moderate. Although the level of external public and publicly guaranteed debt remains below the policy-dependent thresholds under the baseline, a shock to tourism exports could make it difficult for the country to service its external debt.

**The external accounts look much better thanks to a revision of balance of payments numbers.** Goods imports and tourism services exports nearly balance each other out, but substantial outflows through interest payments, dividends and remittances keep the current account in a deficit at 8.0 percent of GDP. The current account is more than fully financed by Foreign Direct Investment (FDI), and gross international reserves are estimated to have increased. Net FDI inflows are estimated at 13.3 percent of GDP.

**While usable reserves are estimated at less than half a months of imports, the private sector is able to supply sufficient quantities of foreign exchange.** As a result of the large improvement in net capital inflows, gross official reserves have increased from USD 368 million at end-2013 to USD 614 million at end-2014,

covering 2.8 months of imports of goods and services. However, net usable reserves remain low at USD 120 million, covering less than a month of imports. Faced with limited investment opportunities in the private sector, banks are parking their assets elsewhere; meanwhile financial soundness indicators have been improving

## Outlook

**Going forward growth is projected to remain at 5 percent in 2015, supported by tourism arrivals, while additional fiscal adjustment may have a negative impact on growth.** The 2015 budget foresees an ambitious fiscal consolidation mostly by increasing one-off revenue and planning a fiscal consolidation. Inflation is projected to remain subdued as global commodity prices are expected to remain low. Lower commodity prices will also benefit the current and fiscal accounts.

**Domestic and external risks remain.** Recent political developments may lead to travel advisories and reductions in tourism. The country remains vulnerable to external shocks, especially to tourism and global commodity prices. SOEs may pose further risks to fiscal sustainability, as most are loss-making and depend on government support, with only nine companies having contributed dividends to the budget in the last four years.

## Challenges

**The immediate macroeconomic challenge is the fiscal and external imbalances driven by high and rising public spending.** However, the economy also remains undiversified and sources of growth and employment remain misaligned. Besides, Maldives' form of tourism-led growth has followed an enclave model, reliant on imported goods, labor and finance.