INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/357

MALDIVES

December 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALDIVES

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with Maldives, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its October 20, 2017 consideration of the staff report that concluded the Article IV consultation with Maldives.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on October 20, 2017, following discussions that ended on July 18, 2017, with the officials of Maldives on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 6, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for Maldives.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

Press Release No. 17/443
FOR IMMEDIATE RELEASE
November 16, 2017

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation with Maldives

On October 20, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation[1] with Maldives.

Maldives' economic growth has been highly volatile, driven primarily by high-end tourism and construction. The economy grew by 3.9 percent in 2016 and continues to improve in 2017 on a recovery in tourism and a continued strength in construction but faces large and growing imbalances. The fiscal deficit widened in 2016 driven by lower-than-expected revenue and large arrears clearance despite unchanged current spending. Public debt as a share of GDP rose nearly 11.5 percentage points from 2014-16. Monetary policy remains accommodative and private sector credit has grown rapidly, led by the housing and construction. Headline inflation continued to decline in 2016 (period average) and is projected to remain low with some lift from the subsidy phase out. The current account deficit widened sharply to 19.6 percent of GDP in 2016, due to increased infrastructure-related imports, moderating tourism receipts, higher remittance outflows, and a large one-off court mandated payment.

The outlook is for a strengthening recovery in the near term, with low inflation, loose financial conditions, but with significant downside risks from a fragile fiscal and external position. Growth is projected to recover in 2017 and stabilize over the medium term, benefitting from the infrastructure scale up, continued recovery in Europe, and favorable short-term and long-term tourism trends. Both the fiscal and current account deficits are projected to gradually decline over the medium term, after widening in 2016, as infrastructure spending winds down. The main challenge remains one of balancing a surge in infrastructure investment that has the potential of transforming the economy against the continuing risks stemming from high and increasing public debt.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors welcomed that the Maldives economy has been improving supported by recovery in tourism and construction and that the medium-term outlook is positive. Directors noted, however, that the rapid buildup in debt, widening current account deficit, and low international reserves amid limited policy space pose difficulties. They emphasized that policy priorities should focus on balancing the large infrastructure investment, reducing fiscal and external deficits, building adequate reserves, and undertaking reforms to enhance longer-term growth potential.

Directors emphasized that decisive fiscal adjustment is needed to restore fiscal and debt sustainability and reduce external imbalances. They underscored that consolidation efforts should focus on implementing revenue measures, containing current spending, and prioritizing investment projects. Recognizing that increased infrastructure investment has the potential to transform the economy, they encouraged the authorities to carefully assess the risks of excessive debt. Directors welcomed the intention to introduce user fees for key infrastructure and the steps being taken to recover tax arrears. They highlighted that strengthening public financial management, including by developing an annual borrowing plan as part of the approved medium-term debt strategy, is critical for supporting fiscal sustainability. Directors encouraged the authorities to rely more on concessional financing.

Directors viewed the stabilized exchange rate arrangement as appropriate. They took note of the weakening external position and agreed that strong fiscal adjustment, combined with a tighter monetary stance and more flexibility in the pegged regime, could better support the peg and help build foreign reserves.

Directors noted that support from monetary and financial policies would be important to help stabilize the external position. They recommended a gradual tightening of the monetary stance so as not to impede credit in support of economic growth. Directors welcomed the authorities' efforts towards fostering financial inclusion and improving the regulatory environment.

Directors recognized the continued efforts to increase investments to address climate change, reduce congestion, and lower costs for providing basic services given the geographical challenges. Structural reforms to expand investment in electricity generation, renewable energy, and waste management would support growth, energy sufficiency, and long-run environmental sustainability. Directors also encouraged integrating risk-reduction and disaster-response programs into the core budget and public investment planning to better address climate change adaptation. Efforts should also continue to improve the accuracy and timeliness of national statistics.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Table 1. Maldives: Selected Economic Indicators, 2014–22 (Baseline Scenario)

Population (in 1,000; 2015)	348
GDP per capita (in U.S. dollars; 2015):	11,544
Quota (in million SDRs, Feb 2016):	21.2

	2014	2015	2016	2017	2018	2019	2020	2021	2022
			Est.	Proj.					
Output and prices	(Annual percentage change)								
Real GDP	7.6	3.3	3.9	4.6	4.7	4.8	5.0	5.0	5.0
Inflation (end-of-period) 1/	1.2	1.2	1.8	2.1	2.2	2.2	2.4	2.4	2.6
Inflation (period average) 1/	2.5	1.4	0.8	2.5	2.1	2.2	2.4	2.4	2.5
GDP deflator	4.5	5.3	1.6	2.0	2.0	2.0	2.4	2.5	2.5
Central government finances	(In percent of GDP, unless otherwise indicated)								
Revenue and grants	26.7	27.7	28.4	28.7	28.6	28.3	28.4	28.5	28.6
Expenditure and net lending	34.1	34.5	38.7	36.6	35.7	34.7	34.3	33.9	32.9
Overall balance	-7.4	-6.8	-10.3	-8.0	-7.1	-6.3	-6.0	-5.3	-4.3
Overall balance excl. grants	-7.7	-7.8	-10.6	-8.2	-7.4	-6.5	-6.2	-5.5	-4.4
Primary balance	-5.1	-4.6	-8.2	-5.8	-4.6	-3.3	-2.6	-1.9	-0.9
Current primary balance	-0.1	1.8	5.2	6.3	5.7	4.7	4.9	5.4	5.8
Public and publicly guaranteed debt	54.2	56.9	65.7	69.4	72.0	73.5	74.3	74.3	73.2
Monetary accounts	(Annual percentage change, unless otherwise indicated)								
Broad money	14.7	12.3	-0.2	9.6	9.7	9.9	10.5	10.6	10.6
Domestic credit	4.7	15.7	19.5	7.1	5.2	5.3	7.1	7.8	7.8
Balance of payments	(In percent of GDP, unless otherwise indicated)								
Current account	-3.2	-7.3	-19.6	-17.2	-17.0	-16.4	-14.3	-12.9	-10.3
Of which:									
Exports	8.1	6.0	6.0	6.3	6.6	6.9	7.2	7.5	7.6
Imports	-53.1	-47.2	-49.5	-52.5	-53.8	-52.8	-51.2	-50.4	-47.4
Tourism receipts (in nonfactor services, net)	73.0	63.9	59.3	59.3	59.2	59.1	59.4	59.7	60.0
Income (net)	-9.6	-8.1	-8.6	-8.9	-9.2	-9.3	-9.5	-9.6	-9.7
Current transfers	-8.3	-8.6	-15.0	-8.5	-8.5	-8.5	-8.5	-8.5	-8.6
Capital and financial account (including e&o)	10.1	6.1	17.4	19.4	18.0	17.0	15.3	13.7	9.9
Of which:									
General government, net	-0.5	-0.1	3.1	7.6	3.5	3.7	3.4	3.2	-0.5
Banks and other sectors, net	6.7	1.7	3.3	4.1	4.1	3.9	3.7	3.6	3.4
Overall balance	6.8	-1.2	-2.2	2.1	1.0	0.6	1.0	0.8	-0.4
Gross international reserves (in millions of US$; e.o.p.) 2/	615	546	468	564	614	645	703	751	724
In months of GNFS imports	2.7	2.4	1.8	1.9	1.9	1.9	2.0	2.0	1.9
Memorandum items:									
GDP (in millions of rufiyaa)	56,867	61,869	65,310	69,648	74,349	79,488	85,446	91,932	98,913
GDP (in millions of U.S. dollars)	3,690	4,015	4,238	4,520	4,825	5,162	5,545	5,966	6,419
Tourism bednights (000')	7,290	6,977	7,138	7,460	7,795	8,154	8,602	9,076	9,575
Tourist arrivals (000')	1,205	1,234	1,286	1,356	1,417	1,483	1,564	1,650	1,741
Tourism bednights (% change)	3.3	-4.3	2.3	4.5	4.5	4.6	5.5	5.5	5.5
Tourist arrivals (% change)	7.1	2.4	4.2	5.5	4.5	4.6	5.5	5.5	5.5
Dollarization ratio (FC deposits in percent of broad money)3/	53.8	50.6	47.7 3/						

Sources: Maldivian authorities; and preliminary IMF staff estimates and projections based on the 2017 Staff Visit.

1/ CPI-Male definition.

2/ MMA liabilities, include allocation of SDR 7.4 million, equivalent to US$11.7 million, made available in Q3 2009, see http://www.imf.org/external/np/tre/sdr/proposal/2009/0709.htm. These are treated as long term liabilities of the MMA.

3/ Data for 2016 Jan-Nov.

INTERNATIONAL MONETARY FUND

MALDIVES

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

October 6, 2017

EXECUTIVE SUMMARY

Context: Maldives' economic growth has been highly volatile, driven primarily by a high-end tourism industry. The economy improved marginally in 2016–17 on a recovery in tourism and construction but continues to face large and growing fiscal and external imbalances. Going forward, Maldives' main challenge is to manage a surge in infrastructure investment which has the potential of transforming the economy but also creating risks from high and rising public debt. The rapid debt buildup, a widening current account deficit, and low international reserves leave the Maldives inherently vulnerable under this constellation of risks and reduced policy space.

Policy advice: To address these vulnerabilities and promote sustained growth, the policy priorities should be to reduce fiscal and external deficits, build adequate FX reserves, develop the financial sector and enhance longer-term growth potential through structural reforms.

- **Fiscal policy.** Policy tightening is urgently needed to restore fiscal sustainability and reduce external imbalances. Fiscal policy should focus on implementing revenue measures, containing current spending, and prioritizing investment projects. To contain fiscal risks, the medium-term fiscal framework should also be strengthened.

- **Monetary, financial and external policies.** The external position is substantially weaker than implied by medium-term fundamentals and desirable policy settings. Higher reserve coverage is needed to guard against risks from slowing tourism receipts and increased non-concessional borrowing. Monetary policy should be tightened to support the buildup of reserves and the stabilized exchange rate arrangement. Over time, a gradual move toward an import-weighted currency composite would also improve external competitiveness. Financial policies should focus on increasing financial access and inclusion for households and SMEs.

- **Sustainable growth and long-run resilience.** Reforms to expand investment in electricity generation, renewable energy, and waste management would support environmental sustainability and energy sufficiency and help address climate change.

Approved By
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Discussions took place in Malé during July 5-18. Staff representatives comprised Philippe Karam (head), Jayendu De, Kyungsuk Lee (APD), Kirthisri Wijeweera (APD, Resident Representative Office), and Eteri Kvintradze (Resident Representative, Sri Lanka and Maldives). Maya Choueiri (OED) joined the discussions.
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THE MALDIVES AT A CROSSROADS

A. The Macroeconomic Context

1. **Maldives is undergoing a massive infrastructure expansion which has the potential to transform the economy.** Expansion of the international and regional airports, major regional hub development and land connectivity in the Greater Malé area, and investment in harbors, sewerage systems and desalination plants are set to increase tourism and demand for ancillary services. This will also support population resettlement, reduce government service cost, and ease congestion. However, this investment surge has added considerably to the already elevated public debt and external financing risks. Banks and other financial institutions also have large exposures to the construction and government sectors.

2. **This year's Article IV consultation focused on policies to mitigate risks arising from the infrastructure surge and position the Maldives in the long-term for sustained growth.** Macro and financial policies should be aligned to restore fiscal sustainability and safeguard financial stability. A tighter fiscal-monetary stance is needed to support the peg and rebuild FX reserves. Structural policies should encourage economic diversification ideally within a multi-year National Development Strategy (NDS) Plan.

3. **The authorities face a tense political and external situation which could complicate reforms**. In October 2016, Maldives withdrew from the Commonwealth citing 'unfair and unjust' treatment by the Commonwealth which had expressed concerns over governance and rule of law. More recently, Maldives severed its diplomatic ties with Qatar. Both events have had little economic repercussions thus far. The domestic political situation remains tense and unpredictable following the loss of the President's Progressive Party of Maldives in the local elections in May.

B. Recent Economic Developments

4. **Revised historical GDP.** The National Bureau of Statistics (NBS) has revised Maldives' national accounts for the period 2003-2015 based on 2014 benchmarked and rebased GDP estimates, with the assistance of the IMF. The average rebased GDP between 2003 and 2015 is higher by around 11 percent annually, compared to the 2003-based GDP estimates. This has largely impacted the debt stock and fiscal variables as ratios of GDP (Figure 7 and Annex I).

5. **In 2016, growth rose, and inflation remained stable.** Real GDP growth rose to 3.9 percent in 2016 from 3.3 percent in 2015. After a sharp decline, tourist arrivals rebounded since 2014 Q3. Shorter stays and a shift towards lower-income groups however, have lowered tourism receipts. in 2016H1, construction continued to grow strongly at around 15 percent while the primary sector (agriculture and fisheries) contracted by over 7 percent. Average inflation continued to decline in 2016 to 0.8 percent. The temporary lift to inflation from the food and electricity subsidy reforms (October 2016) and the increase in import duties on cigarettes, soft and energy drinks (March 2017) is expected to fade this year and next. More broadly, administered subsidized prices for key staple

items, falling international commodities prices and an appreciating U.S. dollar (to which the currency is pegged) have maintained low and stable prices.

6. The fiscal deficit widened in 2016 driven by lower than expected revenue and large arrears clearance despite unchanged current spending. Both staff and the authorities estimate a significantly higher overall fiscal deficit in 2016 (10.3 percent of GDP) compared to the 2016 Budget (5.2 percent of GDP). Lower Tourism-GST (T-GST), non-tax revenues, grants, and large arrear payments largely account for the deviation. Current spending is close to the Budget as a decline in subsidies, transfers and interest payments were offset by higher social welfare contributions. Capital spending is lower than the Budget but remained high. Public debt rose in 2016 up nearly 11.5 percentage points over the past two years. In response, the 2017 Budget aimed to reduce the deficit in line with the Fiscal Responsibility Act (FRA) that came into effect in 2014 and with the fiscal rules of the Fiscal Responsibility Law (FRL) under the Act, in 2017. The Budget includes a continuation of the wage and hiring freeze since 2015, significant cost rationalization following the electricity and food subsidy reforms of 2016, and revenue measures including a new Airport Development Fee (ADF), land sales to the public, and higher import duties on cigarettes and drink items.

7. Monetary policy remains accommodative. The MMA has kept the minimum reserve requirement (MRR) rate at 10 percent and administered yields on Treasury bills and bonds. The parallel market premium increased fourfold during 2015–16, reflecting monetary easing in 2015, moderating tourism receipts and a sharp decline in FX reserves from a large one-off external payment. To restore confidence, the MMA increased FX sales to the banks and sold directly to the public in late 2016. This helped bring down and stabilize the premium at around 4 percent above the upper official rate. Starting in 2017, the MMA increased both its allocation to commercial banks and U.S. dollar sales to SOEs (Annex II).

8. The overall external position has worsened and is assessed to be substantially weaker than implied by fundamentals and desirable policy settings. The current account deficit widened sharply from 7.3 to 19.6 percent of GDP between 2015 and 2016, due to increased infrastructure-related imports, moderating tourism receipts, higher remittance outflows, and a large one-off court mandated payment made later in the year (Table 4).[1] Fisheries, the largest source for goods export, has fallen in value terms driven by a large decline in global prices. Net FDI inflow, new debt and reserve drawdown have financed the deficit. The real exchange rate (RER) is assessed to be well above the norm at end-2016, while the current account (CA) is assessed to be well below. Reserve coverage declined from 2.4 to 1.8 months of imports between 2015 and 2016 (Annex IV).

[1] The MMA has benefitted from recent TA in external sector statistics. The TA concluded that travel receipts were underestimated because of a problem in the main data source and missing components.

9. To boost reserves, the MMA entered into two swap arrangements totaling US$200 million.[2] These swaps with the Reserve Bank of India and a locally based commercial bank have since been settled. More recently, reserves have also benefitted from the first ever sovereign bond issuance (US$200 million)[3] and timely repayments by MACL, on the bond held by MMA. By end-July 2017, gross reserves stood at US$571 million (1.9 months of imports) while usable reserves were US$208 million (0.7 month of imports).

10. Banks' capital position remains strong and asset quality has improved. NPLs in absolute terms have fallen by 36 percent and as a share of total loans have declined, from 21 percent in 2012 to 11 percent in 2016. Profitability remains high with return on equity close to 15 percent. Credit to the tourism industry constitutes the largest share to private sector (40 percent), but has fallen as construction activity has risen sharply in recent years driven by the residential and commercial construction boom. Banks' linkages to public infrastructure projects are limited as the projects are mainly financed externally (Table 5 and Figure 6).

Authorities' Views

11. On inflation, the main drivers are food and oil prices. Food price increases were primarily attributed to the subsidy cut on staples during the latter part of 2016, partly offset by a fall in vegetable prices. Oil price changes on the other hand are not believed to have affected inflation, with less than a clear link between currency movements and inflation.

12. The authorities do not see that the accommodating monetary policy has contributed to BOP pressures. They stressed that the CA deterioration during 2016 is due to the one-off external payment and to the increase in public infrastructure-related imports. Slowdown in tourism receipts and increased infrastructure spending have not added pressure on the availability of U.S. dollars because the MMA increased its intervention in the FX market, evident in the gradual decline in the parallel market premium in the first half of 2017. On reserves, they explained that using months of imports may not be an appropriate measure in assessing reserve adequacy. This is considering the significantly large capital imports related to infrastructure and the high structural nature of the import bill reflecting large demands from tourism.

13. Authorities also pointed to lower than expected revenues and high infrastructure spending resulting in the larger than budgeted fiscal deficits in 2016. Based on outturns so far this year, they however remain confident that overall expenditure will be contained at budgeted levels for 2017.

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[2] In late 2016, gross reserves declined significantly to US$468 million of which US$200 million are usable reflecting an MMA purchase of a US$140 million bond from the SOE, the Maldives Airports Company Limited (MACL), as well as FX withdrawals from local banks.

[3] The first international sovereign bond (US$200 million, at 7 percent with a 5-year maturity) was oversubscribed. Investors were from Asia (83 percent) and Europe. As a pre-requisite, two credit ratings were obtained from Moody's (B2 rating, which is speculative and subject to high credit risk) and Fitch (B+ rating which falls between a BB Speculative and a B Highly Speculative rating).

OUTLOOK AND RISKS

A. Outlook

14. The baseline outlook is for a modest recovery in the near term, with low inflation, loose financial conditions, but with significant downside risks from a fragile fiscal and external position.

- **GDP growth is projected to recover to 4.6 percent in 2017 and stabilize at close to 5 percent over the medium term.** The Maldives is expected to benefit from stronger economic growth in Russia, India and China and continued recovery in Europe. Further ahead, capacity in the tourism sector is set to expand following the infrastructure scale up, and the baseline assumes favorable long-term tourism forecasts in the South Asia region. Under such forecasts (Annex III), medium-term growth could rise to 5 percent (consistent with authorities' projections) but still remain below the annual average of 6 to 7 percent over the last 15 years. Construction is set to continue to grow strongly buoyed by major infrastructure projects. Non-tourism exports are expected to rise gradually as the agriculture and fisheries sectors diversify into new value-added products, and strong growth in Asian and European markets (Maldives' export market destinations) continues.

International Tourism by Region of Destination
(average a year (%))

	2010-'30	2010-'20	2020-'30
World	3.3	3.8	2.9
Asia and Pacific	4.9	5.7	4.2
South Asia	6.0	6.8	5.3

Source: UNWTO tourism towards 2030

- **Following the infrastructure surge, the fiscal deficit is projected to widen significantly before gradually declining over the medium term (Table A).** After reaching a peak of 10.3 percent of GDP in 2016, the headline fiscal deficit is projected to decline gradually to 6.5 percent in 2019 as infrastructure spending winds down. Staff's deficit projection in 2017 is significantly higher than the authorities' Budget which aims to keep the deficit below 3.5 percent of GDP and a primary surplus. Staff projects lower revenues than the Budget factoring in large uncertainties surrounding non-tax measures and grants and the absence of tax revenue measures to cover the large scale up costs. On spending, staff factors in the effect of subsidy reforms, a slower pace of wage and welfare rationalization, higher current spending in support of the major infrastructure scale-up, and still relatively high but more realistic capital spending with due attention to challenges in implementation capacity.

Fiscal Projections 2016-19: Authorities and Staff
(In percent of GDP)

	2016		2017		2018		2019	
	Auth	Staff	Auth	Staff	Auth	Staff	Auth	Staff
Total Revenue incl grants	28.4	28.4	31.3	28.7	29.7	28.6	29.2	28.3
Tax Revenue	20.2	20.2	20.5	20.9	20.1	20.8	20.0	20.4
Non-tax Revenue	7.9	7.8	9.5	7.4	8.4	7.5	8.0	7.6
Total Expenditure & net lending	38.6	38.7	33.5	36.6	32.3	35.8	28.7	34.7
Current Expenditure	24.9	24.9	19.5	24.3	19.0	25.1	18.1	26.5
Wages Costs	10.6	10.7	9.8	10.3	9.2	10.0	8.6	9.6
Interest Costs	1.8	2.0	2.0	2.2	2.2	2.5	2.1	3.0
Social Welfare Contributions	3.5	3.3	1.5	3.1	1.4	3.2	1.3	3.2
Subsidies & Transfers	2.5	2.5	1.7	2.0	1.9	1.9	1.9	1.8
Capital Expenditure 1/	13.2	13.2	14.1	12.4	13.4	10.7	10.7	8.3
Primary Balance	(8.5)	(8.3)	(0.3)	(5.8)	(0.4)	(4.7)	2.6	(3.5)
Overall Balance	(10.3)	(10.3)	(2.3)	(8.0)	(2.5)	(7.2)	0.5	(6.5)
Public Debt 2/	63.6	65.7	65.5	69.4	63.9	72.2	61.5	74.0

1/ Capital expenditures are inclusive of contributions to the sovereign development fund (SDF)
2/ Based on Authorities' preliminary estimates and own nominal GDP (Macroeconomics Outlook, Spring 2017).

- **These sizeable primary deficits will add significantly to public debt.** The projected primary deficits are above FRL recommended balance of primary surpluses from 2017 and restricting future borrowing to financing capital spending. Public debt is projected to rise during 2017–2021, coinciding with the end of the mega projects financing, before falling to 69.8 percent of GDP by 2037. Outstanding sovereign guarantees amount to US$240 million (5.3 percent of GDP) of which the amount of US$75 million has been included in the fiscal accounts. The main risks to public debt include further weakening of the fiscal position, drop in tourism receipts, significant depreciation of the currency, and contracting non-concessional debt. External creditors' willingness to refinance loans may also wane given the large CA deficit and high rollover risk as large amortizations including the sovereign bond payment fall due.

- **The updated DSA continues to assess the external risk rating as high along with a heightened overall risk of debt distress.** External debt sustainability concerns continue to be the present value (PV) of external debt-to-GDP ratio and the public and publicly guaranteed (PPG) external debt service-to-revenue ratio. The external debt path has improved compared to the previous DSA due entirely to the rebasing of GDP as opposed to an improvement in economic and policy fundamentals. A widening current account deficit, low international reserves, and rapid debt buildup continue to skew the risks to the downside and leave the country vulnerable to standard DSA shocks. In addition, the public debt path is substantially above the prudential benchmark throughout the projection period.

- **Credit growth to the public sector is expected to slow but remain high for the private sector in support of construction and tourism.** Credit growth to public enterprises is expected to contract in the near term (as MACL repays its bond to MMA) and then stabilize at a lower level. Large-scale government infrastructure projects are expected to be financed externally with some spillovers to domestic activity. Credit growth to the private sector including construction and tourism is projected to remain high supporting the recovery.

- **The CA deficit is expected to widen significantly due to the infrastructure ramp up, and reserve coverage to remain low**. The deficit is projected to average 15 percent of GDP over 2017–22, financed by a modest increase in FDI and large external borrowing. Investment-related capital imports are projected to remain high with a large part of the trade deficit over the medium-term offset by tourism inflows. External debt is projected to reach 51.2 percent in 2021 up from 34.7 percent in 2016, and PPG external debt service payments will average over US$92 million annually during 2017–21 in addition to the sovereign bond repayment in 2022 (Annex IV).

B. Risks

15. Compared to a year ago, downside risks to the outlook have increased significantly (See Box 1 and Annex V).

- Externally, lower tourism receipts, if persistent, pose a significant risk to the economy. A secular shift to more price-elastic tourists, shorter stays, and the emergence of lower-end hotels and guest houses could depress prices and force some companies to scale down. Given their large exposure to tourism, banks could face increased bad loans and curtail lending, holding back investment and employment. Lower external demand, a stronger U.S. dollar, and a significant tightening of global financial conditions could impact FX reserves, industry competitiveness, and local funding conditions. An exchange rate depreciation shock with low reserve coverage pose a significant risk for external debt servicing.

- Domestically, continued high fiscal deficits and rising debt, including from government guarantees and arrears[4] are key risks, threatening fiscal sustainability. Given extensive government-guaranteed investment and lending, the impact of a severe tourism downturn on the fiscal position could be considerable. Other fiscal risks include possibly higher expenditures related to the 2018 Presidential election, as well as those associated with climate change mitigation and an increase in non-concessional financing. A shallow financial system concentrated in tourism and dominated by state-owned banks accentuates the linkages of risks across sectors. Political and domestic security risks remain elevated and are hard to predict with potential adverse economic effects if they escalate.

Box 1. Maldives and Fragility

Maldives is now classified as a fragile state with the IMF based on two successive weak Country Policy and Institutional Assessment (CPIA) ratings that has brought their three-year averages below the 3.20 threshold. The main reasons for the downgrade include a drop in score for business regulatory environment and the quality of budgetary and financial management from 2014 to 2016, amid a tense and unpredictable political situation.

The authorities are investing heavily to close some large infrastructure gaps to boost tourism and domestic demand, adding though to external financing risks and the already elevated public debt. Authorities however believe that the benefits of the investment surge will be seen overtime. Staff have recommended faster progress in adjustment and implementing the medium-term debt framework to manage financing risks when large repayments fall due. To further their efforts on benefitting from climate change-related funding, staff introduced to the authorities the 'Climate Change Policy Assessment' pilot to which they expressed interest. Capacity building in the form of TA from major multilateral institutions continues (see Informational Annex) to strengthen public financial management (PFM), financial market development, and banking supervision, among others.

- On the upside, stronger global growth would boost Maldives' tourism, its BOP and reserves. Domestically, stronger fiscal management with careful appraisal and selection of capital projects

[4] Total outstanding guarantees is much lower than previously thought as several of these guarantees were cancelled or paid down. New guarantees were being negotiated at the time of discussions but the details were not made available to staff. The stock of arrears were over 5.2 percent of GDP in 2013 and are estimated to have declined to around 2.5 percent of GDP at end-2016, with an unspecified timeline by which arrears should be cleared.

and realistic revenue targets with faster arrear clearance would boost confidence and improve the outlook.

Authorities' Views

16. The authorities expect real GDP growth to be close to 5 percent in the near-term and stronger than projected by staff over the medium-term. The authorities expect large spillovers from public investment to boost growth in the medium-term. On the fiscal side, they see improved external conditions as boosting tourism receipts and steadfast expenditure rationalization to improve the fiscal position. The government downplayed vulnerabilities associated with the sovereign guarantees and stressed the role of the Sovereign Development Fund (SDF) to meet maturing loan obligations and contingencies.

17. They acknowledged risks remain tilted to the downside but also viewed some on the upside. Downside risks are a prolonged decline in Chinese tourism and slowdown in tourist arrivals from the U.K. influenced by the depreciating pound. Upside risks include stronger tourism driven by better-than-expected growth in the Eurozone.

POLICY CHALLENGES AND DISCUSSION

Against this constellation of risks, policy priorities should focus on reducing macro imbalances and improving the policy mix, strengthening financial resilience, and enhancing longer-term growth potential through structural reforms.

A. Reducing Macro Imbalances

Fiscal Consolidation and Debt Sustainability

18. Fiscal consolidation is urgently needed to restore fiscal sustainability. Staff recommends targeting a primary deficit of 4.4 percent of GDP in 2017 which could be achieved under strengthened efforts by the Maldives Inland Revenue Authority (MIRA) implementing procedures to recover outstanding tax arrears and under more realistic execution of prioritized capital spending. Over the medium-term, staff recommends a gradual but steady adjustment to reach a primary surplus in 2020 (Table B). The adjustment would bring the public debt-to-GDP ratio to the 60 percent target by 2022—an appropriate anchor considering Maldives' fiscal and external vulnerabilities. The adjustment is assessed to be consistent with the fiscal structure and capacity constraints while accommodating priority capital spending.

19. To reach this target, staff recommends implementing revenue measures, containing current spending, and cutting non-essential infrastructure spending.

20. Revenue-raising measures and user fees. Durable increases in revenues should rely on strengthening a well-administered tax system and leveraging the small number of broad-based taxes.

Table B: Fiscal Adjustments to the Primary Balance 2017–2025 1/

(In percent of GDP relative to the baseline scenario)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
Revenue measures	**0.3**	**1.0**	**1.4**	**1.7**	**1.6**	**1.6**	**1.5**	**1.5**	**1.5**
Collection of outstanding tax arrears	0.3	0.3	-	-	-	-	-	-	-
G-GST 2/	0.0	0.5	1.0	1.3	1.3	1.2	1.2	1.2	1.2
Business Profits tax (BPT) 3/	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Introduction of bridge toll 4/	0.0	0.0	0.1	0.2	0.2	0.1	0.1	0.1	0.1
Expenditure measures	**1.0**	**1.6**	**0.9**	**2.3**	**2.3**	**2.3**	**2.4**	**2.3**	**2.3**
Wages and allowances 5/	0.0	0.0	0.0	1.2	1.1	1.1	1.1	1.1	1.1
Subsidy reforms and safety nets 6/	0.0	0.0	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Curtailment of Aasandha & Social Welfare costs 7/	0.0	0.6	0.6	0.8	0.9	0.9	1.0	0.9	0.9
Curtailment of planned capital expenditure 8/	1.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Adjustments (Revenue + Expenditure)	**1.3**	**2.7**	**2.3**	**4.0**	**3.9**	**3.9**	**3.9**	**3.8**	**3.8**
Required Adjustment (top-->down)	-0.2	-0.3	1.0	4.7	7.6	8.5	9.5	9.5	9.5
Primary Balance for debt reduction	-6.0	-5.0	-2.5	0.0	2.5	4.0	5.0	5.5	5.5
Contribution for SDF fiscal reserve	0.0	0.0	0.0	2.0	3.0	3.5	3.5	3.0	3.0
Required Primary Balance	-6.0	-5.0	-2.5	2.0	5.5	7.5	8.5	8.5	8.5
Primary Deficit Paths									
Baseline	-5.8	-4.7	-3.5	-2.7	-2.1	-1.0	-1.0	-1.0	-1.0
Alternative Scenario	-4.4	-2.0	-1.2	1.3	1.9	2.9	2.9	2.8	2.7
Public Debt/GDP (baseline) 9/	70.3	73.8	76.0	77.5	78.2	77.9	77.6	77.3	77.0
Public Debt/GDP (alternative) 9/	68.7	69.8	69.8	67.4	64.3	60.3	56.4	52.6	49.0

Source: IMF staff estimates

1/ This table shows the impact of possible adjustment scenario from 2017. Measures are deemed feasible by staff.

2/ G-GST qualifying threshold removed from 2018. And the tax rate increased from 6 to 7% from 2019.

3/ Eliminate BPT qualifying payment threshold from 2018.

4/ A user fee on Malé--Hulhulé--Hulumalé link road effective from 2018. é

5/ Public sector reforms will seek to rationalize both pay scales and employment. Target is to reduce expenditure by 10% from 2020, relative to baseline.

6/ Elimination of electricity and food subsidies and replacement with a cash transfer scheme.

7/ Aasandha and social welfare reforms to set in from 2018: 20% cut in baseline expenditures

8/ Cut capital expenditures by 1.0% of GDP in 2017-2018, targetting non-priority and non-essential projects.

9/ Debt path approximate values using simple debt dynamics tool with D(t)= D(t-1)*(1+r)/(1+g)-PB(t); r and g values were set to their average long term values in the projection period.

- *Recovery of tax arrears*. Estimate of tax arrears at end-2016 are around 0.6 percent of GDP. The government should take legal and/or administrative action against defaulters (e.g., freezing of bank accounts) to recover them. It should also strengthen tax administration measures against tax avoidance by improving accuracy and completeness of the taxpayer register and reporting and shortening the time filing of tax returns. Effective utilization of the Public Accounting System (PAS) to extract business intelligence would also assist revenue optimization.

- *General Goods and Services Tax (G-GST)*. The base could be broadened by eliminating the current qualifying threshold (MVR1 million annually) from 2018 and the rate increased from 6 to 7 percent from 2019. This is estimated to generate additional annual revenues of 1.3 percent of GDP.

- *Business Profits Taxes (BPT)*. Further base broadening through an amendment to the BPT law to abolish the qualifying threshold of MVR500,000 is under consideration and if implemented could raise MVR160 million (0.2 percent of GDP) in annual revenues starting 2018.

- *User fees*. The intention to introduce user fees for key infrastructure is welcome, including a bridge toll which could generate 0.1 percent of GDP in fees.

21. Expenditure savings should focus on:

- *Reducing subsidies and other costs.* Reforms undertaken in 2016 have significantly lowered food subsidies and virtually eliminated electricity subsidies. A proxy-means tested targeting scheme has been developed to cover vulnerable households under the social safety scheme before the complete removal of subsidies. Staff assesses that such a scheme could be fully implemented beginning 2019 with an annual cost savings of around 0.3 percent of GDP.

- *Welfare reforms.* To curb rising health care costs, the authorities have aimed at reducing the operating cost of the universal health care scheme (Aasandha) by localizing service provision at domestic hospitals and introducing generic medicines and co-payment. Rationalization of expenses should be based on a thorough review of costs to accurately identify emerging pressures and find additional savings. Staff recommends that such progressive measures be introduced from 2018 which could save around 0.8 percent of GDP annually.

- *Public sector reforms.* The government has enforced a salary and hiring freeze for two consecutive years (2015-16) in a bid to control wage costs. Nevertheless, further rationalization of the pay structures, staffing and operational efficiency is needed. The Civil Services Commission's ongoing HR audits of line ministries and the National Pay Commission's review of the pay and cadre structure aims to rationalize costs. This could generate savings of around 1.1 percent of GDP annually starting 2020.

- *Sovereign guarantees*. The government initiated a new scheme aimed at the private sector and SOEs beginning in January 2017. This will partly underwrite eligible loans granted by banks to tourism projects, social housing and development projects based on strict criterion with ceilings on the total guaranteed amount. Prior to this scheme, the government had also issued substantial guarantees to various SOEs. Staff recommends including these guarantees as contingent items in the official debt figures and limiting the risk against a call on guarantees through risk sharing with banks and building a fiscal reserve through the SDF. Guarantees should be authorized only after an independent auditing of the project's viability and borrower's ability to repay.

- *Capital spending.* Further project prioritization and phasing would help manage physical bottlenecks and control debt. Staff suggests curtailing planned capital expenditure by around 1 percentage point of GDP over 2017-2018, targeting mainly non-priority and non-essential projects.

22. The proposed mix of fiscal adjustment should help mitigate its negative impact on growth. The recommended adjustment mix is well-balanced in terms of targeting measures with moderate effect on growth. Results based on the Debt Investment Growth (DIG) Model calibrated for the Maldives show that higher growth effects of capital spending can be obtained by raising the efficiency in investment through enhanced PFM measures.[5]

23. Strengthening PFM is critical in supporting fiscal sustainability. IMF TA on Public Investment Management Assessment (PIMA) and PFM recommended to (i) improve efficiency in public spending by establishing a credible budget process; (ii) strengthen medium-term sustainability anchors in a clear fiscal strategy and realistic budget envelop; (iii) develop an action plan to settle arrears; and (iv) streamline tax incentives (ahead of SEZ licensing) to safeguard a simple and transparent tax system. Staff anticipates sizable savings could be generated on transport, communications and utilities by improving SOE oversight and continuing to promote greater use of renewable energy (Annex VI).

24. To reduce risks to fiscal and external sustainability, the authorities should continue to rely on concessional financing for infrastructure and social projects. The current timing may not be ideally suited for tapping capital markets as it may constrain future access to markets (in the event of rising risk premia against fiscal concerns) and to concessional funding. In addition, staff recommended implementing the Medium-Term Debt Strategy framework to better manage risks to the large debt position and avoid borrowing on commercial terms.

Authorities' Views

25. The authorities saw risks from the public debt buildup as moderate and argued that infrastructure investment over time will benefit the economy and help alleviate financing pressures. They stressed that fiscal consolidation is already underway, but acknowledged there is room to do more. They recognized that while the level of debt was high, it was nevertheless necessary to improve and expand the current infrastructure. They urged staff to more fully capture the medium-term growth benefits of expanding the economy's potential. They explained that the SDF, built from contributions from the ADF, green tax, profit transfers (dividends) from SOEs and other non-tax sources, was designed to help pay off maturing debt. These contributions are estimated at 4.4 percent of GDP over 2017-19 and 1 percent of GDP in the long run.

26. The authorities did not favor further revenue measures, advocating that the bulk of adjustment be focused on spending, including better oversight over SOEs and accelerating PFM reforms. They were concerned about the negative implications of raising G-GST on SMEs and the economy more generally and instead stressed arrears collection as a priority.[6] They sought additional TA on tax-gap analysis in strengthening revenue mobilization.

[5] See Appendix I, Maldives Article IV Staff Report, 2016.

[6] The authorities noted large non-tax arrears related to resort lease payments remain (estimated at MVR 3.2 billion) and are being recovered. A new Presidential Commission on state asset recovery in collaboration with the Auditor General's office and the Anti-Corruption Commission of Maldives is being created.

Supportive Exchange Rate, Monetary and Financial Policies

27. Considering Maldives' small scale, high openness, dollarized nature, and volatile export revenue, a stabilized arrangement remains appropriate. The stabilized arrangement has helped anchor inflation and provided a natural hedge for the tourism sector, where income and imports are received and paid in U.S. dollars. The peg so far has been shored up by sustained exchange rate restrictions, but low reserve coverage and rising public debt have undermined its stability and raised the risk of a disorderly exchange rate correction. Strong and durable fiscal adjustment, combined with a tighter monetary stance (see below), can better support the peg going forward and help build foreign reserves. Within the peg arrangement, the authorities could consider a gradual move in the future from the historically-backed link to the U.S. dollar towards an import-weighted currency composite to support the buildup of reserves and price stability.[7]

28. Monetary policy should be tightened to mitigate pressures on the peg from government finances and the infrastructure surge. Moderate FX receipts combined with loose macro policies will continue to push up the CA deficit and external debt, undermining the credibility of the pegged regime. Furthermore, the subsidy phase out could push up inflation through pass-through of higher international prices. To safeguard the peg, the monetary stance should be tightened gradually through an increase in the MRR and in the remuneration rates on rufiyaa-deposits while replenishing FX reserves through sustained net inflows of foreign currency receipts. Reserve coverage should return to three months of imports at a minimum. Tightening should be paced so it does not impede credit in support of economic growth. In the event of building pressures on the peg, a stronger policy mix will be needed including more fiscal and monetary tightening rather than further FX sales or external commercial borrowing.

29. Market-based auctioning of liquidity should be restarted. Renewing open market operations to absorb excess liquidity and gradually expanding the Treasury bond profile into longer maturity to develop a yield curve would enhance financial efficiency. This needs to be well-designed and weighed against a sudden risk of higher debt service under the likelihood of rising external interest rates and fiscal imbalances.

Authorities' Views

30. The MMA did not see the need for monetary policy tightening to support the peg in the absence of inflation and FX market pressures. They noted that the parallel market premium had narrowed considerably from the increased FX intervention. Moving to a more market-based auctioning and developing the domestic bond market would be challenging under the current financial infrastructure which needs to be overhauled. In the event of pressure on the peg, the MMA indicated its ability and readiness to activate alternative monetary instruments based on open market operations, if needed. They saw moving from a dollar peg to an import-weighted currency

[7] Given the high external debt burden, a composite with initially a heavy weight on the U.S. dollar should be introduced gradually to avoid increasing the MVR cost of debt repayment.

composite considering greater tourism and financing from Asia as a possible longer-term policy option. Follow-up TA in this area would be welcome.

B. Strengthening Financial Depth and Resilience

31. The financial system caters mainly to the needs of the tourism and ancillary sectors. Lending is highly concentrated in tourist resorts, and the system is dominated by banks with the state as a large stakeholder in a major bank. Limited competition has led to large net interest margins and interest rate spreads, while limited credit information has kept lending rates high to households and SMEs.

32. Lack of investable opportunities has led to significant investment by financial firms in government Treasury bills and bonds. Difficulty in pricing individual loans tailored to debtor's capacity to repay especially for SMEs, have discouraged financial institutions from diversifying their lending and investment portfolio. Developing a market-based yield curve, encouraging secondary markets, and promoting advanced credit analysis practices would enhance efficiency of resource allocation.

33. Careful monitoring is warranted, supported by prudential measures on housing. Private sector credit has grown rapidly, led by the housing and construction sector. Banks' credit to the private sector has continued to grow, driven by lower NPLs and an accommodative monetary policy stance since 2015. Banks require 150 percent of collateral on loans extended and a 20–25 percent down payment as insurance against default risk, which households can meet by drawing on their pension assets. In the context of a sharp increase in housing-related loans and exposure of the Maldives Pension Administration Office (MPAO), careful monitoring is recommended.

34. The Maldives should continue to focus on fostering financial inclusion. The authorities have undertaken notable initiatives including the launch of a credit guarantee scheme to assist SMEs with limited collateral; issuing mobile banking licenses to two telecommunication service providers; setting up a 'credit information unit' at the MMA; protecting financial consumers; and holding 'financial expos' to enhance financial literacy (Annex VII). To address fiscal risks, they should aim to rationalize SME credit programs and adopt a coherent monitoring and evaluation scheme. Establishing a credit reporting system, a robust insolvency and creditor rights framework backed by adequate legal frameworks will streamline debt recovery and ease business credit standards.

35. MMA has been instrumental in improving the regulatory environment and ensuring system stability. The MMA conducts regular off-site monitoring and on-site examination of banks. The MMA introduced in 2015 prudential regulations which have led to an improvement in banks' overall conditions.[8] Parliament adopted the AML/CFT bill aimed at preventing laundering of

[8] Banks' balance sheets improved in terms of capital adequacy, liquidity and asset concentration. Their capacity to absorb expected and unexpected losses strengthened, supported by provisions covering around 90 percent of NPLs.

proceeds of crime and corruption and putting in place new enforcement measures to increase awareness to boarder control entities.

Authorities' Views

36. **The authorities highlighted their policies toward improving financial stability and inclusiveness and on combating financial crimes.** The MMA introduced new stress testing methods in assessing banks resilience and solicited international auditing companies to evaluate the operational risks of banks. The 2016 'credit guarantee scheme' aims to facilitate SMEs' access to finance and the 'credit information unit' to collect and disseminate credit information. To better combat financial crimes, the MMA strengthened its AML framework by issuing regulation on AML-related customer due diligence measures increasing resources for the independent 'Financial Intelligence Unit'.

C. Addressing Longer-Term Issues and Structural Reforms

37. **The NDS can help manage the risks from the infrastructure surge and support project prioritization**. In enhancing sustainable growth, staff welcomes ongoing measures in areas of infrastructure and investment as well as labor markets and competition in promoting economic diversification. Furthermore, timely and consistent data in the main indicators should be enhanced in supporting reliable policy advice.

38. **Staff supports growth-enhancing and inclusive measures in areas of investment and active labor market (ALM) policies.** Staff supports the authorities' efforts in investing in clean and renewable sources to meet rising energy demand expected with the increase in tourism and in developing appropriate sewage treatment systems as part of their adaptation measures to protect the lagoons and coral reefs from ground water pollution, given their impact on fisheries and tourism. ALM policies can aim at promoting investment in job skill training, including better technical and vocational education, training and skill matching targeted at reducing youth unemployment and boosting low female labor participation rate. In addition, the growth of the guest house sector, and plans to diversify into high-value added marine and agriculture products that would also cater to the tourism sector would help achieve diversification objectives and strengthen the economy's resilience to external shocks.

39. **Integrating risk-reduction and disaster-response programs into the core budget, public investment planning, and debt management frameworks would help address better climate change.** The authorities have signed their Nationally Determined Contribution (NDC) under the Paris Agreement and are currently developing a plan to integrate climate change adaptation and mitigation measures as part of their infrastructure plans. The NDC has highlighted coastal protection, waste management and access to drinking water as key areas needing immediate attention. The Fund's pilot on the 'Climate Change Policy Assessment for Small States' can help integrate climate change impact and policy responses into a holistic macro framework.

40. Data collection needs to be stepped up. Priority should be given to pass the statistics law that provides data collection powers to the MMA, MIRA and NBS. Continued support through TA in the areas of external statistics, national accounts and fiscal areas is a high priority. In this regard, the MMA Board has approved and enacted statistical regulations on July 11, 2017 to be sent for publication. The NBS has just completed a rebasing of GDP (Annex I).

STAFF APPRAISAL

41. GDP growth is projected to rise gradually in the medium-term and inflation to remain stable. Growth in 2017 is set to recover but is expected to remain below longer-term potential growth. Inflation is projected to remain low with some lift from the subsidy phase out on staple food items and electricity.

42. The large infrastructure scale up has the potential of transforming the economy but also of creating risks from high public debt. Expansion and development of airports, a major regional hub, and land connectivity in the Greater Malé area are set to increase tourism and demand for ancillary services but will add significantly to the already high level of public debt. Prospective large external borrowing continues to indicate a high risk of debt distress.

43. A rapid debt buildup, along with a widening current account deficit, and low international reserves call for urgent corrective policy measures. To address large and rising vulnerabilities under a reduced policy space, priorities should focus on reducing fiscal and external deficits, build adequate FX reserves, develop the financial sector and enhance longer-term growth potential through structural reforms.

44. Fiscal consolidation is urgently needed to restore debt sustainability. Staff recommends targeting a gradual but steady adjustment to reach a primary surplus in 2020 and bring debt-to-GDP to the 60 percent target by 2022. Durable increases in revenues include indirect and corporate tax base broadening and higher rates, user fees for key infrastructure facilities, and collection of outstanding tax arrears. Non-essential infrastructure spending in 2017–18 should be reduced, subsidy reforms completed and welfare and public sector reforms pursued to improve efficiency in healthcare spending and contain the wage bill. Strengthening PFM, including establishing a credible budget process and a clear medium-term fiscal strategy is needed.

45. The external position has worsened and is assessed to be substantially weaker than fundamentals and desirable policy settings. The CA deficit has widened sharply and is projected to remain large financed by a modest increase in FDI and large external borrowing. The real exchange rate continued to appreciate and reserves remained low relative to adequacy metrics. A tighter fiscal policy stance along with more flexibility in the pegged regime would improve the external position.

46. Monetary and fiscal tightening would support the buildup of reserves and the stabilized arrangement. Over time, a gradual move toward an import-weighted currency composite would also improve external competitiveness. Financial policies should focus on promoting financial inclusion, strengthening the regulatory environment and ensuring financial system stability.

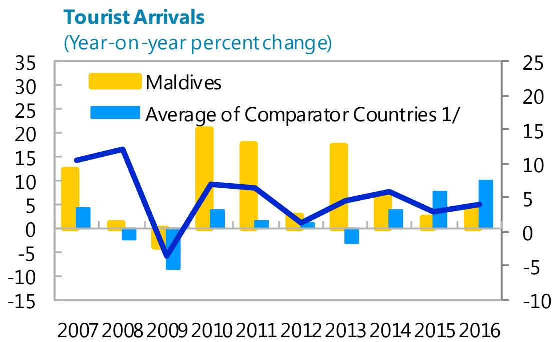
47. Over the medium term, addressing climate change, enhancing sustainable and more inclusive growth and promoting diversification are key challenges. Integrating risk-reduction and disaster-response programs into the core budget, public investment planning, and debt management frameworks would help address climate change. In enhancing sustainable growth and long-run resilience, staff welcomes ongoing measures in areas of infrastructure and investment as well as labor markets and competition in promoting environmental sustainability and energy sufficiency and economic diversification.

48. Timely and accurate statistics should continue to be strengthened in supporting reliable policy advice. Medium-term plan to improve GDP estimates and external statistics is key with the passage of the statistics law helpful in ensuring a timely release of data.

49. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Maldives: Comparison with Other Tourist Dependent Economies

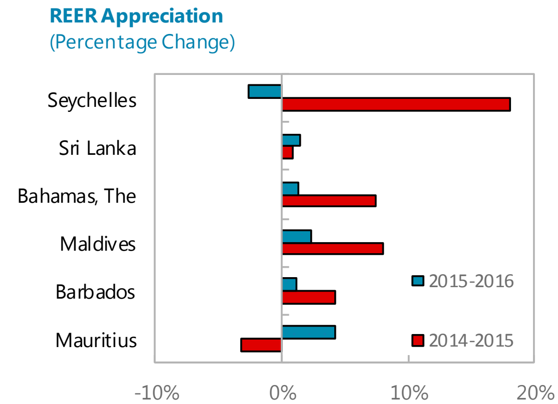
Tourism sector recovered from its contraction in 2015, but performance remains subpar…



1/ Countries include Mauritius, Seychelles, Bahamas and Barbados.

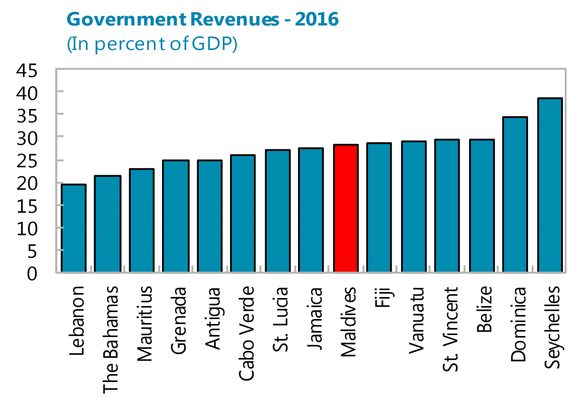
Sources: National Authorities and Staff Calculations

…and the real exchange rate continues to appreciate



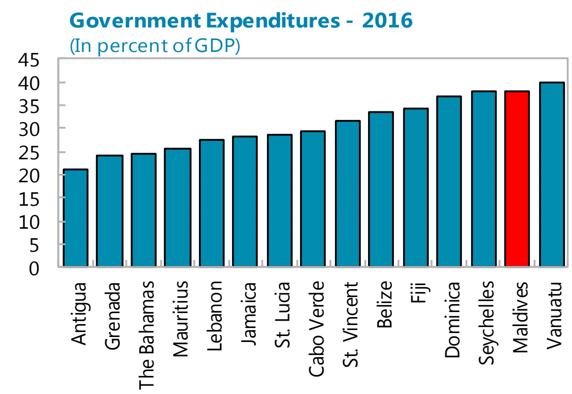
Sources: INS and Staff Calculations

Government revenue remains strong – a relative high performer among peers



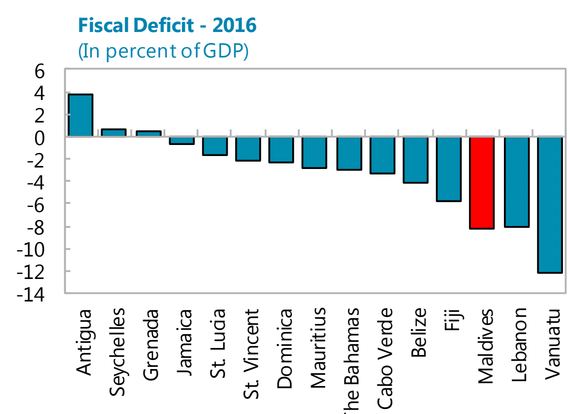
Sources: Maldivian Authorities and World Economic Outlook

…but expenditures are higher – partly because of sizeable non-discretionary component.



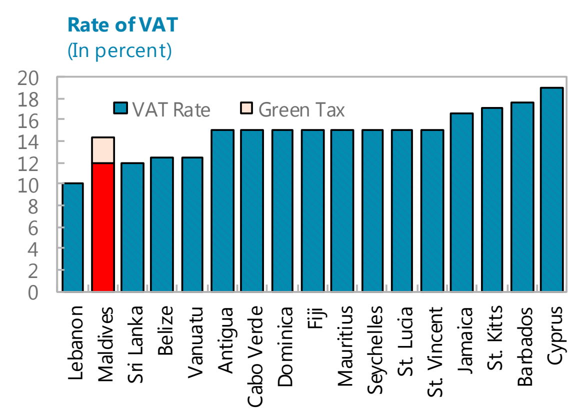
Sources: Maldivian Authorities and World Economic Outlook

Resulting in untenable fiscal deficits



Sources: Maldivian Authorities and World Economic Outlook

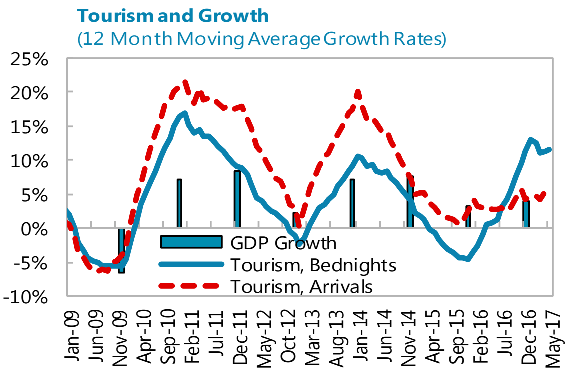
Tourism GST remains a key driver of revenue performance – but at a relatively lower rate compared to peers.



Sources: Maldivian Authorities and World Economic Outlook

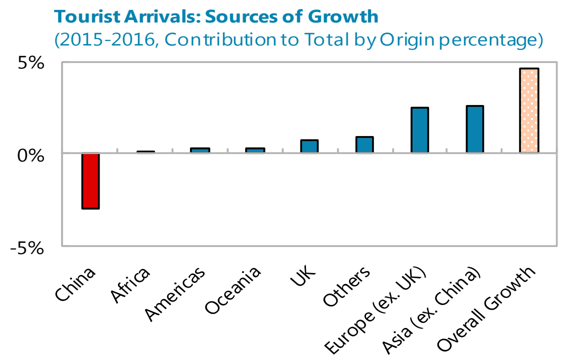
Figure 2. Maldives: Summary of Recent Developments

Growth in tourist arrivals picked up…



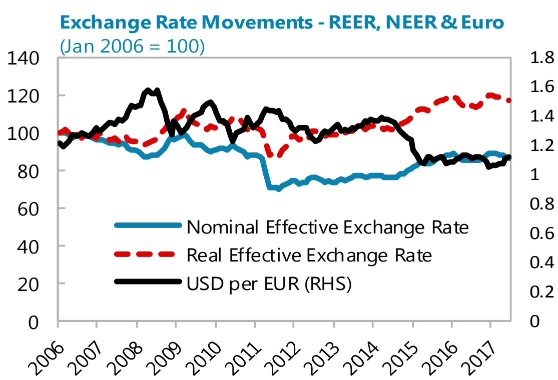
Sources: Maldivian Authorities

…on the back of strong inbound flow from South Asia and Europe while Chinese tourists decreased



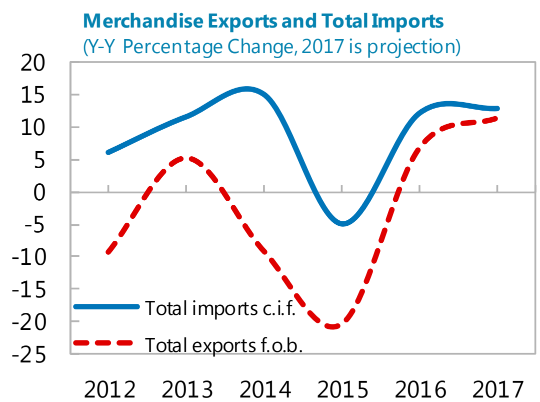
Sources: Maldivian Tourist Authority and Staff Calculations.

Exchange rate appreciation (given the dollar link) may be affecting competitiveness…



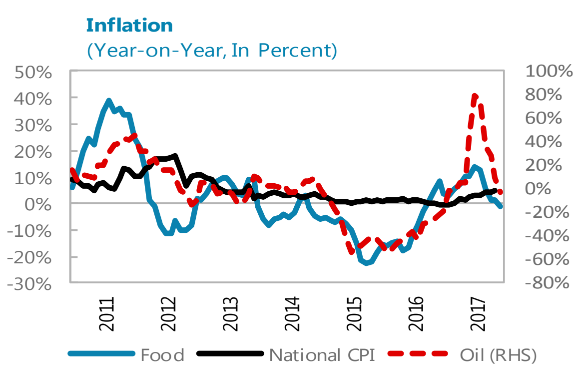
Sources: Maldivian Authorities and Staff Calculations.

… imports are on the rise due to the ramp up in infrastructure and increase in global oil prices



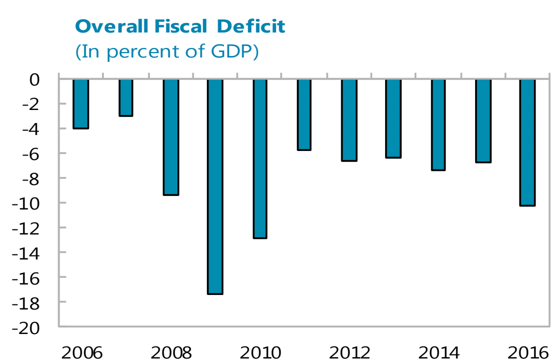
Sources: Maldivian Authorities and Staff Calculations.

Inflation remained contained, but subsidy reform combined with rising international commodity prices are likely to introduce new inflationary pressures



Sources: Maldivian Authorities, WEO and Staff Calculations.

Persistent high fiscal deficits are a major cause for concern

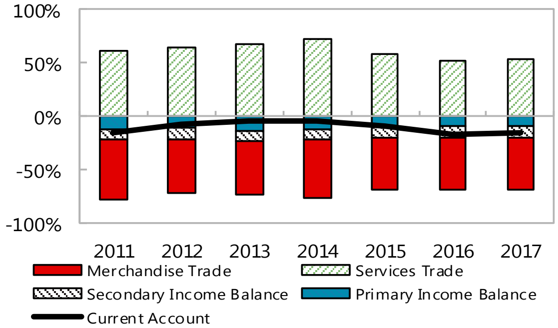


Sources: Maldivian Authorities and Staff Calculations.

Figure 3. Maldives: External Sector Developments

The current account weakened further in 2016, and is projected to continue to remain large in 2017…

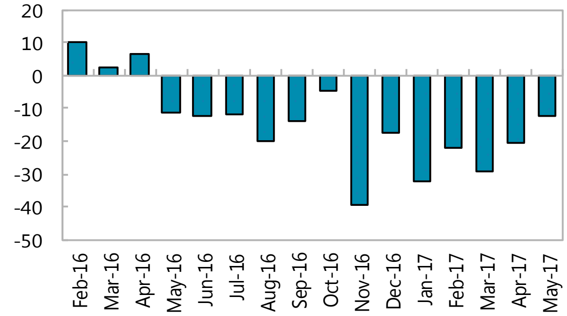
Contributions to Current Account
(In percent of GDP)



Sources: Maldivian Authorities.

…and reserves dropped sharply compared to the same time period over the past year…

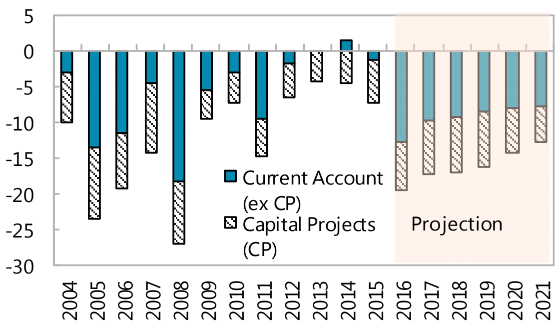
Gross International Reserves
(Y / Y percent change)



Sources: Maldivian Authorities.

The CA deficit is projected to remain large concomitantly with a large import period in support of capital projects…

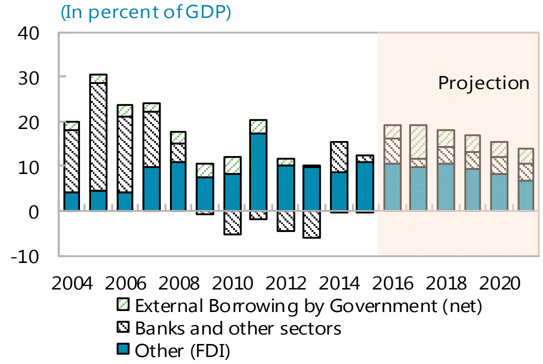
Current Account and Capital Projects
(USD Millions)



Sources: Maldivian Authorities and Staff Calculations.

…which is set to be financed substantially from external borrowing

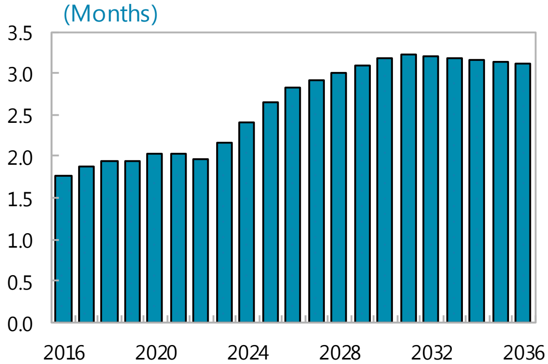
Capital and Financial Account
(In percent of GDP)



Sources: Maldivian Authorities and Staff Calculations.

……exerting pressure on reserves in the medium term

Gross Reserves / GNFS Imports
(Months)



Sources: Maldivian Authorities and Staff Calculations.

… and pushing the debt ratio close to the threshold

Present Value of Debt-GDP Ratio
(In percent)

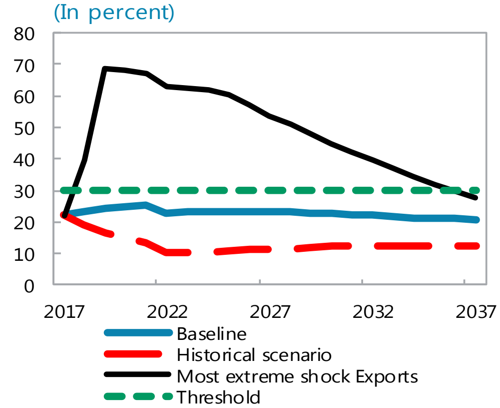
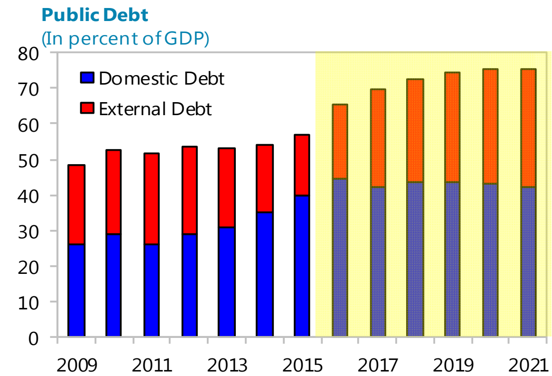


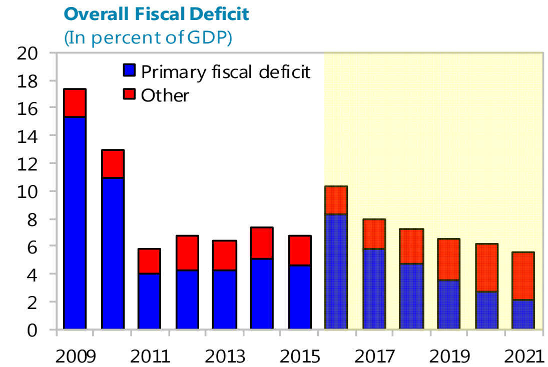
Figure 4. Maldives: Fiscal Developments

Public debt levels remain high –over and above fiscal responsibility law (FRL) limits



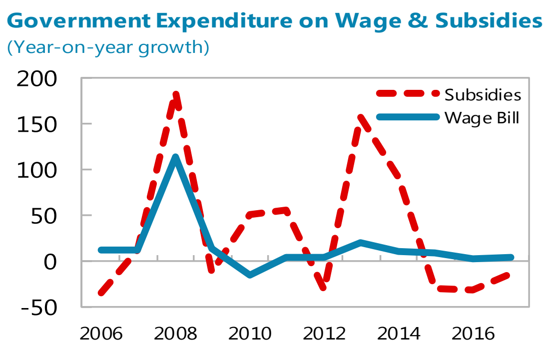
Sources: Maldivian authorities: and IMF staff estimates.

...which is partly a reflection of high primary deficits. But primary deficits are expected to narrow on the back official consolidation efforts 2017–19.



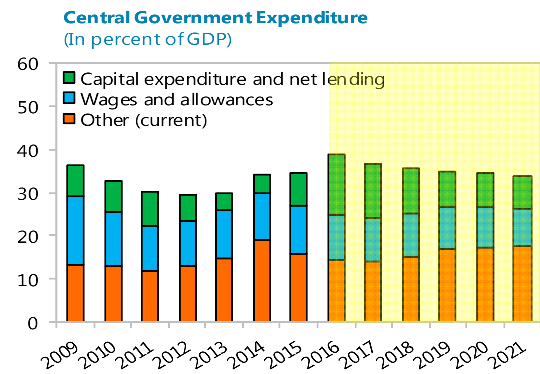
Sources: Maldivian authorities; and IMF staff estimates.

Hiring and wages freeze have managed to contain wage growth, but remains high; and subsidy reforms reduced subsidy (mainly on food and electricity) cost substantially.



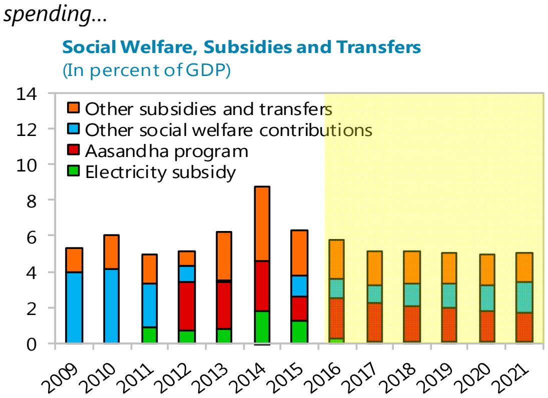
Sources: Maldivian authorities; and IMF staff estimates.

Spending structure is underlined by rigid component of expenditure and high capital spending on account of infrastructure scale-up.



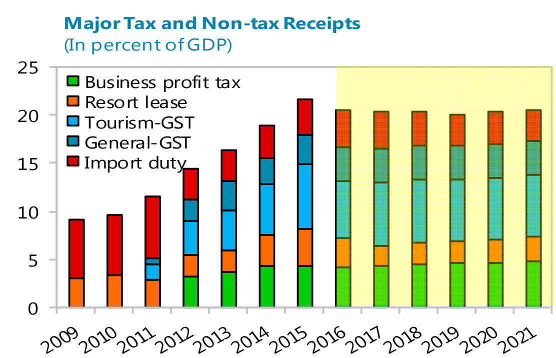
Sources: Maldivian authorities: and IMF staff estimates.

Subsidy and social welfare costs are declining to provide much needed fiscal space for growth-enhancing spending...



Sources: Maldivian authorities; and IMF staff estimates.

...and greater fiscal space is further achieved through existing and new revenue sources

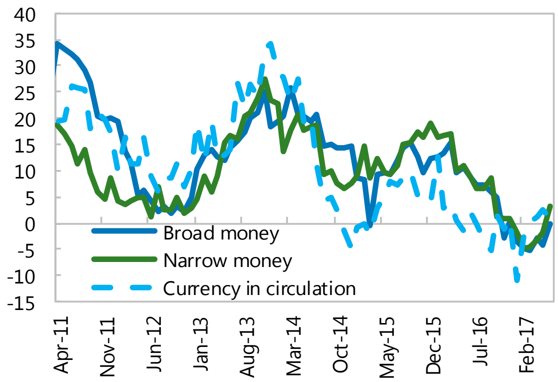


Sources: Maldivian authorities; and IMF staff estimates.

Figure 5. Maldives: Money and Credit Developments

Broad money growth has sharply declined mainly due to decline in non-financial public enterprises' deposits…

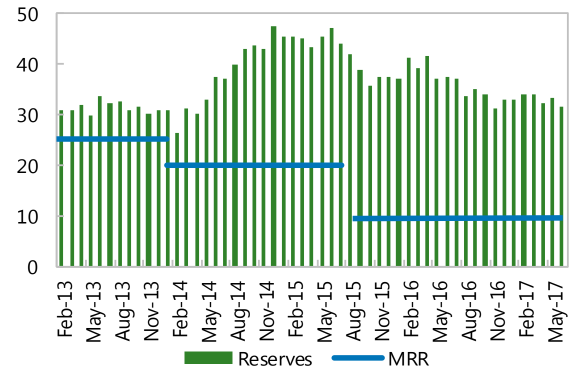
Monetary Variables
(Year-on-year growth, In percent)



Sources: Maldivian authorities; and IMF staff estimates

Banks reduced their excess liquidity…

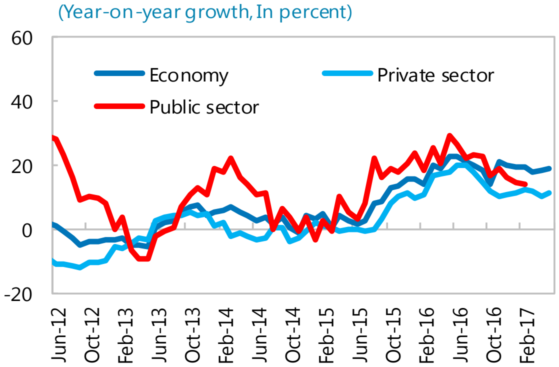
Commercial Banks' Reserves
(In percent of total deposits)



Sources: Maldivian authorities; and IMF staff estimates.

Credit growth remained robust…

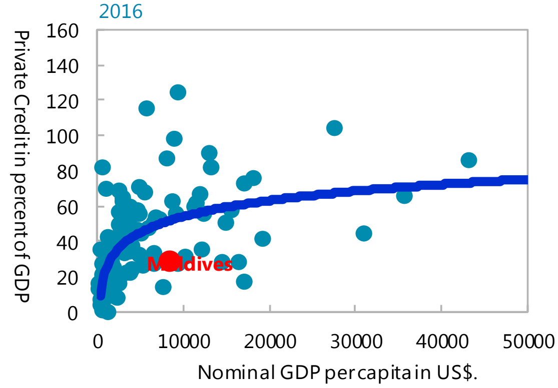
Credit
(Year-on-year growth, In percent)



Sources: Maldivian authorities: and IMF staff estimates.

Though private credit remains low compared to economies at similar income level…

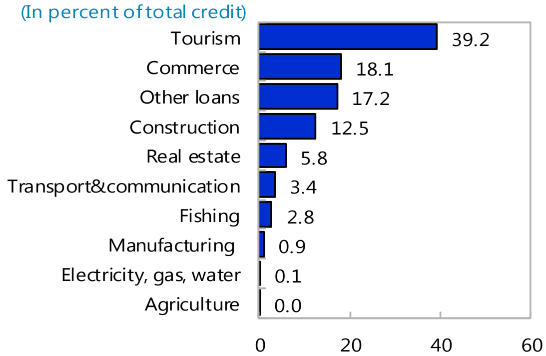
Private Credit, Emerging Markets and LICs
2016



Sources: IMF *World Economic Outlook* and IFS database.

Lending is concentrated in tourism, commerce and construction…

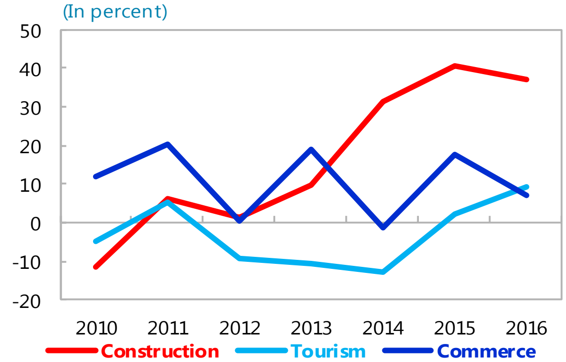
Sectoral Composition of Private Credit, 2016
(In percent of total credit)



Sources: Authorities data and IMF staff calculations.

Lending to construction remains high, lower in commerce, and rebounded in tourism.

Selective Private Sector Credit Growth
(In percent)

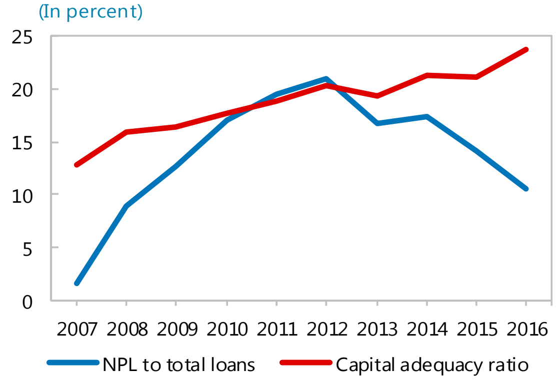


Sources: Authorities data and IMF staff calculations.

Figure 6. Maldives: Financial System and Business Environment

System wide NPLs and capital adequacy have significantly improved….

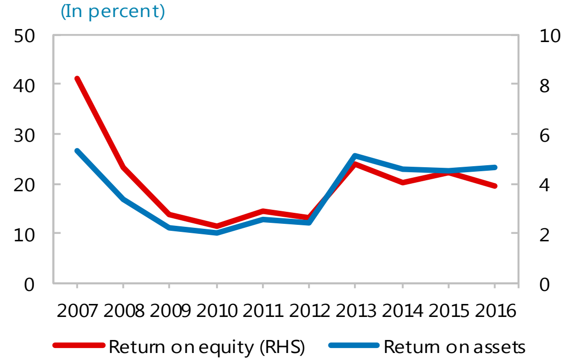
Commercial Banks' Capital and Credit Quality Indicators
(In percent)



Source: Maldivian authorities.

Banks maintain high level of profitability…

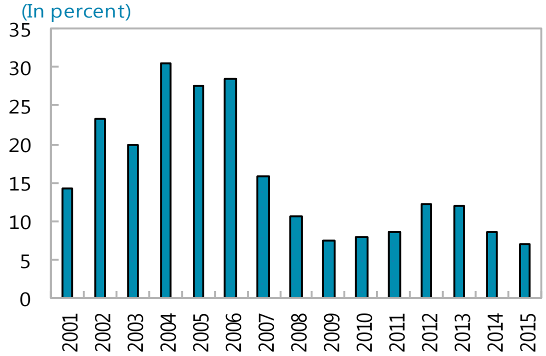
Commercial Banks' Profitability Indicators
(In percent)



Source: Maldivian authorities.

Ratio of offshore banks deposits to domestic bank deposits remains below long-term average….

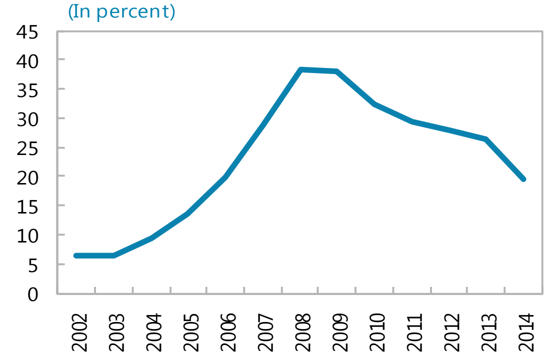
Offshore Bank Deposits to Domestic Bank Deposits
(In percent)



Source: World Bank Financial Structure Database.

Loans from non-resident banks in relative to GDP continue to decline….

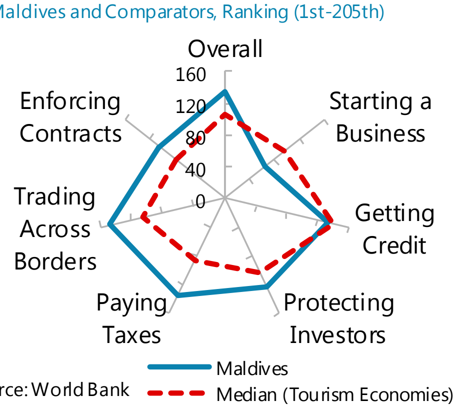
Loans from Non-Resident Banks to GDP*
(In percent)



Source: World Bank Financial Structure Database, * = does not reflect impact of recent revisions to nominal GDP (fig. 7).

Doing Business indicators remain weak…

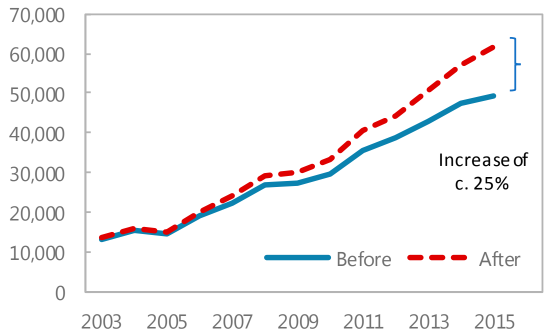
2016 Doing Business Ranking
Maldives and Comparators, Ranking (1st-205th)



Source: World Bank

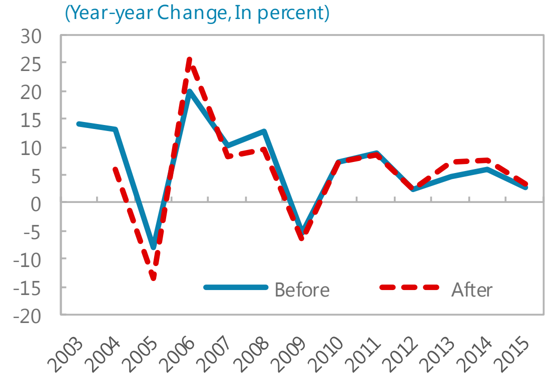
Figure 7. Maldives: Impact of GDP Rebasing on Economic Assessment

Rebasing Nominal GDP
(Level in Millions of Ruffia)



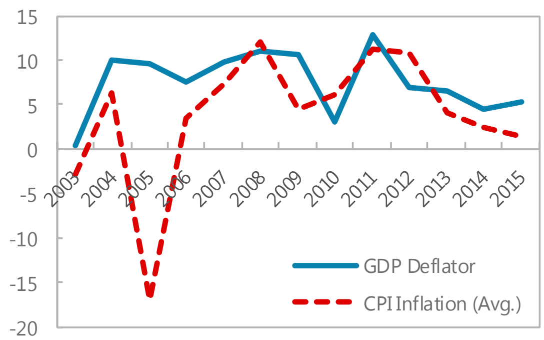
Sources: MMA and Staff Calculation.

Rebasing Real GDP
(Year-year Change, In percent)



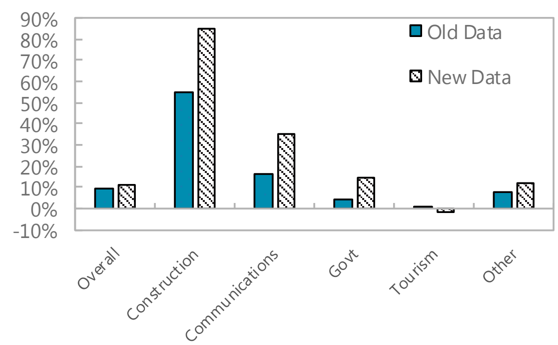
Sources: MMA and Staff Calculation.

Revised GDP Deflator and Comparison with CPI
(Year-year change, In percent)



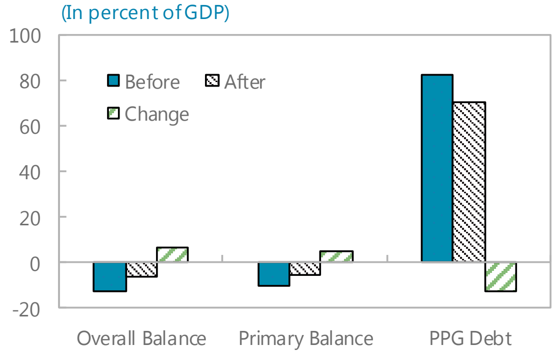
Sources: MMA and Staff Calculation.

Revisions to Sectoral Growth
Cumulative Real Growth (2013-2015, In percent)



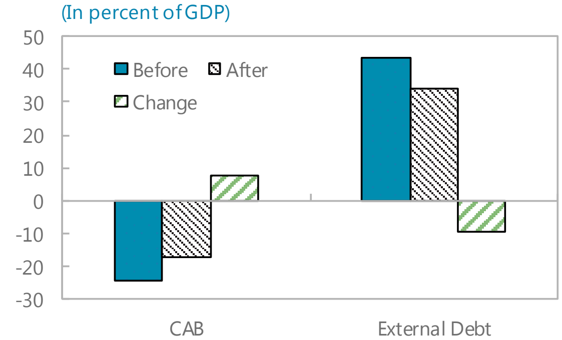
Sources: MMA and Staff Calculation.

Revisions to Fiscal Position
(In percent of GDP)



Sources: MMA, MOF and Staff Calculation.

Revisions to External Position
(In percent of GDP)



Sources: MMA, MOF and Staff Calculation.

Table 1. Maldives: Selected Economic Indicators, 2014–22 (Baseline Scenario)

Population (in 1,000; 2015)	348
GDP per capita (in U.S. dollars; 2015):	11,544
Quota (in million SDRs, Feb 2016):	21.2

	2014	2015	2016	2017	2018	2019	2020	2021	2022
			Est.			Proj.			
Output and prices				(Annual percentage change)					
Real GDP	7.6	3.3	3.9	4.6	4.7	4.8	5.0	5.0	5.0
Inflation (end-of-period) 1/	1.2	1.2	1.8	2.1	2.2	2.2	2.4	2.4	2.6
Inflation (period average) 1/	2.5	1.4	0.8	2.5	2.1	2.2	2.4	2.4	2.5
GDP deflator	4.5	5.3	1.6	2.0	2.0	2.0	2.4	2.5	2.5
Central government finances				(In percent of GDP, unless otherwise indicated)					
Revenue and grants	26.7	27.7	28.4	28.7	28.6	28.3	28.4	28.5	28.6
Expenditure and net lending	34.1	34.5	38.7	36.6	35.7	34.7	34.3	33.9	32.9
Overall balance	-7.4	-6.8	-10.3	-8.0	-7.1	-6.3	-6.0	-5.3	-4.3
Overall balance excl. grants	-7.7	-7.8	-10.6	-8.2	-7.4	-6.5	-6.2	-5.5	-4.4
Primary balance	-5.1	-4.6	-8.2	-5.8	-4.6	-3.3	-2.6	-1.9	-0.9
Current primary balance	-0.1	1.8	5.2	6.3	5.7	4.7	4.9	5.4	5.8
Public and publicly guaranteed debt	54.2	56.9	65.7	69.4	72.0	73.5	74.3	74.3	73.2
Monetary accounts				(Annual percentage change, unless otherwise indicated)					
Broad money	14.7	12.3	-0.2	9.6	9.7	9.9	10.5	10.6	10.6
Domestic credit	4.7	15.7	19.5	7.1	5.2	5.3	7.1	7.8	7.8
Balance of payments				(In percent of GDP, unless otherwise indicated)					
Current account	-3.2	-7.3	-19.6	-17.2	-17.0	-16.4	-14.3	-12.9	-10.3
Of which:									
Exports	8.1	6.0	6.0	6.3	6.6	6.9	7.2	7.5	7.6
Imports	-53.1	-47.2	-49.5	-52.5	-53.8	-52.8	-51.2	-50.4	-47.4
Tourism receipts (in nonfactor services, net)	73.0	63.9	59.3	59.3	59.2	59.1	59.4	59.7	60.0
Income (net)	-9.6	-8.1	-8.6	-8.9	-9.2	-9.3	-9.5	-9.6	-9.7
Current transfers	-8.3	-8.6	-15.0	-8.5	-8.5	-8.5	-8.5	-8.5	-8.6
Capital and financial account (including e&o)	10.1	6.1	17.4	19.4	18.0	17.0	15.3	13.7	9.9
Of which:									
General government, net	-0.5	-0.1	3.1	7.6	3.5	3.7	3.4	3.2	-0.5
Banks and other sectors, net	6.7	1.7	3.3	4.1	4.1	3.9	3.7	3.6	3.4
Overall balance	6.8	-1.2	-2.2	2.1	1.0	0.6	1.0	0.8	-0.4
Gross international reserves (in millions of US$; e.o.p.) 2/	615	564	468	564	614	645	703	751	724
In months of GNFS imports	2.7	2.4	1.8	1.9	1.9	1.9	2.0	2.0	1.9
Memorandum items:									
GDP (in millions of rufiyaa)	56,867	61,869	65,310	69,648	74,349	79,488	85,446	91,932	98,913
GDP (in millions of U.S. dollars)	3,690	4,015	4,238	4,520	4,825	5,162	5,545	5,966	6,419
Tourism bednights (000')	7,290	6,977	7,138	7,460	7,795	8,154	8,602	9,076	9,575
Tourist arrivals (000')	1,205	1,234	1,286	1,356	1,417	1,483	1,564	1,650	1,741
Tourism bednights (% change)	3.3	-4.3	2.3	4.5	4.5	4.6	5.5	5.5	5.5
Tourist arrivals (% change)	7.1	2.4	4.2	5.5	4.5	4.6	5.5	5.5	5.5
Dollarization ratio (FC deposits in percent of broad money) 3/	53.8	50.6	47.7 3/						

Sources: Maldivian authorities; and preliminary IMF staff estimates and projections based on the 2017 Staff Visit.
1/ CPI-Male definition.
2/ MMA liabilities, include allocation of SDR 7.4 million, equivalent to US$11.7 million, made available in Q3 2009, see http://www.imf.org/external/np/tre/sdr/proposal/2009/0709.htm. These are treated as long term liabilities of the MMA.
3/ Data for 2016 Jan-Nov.

Table 2a. Maldives: Central Government Finances, 2014–2022 (Baseline Scenario)

(In millions of rufiyaa)

	2014	2015	2015	2016	2016	2016	2017	2017	2018	2019	2020	2021	2022
		Auth. Rev Est.	Staff	Auth. Budg.	Auth Rev Est.	Staff Est.	Auth. Budg.	Staff			Proj.		
Total revenue and grants	15,164	17,134	17,134	22,760	18,537	18,537	21,774	19,972	21,284	22,534	24,249	26,244	28,323
Revenue (excluding privatization receipts)	14,999	16,497	16,497	21,539	18,348	18,348	20,899	19,772	21,105	22,355	24,070	26,065	28,144
Tax revenue	10,749	12,192	12,192	13,776	13,219	13,219	14,254	14,589	15,488	16,327	17,579	18,946	20,255
Import duties	1,975	2,346	2,346	2,377	2,487	2,487	2,692	2,633	2,527	2,563	2,739	2,944	3,004
Airport service charge	432	497	497	583	538	538	590	523	546	571	603	636	671
Business profit tax (BPT)	2,471	2,674	2,674	2,880	2,748	2,748	2,925	3,070	3,405	3,689	4,035	4,411	4,818
Remittance Tax	-	-	-	-	15	15	83	94	100	107	115	123	133
Goods and services tax (GST)	4,515	6,054	6,054	6,623	6,249	6,249	6,706	6,972	7,541	7,950	8,547	9,191	9,880
Of which: General GST	1,513	1,904	1,904	2,112	2,328	2,328	2,411	2,507	2,677	2,862	3,076	3,310	3,561
Tourism GST	3,002	4,150	4,150	4,511	3,921	3,921	4,294	4,465	4,864	5,088	5,471	5,881	6,319
Tourism tax ($6 green tax) 1/	805	37	37	654	623	623	668	690	721	754	795	839	885
Other	551	584	584	142	68	560	591	608	649	694	746	803	863
Nontax revenue	4,126	4,275	4,275	6,245	5,114	5,114	6,635	4,917	5,499	5,910	6,420	7,097	7,866
SOE profit transfers	782	489	491	596	629	629	1,604	813	871	908	976	1,050	1,130
Royalties, land, and resort rent	1,987	2,514	2,514	3,985	2,113	2,113	2,916	1,638	1,817	2,020	2,259	2,642	3,093
Other	1,357	1,272	1,270	1,664	2,372	2,372	2,115	2,466	2,811	2,981	3,185	3,406	3,643
Capital revenue	124	30	30	1,518	15	15	10	266	117	119	70	22	23
Grants	165	637	637	1,221	188	188	876	200	179	179	179	179	179
Expenditure and net lending	19,366	21,338	21,338	26,132	25,210	25,252	23,364	25,510	26,570	27,547	29,344	31,150	32,543
Current expenditure	16,382	16,735	16,735	16,227	16,232	16,274	13,575	16,922	18,673	21,010	22,767	24,215	25,816
Of which: Salaries and allowances	6,152	6,821	6,821	6,792	6,925	6,962	6,813	7,208	7,415	7,645	7,900	8,168	8,452
Transportation, communication, and utilities	1,377	2,050	2,050	1,681	1,650	1,653	1,287	1,695	2,249	2,988	3,365	3,619	3,895
Social welfare contributions	1,549	1,538	1,538	1,723	2,268	2,160	1,036	2,183	2,373	2,550	2,721	3,084	3,563
Repairs and maintenance	594	386	386	260	316	312	96	319	326	367	413	444	478
Subsidies and transfers	3,383	1,218	2,362	1,884	1,608	1,608	1,219	1,377	1,420	1,466	1,520	1,578	1,641
Interest	1,321	1,348	1,348	1,400	1,182	1,331	1,411	1,531	1,842	2,363	2,900	3,148	3,371
Other	2,005	3,373	2,230	2,487	2,283	2,249	1,713	2,608	3,049	3,631	3,947	4,173	4,417
Capital expenditure	2,585	4,701	4,701	9,889	8,615	8,614	9,841	8,640	7,975	6,617	6,663	7,028	6,825
Of which: Mega projects			210			2,682		4,199	2,668	2,780	1,552	0	0
Of which: SDF							1,128	377	710	843	867	896	924
Net lending	-152	-97	-98	16	364	364	-52	-52	-78	-79	-85	-92	-99
Overall balance	-4,202	-4,204	-4,204	-3,372	-6,673	-6,716	-1,589	-5,538	-5,286	-5,013	-5,095	-4,906	-4,220
Overall balance, excluding grants	-4,367	-4,841	-4,841	-4,593	-6,862	-6,904	-714	-5,738	-5,465	-5,192	-5,274	-5,085	-4,399
Financing 2/	4,202		4,204	3,372		6,716	1,589	5,538	5,286	5,013	5,095	4,906	4,220
External	-311		-297	2,487		2,030	1,360	5,274	2,609	2,948	2,909	2,959	-460
Domestic	4,513		4,502	886		4,686	230	264	2,677	2,065	2,186	1,947	4,681
MMA	226		0	...		0		0	0	0	0	0	0
Commerical banks	1,850		2,071	...		2,155		121	1,231	950	1,006	896	2,153
Other	2,437		2,431	...		2,530		142	1,446	1,115	1,180	1,052	2,527
Memorandum items:													
Current balance	-1,383		-238	...		2,074	7,324	2,850	2,432	1,345	1,303	1,850	2,327
Primary balance	-2,880		-2,857	...		-5,385	-178	-4,007	-3,444	-2,650	-2,195	-1,758	-849
Current primary balance	-62		1,109	...		3,405	8,736	4,381	4,273	3,708	4,203	4,999	5,698

Sources: Maldivian authorities; and IMF staff estimates and projections.

1/ The green tax replaced the bednights tax in 2015

2/ Includes unidentified financing.

Table 2b. Maldives: Central Government Finances, 2014–22 (Baseline Scenario)

(In percent of GDP, unless otherwise specified)

	2014	2015	2015	2016	2016	2016	2017	2017	2018	2019	2020	2021	2022
		Auth. Rev Est.	Staff.	Auth. Budg.	Auth Rev Est.	Staff.	Auth. Budg.	Staff			Proj.		
Total revenue and grants	26.7	27.7	27.7	34.8	28.4	28.4	31.3	28.7	28.6	28.3	28.4	28.5	28.6
Revenue (excluding privatization receipts)	26.4	26.7	26.7	33.0	28.1	28.1	30.0	28.4	28.4	28.1	28.2	28.4	28.5
Tax revenue	18.9	19.7	19.7	21.1	20.2	20.2	20.5	20.9	20.8	20.5	20.6	20.6	20.5
Import duties	3.5	3.8	3.8	3.6	3.8	3.8	3.9	3.8	3.4	3.2	3.2	3.2	3.0
Airport service charge	0.8	0.8	0.8	0.9	0.8	0.8	0.8	0.8	0.7	0.7	0.7	0.7	0.7
Business profit tax (BPT)	4.3	4.3	4.3	4.4	4.2	4.2	4.2	4.4	4.6	4.6	4.7	4.8	4.9
Remittance Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Goods and services tax (GST)	7.9	9.8	9.8	10.1	9.6	9.6	9.6	10.0	10.1	10.0	10.0	10.0	10.0
Of which: General GST	2.7	3.1	3.1	3.2	3.6	3.6	3.5	3.6	3.6	3.6	3.6	3.6	3.6
Tourism GST	5.3	6.7	6.7	6.9	6.0	6.0	6.2	6.4	6.5	6.4	6.4	6.4	6.4
Tourism tax ($6 green tax) 1/	1.4	0.1	0.1	1.0	1.0	1.0	1.0	1.0	1.0	0.9	0.9	0.9	0.9
Other	1.0	0.9	0.9	0.2	0.1	0.9	0.8	0.9	0.9	0.9	0.9	0.9	0.9
Nontax revenue	7.3	6.9	6.9	9.6	7.8	7.8	9.5	7.1	7.4	7.4	7.5	7.7	8.0
SOE profit transfers	1.4	0.8	0.8	0.9	1.0	1.0	2.3	1.2	1.2	1.1	1.1	1.1	1.1
Royalties, land, and resort rent	3.5	4.1	4.1	6.1	3.2	3.2	4.2	2.4	2.4	2.5	2.6	2.9	3.1
Other	2.4	2.1	2.1	2.5	3.6	3.6	3.0	3.5	3.8	3.8	3.7	3.7	3.7
Capital revenue	0.2	0.0	0.0	2.3	0.0	0.0	0.0	0.4	0.2	0.1	0.1	0.0	0.0
Grants	0.3	1.0	1.0	1.9	0.3	0.3	1.3	0.3	0.2	0.2	0.2	0.2	0.2
Expenditure and net lending	34.1	34.5	34.5	40.0	38.6	38.7	33.5	36.6	35.7	34.7	34.3	33.9	32.9
Current expenditure	28.8	27.0	27.0	24.8	24.9	24.9	19.5	24.3	25.1	26.4	26.6	26.3	26.1
Of which: Salaries and allowances	10.8	11.0	11.0	10.4	10.6	10.7	9.8	10.3	10.0	9.6	9.2	8.9	8.5
Transportation, communication, and utilities	2.4	3.3	3.3	2.6	2.5	2.5	1.8	2.4	3.0	3.8	3.9	3.9	3.9
Social welfare contributions	2.7	2.5	2.5	2.6	3.5	3.3	1.5	3.1	3.2	3.2	3.2	3.4	3.6
Repairs and maintenance	1.0	0.6	0.6	0.4	0.5	0.5	0.1	0.5	0.4	0.5	0.5	0.5	0.5
Subsidies and transfers	5.9	2.0	3.8	2.9	2.5	2.5	1.7	2.0	1.9	1.8	1.8	1.7	1.7
Interest	2.3	2.2	2.2	2.1	1.8	2.0	2.0	2.2	2.5	3.0	3.4	3.4	3.4
Other	3.5	5.5	3.6	3.8	3.5	3.4	2.5	3.7	4.1	4.6	4.6	4.5	4.5
Capital expenditure	4.5	7.6	7.6	15.1	13.2	13.2	14.1	12.4	10.7	8.3	7.8	7.6	6.9
Of which: Mega projects			0.3			4.1	0.0	6.0	3.6	3.5	1.8	0.0	0.0
Net lending	-0.3	-0.2	-0.2	0.0	0.6	0.6	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Overall balance	-7.4	-6.8	-6.8	-5.2	-10.2	-10.3	-2.3	-8.0	-7.1	-6.3	-6.0	-5.3	-4.3
Overall balance, excluding grants	-7.7	-7.8	-7.8	-7.0	-10.5	-10.6	-1.0	-8.2	-7.4	-6.5	-6.2	-5.5	-4.4
Financing 2/	7.4		6.8	5.2		10.3	2.3	8.0	7.1	6.3	6.0	5.3	4.3
External	-0.5		-0.5	3.8		3.1	2.0	7.6	3.5	3.7	3.4	3.2	-0.5
Domestic	7.9		7.3	1.4		7.2	0.3	0.4	3.6	2.6	2.6	2.1	4.7
MMA	0.4		0.0	...		0.0		0.0	0.0	0.0	0.0	0.0	0.0
Commerical banks	3.3		3.3	...		3.3		0.2	1.7	1.2	1.2	1.0	2.2
Other	4.3		3.9	...		3.9		0.2	1.9	1.4	1.4	1.1	2.6
Memorandum items:													
Current balance	-2.4		-0.4	...		3.2	10.5	4.1	3.3	1.7	1.5	2.0	2.4
Primary balance	-5.1		-4.6	...		-8.2	-0.3	-5.8	-4.6	-3.3	-2.6	-1.9	-0.9
Current primary balance	-0.1		1.8	...		5.2	12.5	6.3	5.7	4.7	4.9	5.4	5.8
Public and publicly guaranteed debt 3/	54.2		56.9	...		65.7		69.4	72.0	73.5	74.3	74.3	73.2
Domestic	35.3		39.8	...		44.8		42.4	43.3	43.1	42.7	41.8	43.6
External (excluding IMF and currency swaps by MMA)	18.9		17.1	...		20.8		27.0	28.7	30.4	31.6	32.5	29.7
GDP (in millions of rufiyaa)	56,867	61,869	61,869	65,310	65,310	65,310	69,648	69,648	74,349	79,488	85,446	91,932	98,913

Sources: Maldivian authorities; and IMF staff estimates and projections.

1/ The green tax came into effect in November 2015, it replaced the bednights tax (eliminated November 2014).

2/ Includes unidentified financing.

3/ Arrears are included.

Table 3. Maldives: Monetary Accounts, 2014–22 (Baseline Scenario)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
				Proj.					
	(In millions of rufiyaa, e.o.p.)								
Net foreign assets	12,552	12,297	7,827	10,895	11,791	12,407	13,421	14,293	14,013
Maldives Monetary Authority, net	9,110	8,227	5,285	8,213	8,969	9,445	10,318	11,049	10,626
Assets	9,476	8,699	7,219	8,694	9,460	9,945	10,828	11,570	11,157
Liabilities	-366	-471	-1,934	-481	-490	-500	-510	-520	-531
Commercial banks, net	3,442	4,070	2,542	2,682	2,821	2,962	3,103	3,244	3,387
Net domestic assets	14,612	18,195	22,609	22,476	24,833	27,847	31,058	34,896	40,388
Domestic credit	26,008	30,084	35,965	38,536	40,558	42,699	45,741	49,304	53,153
Public sector	10,606	12,963	16,981	17,583	17,346	17,099	17,392	17,692	18,028
Central government (net)	9,273	11,470	13,430	14,622	15,063	15,308	15,558	15,813	16,100
Public enterprises	1,333	1,493	3,551	2,961	2,283	1,791	1,834	1,879	1,928
Private sector	15,114	16,817	18,591	20,523	22,783	25,171	27,919	31,183	34,696
Other items (net)	-11,396	-11,890	-13,356	-16,060	-15,725	-14,852	-14,683	-14,408	-12,766
Broad money	27,164	30,492	30,436	33,371	36,624	40,254	44,479	49,190	54,401
Narrow money	11,202	13,338	13,467	14,766	16,205	17,812	19,681	21,766	24,072
Currency	2,683	2,756	2,695	2,695	2,695	2,695	2,695	2,695	2,695
Public enterprise and local government deposits	1	1	0	0	0	0	0	0	0
Demand deposits	8,518	10,581	10,772	12,071	13,510	15,117	16,986	19,071	21,376
Quasi-money	15,963	17,154	16,968	18,605	20,418	22,442	24,798	27,424	30,329
	(Annual percentage change, unless otherwise indicated)								
Broad money	14.7	12.3	-0.2	9.6	9.7	9.9	10.5	10.6	10.6
Narrow money	7.5	19.1	1.0	9.6	9.7	9.9	10.5	10.6	10.6
Domestic credit, net	4.7	15.7	19.5	7.1	5.2	5.3	7.1	7.8	7.8
Central government	7.4	23.7	17.1	8.9	3.0	1.6	1.6	1.6	1.8
Public enterprises	-15.3	12.0	137.8	-16.6	-22.9	-21.6	2.4	2.4	2.6
Private sector	3.3	11.3	10.5	10.4	11.0	10.5	10.9	11.7	11.3
	(In percent of GDP)								
Broad money	47.8	49.3	46.6	47.9	49.3	50.6	52.1	53.5	59.2
Narrow money	19.7	21.6	20.6	21.2	21.8	22.4	23.0	23.7	26.2
Domestic credit, net	45.7	48.6	55.1	55.3	54.6	53.7	53.5	53.6	57.8
Central government	16.3	18.5	20.6	21.0	20.3	19.3	18.2	17.2	17.5
Public enterprises	2.3	2.4	5.4	4.3	3.1	2.3	2.1	2.0	2.1
Private sector	26.6	27.2	28.5	29.5	30.6	31.7	32.7	33.9	37.7
	(In millions of U.S. dollars)								
Gross foreign assets of MMA	615	564	468	564	614	645	703	751	724
Usable reserves	120	200	199	209	234	250	278	302	289
Commercial banks NFA	223	264	165	174	183	192	201	211	220
Commercial banks forex open position, net	160	116	91	118	130	143	157	173	190
Memorandum items:									
Velocity	2.1	2.0	2.1	2.1	2.0	2.0	1.9	1.9	1.4
Money multiplier	2.2	3.0	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Reserve money (in millions of rufiyaa, e.o.p.)	12,502	10,274	8,978	9,843	10,803	11,874	13,120	14,510	16,047

Sources: Maldivian authorities; and IMF staff estimates and projections.

Table 4. Maldives: Balance of Payments, 2014–22 (Baseline Scenario)
(In millions of U.S. dollars, unless otherwise specified)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
			Est.			Proj.			
Current account	-118	-295	-831	-779	-818	-847	-792	-771	-663
Balance of goods and nonfactor services	545	376	169	7	35	73	207	314	507
Trade balance	-1,660	-1,655	-1,840	-2,088	-2,277	-2,371	-2,440	-2,556	-2,553
Exports (f.o.b.)	301	240	256	285	320	355	401	450	490
Domestic exports	145	144	140	139	160	183	210	242	263
Re-exports	156	96	117	147	160	172	191	208	227
Imports (f.o.b.)	-1,961	-1,894	-2,097	-2,373	-2,597	-2,726	-2,842	-3,006	-3,043
Tourism-related	-372	-359	-347	-372	-396	-423	-457	-494	-534
Other	-1,589	-1,535	-1,749	-2,002	-2,201	-2,303	-2,385	-2,513	-2,509
Of which: Construction	-167	-241	-283	-340	-368	-402	-341	-303	-290
Nonfactor services, net	2,205	2,031	2,009	2,095	2,312	2,444	2,647	2,871	3,061
Of which: Travel receipts	2,696	2,567	2,515	2,681	2,857	3,049	3,293	3,561	3,851
Income, net	-355	-326	-364	-404	-443	-481	-526	-576	-621
Current transfers, net	-308	-345	-635	-382	-410	-439	-473	-510	-549
Receipts	4	24	13	13	12	12	12	12	12
Payments	-312	-369	-648	-395	-422	-451	-485	-521	-561
Capital and financial account	544	501	811	876	868	879	850	819	636
Of which: 1/									
Foreign direct investment, net	333	308	448	452	507	490	457	418	449
Other investment, net	222	60	368	427	365	393	396	406	190
Monetary authorities 2/	-6	-2	96	-100	0	0	0	0	0
General government	-19	-6	132	342	169	191	189	192	-30
Of which: Disbursements of loans	45	44	189	404	226	247	239	251	225
Of which: Mega projects		14	174	273	173	180	101	42	0
Amortization	-66	-63	-58	-62	-57	-56	-51	-59	-255
Banks	20	-23	104	108	113	118	124	130	137
Other sectors 3/	227	91	36	77	83	83	83	83	83
Errors and omissions	-173	-255	-75	0	0	0	0	0	0
Overall balance	253	-50	-95	96	50	32	57	48	-27
Gross international reserves (increase: -)	-246	51	96	-96	-50	-32	-57	-48	27
Use of Fund credit, net	-6	-1	-1	-1	-1	0	0	0	0
Financing gap 4/	0	0	0	0	0	0	0	0	0
Memorandum items:									
Gross international reserves (stock; e.o.p.) 2/	615	564	468	564	614	645	703	751	724
In months of GNFS imports	2.7	2.4	1.8	1.9	1.9	1.9	2.0	2.0	1.9
In percent of short-term debt at remaining maturity	180	154	161	197	186	214	208	192	114
Usable reserves (stock; e.o.p.) 2/	120	200	199	209	234	250	278	302	289
In percent of short-term debt at remaining maturity	42	55	69	73	71	83	82	77	46
Current account (in percent of GDP)	-3.2	-7.3	-19.6	-17.2	-17.0	-16.4	-14.3	-12.9	-10.3
GNFS balance (in percent of GDP)	14.8	9.4	4.0	0.2	0.7	1.4	3.7	5.3	7.9
Exports (volume, percent change)	-7.9	-12.5	9.2	9.9	11.6	10.0	12.4	11.6	8.3
Imports (volume, percent change)	18.3	15.3	19.0	4.5	8.2	4.2	3.5	5.0	0.4
Tourism: bednights (percent change)	3.3	-4.3	2.3	4.5	4.5	4.6	5.5	5.5	5.5
Tourism: travel receipts (percent change)	15.4	-4.8	-2.0	6.6	6.6	6.7	8.0	8.1	8.1
External debt (in percent of GDP) 4/	28.9	27.2	34.7	38.9	42.8	46.4	49.1	51.2	49.3
Medium- and long-term	25.4	23.7	30.5	35.3	38.5	43.2	45.6	47.5	45.4
Short-term	3.5	3.5	4.2	3.6	4.2	3.2	3.5	4.3	4.2
Debt service (in percent of domestic GNFS exports)	6.4	8.0	4.7	5.2	5.3	5.6	5.7	6.0	10.1
Exchange rate (rufiyaa per U.S. dollar; average)	15.4	15.4	15.4	…	…	…	…	…	…
GDP (in millions of U.S. dollars)	3,690	4,015	4,238	4,520	4,825	5,158	5,545	5,966	6,419

Sources: Maldivian authorities; and IMF staff estimates and projections.
1/ There are no capital transfers or portfolio investments.
2/ MMA liabilities, include allocation of SDR 7.4 million, equivalent to US$11.7 million, made available in Q3 2009,
see http://www.imf.org/external/np/tre/sdr/proposal/2009/0709.htm. These are treated as long term liabilities of the MMA.
3/ These flows are treated as non-debt creating, as they mainly reflect intra-company financing for tourism-related projects.
4/ Public and private external debt includes IMF, but excludes domestic foreign-currency denominated debt.

Table 5. Maldives: Selected Financial Soundness Indicators, 2007–2017

(In percent, unless otherwise specified)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016Q1	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2
Capital															
Regulatory capital to risk-weighted assets	15.4	21.0	24.7	28.9	30.3	35.8	34.0	44.5	37.2	40.1	42.9	42.0	44.5	41.3	41.8
Tier 1 capital to risk-weighted assets	24.8	15.4	20.82	24.8	26.3	30.1	30.0	34.5	30.0	35.8	36.4	34.1	34.4	38.3	37.3
Capital to total assets	12.8	15.9	16.4	17.7	18.8	20.2	19.3	21.3	20.5	19.6	21.0	21.8	23.7	22.6	23.0
Asset quality															
Nonperforming loans (gross) to total loans (gross)	1.7	8.9	12.7	17	19.4	21	16.7	17.4	14.1	12.1	11.1	10.5	10.6	10.7	9.6
Nonperforming loans (net of provisioning) to regulatory capital	-1.7	31.8	33	34.9	35.2	16.5	2.4	11.1	3.0	2.9	2.6	1.1	2.4	2.4	2.6
Earnings and profitability															
Return on assets	5.3	3.4	2.2	2.0	2.6	2.4	5.1	4.6	4.5	1.54	2.6	2.6	3.42	3.64	3.54
Return on equity	41.2	23.4	13.8	11.5	14.4	13.2	23.8	20.3	22.1	7.83	12.43	12.43	15.67	16.11	15.42
Liquidity															
Liquid assets to total assets	11.4	9.6	20.7	25.9	27.9	28.3	34.1	43.4	43.1	51.5	50.6	50.4	48.4	47.8	45.3
Liquid assets to short term liabilities	...	...	...	...	...	20.19	25.4	57.63	56.3	66.9	66.8	68.0	68.3	64.8	62.8
Assets of Banks (rufiyaa billions)	18.3	22.7	25.1	25.9	28.7	27.6	32.7	37.0	44.1	47.2	46.8	47.6	46.4	47.4	47.5
Deposits of banks (rufiyaa billions)	10.2	12.2	14.3	15.5	18.3	19.2	22.6	26.8	30.1	32.4	31.7	31.9	30.1	30.8	30.8

Source: STA and Maldives Monetary Authority.

Annex I. Revised GDP Data

1. The Maldives's National Bureau of Statistics (NBS) has been working to revise the national accounts for the period 2003-2015. South Asia Regional Training and Technical Assistance Center (SARTTAC) conducted a TA mission to the Maldives in March 2017 to assist the NBS finalize the GDP benchmarking and rebasing. The IMF Statistics Department has also provided extensive TA to NBS in support of this effort. Prior to the release of the revised time series, staff has used the 2003-based GDP data and its own estimates. A follow-up SARTTAC TA mission in August has helped NBS finalize the new GDP estimates, approved by the government and reflected in the Staff Report.

2. NBS revision has changed the base year from 2003 to 2014. The revised estimates reflect statistical, conceptual, and methodological revisions. Statistical revisions focused on incorporating new data sources from the financial statements of corporate enterprises from the MOFT and the Ministry of Economic Development (MED); as a result, double deflation methods have been used to estimate five economic activities, lessening the need to rely on extrapolating benchmark values. Table 1 shows selected conceptual and methodological revisions that were incorporated during the benchmark. GDP will be presented at purchasers' prices as data on taxes on products are now available; prior to the benchmark, GDP was presented at basic prices.

Table 1 – Maldives: Conceptual and Methodological Revisions Incorporated in the 2014 Benchmark

Category	Pre-benchmark Treatment	Post-benchmark Treatment	Impact
FISIM (Financial Intermediation Services Indirectly Measured)	Estimates based on the *1993 SNA*; service not assigned to using industries.	Estimates based on the *2008 SNA*; service assigned to using industries.	Upward revisions
Insurance	Estimates based on the *1993 SNA*.	Estimates based on the *2008 SNA*.	Upward revisions
Fisheries; Electricity; Water; FISIM; insurance and financial auxiliaries.	Gross value added (GVA) for non-benchmark periods based on single-deflation method.	GVA for non-benchmark periods based on double-deflation method.	Upward revisions
Accommodations, food and beverage services.	Estimates derived for: (i) resorts and safari vessels; and (ii) other hotels, restaurants, and guest houses.	Estimates derived for: (i) resorts; (ii) safaris; (iii) hotels; (iv) guest houses; and (v) food and beverage.	Upward revisions
Education services.	Estimates derived for one unified category.	Estimates derived separately for government and private sector.	Upward revisions
Human health and social care services.	Estimates derived for one unified category.	Estimates derived separately for government and private sector.	Upward revisions

Annex II. The Parallel Foreign Exchange Market—Recent Developments

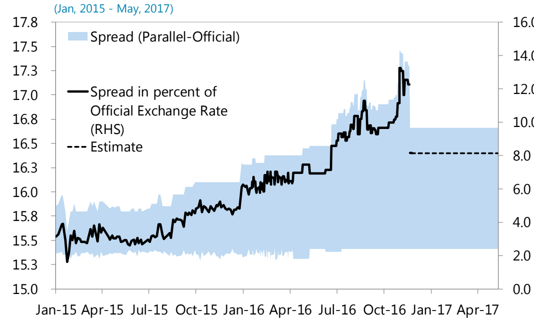
A three-pronged approach that encapsulates reforms in the area of exchange rate arrangement, FX regulation and monetary policy can help eliminate the parallel premium and reduce the extent of dollarization in the Maldives.

1. The active parallel FX market that appeared with the rapid development of tourism continues to flourish in the Maldives. The FX market consists of the MMA, 7 commercial banks, and 429 money changers (MCs) of which 106 are resorts and 323 are private parties.[1] The tourist industry is a key supplier and driver of the parallel market as many resorts have MC licenses to buy and sell foreign currency. In addition, hotels, shops and restaurants in the capital also quote and receive payments in dollars. Regulations governing the operations of MCs are light and hardly enforced. With few transactions recorded or reported, the parallel market rates are based on anecdotal data and unofficial surveys.

2. The parallel market premium increased steadily last year and has now stabilized. The premium, the difference between the official market rate and the parallel market rate, had steadily increased to over 12 percent in 2016. Historically this premium has been in the 5 to 15 percent range.[2] While seasonality explains some of the periodic spikes, the steady increase in 2016 was linked to the significant deterioration of the CA and the large court ordered payment later in the year.[3] The premium gradually declined in the first five months of 2017 following the MMA's increased intervention in the FX market and FX allocation to commercial banks and sales to SOEs.

Parallel Market Spread - Recent Developments

(Jan, 2015 - May, 2017)



Sources: *Bloomberg* and anecdotal data.

3. The high level of dollarization, an active parallel market and fiscal dominance has weakened the monetary transmission channels. It limited the MMA's control over the FX market. The low level of reserves has also led to targeted allocation of FX at the official rate, helping to support the parallel market.

[1] Data based on the AREAER 2015 data accessed online.

[2] Box 5. The Operation of Maldives Parallel FX Market, Maldives: 2014 Article IV—Staff Report, March 11, 2015.

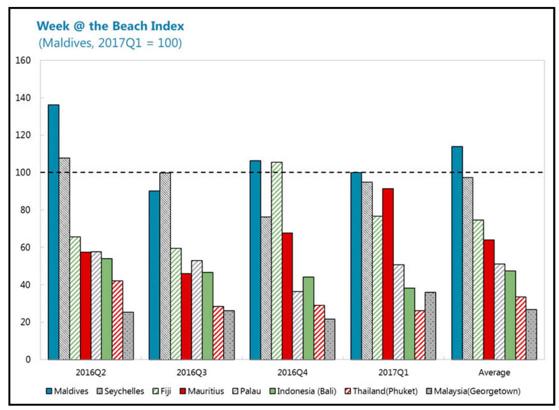
[3] Gross reserves fell to US$467 million in late 2016, of which US$200 million are usable, mainly attributed to the MMA US$140 million bond purchase from the MACL in settling its payment to GMR.

Annex III. Maldives in the Global Tourism Market

The Maldives remains one of the world's premier high-end tourist destinations. In the coming years, supported by a significant expansion of the international airport and other tourism-related infrastructure, the number of tourist arrivals is expected to increase significantly. This expansion is likely to force Maldives into more price-sensitive segments of the global market and expose it to further international competition.

1. Against this background the Annex provides an overview of Maldives' position in terms of relative prices with respect to direct international competitors in the tourism market. It also reports recent trends in airline fares from the most important tourism markets to assess the extent to which these trends can further support the expansion of tourism projected in Maldives over the coming years.

2. Competitiveness in the tourism market is the result of many factors. Relative prices are one of those factors. A simple but nonetheless informative way of gauging potential price effects on global tourism demand is by comparing the cost of a similar stay across destinations. The IMF has developed the Week@theBeachindex[1] to assess and monitor trends in this area. The index comprises a large sample of data from online holiday booking sites to establish an average cost for a comparable one-week holiday across destinations.



3. The Week@theBeach index lists Maldives as the highest cost destination among competitors in Asia and the Indian Ocean. Over the 2016Q2-2017Q1 on average, with the exception of Seychelles, the cost of holidays in Fiji (around 75 percent), Mauritius (65 percent) and Palau and Bali (around 50 percent) are well below those in a similar-rating accommodation in Maldives. Moreover, the corresponding index of other very popular beach destinations in Asia like Phuket in Thailand and Georgetown in Malaysia is around 1/3 of Maldives. Results however show considerable seasonality across the different destinations.

4. There are important additional considerations to bear in mind in interpreting findings based on the index. Firstly, competitiveness in the tourism sector reflect other factors beyond what is reflected in available relative prices. Price competitiveness does not reflect differences in quality amongst the underlying products, experiences, and marketing and type of destinations. This is particularly problematic in the case of tourism, where an ostensibly similar product designation, a 5-star hotel, masks tremendous underlying variation in quality and type of experience. In addition, the inclusion or removal of super-luxury hotels can distort the sample.

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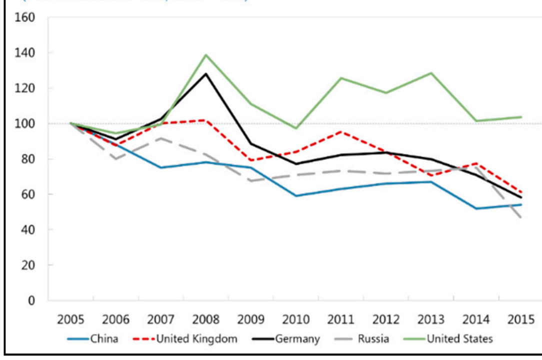
[1] The index is calculated using over 37,000 hotel prices drawn from TripAdvisor, prices data for individual consumable items drawn from the crowdsharing resources Numbeo & World Taxi Fares'- for further details on data and methodology, see Laframboise and others, 2014, "Revisiting Tourism Flows to the Caribbean: What is Driving Arrivals?' IMF WP/14/229.

5. Another important factor to assess the outlook for Maldives tourism is airfares. The week@the beach index does not include airfares, and almost all tourist arrivals to Maldives come by air. Based on IATA data, airfares to Maldives from major markets have fallen over the past decade, which partly reflects global trends in airline fares, driven by technological developments, greater fuel efficiency and increased competition in the airline sector.

Evolution of Fares from Major Sources of Global Tourism to Maldives
(Before Taxes and Fees, 2005 = 100)



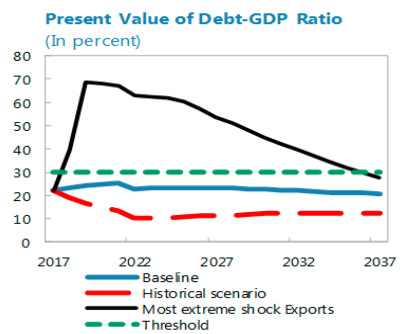
6. Maldives has benefited from the downward trend in global airfares over the last decade.[2] Airline fares to Maldives from the major markets declined between 25-to-50 percent over the last decade. Importantly this downward trend has been observed both for traditional markets like continental Europe and the U.K. but also for more recent tourism markets like Russia and China. Looking forward, this downward trend in airfares has important implications for the expansion of Maldives tourism. On the one hand, an important factor behind these lower fares has been the expansion of new airlines covering Maldives routes mainly from Europe through new international hubs, intensifying competition in the airline sector and improving the service to Maldives as important international destination. On the other hand, these developments in the airline sector have likely facilitated greater access for new destinations into the international tourism market, increasing global competition for Maldives. For example, countries like Fiji and other Pacific Islands, where previously airline connectivity was a prohibitive factor for their nascent tourism industry, are likely to become important competitors in the coming years.

[2] The only destination from where prices have not fallen, the US, constitutes only 2.5% of arrivals to the Maldives (though a larger proportion by expenditure). The growth of American tourists to the Maldives over the past 10 years demonstrates that price factors are just one factor in determining the level of arrivals, with global income trends, marketing campaigns and changing tastes also playing a large role in determining final tourism outcomes.

Annex IV. External Sector Assessment

Overall, the external position is assessed to be substantially weaker than fundamentals and desirable policy settings: Real Effective Exchange Rate (REER) gap is substantial and the risk of external debt distress remains high. With the infrastructure ramp up, the CA is expected to remain in large deficits and reserves at low levels over the medium term. A tighter fiscal policy stance along with more flexibility in the pegged regime would improve the external position.

1. The debt sustainability analysis (DSA) assesses Maldives' external risk rating as high. The external debt ratio is on a rising path over the medium term reflecting the large ongoing infrastructure scale up and the recent US$200 million sovereign bond issuance. The external debt path has improved compared to the previous DSA due entirely to the rebasing of GDP as opposed to an improvement in economic and policy fundamentals. However, a widening CA deficit, low international reserves, and rapid debt buildup leaves the Maldives vulnerable to external shocks.

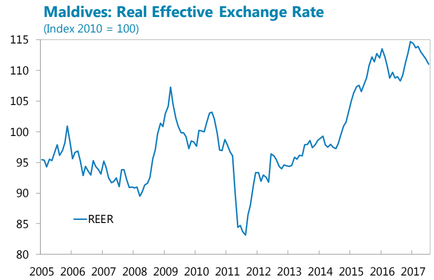


2. The CA deterioration indicates a weaker external position. The CA deficit deteriorated significantly in 2016 (19.6 percent of GDP) compared to last year's projections due to increased infrastructure-related imports, moderate tourism receipts, higher remittance outflows, and reclassification of a large one-off court mandated payment.[1] This deterioration has resulted in a large CA gap (17.2 percent of GDP) in the CA model of the EBA-lite analysis. Coupled with a real exchange gap of 30.3 percent, the CA model points to a '*substantially weaker*' overall assessment of the external sector. The CA gap continues to reflect a saving-investment imbalance and persistent fiscal deficits. Fiscal policy accounts for 2.5 percentage points of the policy gap. However, the CA gap is reduced to 10.7 percent if adjusted for the large one-off court mandated payment – but doesn't change the final assessment. Over the medium term, the CA deficits remain high reflecting the import-heavy nature of the ongoing large infrastructure investments, averaging close to 10 percent of GDP over the long run (2017–37).

	No ad-hoc adjustment	With ad-hoc adjustment
CA-Actual	-19.6%	-13.2%
CA-Norm	-2.4%	-2.4%
CA-Gap	-17.2%	-10.7%
o/w Policy gap	-2.5%	-2.5%
REER Gap	30.3%	18.9%
CA-Fitted	-4.9%	-4.9%
Residual	-14.7%	-8.3%

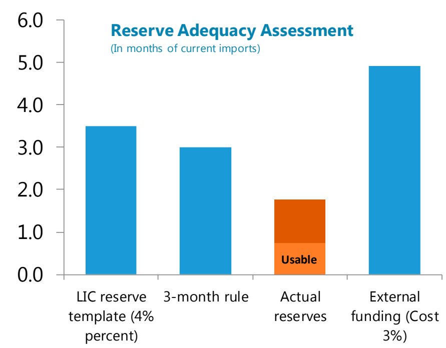
[1] MACL (Airport SOE) settled its claims with GMR (Indian infrastructure firm) payment (US$270 million) late 2016. This was deemed imperative by MMA in avoiding delays of airport expansion plans and averting a sovereign default.

3. Real exchange rate methods point to a substantial exchange rate gap. The EBA-lite CA model assesses the REER gap to be around 30.3 percent and 18.9 percent if adjusted for the one-off court payment. The EBA-lite Index REER model generates a gap of a similar magnitude (15.8 percent). Risks from appreciating currency, weak growth in key advanced and emerging economies, ramifications from Brexit,[2] and the current internal political situation could weaken tourism receipts. Introducing greater exchange rate flexibility under a currency basket peg to help absorb external shocks, enforcing changes to the foreign currency regulation to expand supply of FX in the domestic market, and aligning the liquidity management tools of the MMA in support of MVR would help reduce this gap.



Sources: IMF *Information Notice System (INS)* data and staff calculations.

4. Reserves remain low relative to adequacy metrics. The level of reserves has persistently hovered around the minimum requirement as suggested by adequacy metrics reflecting a dollarized economy and a parallel market supplying dollars at a premium. Going forward, reserves are expected to remain low considering large expected CA deficit and external debt obligations that fall due.[3] Staff's reserve adequacy framework suggests that the optimum level of reserves for the Maldives is in the range of 3.5–5 months of imports.[4]



[2] Close to 90 percent of the tourists come from Europe (including the U.K.) and Asia (including China). By country, China (25 percent), Germany (8 percent) and the U.K. (8 percent) represent the three largest destinations for tourist arrivals to the Maldives.

[3] The estimated debt service payments for PPG external debt averages US$92 million until 2021. In addition, the bullet payment on the sovereign bond (US$200 million) comes due in 2022.

[4] The estimates depend on the assumptions made about the net cost of holding reserves, external funding costs and economic size.

Annex V. Risk Assessment Matrix (RAM)[1/]

	Shocks and Likelihood (Red= high likelihood; green = low likelihood)	Potential Impact (Red= high; green=low)	Policy Response
Domestic	Resumption of political turmoil and a deterioration in conditions such as a downgrade in security or health risks.	Resumption in political turmoil or a rise in extremism resulting in the deterioration in security conditions or a potential health risk could undermine confidence and tourism flows; BOP pressures could be exacerbated, fiscal consolidation derailed with a run up in inflation.	Moderate fiscal easing and increasing transfers to the poor as needed. Reserve buffers could be used to cushion the shock and smooth exchange rate volatility. Under strained or lack of fiscal and external space, official assistance could be considered.
Domestic	Further reserve drawdown and a weak fiscal position reflected in continued high fiscal deficits and debt accumulation.	Given extensive government-guaranteed investment and lending, the impact of a severe tourism downturn on the fiscal position could be considerable. Risks are further compounded by the non-availability of comprehensive data related to (loan) guarantees issued and lack of assessment of fiscal risks associated with guarantees.	Decisive and durable fiscal measures together with strengthened public financial management would reduce both fiscal and external pressures.
External	Structurally weak growth in key advanced and emerging economies (EMs).	Tourism sector is expected to benefit from stronger economic recovery in the Eurozone and a smooth economic rebalancing of the Chinese economy (from investment to consumption). Lower tourism receipts, if persistent, would pose an important risk to the economy considering the macro-economic significance of the tourism sector. Therefore a slowdown in these key markets will impact the tourism industry, with a negative impact on BOP and on reserves.	The exchange rate should be allowed to adjust within the band and fiscal policy would also require some adjustment to keep the deficit broadly in line with the fiscal anchor, with social spending on the poor protected via restraint in other current expenditure.
External	Intensification of the risks of fragmentation/security dislocation in part of the Middle East, Africa, and Europe.	Given the geographical location of the all the major airline hubs that connect the tourist inflows to the Maldives - any disruption in the security situation in the Middle East or Europe is likely to affect tourism inflows.	While traditional markets (like the european market) are the most sought after market in the Maldives, other alternative marketing strategies should be developed to attract non-tradtional markets into the Maldives. Emerging asian countries are one such example where efforts to market Maldives as a destination could be ramped up.
External	Significant further strengthening of the US dollar and/or higher rates.	The REER has risen as the US dollar appreciated and Maldives may be losing some competitiveness compared to other tourist destinations. As a high end destination with around 60 percent of resorts in the 5 star and plus category, Maldives tourist demand is likely to be relatively price and income inelastic—though the new and growing middle-market is likely to be more price sensitive. But over time a further sharp U.S. dollar appreciation against the euro would likely have some dampening effect on demand. If there is a more rapid Fed normalization, then external borrowing is likely to get more expensive affecting debt sustainability.	Further nominal appreciation against the US$ should be resisted in the near term. If consistent with the inflation outlook, monetary policy should be eased. If appreciation pressures prolong into the medium term, the exchange rate should be allowed to adjust. Fiscal policy should aim at reducing the defict and financing needs.

Source: IMF staff.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex VI. Public Investment Trends and Efficiency in the Maldives: Performance, Challenges, and Strategy Going Forward

1. **In the Maldives, public investment trends have been influenced by several contextual factors including the economic dependency on tourism, the high exposure to climate change, and the recent democratization.** The economy is heavily dependent on tourism and has over two decades developed a profitable high tourism sector; the 2004 Tsunami highlighted the vulnerability of the country to climate events; and since the new constitution in 2008, the multi-party democracy has experienced some political tensions.

2. **The economic and social impact of public investment critically depends on its 'efficiency'.** The economic dividends from closing this efficiency gap are substantial: the most efficient public investors get twice the growth "bang" for their public investment "buck" than the least efficient.

3. **Maldives has an important investment 'efficiency gap', underscoring the need to improve public investment management (PIM).** The indicator for physical access to infrastructure indicates relatively low efficiency in public investment (Figure 2.B—FAD PIMA Report, 2016). The resulting 'efficiency gap' between Maldives and the most efficient countries is 50 percent, which suggests that about half of the public capital stock did not achieve its full potential. The gap is wider than the Emerging Market Economies region (EME) average and that of all countries (41 percent), but comparable to the average gap of Emerging and Developing Asia region (EDA) countries (50 percent, Figure 2.C).

Figure 2.B. Efficiency Frontier, Physical Infrastructure (2008-2015)

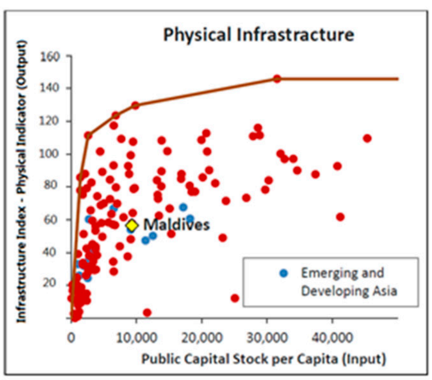
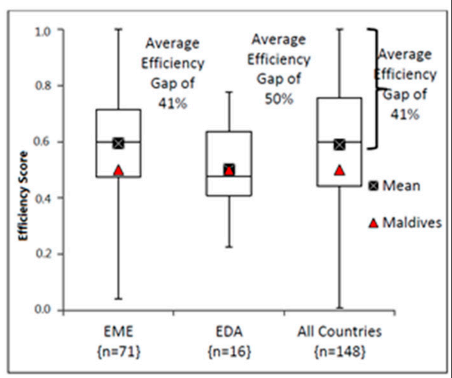


Figure 2.C. Efficiency Gap, Physical Infrastructure (2008-2015)



Source: Staff estimates

4. **Strengthening PIM institutions will help to close this 'efficiency gap'.** The PIMA mission assessed the strength and quality of PIM in the Maldives using a new framework, based on the three phases of the PIM cycle: planning, allocation, and implementation and on 15 key institutions involved in the PIM cycle.

5. **Most public investment institutions are at a basic stage of development and implementation when compared to EME and all countries.** Investing in improving these institutions, based on the PIMA report's recommendations, will significantly enhance efficiency.

PIMA's recommendations and strategy going forward as presented in the FAD TA Report are to:

- **Strengthen strategic guidance and budget ceilings for public investment.** Revise the budget calendar to prepare and to circulate the *Fiscal Strategy Statement* earlier (e.g. in April) to enable it to drive the budget process, set priorities for the public investment and let these be the basis for approved total ceilings. Approve realistic aggregate expenditure ceilings (for recurrent and public investment) at the start of the budget process. Moreover, establishing a ceiling for the PSIP budget at the start of the budget process based on a binding resource envelope and include PSIP ceilings in the budget circular. Better integration of capital and recurrent budget preparation, including capital project selection.

- **Improve central oversight of SOEs and PPPs.** Enhance the oversight of public investment undertaken by non-budgetary institutions, including SOEs, PPPs, and contractor-based financing. Maintain in a database the number and value of public investments undertaken by SOEs. Publish a list of guarantees and contractor-financed projects in the budget.

- **Improve commitment control and cash management.** Release allocations to enable Ministries, Departments and Agencies' (MDAs) purchasing to take place following authorization by MOFT (for on-going projects and new projects) in the material management (MM-PAS) module.

- **Improve institutions for project appraisal, selection, and management.** Strengthen the project *appraisal* process by developing a standard methodology for project appraisal, publishing this methodology and verifying that it is consistently applied by the line ministries. Improve the project *selection* process for the budget by developing better targeted selection and prioritization criteria and processes. This includes developing a project pipeline to improve the medium-term focus of project identification, appraisal, selection and approval.

- **Improve the competitiveness and transparency of the procurement process.** Prescribe that all SOEs use standard National Tender Board (NTB) guidelines and procedures. Strengthen the project management and monitoring framework and ensure implementation in all MDAs and SOEs.

- **Develop a framework for ex-post evaluations and ensure that lessons learned from past projects are incorporated in revised guidelines and practices**.

- **Strengthen capacities of all actors involved in PIM.** Develop and implement a PIM capacity building plan for project managers, supervising officers, operational officers, and MOFT (see Appendix 2 of the FAD PIMA Report). The implementation of all PIM institutions requires not only institutional and legal change but is heavily dependent on building additional capacity within the public sector which takes time.

Annex VII. Financial Inclusion

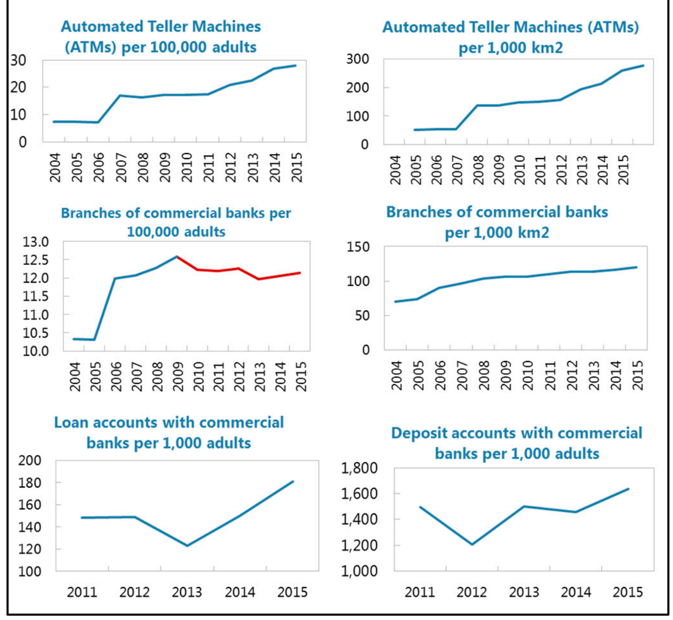
The Maldives has made progress on various indicators of financial inclusion over recent years, and continues to promote a financial inclusion agenda. However, the country remains behind its peers on several major indicators. This is particularly clear when looking at the use of credit by households. Efforts to promote financial literacy, combined with technological solutions such as mobile banking, are needed to continue and consolidate the progress of recent years.

Recent Trends

1. **Developing an inclusive financial sector is an important policy goal as it is associated with stronger growth and greater financial stability.**[1] Maldives has made progress towards greater levels of financial inclusion, defined as the availability and affordability of financial services (savings, credit, insurance and payments).

2. **The progress made is reflected in a variety of commonly used indicators, outlined in Figure 1.** Over the past three years, the Maldives has seen a rise in the number of ATMs, per capita access to deposit accounts and access to credit. However, the level of bank branches has remained flat (indicated in red). Expanding physical infrastructure is particularly challenging in the Maldives and other island nations, given the geographically highly-dispersed population. The lack of expansion reflects both a reluctance of financial institutions to expand into more remote areas / islands but may also imply a greater emphasis on investment on technological solutions, such as mobile banking which was introduced to the Maldives for the first time earlier this year, following the authorities' decision to grant mobile banking licenses to two telecommunications providers.

Figure 1. Progress on Financial Inclusion in the Maldives, 2004-2015



3. **The progress made in recent years has been bolstered by the authorities' efforts to ensure adequate consumer protection and to leverage technology.** Technological solutions are increasingly being used to facilitate the provision services to remote areas (for example, the adoption of mobile money referenced above). The authorities are also using modern data management systems to promote the collection of credit history, thereby lowering the costs

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[1] See IMF, 2017, 'Financial Inclusion: Can it Meet Multiple Economic Goals?' Staff Discussion Note, SDN/15/17

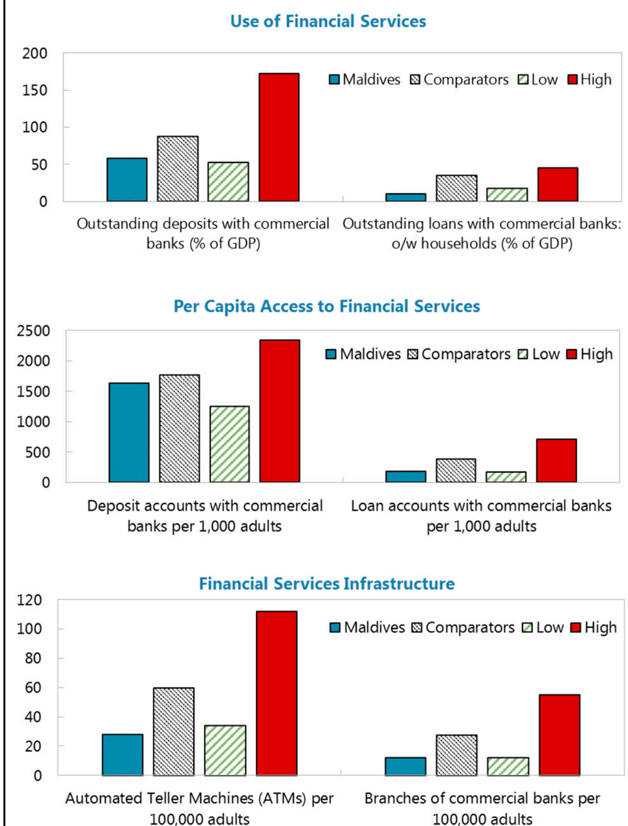
associated with information asymmetry when providing credit (notably through the establishment of a 'credit information unit').

Comparison with other Tourism-Based Island Economies

4. The Maldives shares challenges of financial inclusion with several of its peers. There are logistical constraints that are inherent in being a tourism-based island economies.[2] The dispersion of the population over vast areas makes the delivery of financial services challenging.

5. As Figure 2 shows, Maldives lags behind its competitors on a range of indicators. There is a disparity in terms of indicators of physical infrastructure (branches and ATMs) and of credit (number of loans and amounts outstanding). This is particularly clear in the case of the value of outstanding loans to households, which stood at just 11 percent of GDP in 2015. These low levels reflect a perceived lack of investable opportunities outside of favored sectors and may also indicate a lack of opportunities for alternative forms of finance, particularly micro-finance and Islamic finance.

Figure 2. Financial Inclusion in Tourism-Based Island Economies, 2015



Source: Financial Access Survey

6. Given the cost of physical infrastructure, Maldives and other island economies are particularly suited to employing technological solutions (mobile money, online banking and mobile banking) to facilitate greater access and usage. However, to be effective this should be rolled out as part of a strategy which promotes financial literacy and access to technology. In addition, low-tech solutions such as Maldives' innovative use of boats and agent banking, continue to be a valuable method for promoting inclusion in remote areas. Similarly, the authorities' focus on increasing financial literacy is expected to benefit both access to finance and consumer protection. Finally, authorities should place a renewed emphasis on policies that remove barriers and improve access to credit for households and small businesses. In this context, the focus on better data collection and monitoring is a welcome one.

[2] The tourism-based island economies contained in the sample are: Bahamas, Barbados, Fiji, Mauritius, Seychelles, St. Kitts & Nevis, St. Lucia, and St. Vincent & the Grenadines.

INTERNATIONAL MONETARY FUND

MALDIVES

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

October 6, 2017

Prepared By

Asia and Pacific Department
(In consultation with other departments)

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FUND RELATIONS

(As of August 31, 2017)

Membership Status: Joined: January 13, 1978; Article XIV

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	21.20	100.00
Fund holdings of currency (exchange rate)	16.40	77.34
Reserve Tranche Position	4.80	22.66

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	7.69	100.00
Holdings	3.04	39.54

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
ESF Arrangements	1.13	5.32

Latest Financial Arrangements:

Type	**Arrangement Date**	**Expiration Date**	**Amount Approved (SDR million)**	**Amount Drawn (SDR Million)**
Stand-By	12/04/2009	12/3/2012	49.20	8.20
ESF	12/04/2009	12/3/2011	8.20	2.05

Projected Payments to Fund[1]

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2017	**2018**	**2019**	**2020**	**2021**
Principal	0.21	0.41	0.41	0.10	
Charges/Interest	0.01	0.02	0.03	0.02	0.02
Total	**0.22**	**0.43**	**0.44**	**0.13**	**0.02**

[1]When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Arrangements

Since April 2011, the rufiyaa has floated in a band of 20 percent on either side of Rf 12.85 per dollar. In practice, however, the rufiyaa has been virtually fixed at the band's weaker end of Rf 15.42 per dollar. The de jure exchange rate arrangement is a pegged exchange rate within horizontal bands and the de facto exchange rate arrangement is classified as a stabilized exchange rate arrangement. Maldives continues to avail itself of the transitional provisions of Article XIV but no longer maintains any measures under this provision, and has not yet accepted the obligations of Article VIII, Sections 2, 3, and 4. It maintains an exchange restriction subject to IMF approval under Article VIII, Section 2(a) of the IMF's Articles of Agreement arising from a shortage of foreign exchange at the official rate which leads to the MMA rationing its supply of foreign exchange to commercial banks. This results in a channeling of foreign exchange transactions for current international transactions to the parallel market where transactions take place at an exchange rate that deviates by more than 2 percent from the prevailing market exchange rate. The greater than 2 percent spread gives rise to multiple currency practice subject to IMF approval under Article VIII, Section 3 and also to an exchange restriction, given the additional cost involved for obtaining foreign exchange. The extent of rationing has been eased over the past two years by increasing the amounts provided to commercial banks and adjusting amounts in line with seasonal patterns. The official exchange rate used by the MMA for government transactions is calculated based on the mid-point of the weighted average of the buying and selling rates of foreign exchange transactions conducted by commercial banks one day earlier. The lack of a mechanism to prevent the spread between this official exchange rate used by the MMA for government transactions and the prevailing market exchange rate from deviating by more than 2 percent gives rise to a multiple currency practice subject to IMF approval under Article VIII, Section 3.

Last Article IV Consultation

The 2016 Article IV consultation was concluded by the Executive Board on May 26 2016.

Technical Assistance

FAD: FAD main areas of engagement in recent years have been on conducting a Public Expenditure and Financial Accountability (PEFA) assessment and providing TA on cash management. A joint IMF/WB-led PEFA assessment was carried out in February 2014 to gauge progress made since the last PFM Action Plan for 2009-2011 and identify remaining weaknesses. As a follow-up to the PEFA, the FAD team, together with the World Bank, developed a Public Financial Management Reform Plan (PFMRP) for the Government of Maldives in June 2014. This was a broad PFM reform and consolidation plan aimed at improving the overall policy-making, coordination, implementation and monitoring framework in PFM. Three missions on cash management have been carried out since FY14, which focused on developing a cash management manual for the Government of Maldives and related activities. In August 2015, a headquarters mission reviewed progress on cash management and broadened the scope of this TA to include expenditure and commitment controls. The mission developed an updated action plan to make the cash management unit functional, start using the cash flow forecasting model, and implement a commitment control system. Additional TA, but less intensive in quantity, has related to the Chart of Accounts (CoA) and public investment. In September 2014, FAD carried out a review of the CoA used by the Ministry of Finance and Treasury and proposed a revised structure for the CoA along with an action plan to implement it. The mission was coordinated with an overlapping STA mission to review the mapping of the government CoA to GFSM 2014. A Public Investment Management Assessment (PIMA) was conducted by FAD in December 2016. The purpose of a PIMA is to identify, and propose improvements in, PFM practices that are associated with efficient public investment.

LEG: In October 2003 provided technical assistance on the revision of the Maldives Monetary Authority Act (MMA Act). A series of missions (March and September 2005, and April 2006) were provided to revamp the banking law. In August 2009, a mission provided assistance on the MMA Act (jointly with MCM). A follow-up mission in February 2011 focused on payments law. LEG conducted an

AML/CFT assessment in October 2010 and conducted a desk-based review of the draft AML/CFT law in May 2012. In 2014 and 2015 LEG provided advice on the Special Economic Zones Law, offshore banking legislation and deposit insurance.

MCM: In 2006, two missions provided TA on monetary operations, financial market development, and banking issues. In 2007, TA on debt management, monetary policy and financial supervision was delivered. In 2008, three missions consulted on monetary operations and liquidity management, monetary policy and financial supervision issues. In November 2008 and March/May/August 2009, TA was provided on research capacity building, banking supervision, and monetary policy and reviewing of the MMA Act with recommendations. Furthermore, two missions also provided advice on monetary operations, liquidity management, and the development of a crisis management framework. In December 2010, MCM conducted a TA mission on crisis preparedness and management, bank restructuring, and monetary operations. In May and September 2011, TA on the development of debt markets and on-site banking supervision was provided and in February 2012, on assessing the foreign exchange operations framework. In the first half of 2014, MCM continued its TA delivery on banking supervision along with a joint MCM-APD mission on developing foreign exchange market. The Department also provided advice on deposit insurance schemes during 2014. Banking supervision (March) and foreign exchange reserve management (September) continued to be areas of priority to the authorities in 2015 with MCM TA responding with follow-up missions. In March 2016 further TA on foreign exchange and monetary policy operations was also provided. A follow-up mission on banking supervision with a focus on operational risk took place in May 2016. During FY2017, four TA missions have taken place so far: two HQ-staffed missions covering accounting and auditing framework for MMA, and two SARTTAC-initiated missions establishing the work plan for monetary operations and banking supervision.

***STA*:** In May 2007, STA conducted a mission on money and banking statistics. In February and April 2011, STA offered TA on multiple topics covering improvements in balance of payments statistics, government financial statistics (GFS), monetary and financial statistics (MFS) and national accounts. In June and September 2011, STA conducted TA missions on improving price statistics and on the General Data Dissemination System (GDDS). In February, May, and October 2012 STA continued providing TA on improving price statistics. Similarly, in April 2012, a TA mission on improving national accounts covered constructing GDP from the expenditure side and compiling quarterly national accounts. Further advice on improving GDP and developing quarterly GDP was provided in November 2012, January and July, 2014, and April 2015, the latter jointly with APD. Subsequently, Maldives attended a workshop for the ICP-SNA project covering both national accounts and price statistics. Between March 2013 and January 2016, STA field eight TA missions on balance of payments statistics and two on government finance statistics, in the context of a project funded by the Government of Japan. A last TA mission was conducted on February 05-16 2017.

Safeguards Assessment

In line with the Fund's safeguards assessments policy, an assessment of the Maldives Monetary Authority was concluded in March 2010. In addressing recommendations, the MMA appointed an external auditor and strengthened controls over foreign payments through the automation of the authorization process. A Chief Internal Auditor has also been appointed, while capacity in the internal audit function continues to be improved. In addition, to strengthen the legal framework, amendments to the MMA Act were drafted in 2011 in consultation with the Fund. While the MMA Act was amended in 2015, some safeguards recommendations on the establishment of an Audit Committee, limits on credit to government, and safeguards for personal autonomy of Board members have not been incorporated.

IMF-WORLD BANK JOINT MANAGEMENT ACTION PLAN

(As of July 2017)

The strategic objectives of the Country Partnership Framework (CPF) FY16-19, (which relies heavily on the World Bank Group Systematic Country Diagnostic (SCD) (2015) for Maldives) are to contribute to enabling more inclusive growth and improving the management of the country's wealth generating natural resources and financial resources as key drivers of poverty reduction and boosting shared prosperity. The CPF's objectives are (1) enhancing employability and economic opportunities for Maldivians; (2) strengthening natural resource management and climate resilience; and (3) improving the efficacy of public finance management and policy making. It will also deepen the engagement in the sectors reflected in the legacy portfolio which covers: education, public financial management and environmental management. The CPF program will be underpinned by three cross-cutting themes youth, gender and governance recognized by the SCD as essential for effective management of resources and social inclusion. These themes will be embedded in WBG's investment operation and analytical work.

The World Bank is supporting a Public Financial Management Systems strengthening project for FY 15-20, with the objective to enhance budget credibility, transparency, and financial reporting of central government finances. It is focusing on strengthening the PFM environment (including enhancing the medium-term fiscal framework and strengthening debt and cash management) and strengthening budget execution. A joint Public Investment Management Assessment (PIMA) mission took place in December 2016 and its recommendations will be integrated into the project. A separate Bank-funded project supports the office of the Auditor General in updating the audit law, conducting performance audit pilots and training the staff on auditing the consolidated financial statements of the country using international audit standards.

The (IMF-WB) teams have been holding, and will continue to hold, joint missions and regular briefing meetings on macroeconomic developments. Public financial management is a key area of collaboration for these operations.

The Bank is taking the lead on several initiatives aimed at improving targeting of universal subsidies and reforming social protection:

- **Health:** Bank technical support currently focuses on helping achieving operational savings for Aasandha, though substantial capacity building of the implementing agency, the National Social Protection Agency (NSPA) of Maldives, would be needed to plan, implement and monitor the much-needed reforms.
- **Poverty:** The Bank – through the Poverty and Shared Prosperity Project, including a component on Statistical Capacity Building and Technical Assistance on Poverty Measurement – has assisted in the design of a new Household Income and Expenditure Survey (HIES), which was recently completed. The poverty team will assist the National Bureau of Statistics (NBS) in the estimation of a new, official national poverty line and a set

of poverty and inequality estimates for Maldives. Preliminary results are expected by the end of 2017.

- **Proxy Means Testing (PMT):** The Bank has helped the NSPA develop a targeting mechanism based on both means and PMT methods to target the electricity subsidy and other social safety net programs; the PMT formula will be updated once new HIES data is available. NSPA's staff will be trained to conduct these updates independently in the future.

The table below details the macro-critical activities that the Bank and the IMF? will work on over the coming year.

Table I. Maldives IMF-World Bank Joint Management Action Plan

Title	Products/Activity	Expected Dates
World Bank work program in the next 12 months	**A. Strategy and Analytical Work**	**Delivery date**
	Macro Monitoring & Analysis	FY 18
	Maldives Youth and Gender Behavioral Initiative	FY 18
	Health financing sustainability	FY 18
	Social Protection Update	FY 18
	Poverty Program	FY 21
	B. Lending	**Approval date**
	Enhancing Education Development Project	April 2013
	Public Financial Management Systems Strengthening Project	June 2014
	Accelerating Sustainable Private Investments in Renewable Energy (ASPIRE)	June 2014
	Sustainable Fisheries Resources Development Project	May 2017
	Maldives Clean Environment Project	June 2017
	C. Technical Assistance	**Delivery date**
	RE Resource Mapping: Maldives	FY 20
	Maldives Social Protection Support TA	FY 18
	Maldives #C001 Enabling a Non-Bank Mobile Money Solution	FY 18
	Proxy Means Test Update	FY 18
	Technical Assistance on statistical capacity building (poverty measurement, LFS)	FY 18
Joint products	**Agreement on joint products**	**Delivery date**
	Joint Bank-Fund Debt Sustainability Analysis	FY 18

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of July, 2017)

The ADB country operations business plan (COBP), 2018–2020 for Maldives was prepared based on discussions held between the government and ADB. The indicative pipeline of priority projects is based on a preliminary analysis of the government's proposed projects, and detailed consultations with relevant government officials. The country assistance results areas (Appendix 1) are in line with the country partnership strategy (CPS), 2007–2011[1]. The COBP 2018-20 extends the validity of the CPS 2007−2011 until a new CPS is in place.

In April 2016, the government requested the ADB to shift the focus of its assistance to developing the Greater Malé Region[2]. The government and ADB agreed to carry out analytical work on the development of the region. The results of the study, which is expected to be completed by the end of 2017, will help the government formulate a comprehensive development strategy, which will then serve as the basis for the preparation of ADB's CPS for Maldives. The new CPS will also take into account the new national development plan, which will be prepared following the presidential elections in September 2018.

Maldives, a group A developing member country, is eligible for Asian Development Fund (ADF) grants. The indicative ADF grant resource allocation available for commitment for 2018–2020 is $37.34 million[3]. The final allocation will depend on available resources and the outcome of the country performance assessments. The 2016 debt distress classification of Maldives was assessed to be at high risk of debt distress. In accordance with the ADF grants framework, the country is to receive 100% of its country allocation in grants in 2017, subject to a 20 percent volume discount on the grant portion of the country allocation[4]. Co-financing and funding from other sources, including the regional pool under concessional resources, and opportunities for the country to access regular ordinary capital resources for projects which could generate foreign exchange revenues that could meet more than their foreign debt-service requirement, will be explored.

Country Program (Lending, Non-Lending and Non-Sovereign Operations)

The lending and nonlending programs during 2018–2020 (Appendix 2) will support the development outcomes in water and other urban infrastructure and services, trade and industry, and public sector management, which are all in line with the priority areas of the previous CPSs. The lending program will total $52.27 million, of which $49.77 million will be from ADF grant resource allocation for 2017–2020, and the balance will be sourced from the regional pool allocation. The non-lending program during the period amounts to $2.30 million. The assistance program for both lending and non-lending products

[1] ADB. 2007. Country Partnership Strategy: Maldives, 2007–2011. Manila.

[2] The Greater Malé Region includes Fonadhoo, Gulhifalhu, Hulhulé, Hulhumalé, Malé, Thilafushi, and Villingili.

[3] Maldives is classified a 100% grant recipient country, so it is not eligible for concessional ordinary capital resources lending. The indicative resources available for commitment for 2018–2020 include allocation of resources for disaster risk reduction.

[4] The proportion of grants for the resource allocations during 2018–2020 will be determined by future annual debt distress classifications in accordance with the ADF grants framework

for the current year is in Appendix 3. Appendix 4 provides the list of indicative knowledge publications and events for 2017 and 2018, which seek to respond to the country's priority knowledge needs.

Lending program

The Greater Malé Connectivity Improvement Project (programmed for 2019 with preparatory work scheduled for 2017) was dropped since the project's economic viability has not been confirmed. The Greater Malé Environmental Improvement and Waste Management Project remains in the new COBP with the following changes: (i) increase in ADF grant allocation from $25.29 million to $49.77 million; (ii) shift from a single project to phased implementation: Phase 1 scheduled for 2018 for $24.85 million, and Phase 2 scheduled for 2019 for $24.92 million contingent on the availability of suitable land to be secured and funded by the government for the project; and (iii) sector reclassification from energy to water and other urban infrastructure and services following the shift in project focus from energy supply to waste management.

A new area of intervention is the South Asia Sub-Regional Economic Cooperation National Single Window Project, which is programmed as a standby project for 2018 and as a firm project for 2019. The project, which will be ADB's first regional cooperation and integration project in Maldives, will help promote trade facilitation and is in line with the government's objective of improving the business environment.

Non-lending program

The transaction technical assistance (TA)[5] to accompany the Greater Malé Connectivity Improvement Project was dropped from the 2019 program. Two nonlending programs scheduled for 2018 in the previous COBP will be retained: (i) transaction TA for $2 million[6] to help the government develop capacity to implement the Greater Malé Environmental Improvement and Waste Management Project; and (ii) knowledge and support TA for $300,000 for Capacity Building for Portfolio Management.

Non-sovereign operations

The pursuit of private sector investments and non-sovereign operations faces ongoing constraints in Maldives, such as the lack of effective convertibility of the rufiyaa, the generally weak capacity of the private sector in key areas (financial management and accounting), and the lack of a skilled workforce. ADB will continue to explore potential private sector operations to support capacity building and promote the expansion of tourism and emerging export industries.

[5] The TA was formerly referred to as capacity development technical assistance under the old classification system

[6] Of the TA's total amount of $2 million, $1 million will come from the Technical Assistance Special Fund and $1 million from other sources, which are yet to be determined

Appendix I. Country Assistance Results Areas

Key Country Development Outcomes that ADB Contributes to	ADB		
	Key Areas of Assistance	**Indicative Resource Allocation in 2018–2020**	**Changes from Last COBP**
1. Water and Other Urban Infrastructure and Services			
Improved access to sustainable solid waste management services benefiting the poor and women Improved quality and reliability of electricity supply Improved institutional capacity for policy formulation, sector regulation, and project implementation	Improved waste management facilities Enhanced energy efficiency, transmission, and distribution Capacity building for the relevant agencies	Grants: Amount: $49.77 million (ADF) Share of COBP envelope: 95% TA: Amount: $1 million (TASF) and $1 million (cofinancing, source to be determined)	ADF grant allocation increased from $25.29 million to $49.77 million. From a single project, phased implementation will be adopted, subject to availability of suitable land to be secured and funded by the government for the project. Sector classification changed from energy to water and other urban infrastructure and services.
2. Industry and Trade			
Improvements in ease of doing business Efficient, effective, transparent, secure, and service-oriented processing of cross- border trade in South Asia Developed and expanded private small and medium-sized enterprises subsector	Modern and effective customs administration Streamlined and transparent business regulations and procedures Improved merchandise trade of the private sector, including small and medium- sized enterprises	Grants: Amount: $2.5 million (ADF) and $2.5 million (cofinancing, source to be determined) Share of COBP envelope: 5%	South Asia Sub-Regional Economic Cooperation (SASEC) National Single Window Project was added in 2018 (standby) and 2019 (firm) as a new area of intervention based on the government's request to participate in SASEC trade facilitation agenda.

ADB = Asian Development Bank, ADF = Asian Development Fund, COBP = country operations business plan, TA = technical assistance, TASF = Technical Assistance Special Fund.

Note: The transport sector was dropped and replaced with industry and trade as a new area of intervention.

Source: ADB estimates.

Appendix II. Indicative Assistance Pipeline

Table A2.1. Lending Products, 2018-2020

						Cost ($ million)						
						ADB						
Project/Program Name	**Sector**	**Poverty Targeting**	**Strategic Agendas and Drivers of Change**	**Division**	**Year of TRTA/ PDA**	**Total**	**Regular OCR**	**COL**	**ADF Grants**	**Total**	**Gov't**	**Co-financ**
2018 Firm												
Greater Malé Environmental Improvement and Waste Management Project (Phase1)	WUS	TI-G	IEG, PAR, and GEM	SAUW	2017	TBD	0.00	0.00	24.85	24.85	TBD	TBD
Total						**TBD**	**0.00**	**0.00**	**24.85**	**24.85**	**TBD**	**TBD**
2018 Standby												
SASEC National Single Window Project	IND	TI-G	RCI and GEM	SARC		6.00	0.00	0.00	2.50	2.50	1.00	2.50
Total						**6.00**	**0.00**	**0.00**	**2.50**	**2.50**	**1.00**	**2.50**
2019 Firm												
Greater Malé Environmental Improvement and Waste Management Project (Phase 2)	WUS	TI-G	IEG, PAR, and GEM	SAUW	2017	TBD	0.00	0.00	24.92	24.92	TBD	TBD
SASEC National Single Window Project	IND	TI-G	RCI and GEM	SARC		6.00	0.00	0.00	2.50	2.50	1.00	2.50
Total						**TBD**	**0.00**	**0.00**	**27.42**	**27.42**	**TBD**	**TBD**

ADB = Asian Development Bank; ADF = Asian Development Fund; COL = concessional OCR lending; GEM = gender equity and mainstreaming; gov't = government; IEG = inclusive economic growth; IND = industry and trade; OCR = ordinary capital resources; PAR = partnerships; PDA = project design advance; RCI = regional cooperation and integration; SARC = Regional Cooperation and Operations Coordination Division, South Asia Department; SASEC = South Asia Subregional Economic Cooperation; SAUW = Urban Development and Water Division, South Asia Department; TBD = to be determined; TI-G = targeted intervention—geographic dimensions of inclusive growth; TRTA = transaction technical assistance; WUS = water and other urban infrastructure and services.

Table A2.2. Nonlending Products and Services, 2018-2020

				Sources of Funding				
				ADB		Others		
Assistance Name	Sector	Division	Assistance Type	Source	Amount ($'000)	Source	Amount ($'000)	Total ($'000)
2018								
Greater Malé Environmental Improvement and Waste Management Project	WUS	SAUW	TRTA	TASF	1,000.00	TBD	1,000.00	2,000.00
Capacity Building for Portfolio Management	PSM	SARC	KSTA	TASF	300.00		0.00	300.00
Total					**1,300.00**		**1,000.00**	**2,300.00**

ADB = Asian Development Bank; KSTA = knowledge and support technical assistance; PSM = public sector management; SARC = Regional Cooperation and Operations Coordination Division, South Asia Department; SAUW = Urban Development and Water Division, South Asia Department; TASF = Technical Assistance Special Fund; TBD = to be determined; TRTA = transaction technical assistance; WUS = water and other urban infrastructure and services.

Source: Asian Development Bank.

Table A3.1. Lending Products, 2017

Project/Program Name	Sector	Poverty Targeting	Strategic Agendas and Drivers of Change	Division	Year of TRTA/ PDA	Cost ($ million) ADB Total	Regular OCR	COL	ADF Grants	Total	Gov't	Co-finance
None						0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total						**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**

ADB = Asian Development Bank; ADF = Asian Development Fund; gov't = government; OCR = ordinary capital resources; PDA = project design advance. TRTA = transaction technical assistance.

Note: Investment lending accounted for 100% of sovereign lending commitments during 2014-2016.

Source: Asian Development Bank.

Table A3.2. Nonlending Products and Services, 2017

Assistance Name	Sector	Division	Assistance Type	Sources of Funding: ADB Source	ADB Amount ($'000)	Others Source	Others Amount ($'000)	Total ($'000)
Greater Malé Environmental Improvement and Wast Management Project	WUS	SAUW	TRTA	TASF	600.0		0.00	600.00
Total					**600.00**		**0.00**	**600.00**

ADB = Asian Development Bank; SAUW = Urban Development and Water Division, South Asia Department; TASF = Technical Assistance Special Fund; TRTA = transaction technical assistance; WUS = water and other urban infrastructure services.

Source: Asian Development Bank.

Appendix IV. Indicative Knowledge Publications and Events

Table A4.1. Knowledge Publications and Events for 2018

Title of Publication or Event	Subject	Type	Department or Sector Group or Thematic Group	Technical Assistance
Publications				
Asian Development Bank and Maldives: Fact Sheet 2017	ADB administration and governance	Publication and documentation	DER	Administrative core budget (staff)
Asian Development Outlook 2018	Capacity development, economics, governance and public sector management	Publication and documentation	ERCD	Administrative core budget (staff)
Key Indicators for Asia and the Pacific 2018	Capacity development, economics, governance and public sector management	Publication and documentation	ERCD	Administrative core budget (staff)
Asian Economic Integration Report 2018	Capacity development, economics, governance and public sector management, industry and trade, regional cooperation and integration	Publication and documentation: flagship study	ERCD	Administrative core budget (staff)
The Economic Effects of Participating in Global Value Chains: Country and Sector Level Analysis	Capacity development, economics, governance and public sector management	Publication and documentation	ERCD	TA 8779
Road Safety Campaign in Malé	Transport	Publication and documentation	SARD (SATC)	Administrative core budget (staff)
ADB's Contribution to Urban Development in South Asia: Two-Decade Journey	Water, urban development	Publication and documentation: flagship study	SARD	Administrative core budget (staff)
South–South Learning	Knowledge management	Publication and documentation: technical study	SARD	TA 7997

Title of Publication or Event	Subject	Type	Department or Sector Group or Thematic Group	Technical Assistance
Urban Health in South Asia	Health, urban development	Publication and documentation	SDCC (Health Sector Group)	Sector group, thematic group budget, administrative core budget (staff)
Events				
Asia Clean Energy Forum 2018	Energy, environment, finance, regional cooperation and integration	Flagship event	SDCC (Energy Sector Group)	TA 8953
Asia Solar Energy Forum 12th Meeting	Capacity development, climate change, energy, environment, finance	Flagship event	SDCC (Energy Sector Group)	TA 8953
Total number of publications = 9 **Total number of events = 2**				

ADB = Asian Development Bank; DER = Department of External Relations; ERCD = Economic Research and Regional Cooperation Department; SARD = South Asia Department; SATC = Transport and Communications Division, SARD; SDCC = Sustainable Development and Climate Change Department; TA = technical assistance, TBD = to be determined.
Source: Asian Development Bank.

Table A4.2. Additional Knowledge Publications and Events Delivered in 2017

Title of Publication or Event	Subject	Type	Department or Sector Group or Thematic Group	Technical Assistance
Publications				
Asian Development Bank and Maldives: Fact Sheet 2016	ADB administration and governance	Publication and documentation	DER, SARD	Administrative core budget (staff)
ADB Economics Working Paper Series No. 507: Impacts of Sea Level Rise on Economic Growth in Developing Asia	Climate change	Publication and documentation	ERCD	Administrative core budget (staff)
Asian Development Outlook 2017: Transcending the Middle-Income Challenge	Capacity development, economics, governance and public sector management	Publication and documentation	ERCD	Administrative core budget (staff)
Compendium of SUTs for Asia: Benchmark Supply and Use Tables for Selected Economies in Asia and the Pacific	Economics, capacity development, governance and public sector management	Publication and documentation	ERCD	TA 8838
Key Indicators for Asia and the Pacific 2017	Capacity development, economics, governance and public sector management	Publication and documentation: flagship study	ERCD	Administrative core budget (staff)
Asian Economic Integration Report 2017	Capacity development, economics, governance and public sector management, industry and trade, regional cooperation and integration	Publication and documentation: flagship study	ERCD	Administrative core budget (staff)
Second knowledge product on priority legal and regulatory issues in South Asia	Governance and public sector management, regional cooperation and integration, capacity development	Publication and documentation: technical study	OGC	TA 8801
Assessment of Power Sector Reforms in South Asia	Energy	Publication and documentation	SARD, SDCC	TA 7997
Cross-border Power Generation, Transmission and Trading – A Way Forward for South Asia	Energy	Publication and Documentation	SARD	TA 7997
Country Readiness Assessment Framework for South Asia Economic Corridor Development	Economics	Publication and documentation	SARD	TA 8254

Title of Publication or Event	Subject	Type	Department or Sector Group or Thematic Group	Technical Assistance
Next Steps to South Asian Economic Union	Regional cooperation and integration	Publication and documentation	SARD	TA 7997
Road Map for National Single Window in Maldives	Trade facilitation, transport	Publication and documentation	SARD (SARC)	TA 7997
Risk Management in Maldives: Action Plan and Recommendations	Customs valuation, risk management, trade facilitation	Publication and documentation	SARD (SARC)	TA 7997
Fast-Track Reform: Lessons from Maldives	Taxation, tax reform, finance, economics	Publication and documentation	SARD (SAPF)	TA 7997
Innovative Strategies for Accelerated Human Resource Development in South Asia: Teacher Professional Development	Education, human resource development	Publication and documentation: technical study	SARD (SAHS)	TA 7997
South Asia Subregional Economic Cooperation: Powering Asia in the 21st Century	Regional cooperation and integration	Publication and documentation: technical study	SARD	TA 7997
SASEC 15-Year Anniversary Coffee Table Book	Regional cooperation and integration	Publication and documentation: technical study	SARD	TA 7997
Development of Hybrid Renewable Energy in Minigrids	Energy	Publication and documentation: technical study	SARD	TA 8435
ADB–UN Women Benchmark Publication on Gender Equality and the SDGs in Asia and the Pacific	Gender	Publication and documentation	SDCC	TA 8797
Events				
Regional Technical Evaluation and Training Workshop on International Comparison Program	Capacity development	Capacity development event for DMCs	ERCD	TA 7507
2nd Conference on the Development of Supply and Use Tables (SUT) in Asia and the Pacific	Capacity development	Capacity development event for DMCs	ERCD	TA 8838
Writeshop: Compendium of SUTs in Asia and the Pacific	Capacity development	Capacity development event for DMCs	ERCD	TA 8838

Title of Publication or Event	Subject	Type	Department or Sector Group or Thematic Group	Technical Assistance
Inception Meeting for National Implementing Agencies	Capacity development	Capacity development event for DMCs	ERCD	TA 9238
Training on Time Series/Annual SUT Updating/Estimation	Capacity development	Capacity development event for DMCs	ERCD	TA 8838
Regional Technical Evaluation and Training Workshop on ICP	Capacity development	Capacity development event for DMCs	ERCD	TA 7507
SASEC Finance Ministers' Meeting	Regional cooperation and integration	Event organization	SARD	TA 9231
SASEC Trade Facilitation and Transport Working Group Meeting	Regional cooperation and integration, transport	Event organization	SARD	TA 7491
Maldives: National Consultation on Sanitary/Phytosanitary and Technical Barriers to Trade Diagnostic Study	Regional cooperation and integration	Event organization	SARD	TA 6512
Total number of publications = 19				
Total number of events				

ADB = Asian Development Bank; DER = Department of External Relations; DMC = developing member country; ERCD = Economic Research and Regional Cooperation Department; ICP = International Comparison Program; OGC = Office of the General Counsel; SAHS = Human and Social Development Division, SARD; SAPF = Public Management, Financial Sector, and Trade Division, SARD; SARC = Regional Cooperation and Operations Coordination, SARD; SARD = South Asia Department; SASEC = South Asia Subregional Economic Cooperation; SDCC = Sustainable Development and Climate Change Department; SDG = Sustainable Development Goal; SUT = supply and use table; TA = technical assistance; UN Women = United Nations Entity for Gender Equality and the Empowerment of Women.

Source: Asian Development Bank.

Table A4.3. Innovation, Advanced Technology, and Pilot Initiatives to be Implemented in 2018				
Item	**Nature**	**Project Number**	**Sector or Theme**	**Division**
Use of high-level technology through waste-to-energy	Advanced technology	51077-002	Environment	SAUW
Total number of innovation, advanced technology, and pilot initiatives = 1				

SAUW = Urban Development and Water Division, South Asia Department. Source: Asian Development Bank.

STATISTICAL ISSUES

(As of July 11, 2017)

I. Assessment of Data Adequacy for Surveillance
General: Macroeconomic statistics have improved in recent years, with technical assistance from STA and the Asian Development Bank (AsDB). While data are broadly adequate for surveillance (Category B) there are nonetheless significant data gaps that complicate policy making and aspects of surveillance. Remaining shortcomings affect the balance of payments, government finance, and national accounts statistics.
Real sector: Annual and quarterly GDP estimates are available with a considerable lag. The estimates of GDP have been revised using new benchmark data (including supply and use tables) and have been rebased to 2014. The revised annual and quarterly GDP estimates from 2003 to 2016 will be released at the end of 2017. Estimates of GDP by expenditure at current prices were prepared as part of the 2014 supply and use tables, which was balanced so that there was no statistical discrepancy. However, going forward, the authorities plan to prepare independent estimates of GDP by expenditure, and to compare them with estimates of GDP by economic activity to assess the statistical discrepancy and the quality of the two measures. STA has provided substantial assistance for improving the annual production and expenditure GDP measures, and for developing quarterly GDP series. The CPI was rebased to June 2012=100, with assistance from STA. Weights are based on the 2012 household income and expenditure survey.
Fiscal sector: General government data are reported for publication in the *GFS Yearbook* and the latest published data are for 2014. Monthly data on revenue and expenditure are available, but the reporting system is new, and its reliability needs improvement. In particular, the consistency of these data with below-the-line financing numbers provided by the monetary authorities is weak. Data on external debt are subject to reconciliation with creditors. Data on the operations of state enterprises are limited.
Financial sector: APD receives an electronic report on monetary statistics every two weeks, covering the balance sheets of the MMA and the commercial banks. Current summary data are published in the MMA's *Monthly Statistics* publication as well as in its *QEB* and *AR*. There are inconsistencies between monetary and fiscal data regarding the financing of the fiscal deficit due to issues of timing and coverage. The MMA uses the standardized report forms (SRFs) to report data for the central bank, other depository corporations and other financial corporations on a regular basis. An integrated monetary database that meets the needs of the MMA, STA, and APD and is operational. MMA also provides financial soundness indicators (FSIs) to STA on a quarterly frequency. All core FSIs as well as two encouraged FSIs for deposit takers (capital to assets, large exposures to

capital) are reported. MMA could improve its FSI reporting to include the remaining encouraged FSIs.
External sector: The MMA compiles balance of payments data on an annual basis. Coverage has improved substantially but is still limited in some areas and recent recommendations provided by technical assistance missions have yet to be implemented. Estimation of travel credits should be further improved, and a new survey should be launched to capture the ongoing construction boom. The results of the surveys on direct investment (DI) are still to be exploited for the compilation of the IIP, and for the participation in the IMF`s Coordinated Direct Investment Survey (CDIS). Other private financial flows are estimated on the basis of the CPIS and BIS data, while useful information collected with the DI surveys could also be used. MMA is not reporting to STA any IIP data and has troubles pulling together all the existing information, that would allow for a consistent compilation of the financial transactions and of the IIP. Quarterly data on external debt and debt service are available for the government and the monetary authority, and to some extent for the banking sector and state enterprises at the time of the annual consultation missions, but no data are reported to the World Bank Quarterly External Debt Statistics database. MMA made a considerable compilation work over the last four years, however further steps are needed to transform this work in data available to the users. The high staff turnover is hindering progress in the compilation and dissemination of IIP and External Debt data. Official reserves assets are reported every two weeks with a (variable) one-week lag. Predetermined foreign currency outflows (mainly debt service payments) are known and reported to APD at the time of annual Article IV consultation missions, while other movements of foreign currency assets are not identified.

II. Data Standards and Quality	
Maldives has participated in the General Data Dissemination System (GDDS) since October 14, 2011.	No data ROSC available.

III. Reporting to STA (Optional)
The authorities report macroeconomic data to the IMF on a regular and generally timely basis for publication in the *IFS*, *BOPSY*, *and GFSY*.

Maldives: Table of Common Indicators Required for Surveillance

(As of Oct, 3, 2017)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	Jul 2017	Aug 2017	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Aug 2017	Sep 2017	D	D	D
Reserve/Base Money	Aug 2017	Sep 2017	W	W	M
Broad Money	Aug 2017	Sep 2017	W	W	M
Central Bank Balance Sheet	Aug 2017	Sep 2017	W	W	M
Consolidated Balance Sheet of the Banking System	Aug 2017	Sep 2017	W	W	M
Interest Rates[2]	Aug 2017	Sep 2017	W	W	M
Consumer Price Index	Jul 2017	Sep 2017	W	W	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2014	11/30/2015	A	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2014	11/30/2015	A	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2014	11/30/2015	A	M	M
External Current Account Balance	2016	Jun 2017	A	M	M
Exports and Imports of Goods and Services	11/30/2015	03/07/2016	M	M	M
GDP/GNP	2015	01/18/2017	A	M	M
Gross External Debt	2014	10/30/2015	A	M	M

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2]Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds. Interest rates on bank deposits are not provided.
[3]Foreign, domestic bank, and domestic nonbank financing.
[4]The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5]Including currency and maturity composition.
[6]Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND

MALDIVES

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

October 6, 2017

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Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)

This Debt Sustainability Analysis (DSA) updates the May 2016 DSA. Maldives' risk rating continues to be rated at 'high risk of external debt distress', based on an assessment of public external debt and rebased GDP figures, and it continues to maintain a heightened overall risk of debt distress.[1]

The current government continues its massive scaling up of infrastructure investment to achieve sustainable and inclusive economic growth and diversify the economy. This scaling up could transform the economy but it also carries risks. The slowdown in tourism receipts in 2015 and 2016 and rise in recurrent and capital spending have weakened public finances. The country faces challenges with rising debt levels, greater reliance on external financing, and tighter limits on capacity to repay.[2]

In 2016, the authorities undertook bold initiatives to eliminate electricity subsidies and significantly scaled down food subsidies (a saving of 2 percent of GDP) and continue to improve the targeting of key welfare programs. Revenue measures are expected to generate additional receipts of 2.9 and 1.8 percent of GDP in 2017 and 2018 by government estimates. These ambitious efforts have been reflected only in part in the staff baseline, as fiscal policy slippages and shocks to tourism exports and capital expenditures remain key risks. Stabilizing and reducing public debt ratios will require strengthening the medium-term fiscal framework to improve the external position and sustain confidence in fiscal sustainability.

[1] The IMF has provided Technical Assistance (TA) to the National Bureau of Statistics (NBS) on compiling 2014-benchmarked and rebased GDP estimates in revising the national accounts for the period 2003-2015. This DSA is based on the results of the rebased GDP estimates, to be released in October 2017.

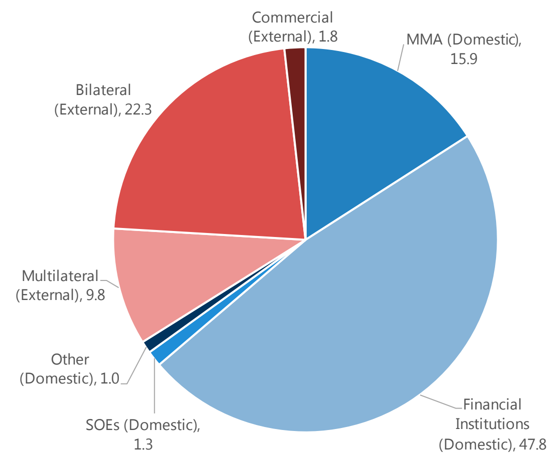
[2] Maldives continues to be PRGT-eligible to date even though it meets the PRGT income criterion by a large margin. Short-term macroeconomic vulnerabilities in the Maldives, particularly a risk of income decline and loss of market access from elevated debt, has kept it from graduating from PRGT eligibility. Broad alignment with IDA practices is also an important element in defining its PRGT eligibility as it remains an IDA-only country based on the small island economy exception, receiving most of its assistance from IDA on grant terms.

RECENT DEBT DEVELOPMENTS

1. **The Maldives is embarking on large infrastructure investment to ease structural constraints and close gaps in communications, electricity and transportation.** Expansion of the international and regional airports, resorts, hotel and guest house developments are expected to increase tourism and the demand for ancillary services.[3] Major regional hub development and land connectivity in the Greater Malé area will support population resettlement, reduce government service costs, and ease congestion. However, this investment surge has added considerably to already elevated public debt and external financing risks.

2. **Total public debt is estimated at about US$2.8 billion (65.7 percent of GDP) in 2016.**[4] Public debt is defined as the debt of the non-financial public sector comprising central government, including loans on-lent to State Owned Enterprises (SOEs), sovereign guarantees issued to SOEs[5] and domestic payable arrears which have accumulated since 2012.[6] Public debt is held mainly by domestic banks, pension funds, the Maldives Monetary Authority (MMA) and official multilateral and bilateral creditors. Private sector external debt data is estimated to be around US$0.6 billion but is subject to large errors and further revisions given the open capital account and little reporting. The government has relied heavily on the issuance of Treasury bills and monetization (at least in the past) as well as external borrowing to finance its deficits.[7]

Public Debt Holdings by Sector
(Percent distribution)



3. **Public debt remains above the 60 percent limit specified in the Fiscal Responsibility Act (FRA) (Table 3).** The increase in debt initially reflected additional expenditure needs in the aftermath of the 2004 Tsunami but since then higher recurrent spending on wages, social welfare, and subsidies and (more recently) capital spending on infrastructure scale up have added to the deficit. Primary deficits are expected to be above debt-stabilizing levels over the medium term until such time infrastructure spending winds down. Thereafter, primary deficits are expected to improve driven by new revenue measures introduced over 2016-17 (particularly increased import duties and the Airport Development Fee (ADF)) and subsidy reforms. Under the baseline scenario, public debt is set to decline starting in 2022 reaching around 69.8 percent of GDP by 2037.

[3] Capacity in the tourism sector is set to expand following the infrastructure scale up, and the baseline assumes favorable long-term tourism forecasts in the South Asia region, according to "Tourism towards 2030" (UN-World Tourism Organization).

[4] The fiscal year for Maldives corresponds with the calendar year.

[5] The Ministry of Finance and Treasury (MOFT) continues to compile and record all data and information regarding outstanding sovereign guarantees.

[6] Staff's initial estimates indicate the arrears to be around 2.5 percent of GDP as of end-2016.

[7] Recourse to direct monetization was banned under the Fiscal Responsibility Act (FRA), enacted in 2014.

4. The external debt ratio is sharply increasing and peaks in the medium term, reflecting the large ongoing infrastructure scale up and the recent sovereign bond issuance of US$200 million. Total external disbursements are estimated to be US$1.4 billion over 2016-2021, which include megaprojects such as the international airport development, a road bridge connecting the airport to the capital, continued investment in new housing developments, and the relocation and expansion of the sea port. Major creditors include both bilateral and multilateral creditors such as China, Saudi Arabia, Abu Dhabi and the OPEC Fund with lending at interest rates of 2 to 5 percent and maturities close to 20 years or longer. In contrast, the recent issuance of sovereign bonds in June 2017 at 7 percent interest and shorter maturity runs counter to these terms.

5. Maldives' CPIA score has deteriorated, changing the category of its policies and institutions to 'weak', and tightening debt thresholds for the DSA analysis. The three-year average CPIA score of Maldives (2014–16) dropped to 3.18 from 3.20 (2013-15). Weak policies and institutions as measured by this index in the areas of quality of budgetary and financial management and social inclusion and business environment have led to the downgrade, tightening the thresholds for the indicators related to the present value (PV) of Public and Publicly Guaranteed (PPG) external debt.[8]

MACROECONOMIC ASSUMPTIONS

6. The baseline scenario is built on current policies, including staff's assessment of the 2017 Budget. The 2017 Budget was underpinned by two considerations: (i) adhering in principle to the FRA's fiscal rule on primary balance, and (ii) finding fiscal space for infrastructure scale-up. While substantial benefits are likely to accrue from the 2016 subsidy reforms, the 2017 Budget is underpinned by optimistic assumptions. Staff's baseline does not include estimates for revenues from the Special Economic Zones (SEZs) and takes a more cautious view on new and existing revenue sources (particularly income from SOEs) than do the government's estimates.[9] Staff projections factor in implementation bottlenecks associated with capital projects and allow a modest growth in recurrent expenditure to accommodate higher capital spending. Consequently, the primary balance deficit is expected to deteriorate in 2017 before improving thereafter as capital spending winds down and additional revenue measures become better established.

7. The NBS has revised Maldives' national accounts for the period 2003-2015 based on 2014 benchmarked and rebased GDP estimates. The South Asia Regional Training and Technical Assistance Center (SARTTAC) and the IMF Statistics Department have provided TA to assist the NBS in their efforts to finalize the GDP benchmarking and rebasing. The average rebased GDP between 2003 and 2015 is higher by around 11 percent annually, with 2015 GDP revised up by as high as 25 percent (reaching MVR 61.8 billion) compared to 2003-based GDP estimates.

[8] The new thresholds for the indicators related to the PV of PPG external debt are 30 percent as a ratio to GDP (down from 40); 100 percent as a ratio to exports (down from 150); and 200 percent as a ratio to revenue (down from 250). Similarly, the thresholds for debt service indicators changed from 20 to 15 percent as a ratio to exports, and from 20 to 18 percent as a ratio to revenue.

[9] However, staff projections take into account the new revenue measures, the ADF and increased customs duties, for which requisite legislation has already been passed and made into law.

8. Key assumptions: Overall, the baseline macroeconomic assumptions are more favorable compared to the previous DSA over the near- to medium-term coinciding with the anticipated growth effects of the airport and other infrastructure development materialize (text table 1).[10]

- **Real GDP growth.** Growth is expected to recover gradually to 4.6 percent in 2017 and 4.7 percent in 2018. It is projected to average around 5.0 percent in the long term largely driven by the positive impact of infrastructure development. It is slower though than the average of the past ten years (around 6.5 percent) reflecting the earlier rapid development of the tourism sector.

Text Table Maldives: Changes in Macro Assumptions

	2017	2018	2019	2020	2021	2022
Real GDP growth (in percent)						
Previous	3.9	4.6	4.7	4.8	4.7	4.7
Current	4.6	4.7	4.8	5.0	5.0	5.0
Inflation						
Previous	2.5	2.8	3.0	3.2	3.2	3.2
Current	2.0	2.0	2.0	2.4	2.5	2.5
Primary fiscal balance (in percent of GDP)						
Previous	-14.7	-14.5	-10.7	-4.9	-4.6	-4.6
Current	-5.8	-4.6	-3.3	-2.6	-1.9	-0.9
Current account balance (in percent of GDP)						
Previous	-14.7	-17.3	-14.1	-10.9	-10.6	-10.4
Current	-17.2	-17.0	-16.4	-14.3	-12.9	-10.3

- **Inflation.** CPI inflation is projected to pick up in 2017 mainly due to the temporary effect of staple food and electricity subsidy reforms along with an increase in import duty on cigarettes, soft-and energy drinks, and higher international oil prices. It is expected to stabilize around 2.5 percent in the medium- to long-term reflective of stable commodity prices and economic performance.

- **The current account.** The current account deficit widened sharply to 19.6 percent of GDP in 2016, due to increased infrastructure-related imports, moderate tourism receipts, higher remittance outflows, and a large one-off court mandated payment. The current account remains in large deficit territory for a few years; the deficit starts to decline with completion of the large projects in the pipeline and stabilizes, albeit at a still high level of around 9.5 percent of GDP on average over 2022–2037.

- **The fiscal deficit.** The primary deficit under the baseline, is expected to widen in 2017 before falling in subsequent years mainly because of tapering capital spending, full materialization of subsidy reforms undertaken in 2016, and introduction of new but modest revenue measures.[11]

- **Financing.** In recent past, the bulk of deficit financing has been met from domestic sources, through the domestic banking system and the pension fund. Interest rates rose sharply in the primary market for Treasury bills in 2012 and 2013. Starting in mid-2014, the auction system was replaced with a 'tap system' of administered interest rates, lowering the rates to a range of

[10] The baseline scenario in the DSA assumes that the stabilized arrangement is maintained despite reserve cover dwindling through 2034.

[11] For all new revenue measures in the budget, their full year's effect will be seen from 2018 given that measures were mostly implemented starting in 2017H1.

3.5–4.6 percent across maturities ranging from 28 to 364 days and temporarily stabilizing interest costs on domestic debt. So far, the banks have sustained their demand for Treasury bills. However, as debt rises, yields may increase along with global interest rates. Accordingly, staff assumes that domestic yields will tighten over the forecast horizon. In countering such roll-over / market risks authorities are seeking to lengthen the maturity structure of domestic debt by issuing longer-term instruments. Such efforts are at a planning stage but if implemented effectively they can lower the re-pricing and roll-over risk of the domestic debt portfolio. Non-market, external infrastructure loans are assumed to be on semi-concessional terms at relatively lower interest rates (ranging from 2 to 5 percent) and longer maturities (20 years or longer).

- **New debt.** New infrastructure projects were included in the 2016 Budget. The DSA assumes external disbursements totaling US$1.4 billion over the period 2016-21. This includes the government's first international sovereign bond issuance in June 2017 to help fund the mega projects. Being the first, these bonds will act as benchmark for future issuances for both the private sector and SOEs. Moody's assigned the Maldives a B2 sovereign rating (considered 'speculative and subject to high credit risk') and Fitch a B+ rating (falling between a BB Speculative and a B Highly Speculative). Given that a large share of the loans contracted and the bonds are not on concessional terms, this will affect IDA's financing decision going forward (see Box 1).[12]

- **Sovereign guarantees.** Liabilities arising from sovereign guarantees amount to US$240 million (5.6 percent of 2016 GDP). Guarantees are included in the definition of PPG external debt and the called guarantees in the fiscal accounts.

[12] Maldives is a group A (ADF only) country in the AsDB and an IDA-eligible country under the small island exception. The proportion of grant financing for both these institutions is contingent on the country's risk of external debt distress. This is determined by the outcome of a forward-looking DSA. For more information, visit http://www.adb.org/site/adf/faqs and http://www.worldbank.org/ida/financing.html.

Box 1. Maldives and IDA's Non-Concessional Borrowing Policy[1]

Maldives, an IDA-grant eligible country, is subject to IDA's Non-Concessional Borrowing Policy (NCBP), and is required to seek external loans with a minimum grant element of 35 percent.[2] Between 2015 and June 2017 Maldives signed US$1,031 million (24.3 percent of 2016 GDP) in external loans on non-concessional terms including the sovereign bond. In the absence of an IMF program and its associated borrowing limits, IDA still has its NCBP in place and therefore a breach will entail requesting a waiver to the policy. Waivers are considered based on country- and loan-specific criteria. IDA's NCBP committee found Maldives in breach of the NCBP and responded through the provision of the country's notional IDA allocation for FY2018 on a 50 percent grant and 50 percent IDA credit basis.

Going forward, the MOFT has committed to seeking external loans on the most concessional terms possible, and to the extent that it is necessary to borrow on non-concessional terms for high-return development projects, it will request the approval of the IDA Board for a ceiling to cover the projected non-concessional borrowing to comply with the NCBP.

[1] NCBP Board paper, October 2015: http://ida.worldbank.org/sites/default/files/pdfs/ncbpoct2015.pdf. For more information, visit http://www.worldbank.org/ida/non-concessional-borrowing.html

[2] IDA countries subject to the NCBP in FY2017: http://ida.worldbank.org/sites/default/files/pdfs/fy17_listcountries_traffic_lights.pdf. Non-concessional debt ceilings under the NCBP in FY2017: http://ida.worldbank.org/sites/default/files/pdfs/oecd_dlp_and_ncbp_table_05_31_2017.pdf.

EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

9. External debt sustainability. The main concern continues to be the PV of external debt-to-GDP ratio and the PPG external debt service-to-revenue ratio. Under the baseline scenario, the nominal PPG external debt rises to 51.3 percent of GDP over the medium term and falls slightly to 49.7 percent of GDP by 2037 while the PV of PPG external debt peaks at 25.6 percent of GDP over the medium term and falls to 20.8 percent by the end of the projection period (Figure 1, panel b). The external debt path is vulnerable to all DSA's standard shocks but especially to an exports' shock highlighting the risk that a slowdown in tourism is critical to both the balance of payments and debt sustainability. While the PPG external debt service-to-revenue ratio spikes in 2022 due to the bond redemption, it remains below but extremely close to the threshold under the baseline, and is vulnerable to exports, combination and depreciation shocks (Figure 1, panel f).

10. Public debt sustainability. The primary deficit is expected to fall in subsequent years mainly on the back of tapering capital spending, subsidy reforms in 2016 and adoption of new revenue measures. The public debt ratio stands well above the indicative benchmark over the projection period, but is projected to be on a downward trend compared to the previous DSA. Under the baseline, the PV of public debt rises from 61.3 percent of GDP in 2016, peaks at 67.7 percent in 2020 and then falls to 62.9 percent of GDP by 2037 (Figure 2).

ALTERNATIVE SCENARIO

11. To highlight risks from the sovereign guarantees, staff includes the impact of calling guarantees under an alternative scenario. The probability that guarantees are called presents a substantial vulnerability given the lack of fiscal space currently. To illustrate the full impact of this, the alternative scenario assumes the following:

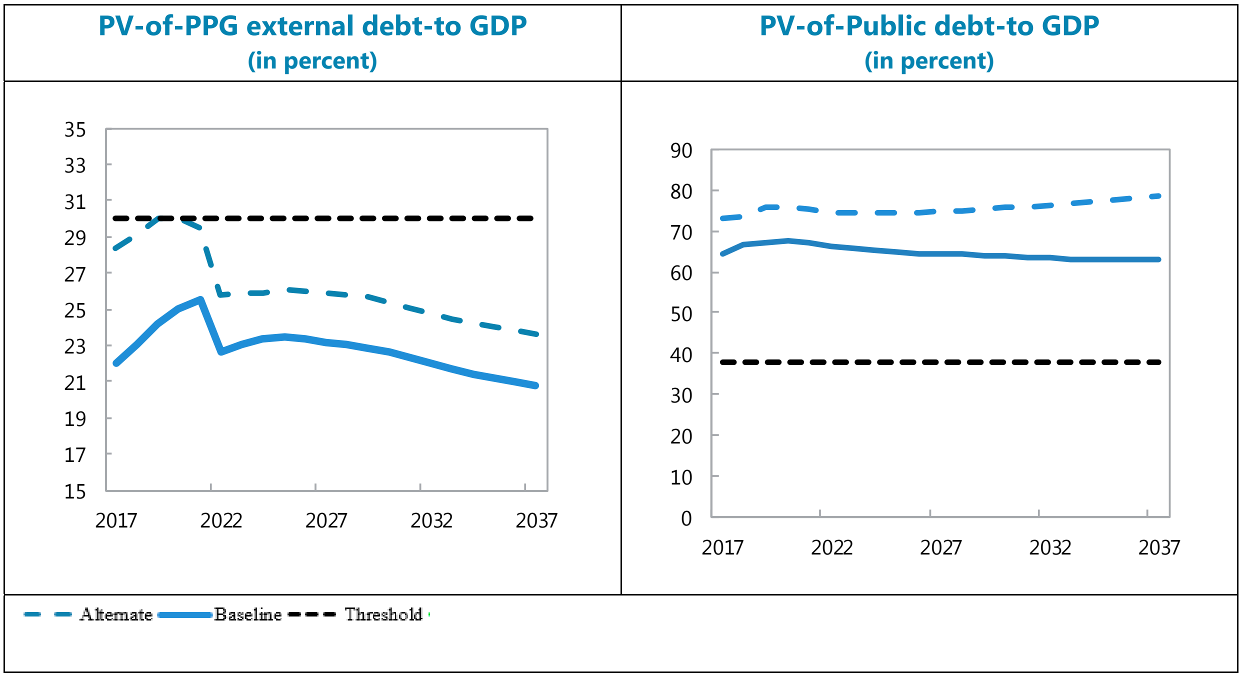
- **2017 sovereign guarantee scheme.** A guarantee scheme was introduced in January 2017 under which the government partly underwrites eligible loans granted by banks to tourism, social housing and development projects, at rates not exceeding 4 percent. Eligible borrowers can be the private sector or SOEs. Ceilings on the amounts issued are yet to be announced. Based on estimates of the portfolio growth of eligible loans, sovereign guarantees are estimated at around 0.4 percent of GDP.[13] The alternative scenario includes cost estimates associated with sovereign guarantees to the private sector in the form of fiscal costs in the event of a default.[14]

- **Existing sovereign guarantee scheme.** Under the alternative scenario, it is also assumed that all uncalled guarantees will be called. In addition, the authorities are currently negotiating new guarantees with creditors – the amounts and terms of which are not clear. To capture this, the scenario also assumes that new guarantees in the amount US$110 million will be issued and called. These assumptions attempt to highlight the fiscal and external vulnerability from the proposed guarantees in the pipeline.

12. Assessment. As anticipated, under the alternative scenario, both the PV of PPG external debt-to-GDP ratio and the PV of public debt-to-GDP ratio are worse than the baseline. The PV of PPG external debt-to-GDP ratio hovers around the threshold and the PV of public debt-to-GDP ratio deteriorates by almost 10 percentage points of GDP. This scenario strengthens the argument to tighten fiscal policy and scrutinize borrowing plans, to design guarantees to avoid unnecessarily exposing the government to fiscal risk as well as to strengthen practices and improve institutions to appraise and manage projects and implement them at an adequate pace over the medium term.

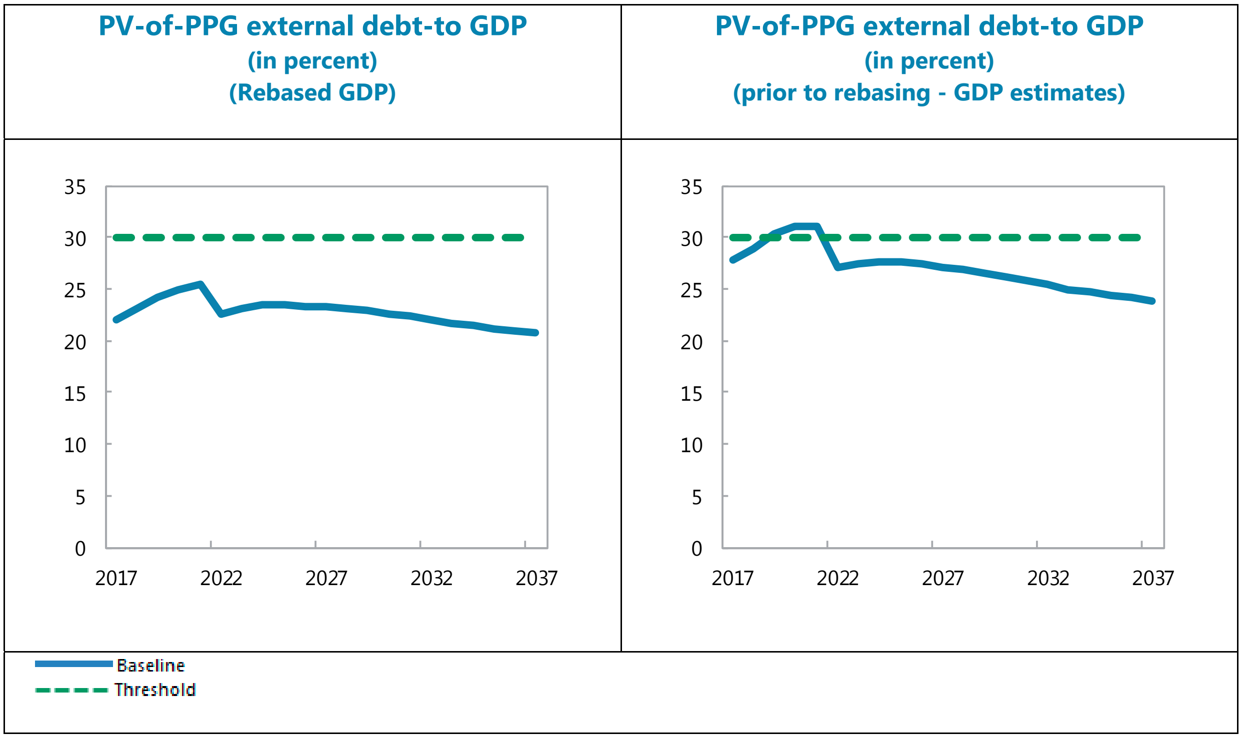
[13] The scheme as it stands now is tightly ring-fenced in terms of qualifying loans, thorough evaluation by the government, ability of the government to insist on additional security and a lower pecking order recourse to the guarantee in the event of a default.

[14] Costs are estimated based on (i) only a certain percent of all loans (estimated at 30 percent) to the private sector and SOEs qualifying for the sovereign guarantee scheme; (ii) a 30 percent probability of default is assumed on the guaranteed loans; and (iii) the fiscal cost to the government to be 50 percent of the default value (because of the lower pecking order claim on the guarantee in the event of a default).



ASSESSMENT

13. The DSA highlights the need to bring down debt ratios and calls for additional fiscal consolidation measures, greater prioritization of overall capital expenditures, improved public financial management practices and measures to reduce the risk of the debt portfolio. The authorities are seeking financing on the best available terms for a much-needed boost to infrastructure. At the same time, they should pursue new financing opportunities such as those on concessional terms associated with the Paris agreements on climate change and from private investors, under enhanced public-private partnership oversight. With a need for high and sustained financing, it is important that the best terms are continuously negotiated and guarantees designed to limit fiscal risk are stringently monitored. The authorities are implementing fiscal measures and project public debt on a downward path. They have approved a Medium-Term Debt Management Strategy 2018-20 aiming to increase the maturity of domestic debt and reduce refinancing risk, although they need to develop an annual borrowing plan to implement it. However, despite such measures coming on stream, the DSA highlights that the high level of public debt remains a vulnerability for years to come. In addition, given the central nature of tourism in the economy, a slowdown in this sector or an abatement in FDI could exert pressure on financing. It is also worth mentioning that the DSA results based on previous estimates of GDP (before the 2014-based rebasing and benchmarking) have shown a clear breach in the PV of PPG of debt-to-GDP threshold underscoring vulnerabilities in the debt outlook.



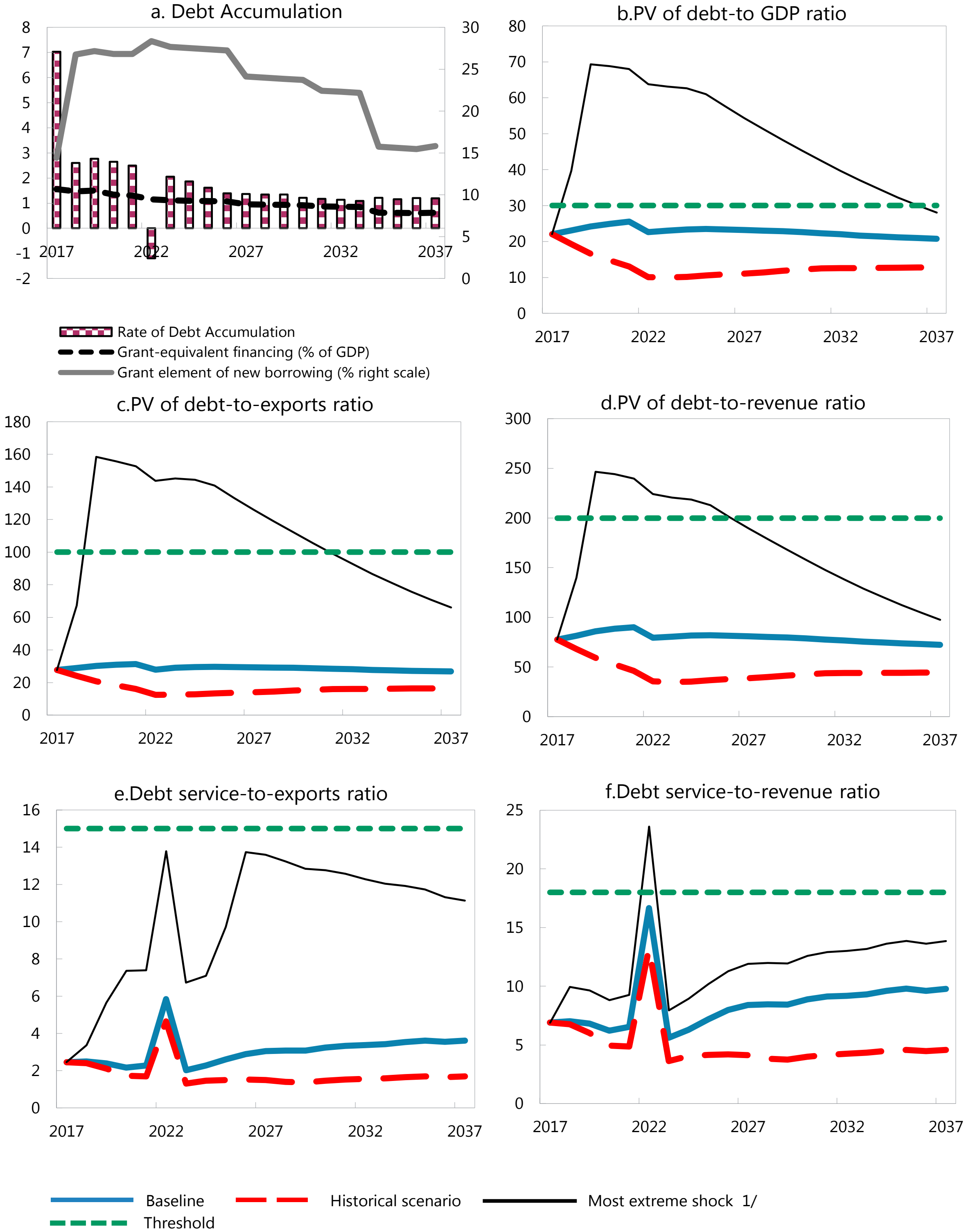
CONCLUSION

14. Risk rating. Maldives' main challenge remains one of balancing a surge in infrastructure investment which has the potential of transforming the economy against the continuing risks stemming from high and rising public debt, the bond redemption in 2022, and the short maturity of domestic debt. While the GDP rebasing suggests that the capacity to service the debt is higher than previously estimated, the improvement in the external debt path below relevant thresholds is due entirely to the rebasing of GDP as opposed to an improvement in economic and policy fundamentals. A widening current account deficit, low international reserves, pipeline of guarantees, and rapid debt buildup continue to skew the risks to the downside and leaves the country vulnerable to standard shocks, particularly a one-time depreciation and an exports shock. In addition, the public debt path is substantially above the prudential benchmark throughout the projection period underscoring a heightened overall risk of debt distress. Based on this, it is assessed that the external risk rating for the Maldives' continues to be rated as "high" risk of external debt distress.

AUTHORITIES' VIEWS

15. The authorities recognized that while the level of debt was high, it has been invested mainly in growth-enhancing infrastructure. They pointed out that the IMF estimates do not fully capture the future growth impacts from the borrowing. They expect significant economic benefits and faster economic growth from the infrastructure scale-up and improved connectivity in the Greater Malé region. In anticipation of impending future debt service, the government has established a Sovereign Development Fund aimed at helping pay maturing debt in the future and contingencies under sovereign guarantees. Nevertheless, they added that obtaining loans on concessional terms has become increasingly challenging.

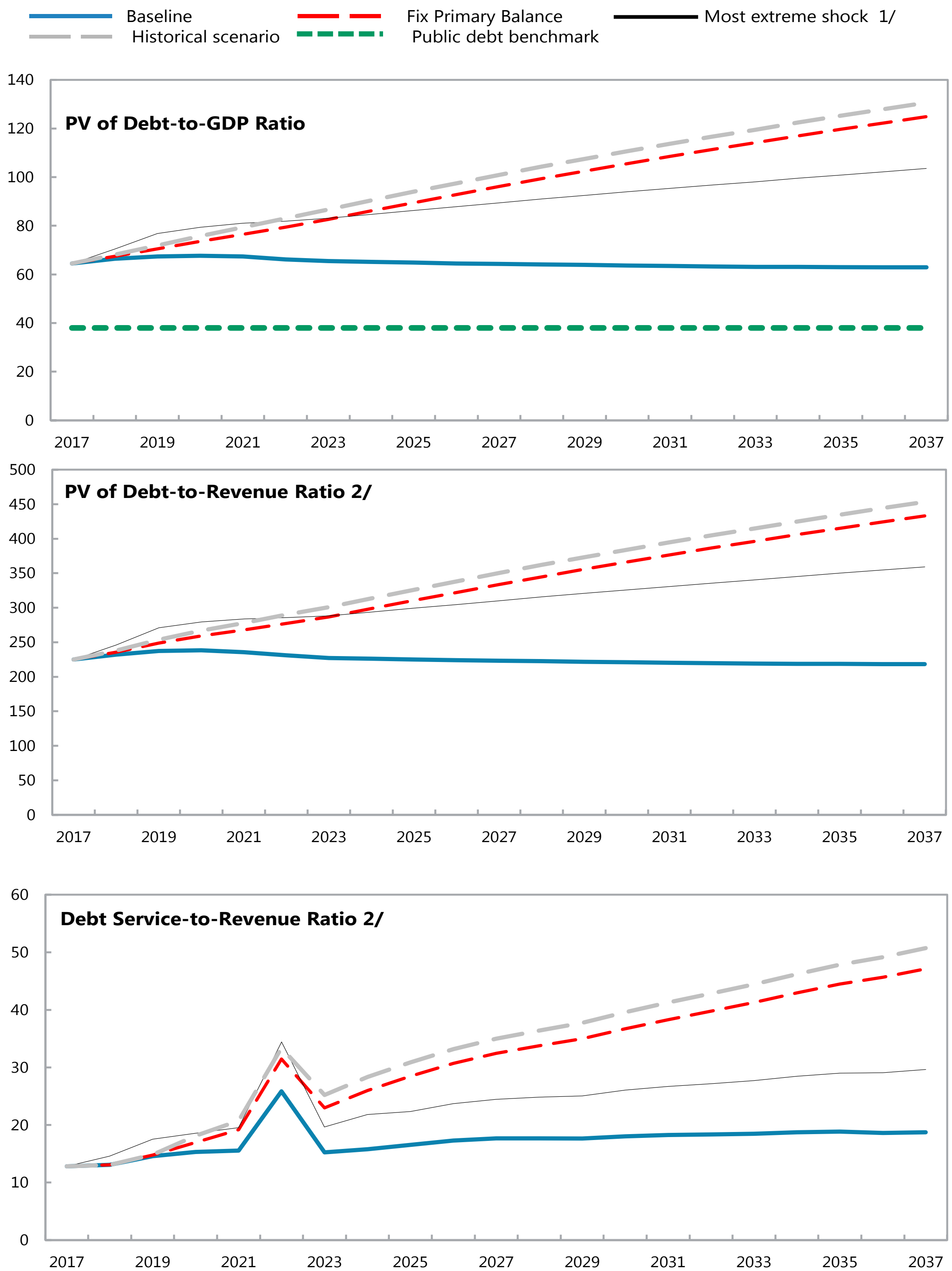
Figure 1. Maldives Baseline Scenario: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2017–2037 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2027. In figure b. it corresponds to a Exports shock; in c. to a Exports shock; in d. to a Exports shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Maldives Baseline Scenario: Indicators of Public Debt Under Alternative Scenarios, 2017–2037 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2027.
2/ Revenues are defined inclusive of grants.

Table 1. Maldives: External Debt Sustainability Framework, Baseline Scenario, 2014–37 1/

(In percent of GDP, unless otherwise indicated)

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2014	2015	2016			2017	2018	2019	2020	2021	2022	2017-2022 Average	2027	2037	2023-2037 Average
External debt (nominal) 1/	**28.9**	**27.2**	**34.7**			**38.9**	**42.8**	**46.4**	**49.1**	**51.2**	**49.3**		**53.6**	**49.7**	
of which: public and publicly guaranteed (PPG)	18.9	17.1	20.8			27.0	28.7	30.4	31.6	32.5	29.7		30.7	27.7	
Change in external debt	2.2	-1.7	7.5			4.2	3.9	3.6	2.7	2.1	-1.9		0.2	-0.6	
Identified net debt-creating flows	-8.8	-2.7	7.6			5.8	4.8	5.0	3.9	3.7	1.0		1.0	0.5	
Non-interest current account deficit	**2.5**	**6.5**	**18.6**	**10.3**	**7.3**	**16.0**	**15.4**	**14.7**	**12.5**	**11.0**	**8.4**		**7.7**	**6.9**	7.5
Deficit in balance of goods and services	-14.8	-9.4	-4.0			-0.2	-0.7	-1.4	-3.7	-5.3	-7.9		-9.1	-9.9	
Exports	89.4	78.3	79.4			79.7	79.9	80.0	80.7	81.4	81.0		78.9	77.6	
Imports	74.6	69.0	75.4			79.5	79.1	78.5	77.0	76.1	73.1		69.8	67.7	
Net current transfers (negative = inflow)	8.3	8.6	15.0	9.2	2.1	8.5	8.5	8.5	8.5	8.5	8.6		8.6	8.7	8.6
of which: official	-0.3	-1.0	-0.7			-0.4	-0.2	-0.2	-0.2	-0.2	-0.2		-0.1	-0.1	
Other current account flows (negative = net inflow)	8.9	7.3	7.6			7.7	7.6	7.6	7.7	7.7	7.8		8.2	8.2	
Net FDI (negative = inflow)	**-9.0**	**-7.7**	**-10.6**	**-9.2**	**2.8**	**-10.0**	**-10.5**	**-9.5**	**-8.3**	**-7.0**	**-7.0**		**-6.5**	**-6.2**	-6.5
Endogenous debt dynamics 2/	**-2.2**	**-1.5**	**-0.5**			**-0.2**	**-0.2**	**-0.3**	**-0.3**	**-0.4**	**-0.5**		**-0.2**	**-0.1**	
Contribution from nominal interest rate	0.7	0.8	1.0			1.3	1.5	1.7	1.8	1.9	1.9		2.0	2.1	
Contribution from real GDP growth	-1.8	-0.9	-1.0			-1.5	-1.7	-1.9	-2.1	-2.3	-2.4		-2.2	-2.2	
Contribution from price and exchange rate changes	-1.1	-1.5	-0.4			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**11.0**	**1.0**	**-0.1**			**-1.5**	**-0.9**	**-1.4**	**-1.2**	**-1.5**	**-2.8**		**-0.8**	**-1.2**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	30.3			34.0	37.2	40.2	42.4	44.2	42.3		46.1	42.8	
In percent of exports	...	...	38.2			42.6	46.6	50.2	52.6	54.3	52.2		58.5	55.1	
PV of PPG external debt	**...**	**...**	**16.5**			**22.0**	**23.1**	**24.2**	**25.0**	**25.5**	**22.6**		**23.2**	**20.8**	
In percent of exports	**...**	**...**	**20.7**			**27.7**	**28.9**	**30.2**	**30.9**	**31.4**	**27.9**		**29.4**	**26.8**	
In percent of government revenues	**...**	**...**	**58.7**			**77.7**	**81.3**	**86.0**	**88.6**	**90.0**	**79.5**		**80.9**	**72.4**	
Debt service-to-exports ratio (in percent)	**6.1**	**7.8**	**4.6**			**5.1**	**5.2**	**5.5**	**5.6**	**5.9**	**9.7**		**7.8**	**8.3**	
PPG debt service-to-exports ratio (in percent)	**2.5**	**1.9**	**2.1**			**2.5**	**2.5**	**2.4**	**2.2**	**2.3**	**5.9**		**3.1**	**3.6**	
PPG debt service-to-revenue ratio (in percent)	**8.5**	**5.5**	**5.8**			**6.9**	**7.0**	**6.8**	**6.2**	**6.5**	**16.7**		**8.4**	**9.8**	
Total gross financing need (Millions of U.S. dollars)	13.8	329.0	635.1			630.9	599.9	701.7	649.1	720.8	821.9		1021.2	1894.3	
Non-interest current account deficit that stabilizes debt ratio	0.3	8.2	11.2			11.7	11.5	11.1	9.8	8.9	10.3		7.4	7.5	
Key macroeconomic assumptions															
Real GDP growth (in percent)	7.6	3.3	3.9	5.1	4.8	4.6	4.7	4.8	5.0	5.0	5.0	4.8	4.4	4.6	4.5
GDP deflator in US dollar terms (change in percent)	4.5	5.3	1.6	5.3	5.2	2.0	2.0	2.0	2.4	2.5	2.5	2.2	2.0	2.0	2.0
Effective interest rate (percent) 5/	3.1	3.0	3.7	3.4	1.5	4.0	4.2	4.2	4.2	4.2	4.0	4.1	4.1	4.4	4.2
Growth of exports of G&S (US dollar terms, in percent)	13.5	-4.7	7.0	20.2	41.0	7.0	7.0	7.0	8.5	8.5	7.1	7.5	6.3	6.5	6.3
Growth of imports of G&S (US dollar terms, in percent)	14.8	0.5	15.5	14.1	23.3	12.4	6.3	6.1	5.3	6.4	3.4	6.6	5.9	6.5	6.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	14.4	26.8	27.2	26.8	26.8	28.3	25.1	24.1	15.8	22.3
Government revenues (excluding grants, in percent of GDP)	26.4	26.7	28.1			28.4	28.4	28.1	28.2	28.4	28.5		28.7	28.7	28.7
Aid flows (in Millions of US dollars) 7/	-45.0	-11.5	423.9			112.1	55.9	59.8	91.6	95.5	92.0		118.8	151.8	
of which: Grants	10.7	41.3	12.2			13.0	11.6	11.6	11.6	11.6	11.6		11.6	11.6	
of which: Concessional loans	-55.7	-52.9	411.7			99.1	44.2	48.2	80.0	83.9	80.4		107.2	140.1	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.6	1.5	1.5	1.3	1.3	1.1		1.0	0.6	0.9
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			17.1	30.4	30.5	30.3	30.1	32.0		26.9	17.5	24.8
Memorandum items:															
Nominal GDP (Millions of US dollars)	3690.2	4014.8	4238.2			4519.7	4824.7	5158.2	5544.8	5965.8	6418.8		8847.7	16787.7	
Nominal dollar GDP growth	12.4	8.8	5.6			6.6	6.7	6.9	7.5	7.6	7.6	7.2	6.5	6.7	6.6
PV of PPG external debt (in Millions of US dollars)			698.5			996.5	1114.0	1247.7	1384.5	1522.8	1451.6		2052.0	3491.3	
(PVt-PVt-1)/GDPt-1 (in percent)						7.0	2.6	2.8	2.7	2.5	-1.2	2.7	1.4	1.2	1.4
Gross workers' remittances (Millions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	16.5			22.0	23.1	24.2	25.0	25.5	22.6		23.2	20.8	
PV of PPG external debt (in percent of exports + remittances)	...	...	20.7			27.7	28.9	30.2	30.9	31.4	27.9		29.4	26.8	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.1			2.5	2.5	2.4	2.2	2.3	5.9		3.1	3.6	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes change in assets and valuation effects and over the projection period banks pay down debt abroad/ increase asset position abroad.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Maldives: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37

(In percent)

	Projections							
	2017	2018	2019	2020	2021	2022	**2027**	2037
PV of debt-to GDP ratio								
Baseline	22	23	24	25	26	23	**23**	21
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	22	19	17	15	13	10	**11**	13
A2. New public sector loans on less favorable terms in 2017-2037 2	22	24	26	28	30	27	**32**	36
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	22	24	26	27	28	25	**25**	23
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	22	40	69	69	68	64	**54**	28
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	22	24	25	26	26	23	**24**	22
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	22	29	34	35	35	32	**30**	22
B5. Combination of B1-B4 using one-half standard deviation shocks	22	31	44	44	44	41	**37**	24
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	22	33	34	35	36	32	**33**	29
PV of debt-to-exports ratio								
Baseline	28	29	30	31	31	28	**29**	27
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	28	24	21	18	16	12	**14**	16
A2. New public sector loans on less favorable terms in 2017-2037 2	28	30	33	35	36	34	**40**	47
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	28	29	30	31	31	28	**29**	27
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	28	67	158	156	153	144	**126**	66
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	28	29	30	31	31	28	**29**	27
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	28	36	43	43	43	39	**38**	29
B5. Combination of B1-B4 using one-half standard deviation shocks	28	42	62	62	61	57	**53**	35
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	28	29	30	31	31	28	**29**	27
PV of debt-to-revenue ratio								
Baseline	78	81	86	89	90	79	**81**	72
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	78	68	59	52	46	36	**39**	44
A2. New public sector loans on less favorable terms in 2017-2037 2	78	85	93	99	104	97	**111**	127
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	78	85	94	97	98	87	**88**	79
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	78	140	247	244	240	224	**190**	98
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	78	83	89	92	93	82	**84**	75
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	78	101	122	123	123	112	**105**	78
B5. Combination of B1-B4 using one-half standard deviation shocks	78	110	157	157	156	143	**129**	85
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	78	115	122	126	128	113	**115**	102

Table 2. Maldives: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37 (concluded)

(In percent)

	Projections							
	2017	2018	2019	2020	2021	2022	**2027**	2037
Debt service-to-exports ratio								
Baseline	2	2	2	2	2	6	**3**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	2	2	2	2	2	5	**2**	2
A2. New public sector loans on less favorable terms in 2017-2037 2	2	2	2	2	2	2	**3**	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	2	2	2	2	2	6	**3**	4
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	2	3	6	7	7	14	**14**	11
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	2	2	2	2	2	6	**3**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	2	2	3	3	3	6	**4**	4
B5. Combination of B1-B4 using one-half standard deviation shocks	2	3	3	3	3	8	**6**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	2	2	2	2	2	6	**3**	4
Debt service-to-revenue ratio								
Baseline	7	7	7	6	7	17	**8**	10
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	7	7	6	5	5	13	**4**	5
A2. New public sector loans on less favorable terms in 2017-2037 2	7	7	6	5	6	6	**8**	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	7	7	7	7	7	18	**9**	11
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	7	7	9	12	12	22	**20**	16
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	7	7	7	6	7	17	**9**	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	7	7	7	7	8	18	**11**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	7	7	8	9	9	19	**14**	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	7	10	10	9	9	24	**12**	14
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	20	20	20	20	20	20	**20**	20

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. Maldives: Public Sector Debt Sustainability Framework, Baseline Scenario, 2014–37
(In percent of GDP, unless otherwise indicated)

	Actual					Estimate				Projections					
	2014	2015	2016	Average 5/	Standard Deviation 5/	2017	2018	2019	2020	2021	2022	2017-22 Average	2027	2037	2023-37 Average
Public sector debt 1/	54.2	56.9	65.7			69.4	72.0	73.5	74.3	74.3	73.2		71.8	69.8	
of which: foreign-currency denominated	19.3	17.1	20.8			27.0	28.7	30.4	31.6	32.5	29.7		30.7	27.7	
Change in public sector debt	0.5	2.7	8.8			3.7	2.6	1.5	0.7	0.0	-1.1		-0.2	-0.1	
Identified debt-creating flows	1.5	2.4	7.3			3.9	2.7	1.7	0.8	0.1	-1.0		-0.1	-0.1	
Primary deficit	5.1	4.6	8.2	6.7	4.0	5.7	4.6	3.3	2.5	1.9	0.8	3.1	0.9	0.9	0.9
Revenue and grants	26.7	27.7	28.4			28.7	28.6	28.3	28.4	28.5	28.6		28.8	28.8	
of which: grants	0.3	1.0	0.3			0.3	0.2	0.2	0.2	0.2	0.2		0.1	0.1	
Primary (noninterest) expenditure	31.7	32.3	36.6			34.4	33.2	31.6	30.9	30.4	29.5		29.7	29.7	
Automatic debt dynamics	-3.6	-2.2	-1.0			-1.8	-1.9	-1.6	-1.7	-1.8	-1.8		-1.0	-1.0	
Contribution from interest rate/growth differential	-2.9	-1.5	-0.9			-1.8	-1.9	-1.6	-1.6	-1.6	-1.7		-1.0	-1.0	
of which: contribution from average real interest rate	0.8	0.2	1.2			1.1	1.2	1.7	1.9	1.9	1.9		2.0	2.1	
of which: contribution from real GDP growth	-3.8	-1.7	-2.1			-2.9	-3.1	-3.3	-3.5	-3.5	-3.5		-3.0	-3.1	
Contribution from real exchange rate depreciation	-0.6	-0.7	0.0			0.0	0.0	0.0	-0.1	-0.1	-0.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-1.0	0.3	1.5			-0.1	-0.1	-0.1	-0.1	-0.1	-0.1		-0.1	0.0	
Other Sustainability Indicators															
PV of public sector debt	...	...	61.3			64.5	66.4	67.3	67.7	67.3	66.2		64.3	62.9	
of which: foreign-currency denominated	...	...	16.5			22.0	23.1	24.2	25.0	25.5	22.6		23.2	20.8	
of which: external	...	...	16.5			22.0	23.1	24.2	25.0	25.5	22.6		23.2	20.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	37.0	40.6	49.4			51.5	48.1	48.0	47.0	46.0	47.1		44.6	45.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	216.0			224.8	232.0	237.5	238.4	235.8	231.2		223.2	218.3	
PV of public sector debt-to-revenue ratio (in percent)	...	...	218.2			227.1	234.0	239.4	240.2	237.4	232.6		224.3	218.8	
of which: external 3/	...	...	58.7			77.7	81.3	86.0	88.6	90.0	79.5		80.9	72.4	
Debt service-to-revenue and grants ratio (in percent) 4/	15.9	12.4	12.0			12.8	13.1	14.6	15.3	15.6	25.8		17.7	18.7	
Debt service-to-revenue ratio (in percent) 4/	16.1	12.9	12.1			12.9	13.2	14.7	15.4	15.7	26.0		17.7	18.8	
Primary deficit that stabilizes the debt-to-GDP ratio	4.5	1.9	-0.5			2.0	2.0	1.8	1.8	1.9	1.9		1.1	1.0	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.6	3.3	3.9	5.1	4.8	4.6	4.7	4.8	5.0	5.0	5.0	4.8	4.4	4.6	4.5
Average nominal interest rate on forex debt (in percent)	1.6	1.2	1.6	1.9	0.8	2.8	3.1	3.0	2.9	2.9	2.6	2.9	2.5	3.0	2.6
Average real interest rate on domestic debt (in percent)	2.9	0.7	3.1	-0.5	4.2	2.0	2.4	3.4	4.0	3.9	4.3	3.3	4.8	4.5	4.7
Real exchange rate depreciation (in percent, + indicates depreciation)	-2.9	-3.8	-0.1	-3.0	4.6	-0.2	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.5	5.3	1.6	7.2	3.7	2.0	2.0	2.0	2.4	2.5	2.5	2.2	2.0	2.0	2.0
Growth of real primary spending (deflated by GDP deflator, in percent)	23.1	5.2	17.8	4.6	8.6	-1.9	1.1	-0.1	2.6	3.3	1.7	1.1	4.4	4.6	4.5
Grant element of new external borrowing (in percent)	...	...	...	...	...	14.4	26.8	27.2	26.8	26.8	28.3	25.1	24.1	15.8	...

Sources: Country authorities; and staff estimates and projections.

1/ Public debt is defined as the debt of the non-financial public sector comprising central government, including loans on-lent to State Owned Enterprises (SOEs), sovereign guarantees issued to SOEs and domestic payable arrears.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. Maldives: Sensitivity Analysis for Key Indicators of Public Debt, Baseline Scenario, 2017–37

	Projections							
	2017	2018	2019	2020	2021	2022	2027	2037
PV of Debt-to-GDP Ratio								
Baseline	64	66	67	68	67	66	64	63
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	64	68	72	76	79	83	101	131
A2. Primary balance is unchanged from 2017	64	67	71	74	76	79	96	125
A3. Permanently lower GDP growth 1/	64	67	69	71	73	73	85	128
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	64	70	77	79	81	82	89	104
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	64	72	80	79	78	77	74	70
B3. Combination of B1-B2 using one half standard deviation shocks	64	71	78	79	80	79	81	85
B4. One-time 30 percent real depreciation in 2018	64	75	76	75	74	73	70	69
B5. 10 percent of GDP increase in other debt-creating flows in 2018	64	76	76	76	75	74	71	68
PV of Debt-to-Revenue Ratio 2/								
Baseline	225	232	237	238	236	231	223	218
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	225	238	254	267	278	290	350	453
A2. Primary balance is unchanged from 2017	225	236	249	259	268	277	334	433
A3. Permanently lower GDP growth 1/	225	235	245	251	254	256	294	445
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	225	246	271	279	284	286	310	359
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	225	252	281	279	275	268	256	243
B3. Combination of B1-B2 using one half standard deviation shocks	225	249	277	280	279	277	280	295
B4. One-time 30 percent real depreciation in 2018	225	263	267	265	261	254	242	239
B5. 10 percent of GDP increase in other debt-creating flows in 2018	225	264	269	268	264	258	247	236
Debt Service-to-Revenue Ratio 2/								
Baseline	13	13	15	15	16	26	18	19
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	13	13	15	18	21	33	35	51
A2. Primary balance is unchanged from 2017	13	13	15	17	19	31	32	47
A3. Permanently lower GDP growth 1/	13	13	15	16	17	29	26	46
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	13	14	16	19	21	33	28	37
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	13	13	16	23	26	32	21	23
B3. Combination of B1-B2 using one half standard deviation shocks	13	13	16	21	24	33	24	29
B4. One-time 30 percent real depreciation in 2018	13	15	18	19	20	34	24	30
B5. 10 percent of GDP increase in other debt-creating flows in 2018	13	13	16	26	20	31	20	22

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

Statement by Hazem Beblawi, Excutive Director for Maldives and Maya Choueiri, Senior Advisor to Executive Director October 20, 2017

1. The Maldives economy has undergone a remarkable transformation over the past three decades, turning from a low per capita income of US $275 in 1980, to middle income levels with a per capita income of US $11,544 in 2015. This transformation was due to the development of a dynamic high-end tourism sector. In order to achieve high sustainable and inclusive growth, diversify the economy, consolidate population in a widely-dispersed island economy, and close gaps in communications, electricity and transportation, the authorities have launched large infrastructure investment projects. These include the expansion of the international and regional airports, development of major regional hubs and land connectivity in the greater Malé area, as well as investment in harbors, sewage systems and desalination plants. All these projects have aimed at addressing the country's development challenges, mitigating the impact of climate change, protecting inhabitants and physical infrastructure, as well as increasing demand for the tourism industry and ancillary services. The authorities are fully aware of the temporary widening of the fiscal and external deficits associated with the scaling-up of infrastructure investment, but believe that such expansion is necessary as it will expand the country's growth potential over the medium term.

Fiscal Policies and Reforms

2. The country's geography—with 1,192 small coral islands and a widely-dispersed population of over 341,000 across about 190 distant islands—creates fiscal challenges. Despite these challenges, the authorities fully concur with staff that fiscal consolidation is needed to restore fiscal sustainability. They have taken active measures towards that in the recent years, in line with past IMF advice. The 2016 budget encompassed several expenditure-reduction measures, including a continuation of the wage and hiring freeze introduced in 2015, as well as bold initiatives to eliminate electricity subsidies and significantly scale down food subsidies. Nonetheless, the fiscal deficit widened in 2016 relative to the budget, on account of lower revenue, high infrastructure spending, and larger spending on the health insurance scheme. In order to improve the fiscal position, the 2017 budget continued the wage and hiring freeze. It also reduced the operational cost and improved the efficiency of key welfare programs, notably health care. The budget also introduced new revenue measures including an Airport Development Fee, land sales to the public, and higher import duties on cigarettes, soft and energy drinks.

3. Notwithstanding these efforts, the authorities acknowledge that further fiscal adjustment is needed and take note of staff's recommendations in this regard. They are concerned about the regressive nature of the General Sales Tax and do not favor increasing it. They consider that further fiscal adjustment should focus on spending, including better oversight over State-Owned Enterprises (SOEs), and strengthening Public Financial Management (PFM). The authorities have taken steps to strengthen PFM measures, including

budget preparation, as well as better commitment control and cash management. They highly appreciate the technical assistance provided by the IMF on PFM and on the Public Investment Management Assessment. Stressing arrear collection as a priority, the authorities plan to collect non-tax resort lease payments estimated at MVR 3.2 billion. In this connection, they are establishing a Presidential Commission[1] on state asset recovery in collaboration with the Auditor General's office and the Anti-Corruption Commission of Maldives. Other public sector reforms include the Civil Services Commission's ongoing human resources audits of line ministries and the National Pay Commission's review of the pay and cadre structure. These reforms aim to institutionalize a fair and structured compensation system, which would retain technical staff and improve the efficiency of the civil service and thus contain the growth in expenditure. The authorities have also approved a Medium-Term Debt Management Strategy for 2018-20 aimed at increasing the maturity of domestic debt as well as anticipating and securing sufficient resources against refinancing risk.

4. The authorities consider that risks from the public debt buildup are moderate and stress that infrastructure investment over time will benefit the economy and help alleviate financing pressures. The authorities indeed believe that though the debt level is high, it has gone towards financing growth-enhancing infrastructure. They welcome the fact that the baseline macroeconomic assumptions under the updated Debt Sustainability Analysis (DSA) are more favorable than the previous DSA, particularly in the near-term. Nonetheless, they consider that the DSA—notably staff's assessment that the investment scale-up would add only 0.1 percent of GDP to GDP growth in 2018 and 2019, with no increase in the outer years—does not fully capture the medium-term growth benefits of expanding the economy's potential. They expect significant economic benefits and faster economic growth from the infrastructure scale-up and improved connectivity in the Greater Malé region. The authorities believe that the DSA framework should take into consideration the special circumstances of small states that are necessarily reliant on external financing to close their infrastructure gap. The authorities also believe that the staff assessment that Maldives' continues to be rated at high risk of external debt distress and maintains a heightened overall risk of debt distress is based on overly conservative assumptions. Specifically, there is a risk that the above rating may be unsettling for markets at a time when the government issued its first international sovereign bond in June 2017 and is now being scrutinized by investors and rating agencies.

5. The authorities do not share staff's concern that sovereign guarantees may compound fiscal vulnerabilities, as illustrated in the DSA's Alternative Scenario. Indeed, in anticipation of expected future debt service, they have established the Sovereign Development Fund (SDF) targeted to reach U.S.$500 million in the medium term to help pay for maturing loan obligations and contingencies under sovereign guarantees. The SDF could be fed by contributions from the Airport Development Fee, the green tax, dividends from SOEs and

[1] The Presidential Commission estimates that total missing state assets amount to MVR 13.5 billion.

other non-tax sources going forward. In 2017, the Airport Development Fee has been fully earmarked to the SDF.

Monetary and Financial Sector Policies

6. The authorities concur with staff's view that the current peg to the U.S. dollar remains appropriate given the country's small scale, high openness, dollarized nature, and its volatile export revenue. The peg has indeed helped anchor inflation and provided a natural hedge for the tourism sector, where income and imports are received and paid in U.S. dollars. The authorities share staff's view that strong and durable fiscal adjustment can better support the peg going forward and help build foreign reserves. The Maldives Monetary Authority (MMA) does not see, however, the need for monetary policy tightening to support the peg in the absence of inflation and foreign exchange market pressures. The parallel market premium had indeed narrowed considerably in light of the MMA decision in 2016 to increase foreign exchange sales to banks and to sell it directly to the public. MMA also increased its foreign exchange allocation to commercial banks and U.S. dollar sales to SOEs starting in 2017. In the event of pressure on the peg, the MMA is able and ready to activate alternative monetary instruments based on open market operations, if needed.

7. The MMA maintained an accommodative monetary stance in the past year by keeping the minimum reserve requirement rate at 10 percent. This helped reduce borrowing costs, boost private credit, and lengthen maturities on sovereign bonds. Despite this easing, broad money growth declined sharply in the past months mainly due to the decline in non-financial public enterprise deposits. Moreover, though credit growth is robust, private credit remains low compared to economies at similar income level. The MMA does not share staffs' assessment that the accommodating monetary policy has contributed to balance of payments pressures. The MMA attributes the latter to one-off external payments in 2016 and to the increase in public infrastructure-related imports. With regard to reserves, the MMA believes that using months of imports may not be an appropriate measure in assessing reserve adequacy. This is due to the significantly large and temporary capital imports associated with infrastructure investment and the high structural nature of the import bill reflecting large demands from the tourism sector. They encourage staff to consider other reserve adequacy metrics that would more appropriately assess reserves.

8. The MMA strives to promote financial depth and resilience, building on past years' efforts to improve the regulatory environment and ensure financial stability. They share staff's assessment that banks' capital position remains strong and asset quality has improved. To enhance financial stability, the MMA introduced new stress testing methods in assessing banks resilience and solicited international auditing companies to evaluate the operational risks of banks. To promote financial inclusiveness, the MMA introduced in 2016 the *credit guarantee scheme* that aims to facilitate SMEs' access to finance and the *credit information unit* to help collect and disseminate credit information. In order to better combat financial crimes, the MMA strengthened its AML framework by issuing regulation on AML- related

customer due diligence measures increasing resources for the independent Financial Intelligence Unit.

Climate Change

9. Climate change is a major threat to the Maldives in the long run. According to the World Bank, rising sea levels could cause the entire country to be submerged before the end of the century as 80 percent of land is less than one meter above sea level. The authorities shared the *Maldives Climate Change Policy Framework*[2] with staff in the context of the 2016 Article IV Consultation. The plan highlighted the challenges and policies considered important to mitigate the impact of climate change. Maldives is already investing in a number of areas to adapt to climate change, including food and water security, infrastructure resilience, public health, coastal protection, fishing industry, waste management and renewable energy. The government is promoting long voluntary resettlement to regional hubs and improving transport connectivity. The authorities agree that there is scope for integrating risk-reduction and disaster-response programs into the core budget, as well as carrying out public investment planning and debt management frameworks to help address climate change.

Conclusion

10. The Maldives authorities welcome the opportunity to have an open and candid exchange of views with staff on their current challenges and policies and appreciate the Fund's valuable technical assistance. They also appreciate the invaluable support provided by the Resident Representative Office based in Sri Lanka. In order to ensure deeper knowledge of the Maldivian institutions and stronger engagement with the IMF, the authorities would be grateful if consideration be given to employing a Maldivian national in the Resident Representative Office. This would provide dedicated coverage at the local level of the issues and challenges pertaining to the Maldives. The authorities welcome the IMF's increased focus on issues of relevance to small states under the leadership of Deputy Managing Director Zhang.

[2] http://www.environment.gov.mv/v2/en/download/4594.