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700 19th Street, NW
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IMF Concludes 2002 Article IV Consultation with Maldives

On January 8, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the 2002 Article IV consultation with Maldives.[1]

Background

The Maldivian economy has prospered over the past decade with the rapid expansion of tourism and the modernization of the fisheries sector. During the 1990s, annual GDP growth averaged around 8 percent, raising per capita income to about US$2,200 in 2001. Though poverty incidence in the outer atolls remains high, social indicators have improved steadily.

Economic growth slowed, however, in recent years, and continues to be dampened by the tourism slowdown which began in mid-2001. Growth is estimated at 4.3 percent for 2002, driven by a gradual recovery in tourism and an improving fish catch, as well as government spending. Despite the July 2001 devaluation of the rufiyaa, inflation has been kept in check. International competitiveness of resorts and fisheries does not seem to be at issue.

After a loss of international reserves in 2001, the balance of payments has improved. Reserves recovered to about 3 and a half months of imports by November 2002. The external current account deficit is expected to remain wide, but capital inflows, both public and private, have provided the necessary financing. External debt, most of which is on concessional terms, has

[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. 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.

risen to around 42 percent of GDP in 2002, with debt service about 5.5 percent of exports of goods and nonfactor services.

After several years of improving fiscal performance, the budget deficit has widened recently. It is expected to have reached 7 percent of GDP in 2002, reflecting strong capital expenditures, increasingly financed externally on commercial terms. Current spending has also continued to grow, mainly in the areas of general administration and social services. Falling yields in tourism-related taxes have further weakened the budgetary outturn.

Monetary developments in 2002 have been characterized by continued central bank financing of budgetary imbalances. Effective liquidity management remains an issue, while the banking system is being challenged by slowing growth, removal of credit ceilings, and stronger competition.

Structural reforms are gaining momentum. Important economic laws are in the works and inroads are being made toward the privatization of key state-owned enterprises.

Executive Board Assessment

Executive Directors noted that, after a commendable performance characterized by fast growth, low inflation, and broad macroeconomic stability, that had raised living standards consistently for some twenty years, growth has been interrupted recently by temporary exogenous shocks, policy slippages, and remaining structural weaknesses—some of which are related to the small-island and geographic nature of the Maldives economy. Macroeconomic and structural policies need to be refocused to reduce existing imbalances and to set Maldives once again on the path of medium-term sustainable growth. While the emerging signs of recovery in the tourism and fisheries sectors—the pillars of Maldives's economy—were encouraging, the authorities should nevertheless move forcefully to bolster the public finances, broaden the economy's productive base, and improve the environment for private sector investment and activity. Improving social conditions in the country's outer islands, where poverty remains high, is also a continuing priority.

Directors emphasized that growing fiscal deficits financed by central bank resources pose a threat to the fixed exchange rate regime, and a risk to Maldives's external viability. Both revenue and expenditure measures are needed to contain the deficit, including broadening the tax base, reassessing tax rates, and managing more carefully government current and capital spending. Several Directors considered that an increase in the tourism tax to restore its real value, and higher rental fees for public land use, would go a long way toward strengthening the fiscal position. Other Directors, however, noted that given the prevailing weaknesses in tourism, the timing and rate of increase in the bed tax should be set so as to minimize the effect of the increase on the sector. Spending on general administration and wages should also be contained, and public projects carefully prioritized. Directors welcomed the authorities' intention to operationalize quickly the planned expenditure monitoring mechanism, which should assist in controlling spending, following the revamping of the public accounting system.

Given the importance of breaking the pattern of widening fiscal imbalances, Directors were disappointed that the 2003 budget does not contain firmer consolidation measures. However, they welcomed indications from the authorities that in the event that the planned foreign financing is less than anticipated, they would take action to avoid additional recourse to central bank funds to cover the deficit.

Directors indicated that institutional and administrative reforms are also required to improve the public finances. They recommended in particular the early introduction of government securities, and an overhaul of the system of allowances for public sector employees. Prudence in tapping external commercial funds to finance public investment is also essential to prevent an unsustainable buildup in the public debt in the longer term.

Directors welcomed recent steps taken to limit the use of direct instruments of monetary control, including the dismantling of bank-by-bank credit ceilings. Monetary operations could be strengthened through more flexible terms for the sale of central bank papers. Directors agreed that consideration of a gradual reduction in reserve requirements should be deferred until more effective liquidity management tools are in place.

Directors noted that the devaluation of the rufiyaa in 2001 had succeeded in restoring the level of international reserves and eliminating the parallel foreign exchange market, and had strengthened Maldives's competitiveness. They agreed that the pegged exchange rate system has served Maldives well, and should continue to be an important element of the macroeconomic framework. However, the financing of budgetary deficits on a continuing virtually automatic basis threatens the fixed exchange rate regime and weakens fiscal discipline; curtailment of the government's overdraft facility at the central bank should therefore be a priority. Early enactment of the revised Maldives Monetary Authority Act would help in strengthening monetary policy independence.

Directors welcomed the progress made in promoting greater competition in the banking sector, which holds out the promise of improved access to credit for the private sector. At the same time, prudential supervision needs to keep pace with financial sector developments, and it will therefore be important to review the adequacy of current regulations on loan classification and provisioning.

Directors considered that gradually moving away from government intervention in the economy, enhancing the role of the private sector, and broadening the production base would help to make Maldives more resilient to external shocks. They emphasized the importance of paying attention to the sequencing and timing in the application of policies to help diversify the economy. Directors welcomed the recent progress made in restructuring and privatizing state-owned enterprises. The authorities are encouraged, however, to press ahead with privatization and legal reform—in particular, early implementation of legislation to strengthen the accountability and operational efficiency of state enterprises—with a view to further divestment.

Directors observed that Maldives's trade policy remains moderately restrictive, with wide dispersion of tariff rates and a complex system of exemptions. They urged the authorities to use the opportunity presented by the upcoming WTO trade policy review to move ahead with trade liberalization.

Directors encouraged the authorities to continue their efforts to strengthen legislation to combat money-laundering and the financing of terrorism.

Directors welcomed recent improvements in the compilation of economic statistics, but noted that data quality in many areas remains inadequate for effective policy design and evaluation. They encouraged the authorities to persevere in their efforts to build statistical capacity.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Maldives: Selected Economic Indicators, 1998-2001

	1998	1999	2000 Est.	2001 Est.
	(Annual percentage change)			
Growth and prices				
Real GDP	9.8	7.2	4.8	3.5
Consumer prices (period average)	-1.4	3.0	-1.2	0.7
	(Percent of GDP)			
Central government				
Revenue and grants	30.4	32.1	32.3	33.0
Expenditure and net lending	32.3	36.1	36.7	37.7
Of which: Capital spending	12.8	13.7	11.8	12.3
Overall balance	-1.9	-4.1	-4.4	-4.7
Financing				
Domestic	-0.1	3.2	4.3	2.8
Foreign	2.0	0.8	0.0	1.9
	(Twelve-month change at year-end)			
Money and credit				
Domestic credit	18.6	8.0	14.5	19.4
Public sector	9.2	14.1	23.3	7.0
Central government, net	1.4	12.9	30.9	8.4
Private sector	25.7	4.0	8.0	29.9
Broad money	22.8	3.6	4.1	9.0
	(In millions of U.S. dollars)			
Balance of payments				
Exports (including re-exports)	95.6	91.5	108.7	110.2
Imports	-311.5	-353.9	-342.0	-348.3
Non-factor services, net	232.4	234.6	238.8	244.8
Current account balance	-23.3	-81.6	-53.0	-57.3
(In percent of GDP)	-4.3	-13.8	-8.5	-9.2
Overall balance	29.1	-7.2	-7.9	-21.4
Gross official reserves (year-end)	119.9	128.5	124.1	94.3
(In months of following year's imports of GNFS) 1/	3.1	3.4	3.3	2.5
External debt (year-end)	200.8	212.9	211.6	209.8
(In percent of GDP)	37.2	36.1	33.9	33.6
Debt service	16.3	19.0	22.1	22.0
(In percent of GNFS exports, net of goods re-exports) 1/	4.0	4.7	5.2	5.1
(In percent of total exports of GNFS) 1/	3.8	4.4	4.8	4.7
Exchange rate				
Rufiyaa per US$ (period average)	11.77	11.77	11.77	12.24
Nominal Effective Exchange Rate (percent change)	5.4	0.5	6.7	0.8
Real Effective Exchange Rate (in percent change)	2.3	2.6	3.4	-0.6
Memorandum item:				
Nominal GDP (millions of rufiyaa)	6,357	6,935	7,348	7,651

Sources: Maldivian authorities; IMF staff estimates and projections.

1/ GNFS = Goods and Non Factor Services.