Maldives: 2019 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Maldives

INTERNATIONAL MONETARY FUND

INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/156

MALDIVES

June 2019

2019 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 2019 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 May 29, 2019 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 May 29, 2019, following discussions that ended on March 5, 2019, 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 April 30, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for Maldives.

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June 10, 2019

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation with Maldives

On May 29, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Maldives.

The Maldives' growth has been strong in recent years, driven by tourism, commerce, and construction. Real GDP growth reached 6.9 percent in 2017 and an average of 9.1 percent in the first three quarters of 2018 (y/y), led by strong investment in tourism, commerce, and construction. Inflation has decelerated to 0.2 percent in early 2019 driven by a decrease in administered prices for staples in April 2018 and reinstatement of staple food subsidies. However, the Maldives continues to face large and growing public debt and a high current account deficit. The 2018 fiscal deficit (including grants) is estimated at 4.3 percent of GDP, compared to 3 percent of GDP in 2017, and public and publicly guaranteed debt continued to increase, to over 70 percent of GDP in 2018, partly reflecting government guarantees to external borrowing by state-owned enterprises. The widening of the deficit reflects mainly an accelerated growth in social welfare contributions, subsidies, health, and student loan scheme spending. Monetary policy has been accommodative and growth of credit to private sector has picked up. Despite strong growth in tourism revenues, the current account deficit reached 24 percent of GDP in 2018, reflecting higher imports associated with increased public infrastructure investment and new resort developments.

The outlook is for continued strong growth and moderate inflation, and only a gradual improvement in fiscal and current account deficits. Real GDP growth is projected to reach 7.5 percent in 2018 and to remain strong at 6.5 percent in 2019, driven by government infrastructure investment, tourism, and construction. Inflation is forecast to increase moderately in 2019. As major infrastructure projects will gradually start to unwind, the current account deficit will begin to narrow. Under the current policies, the fiscal deficit is projected to remain elevated. However, successful implementation of tax reforms and improved tax administration,

[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.

together with measures to contain budgetary spending, would result in a narrowing of both fiscal and current account deficits and mitigate the risks posed by high and rising public and external debt.

Executive Board Assessment[2]

Executive Directors welcomed the strong growth of the Maldives' economy, supported by tourism, commerce, and construction and indicated that the medium-term growth outlook remains positive. Noting Maldives' high and growing public and external debt, moderate foreign reserves, and vulnerabilities to shocks, Directors called for policies to reduce fiscal and external imbalances, build resilience to shocks, including from natural disasters and climate change, and that foster sustained and inclusive growth.

Directors welcomed the authorities' commitment to fiscal consolidation to restore fiscal and debt sustainability and reduce external imbalances. They noted that a combination of revenue and expenditure measures is needed to achieve a growth-friendly fiscal consolidation. In this context, Directors welcomed the authorities' intention to introduce a personal income tax and emphasized the need for strengthened tax administration. Directors also called for keeping current spending under control, investment spending prioritization and continuous improvements in public financial management and budget control. Directors also noted the potential fiscal risks associated with external borrowing by state-owned enterprises (SOEs) and associated public guarantees and stressed the need for a strengthening of debt management, including the oversight and institutional framework of the SOE activities.

Directors indicated that a tighter monetary policy stance would ensure compatibility with the exchange rate peg, and together with fiscal consolidation would contribute to lower external imbalances and a build-up in reserves. They noted that the authorities' decision to establish the Sovereign Development Fund was a welcome development. Directors encouraged increasing technical assistance to support the Maldives Monetary Authority's ongoing efforts to modernize monetary policy and the foreign exchange operations framework.

Directors commended the authorities' efforts in making growth more inclusive and diversifying the economy, while ensuring financial resilience. They welcomed the formation of the National Development Strategy focusing on building resilience and creating economic opportunities and encouraged the authorities to implement structural reforms, such as strengthening the rule of law, property rights, and the legal and regulatory environment, to improve the business climate and boost competitiveness. On the financial sector, while noting strong capital positions and

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[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.

profitability of banks, they encouraged the authorities to address supervisory data gaps and enhance financial inclusion.

Directors also welcomed the authorities' commitment to strengthening governance and transparency. They noted that further improvement is needed to strengthen AML/CFT compliance and to improve the anti-corruption framework.

Table 1. Maldives: Selected Economic Indicators, 2016–2023

	2016	2017	2018	2019	2020	2021	2022	2023
					Proj.			
Output and prices				(Annual percentage change)				
Real GDP	7.3	6.9	7.5	6.5	6.0	5.5	5.5	5.5
Inflation (end-of-period) 1/	1.8	2.2	0.5	2.1	2.4	2.5	2.6	2.6
Inflation (period average) 1/	0.8	2.3	1.4	1.5	2.3	2.5	2.5	2.5
GDP deflator	0.1	3.2	2.0	2.0	2.4	2.5	2.5	2.5
Central government finances				(In percent of GDP)				
Revenue and grants	27.3	27.1	26.5	26.0	26.0	25.8	25.8	25.8
Expenditure and net lending	36.6	30.1	30.8	31.0	31.5	31.0	30.7	30.4
Overall balance	-9.3	-3.0	-4.3	-4.9	-5.5	-5.2	-4.9	-4.6
Overall balance excl. grants	-9.6	-3.3	-4.8	-5.6	-6.1	-5.7	-5.5	-5.0
Financing	9.3	3.0	4.3	4.9	5.5	5.2	4.9	4.6
Foreign	5.9	4.1	3.9	2.4	2.4	1.5	-1.9	-0.1
Primary balance	-7.4	-1.5	-2.6	-3.0	-3.2	-2.6	-2.2	-1.8
Public and publicly guaranteed debt	59.4	61.6	71.4	76.8	80.7	83.1	81.5	81.4
Monetary accounts				(Annual percentage change)				
Broad money	-0.2	5.2	3.4	8.6	8.6	8.1	8.1	8.0
Domestic credit	19.7	1.7	5.2	4.4	6.0	5.8	5.9	5.9
Balance of payments				(In percent of GDP, unless otherwise indicated)				
Current account	-23.2	-21.9	-23.9	-19.5	-15.1	-13.4	-11.4	-9.8
Of which:								
Exports	5.8	6.6	5.9	5.7	5.9	6.1	6.1	5.7
Imports	-47.6	-45.8	-48.2	-43.4	-40.8	-39.7	-38.7	-35.8
Tourism receipts (in nonfactor services, net)	56.9	56.4	54.9	58.1	59.2	60.6	62.0	57.4
Income (net)	-7.8	-8.1	-7.7	-9.8	-9.6	-9.3	-8.7	-8.0
Current transfers	-14.3	-9.2	-9.5	-9.2	-9.0	-8.8	-8.7	-8.0
Capital and financial account (including e&o)	21.0	24.4	27.1	16.4	15.6	15.1	11.1	10.3
Of which:								
General government, net	5.9	3.7	9.8	3.6	2.4	1.5	-1.9	-1.8
Banks and other sectors, net	-0.1	3.5	0.7	2.8	1.7	1.8	1.7	1.5
Overall balance	-2.2	2.5	3.2	-3.1	0.5	1.7	-0.3	-0.2
Gross international reserves (in millions of US$; e.o.p.)	467	586	754	576	609	725	706	913
In months of GNFS imports	1.8	2.0	2.4	1.8	1.9	2.1	1.9	2.4
Memorandum items:								
GDP (in millions of rufiyaa)	67,837	74,866	82,101	89,158	96,817	104,706	113,236	122,310
GDP (in millions of U.S. dollars)	4,402	4,858	5,328	5,789	6,283	6,795	7,348	7,937
Tourism bednights (000')	7,771	8,596	9,472	10,230	11,048	11,932	12,887	13,917
Tourist arrivals (000')	1,286	1,386	1,553	1,677	1,811	1,956	2,113	2,282
Tourism bednights (% change)	6.1	10.6	10.2	8.0	8.0	8.0	8.0	8.0
Tourist arrivals (% change)	4.2	7.8	12.0	8.0	8.0	8.0	8.0	8.0
Dollarization ratio (FC deposits in percent of broad money)	48.5	48.7	48.8	...	...	...	...	...

Sources: Maldivian authorities and IMF staff projections.
1/ CPI-Male definition.

MALDIVES

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

April 30, 2019

KEY ISSUES

Context. Growth has been strong and is projected to remain so in 2019 driven by tourism, commerce, and construction. Nonetheless, the Maldives remains highly vulnerable with reduced policy space due to large and growing public debt and rising pressures on external stability. The imbalances call for urgent action for maintaining stability. Going forward, the new administration's main challenge is to manage fiscal and external imbalances given weak buffers and tightening global financial conditions, while large projects are ongoing.

Article IV Consultation. The consultation focused on addressing external imbalances including offering advice on restoring fiscal buffers, strengthening public finance management, reforming the exchange rate regime, building international reserves, improving governance, implementing structural reforms, and encouraging diversification.

Policy priorities

- **Enhancing fiscal sustainability.** Fiscal buffers should be rebuilt, with spending prioritized to productive infrastructure and development spending. Increasing revenues require tax policy measures, strengthening tax administration, and improving efficiency and equity. Managing risks from contingent liabilities calls for reviewing public guarantees and strengthening public financial management.
- **Liquidity and external vulnerability risks** should be closely monitored and managed to address gross financing needs.
- **Monetary, financial, and external policies.** Monetary policy needs to be tightened to ensure compatibility with the exchange rate peg. Eventually, moving to a basket exchange rate peg, once operational prerequisites are met could increase resilience to exogenous shocks, and accumulate foreign reserves. Addressing supervision data gaps and enhancing financial inclusion are welcome steps in safeguarding financial stability.
- **Supporting sustained and inclusive growth.** Key structural reforms should focus on increasing competitiveness and encouraging the private sector role in new growth areas, predicated on an enhanced regulatory environment, strong rule of law, and decisive anticorruption efforts.

Approved By
Ranil Salgado (APD) and Vikram Haksar (SPR)

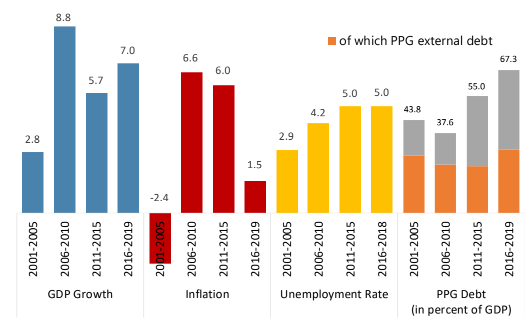
Discussions took place in Malé during February 20–March 5, 2019. The staff team comprised Messrs. Karam (head), Jonas, Jauregui, and Ms. Moussa (all APD). Ms. Choueiri (OED) also participated in the mission. Ms. Gamwalla-Khadivi and Ms. Zhu (both APD) assisted in the preparation of this report.

CONTENTS

INTRODUCTION

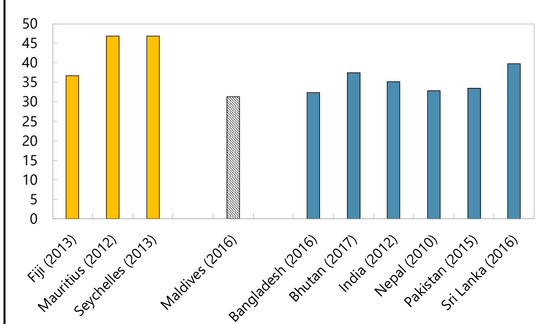
1. The Maldives has experienced strong albeit volatile growth, and the new administration needs to tackle large fiscal and external imbalances. Real GDP growth averaged 6.1 percent per year during 2011–17, moderating from an average of 8.8 percent during 2006–10. Volatility has reflected lack of diversification and reliance on the tourism sector. Large public investment and an accommodative monetary policy have supported high growth but also contributed to rising public and publicly-guaranteed (PPG) debt to above 70 percent of GDP in 2018 and pressures on external stability. While the Maldives ranks better than peers in poverty and inequality, strong growth has not fully translated to poverty reduction, underscoring the need for sustained and inclusive growth policies. Addressing Maldives' exposure to natural disasters and climate change remains a long-term concern.

Maldives: Economic Performance During 2001-2019
(In percent, average over relevant period)



Sources: MMA, Maldives MoF, ILO and IMF Staff Estimates.

GINI Coefficient



Sources: World Bank.

2. The new government is committed to macroeconomic stability and has an ambitious reform agenda centered on sustaining growth. It recognizes the need to build buffers and adjust policies to manage external and domestic risks and address longer-term challenges. The government aims to put public finances on a more sustainable footing while addressing investment needs, fight corruption, and improve the quality of growth by encouraging greater private sector involvement. Decisive actions will be needed to address long-standing governance challenges, enforce anti-corruption measures, and ensure full costing of new programs over the medium term to maintain sustainability.

3. Staff emphasized the need to strike a balance between pro-growth policies and maintaining stability in the current global environment. Against the backdrop of slowing global growth and uncertain global financial conditions, policies should aim to prevent a buildup of vulnerabilities, focusing on: tightening monetary conditions to ensure compatibility with the exchange rate peg; limiting fiscal deficits to build fiscal buffers; and addressing external imbalances and reforming the exchange rate regime with a move to a basket exchange rate peg once operational and communication challenges are addressed to maintain exchange rate stability. Reforms aimed to encourage diversification and competitiveness, ensure consistent productive infrastructure investment, and improve health, education, and social protection, while enhancing financial inclusion are key to maintaining robust and inclusive growth and accelerating poverty reduction.

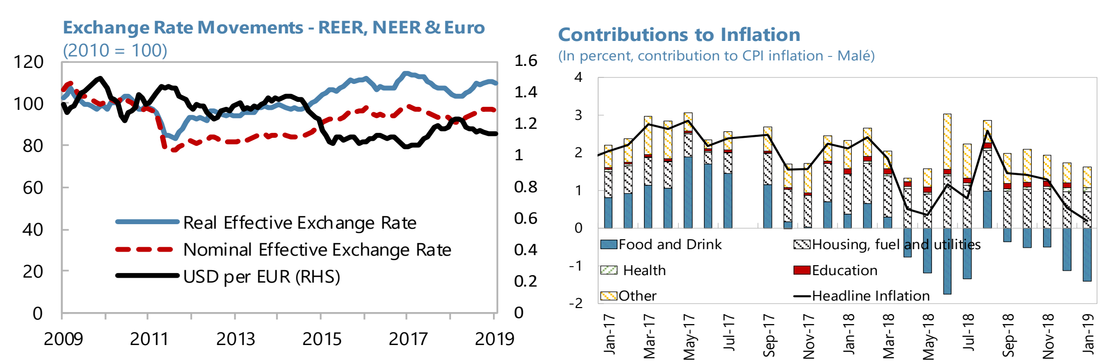
4. Authorities' response to past Fund advice. The authorities have followed up on a number of past Fund policy recommendations (Annex I). Progress has been made in implementing the 2016 PIMA recommendations. The MMA is implementing the 2018-22 Strategic Plan that includes modernization of the monetary policy framework and a review of the current exchange rate regime to maintain exchange rate stability. Further progress in improving financial inclusion has been achieved and a National Financial Inclusion Strategy (NFIS) has been formulated.

RECENT DEVELOPMENTS

5. Growth and inflation. Real GDP grew at 6.9 percent in 2017 and an average of 9.1 percent in the first three quarters of 2018 (y/y) led by strong investment in tourism, commerce, and construction. Inflation in Malé decelerated to 0.2 percent (y/y) in January 2019 driven by a decrease in administered prices for staples in April 2018, reversing a 2016 policy of reducing food subsidies for consumers; an equalization of tariff rates for utilities throughout the Maldives; and a dissipation of the base effect of increased import duties on selected products (Figure 1).

6. The external position has worsened despite strong tourism receipts. The current account deficit (CAD) reached 24 percent of GDP in 2018, reflecting higher imports associated with increased activity in both public infrastructure projects and new resort investments (ten new resorts opened in 2018). Investment in public infrastructure doubled between 2017 and 2018 due to an overlap of ending (i.e., bridge, airport runway, and housing) and starting (notably, new housing development and airport terminal) projects. The CAD was financed in part with external debt (10 percent of GDP), including the issuance of a US$100 million sovereign bond (privately placed with the United Arab Emirates, in addition to a US$250 million bond issued in 2017), foreign direct investment (FDI) (8.5 percent of GDP), and a 3-month, US$100 million swap arrangement availed in December from the Reserve Bank of India (RBI) under the South Asian Association for Regional Cooperation (SAARC). Private sector investment activity is financed largely with FDI, and the public sector relies on external financing of its infrastructure projects (Figure 2).

Maldives: Economic Developments

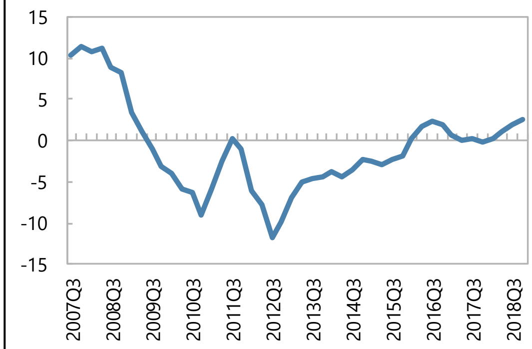


Sources: Maldivian Authorities and Staff Calculations.

Note: Data for August 2017 is unavailable.
Sources: MMA, IMF Staff Calculations.

7. Macro-financial developments. Credit growth has partly reflected rapid economic growth and some financial deepening, with lending mainly geared to productive investment. Financial stability risk is attenuated by banks' high capitalization with adequate risk weighting, high but volatile profitability, declining nonperforming loans (NPLs) and nearly total provisioning for specific loan losses. Currency risk is limited as banks extend foreign currency loans primarily to borrowers with income in foreign currency. On a cautionary note, the pace of credit growth to the private sector should be monitored in relation to nominal GDP growth, as the negative credit gap (estimated using a Hodrick-Prescott filtration method) has recently closed. Furthermore, there is a risk that banks, the main buyers of government securities (T-Bills), may not be willing to extend their purchases at fixed-rate auctions considering rising global yields (Figures 3 and 4).

Maldives: Change in Private Credit to GDP Ratio
(Year-on-year, in percentage points)

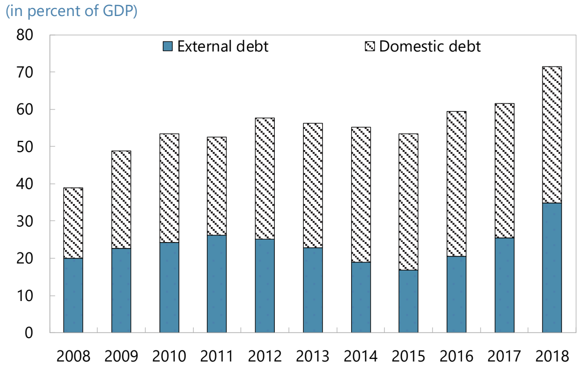


Sources: MMA and IMF Staff Calculations.

8. The fiscal deficit widened in 2018, driven mainly by increased current spending. The 2018 fiscal deficit (including grants) is estimated at 4.3 percent of GDP. It widened by 1.3 percent of GDP compared to 2017 and exceeded the budget target of 3 percent of GDP, mainly driven by a 20 percent growth in current expenditures (equivalent to 2 percent of GDP), reflecting rapid growth in social welfare contributions, subsidies, health, and student loan scheme spending. Spending on health insurance (Aasandha) increased by 0.6 percent of GDP, reflecting payment of pending bills and delays in implementing efficiency measures. Subsidy expenditures increased by 1 percent of GDP, due to higher fuel prices and the reversal of the 2016 food subsidy reforms. Capital spending was lower than budgeted, partly offsetting the rise in current spending. Total tax revenues were less than budgeted, despite the strong tourism-related tax collection, due to lower dividends from state-owned enterprises (SOEs) and to shortfalls in the General Goods and Services Tax (G-GST) and the Business Profit Tax (BPT) because originally-planned revenue measures were not implemented (Figure 5).

9. Maldives remains at a high risk of debt distress. Total PPG debt rose to 72 percent of GDP in 2018 driven by an increase in external debt guarantees. External PPG debt stood at 35 percent of GDP in 2018, of which 11 percent is guaranteed debt. About 50 percent of external PPG debt is owed to China of which 43 percent is guaranteed. External PPG debt is expected to rise to 40 percent of GDP by 2020 and fall to 33 percent of GDP in 2028. Over the medium term, high primary deficits will raise domestic debt from 37 percent in 2018 to 45 percent of GDP by 2023, putting total PPG debt at 82 percent of GDP.

Total Public and Publicly Guaranteed Debt
(in percent of GDP)



Sources: data from authorities and IMF staff estimates

10. Reserves have improved but remain below recommended levels. Gross international reserves (GIR) increased from US$586 million at end-2017 to US$756 million, or 2.4 months of imports, at end-January 2019, boosted in part by the US$100 million RBI swap. The Maldives Monetary Authority (MMA) is exploring the idea of larger and longer-term swap arrangements with the RBI. The MMA recognizes the temporary nature of using swaps to manage reserves and is seeking ways to build buffers by limiting drainage and raising foreign exchange (FX) inflows. Its holistic reform plan includes provision of incentives to hold domestic currency, supporting de-dollarization, strengthening FX market operations, and enhancing FX intervention effectiveness. Furthermore, in 2017, the authorities have established a Sovereign Development Fund (SDF) to serve as a fiscal reserve against the amortization of sovereign bonds coming due in 2022 and 2023.[1]

Authorities' Views

11. The authorities noted that the acceleration of growth in 2018 reflects robust growth in tourism, wholesale, retail, and construction supported by new resort development, infrastructure and housing projects. Lower inflation was driven by policy changes (lowering of administrative prices of staples and electricity) and global trends in food prices. They highlighted that high CADs reflected temporary increases in imports associated with large infrastructure projects and noted that the reserves adequacy metric of months of imports coverage may not be a most suitable metric used by itself, for the Maldives, considering the large capital imports related to infrastructure projects and imports by the tourism sector. The authorities attributed the increase in the 2018 fiscal deficit to lower-than-budgeted revenues (the originally-planned reductions in GST and BPT thresholds were not implemented) and to increased spending pressures (reflecting, election-related spending and settlement of arrears).

OUTLOOK AND RISKS

12. Outlook. Real GDP growth is estimated at 7.5 percent in 2018 and projected to remain strong at 6.5 percent in 2019, driven by tourism, commerce, and construction. The government's infrastructure push, together with stable FDI and credit growth, is expected to continue to support growth in fixed investment. Inflation is forecast to rise in 2019, led by the dissipation of government policy changes which reduced prices of staples and electricity, countered somewhat by a projected fall in oil prices. The CAD is projected to improve to 19.5 percent of GDP in 2019 as major infrastructure projects start to unwind. Most of these projects are carried out by SOEs and are off-budget. The CAD is projected to be financed in part with project-related external debt and FDI. Strong and steady FDI has generally supported foreign reserves, though they remain low for structural reasons. Over the medium term, staff projects growth at 5.8 percent on average for 2019-23, inflation at 2.4 percent, and the CAD to gradually adjust to just below 10 percent of GDP in 2023.

[1] The SDF is financed mainly by U.S. dollar proceeds from airport development fees and airport service charge. The SDF balances reached US$124 million at end-February 2019, covering 35 percent of the maturing sovereign bonds.

13. The CAD is projected to adjust towards its norm over the medium term. EBA-lite models assess the external position to be substantially weaker than fundamentals suggest. The CA-norm is estimated at around 9 percent of GDP leading to a CA-gap of 15 percent. The external adjustment is driven by a tapering of large public infrastructure projects and continued growth in tourism receipts, boosted by completion of the airport and seaplane terminals and continued strong private investment in resorts expected over the medium term.

14. Important external financing challenges exist. Although public investment activity and external debt disbursements are set to moderate over the medium term, the repayment of outstanding debt from major infrastructure projects is set to pick up starting in 2019. Interest and amortization payments are projected at nearly 5 percent of GDP per year over the medium term, with a noted rise in 2022 to 9 percent of GDP, coinciding with the redemption of the maiden US$250 million sovereign bond. While reserve buffers are presently low and provide limited scope to absorb payments on outstanding debt beyond a year, the authorities have sought to build the SDF (¶9) and reserve buffers to alleviate financing pressures.

15. Under the Fund staff's baseline scenario, the fiscal deficit is projected to rise in 2019 and 2020, with only slight improvement over the medium term. The fiscal deficit is projected to increase to almost 5 percent in 2019, ½ percent of GDP higher than the 2019 Budget. Staff sees rising spending pressures pushing current spending above the budgeted level by about 1 percent. This includes higher-than-budgeted costs of new policy initiatives (i.e., student loan schemes, and higher domestic air fares subsidy), increased spending on food subsidies and on local councils and health workers. Capital spending is projected to increase by 0.5 percent of GDP. In 2020, staff projects a further widening of the deficit in the baseline scenario with unchanged policies, reflecting a projected increase in capital spending and higher interest payments, under broadly stable revenues in percent of GDP.

16. Fiscal buffers will be further eroded, and fiscal sustainability will remain at risk, under current policies. Staff projects the deficit to decline below 5 percent of GDP only by 2022, putting the PPG debt at 82 percent of GDP. Maldives' debt-carrying capacity remains low and the risk of external and overall debt distress remains high. In the event of adverse shocks, the debt-to-GDP ratio could increase further, raising refinancing costs and weakening investor confidence. The new government has expressed concern about the quality of some past guaranteed debt-financed investments and has begun incorporating previously contracted guaranteed debt and has pledged to improve debt data transparency. Staff welcomes the authorities' regular audit and publication of guaranteed debt.

17. Risks (Annex II). On balance, risks are tilted to the downside. *Domestically*, key vulnerabilities include slower than projected CAD reduction due to SOE investment tapering not materializing and inadequate fiscal adjustment; elevated public debt leaving limited fiscal space for addressing the long-term challenge of climate change; and higher credit growth which could increase the buildup of financial sector risks. *Externally*, shocks could arise from volatility in global oil prices; slower global growth due to trade tensions and policy uncertainty in key European economies impacting travel and tourism revenues; and tighter financial conditions increasing borrowing costs, especially for vulnerable economies with a need to access international markets. On the upside, stronger fiscal management, greater government spending efficiency, and improved investment laws can strengthen investor confidence and boost business activity.

Authorities' Views

18. The authorities expect real GDP growth to remain high over the medium term, owing to large spillovers from public investment and continued development in tourism. Vulnerabilities associated with sovereign guarantees are now scrutinized under stricter guidelines. They emphasized the importance of safeguarding the SDF to meet maturing sovereign debt obligations and contingencies. The authorities assessed the evolution of the CAD under the baseline as sensible and acknowledged risks, which they judge to be balanced. On the fiscal outlook for 2019, they acknowledged the risk of higher-than-budgeted current spending and emphasized their resolve to avoid an increase in fiscal deficits through a tighter control of capital spending.

POLICY RECOMMENDATIONS

A. Macroeconomic Policies

19. The policy mix should address external imbalances and contain fiscal pressure while safeguarding financial stability. The large CAD, slow accumulation of foreign reserves, and real effective exchange rate (REER) appreciation suggest significant external imbalances. Growing tourism proceeds and the unwinding of large infrastructure projects undertaken by SOEs should reduce the CAD. This part of the external adjustment will be largely off-budget as SOE activity is not entirely documented in the budget's capital expenditures (Text Table). Private investment will also moderate over the medium term though by less than public investment as investment in the tourism industry is projected to remain robust. Growth in tourism receipts will further contribute to the external adjustment by increasing private savings. Strengthening governance in core fiscal and regulatory institutions is critical to effective implementation of recommended policies (¶3).

Medium-Term Current Account Deficit Adjustment

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
CAD	-4.3	-3.7	-7.5	-23.2	-21.9	-23.9	-19.5	-15.1	-13.4	-11.4	-9.8
(S-I) govt budget	-4.1	-5.8	-6.1	-9.3	-3.0	-4.3	-4.9	-5.5	-5.2	-4.9	-4.6
S govt budget	-0.2	-1.6	1.2	3.9	7.1	4.6	4.5	4.0	3.7	3.6	3.6
I govt budget	3.9	4.3	7.3	13.2	10.1	8.9	9.4	9.5	8.9	8.6	8.2
(S-I) private and SOEs	-0.2	2.2	-1.4	-14.0	-18.9	-19.6	-14.6	-9.6	-8.2	-6.4	-5.3
S private and SOEs	13.1	12.5	7.4	3.4	-3.7	-0.5	0.6	4.6	4.6	5.4	5.5
I private and SOEs	13.3	10.3	8.8	17.4	15.2	19.1	15.2	14.1	12.9	11.8	10.8
I private	11.0	9.0	7.3	10.4	10.1	8.5	9.2	9.2	8.6	7.8	7.6
I SOEs	2.4	1.2	1.5	7.0	5.1	10.6	6.0	5.0	4.3	4.0	3.2

In percent of GDP

Fiscal Policy—Sustaining Macro Stability and Bolstering Growth

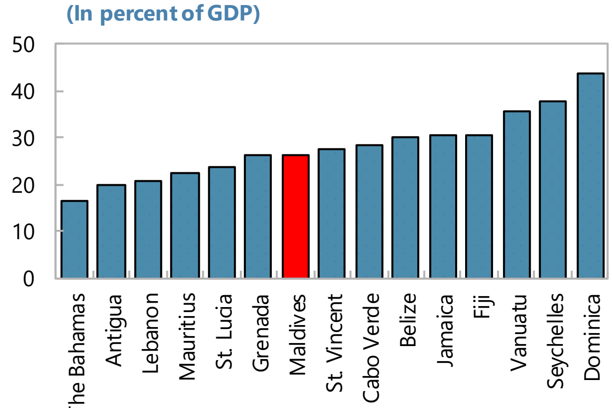
20. High and growing public debt poses a threat to debt sustainability, and fiscal consolidation remains a priority. The recent acceleration of infrastructure spending has pushed PPG to a historical high of 72 percent of GDP in 2018, up from 53 percent of GDP in 2015. Spending pressures and limited improvements in revenue collection have reduced fiscal space, leaving the Maldives with small fiscal buffers and high external vulnerability. PPG debt is projected to rise further, peaking in 2021 above 83 percent of GDP. Absent sustained fiscal consolidation, debt sustainability will continue to be called into question. The new administration is aware of these constraints and has emphasized its commitment to reducing the deficit by boosting revenues and cutting inefficient spending, while actively seeking new sources of funds at favorable terms, ideally used to repay expensive debt or finance productive capital spending.

21. Staff recommends adopting a fiscal consolidation strategy to reduce the deficit by over 3 percent of GDP to stabilize public debt and rebuild fiscal buffers. Staff underscores that any new spending policy initiatives should be developed within the limits of ensuring debt sustainability, and flagged concerns about boosting spending on the back of concessional financing that may become available, but that could impact sustainability.

22. Creating additional fiscal space would allow the authorities to implement new policy initiatives while maintaining fiscal sustainability. To this end, staff proposes a three-pronged strategy: (i) tax policy measures and strengthening tax administration to increase budget revenues; (ii) tight expenditure control, supported by reforms of major spending programs, to keep the growth of recurrent spending under control; and (iii) continued effort to improve public financial management (PFM) and budget control to increase the efficiency of delivering public services.

23. Staff strongly endorses the authorities' planned tax policy reforms. While tax and nontax revenues are broadly in line with comparator countries, financing of new policy initiatives while simultaneously reducing the fiscal deficit and public debt, will have to rely increasingly on domestically-generated resources. Staff welcomes the authorities' plans to introduce the personal income tax (PIT), which under a proper calibration of tax brackets should also make the tax system more progressive.[2] Other options include raising the G-GST rate, increasing the airport service charge (ASC), and introducing user fees such as the bridge toll. Staff also welcomes the

Government Revenues - 2018
(In percent of GDP)



Sources: Maldivian Authorities and World Economic Outlook

[2] FAD Technical Assistance Report, 2019, 'Reform Options to Strengthen Tax Policy' (March).

establishment of a Tax Policy Unit at the Ministry of Finance (MOF) aimed at strengthening capacity in analyzing and designing tax policies.

24. **Sustaining revenues will also require modernizing tax administration.** Since its inception, the Maldives Inland Revenue Authority (MIRA) has made impressive progress in establishing modern tax administration, but important challenges remain, including the need to further strengthen the capacity in risk management and international taxation. MIRA would also benefit from a tax administration diagnostic assessment to help prioritize additional capacity development and institutional strengthening needs.

25. **Recurrent spending pressures should be contained.** There is scope to strengthen expenditure control and increase savings through (i) better-targeted food and energy subsidies – the reversal of food subsidy reforms, harmonization of electricity tariffs, and increasing oil prices led to a large jump in 2018 spending on subsidies, underscoring the need to replace the currently generous subsidy system with a more targeted social protection; (ii) reforming the costly and inefficient universal health care scheme – harmonizing the price of drugs and third-party administration of overseas spending can raise savings and the government should proceed with reforming Aasandha in 2020 to increase its efficiency; and (iii) rationalizing the relatively high public-sector wage bill. Staff welcomes the completion of the HR audits of line ministries by the Civil Service Commission, which should provide the opportunity for 'rightsizing' the civil service – rationalizing the wage costs while improving the operational efficiency.

26. **Further strengthening of PFM is required.** Staff is encouraged by the progress made by the authorities in implementing a number of the IMF 2016 Public Investment Management Assessment (PIMA) recommendations, which will also help reduce vulnerabilities to corruption. Staff has noted important challenges to overcome, including the limited capacity of line ministries in conducting a proper appraisal and selection of capital projects. The IMF technical assistance (TA) support to the new Ministry of National Planning and Infrastructure (MNPI) in developing the project appraisal guidelines, and increasing line ministries' capacity to implement these guidelines, should further improve the efficiency of implementing capital projects. Staff also welcomes the progress made in improving the budget process in reducing expenditure reallocations within a budget year.

27. **Managing risks from contingent liabilities calls for limiting public guarantees and improving the oversight and governance of SOEs.** SOEs have played an important role in providing services to the Maldivian economy. However, some inefficient SOEs have been a source of budgetary burden, with guaranteed SOE external borrowing posing large fiscal risks (Annex III). Staff advised that the scope of SOE activities and underlying guarantees should be re-assessed, and SOE oversight and institutional frameworks strengthened, to curtail inefficient quasi-government activities and vulnerabilities to corruption.

28. **Staff recommended further fiscal adjustment, drawing on a scenario, consisting of revenue measures and recurrent expenditure savings.** The proposed primary balance adjustment of slightly over 3 percent of GDP by 2023 relies on additional revenues predicated on tax reforms

and enhanced tax administration and cutting inefficient spending, thus minimizing the negative impact on growth. Over the medium term, the fiscal deficit would decline to 1.5 percent of GDP, the primary balance would move to a surplus of 1.4 percent of GDP, and the PPG debt to-GDP ratio to 70 percent of GDP (Annex IV). This would also support external adjustment, with the CAD 3 percent lower than in the baseline.

Authorities' Views

29. The authorities shared staff's view that reducing fiscal deficits is important to ensure fiscal sustainability and increase fiscal buffers. They concurred that fiscal adjustment should be based on a combination of revenue measures and spending discipline, while noting already high tax revenues in the Maldives. They underscored the intention to introduce the PIT in 2020 and to strengthen tax administration to increase tax revenues but were not in favor of raising the G-GST rate or ASCs, out of concern the latter would likely negatively affect the guesthouse sector. They argued that important savings could be achieved by addressing spending inefficiencies and leakages in the health care system, reforming subsidies, and enhancing the efficiency of SOEs or closing some, particularly the ones exerting large budgetary pressures.

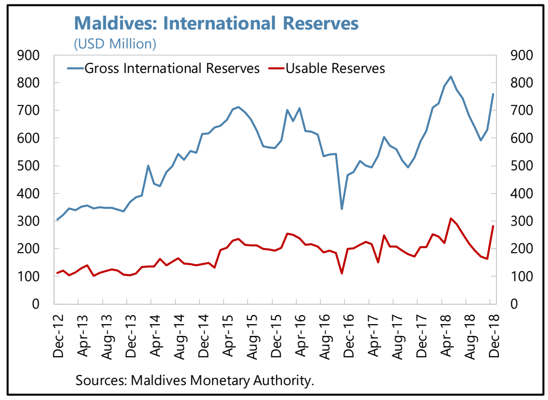
Enhancing the Effectiveness of Monetary Policy and Exchange Rate Management

30. The monetary policy stance needs to be tightened to ensure compatibility with the exchange rate peg. The MMA needs to monitor the expansion of credit to the private sector and related excess liquidity in the banking system and maintain reserves consistent with the fixed exchange rate. Staff underscores coordinating monetary and fiscal policies to support external stability. The current economic environment, with strong domestic demand fueled by credit growth and an expansionary fiscal policy, has exerted pressures on the CA and foreign reserves (estimated at below reserve adequacy metrics), calling for an active response of monetary policy. Reliance on short-term currency swaps exacerbates external vulnerability under an unchanged FX reserve accumulation policy (¶10 and ¶33)

31. The MMA has maintained tight controls on the availability and use of foreign exchange (FX). The FX rationing to banks, despite some easing recently, involves measures inconsistent with Article VIII of the IMF Articles of Agreement. The FX shortage has impacted banks' FX intermediation, leading to the emergence of the parallel market. Staff does not recommend approval of existing exchange rate restrictions and multiple currency practices (MCPs) and advises the MMA to accept the obligations of Article VIII as a measurable goal of its Strategic Plan.

32. The authorities are implementing a broad range of reforms to monetary and exchange rate policies. The Fund supports the implementation of the MMA's Strategic Plan through a multi-year TA program, aiming to: (i) strengthen the monetary policy and operational framework, including defining an interest rate corridor and directing interbank interest rates inside it, through re-activating open market operations (OMOs) at an appropriate time; (ii) develop functioning FX markets; (iii) review the current exchange rate regime to support resilience and implement a strategy for partial and gradual de-dollarization and FX reserve accumulation; and (iv) issue government securities based on competitive bidding and lengthen the maturity structure of public debt to reduce rollover risks. A sustained MMA strategy to build reserves is aiming at normalizing FX operations, redirecting FX receipts from the parallel market, and reviewing FX allocation to SOEs, beyond relying on currency swaps for emergency liquidity assistance.

33. Staff sees merit in shifting the exchange rate target to a composite basket peg from the current peg to the US dollar. Given a structural excess liquidity and a weak interest rate transmission channel, the peg continues to be a suitable nominal anchor for monetary policy. Nonetheless, moving to pegging against a basket could increase resilience to exogenous shocks. However, further technical work is needed, including on the design and composition of a basket, before any such plan is implemented and a careful communication policy strategy will also need to be developed.[3]



34. The medium-term CAD adjustment under the baseline is subject to large risks, in particular waning SOE investment failing to materialize in the coming years. The current exchange rate peg has been shored up by sustained exchange rate restrictions. Low reserves (the authorities' measure of freely usable reserves covers only one month of imports) and rising public debt potentially undermine the peg's stability and raise the risk of a disorderly exchange rate correction. In case the envisioned adjustment mechanisms do not materialize, already high risks to external stability would increase. This would call for either additional fiscal adjustment (such as in the staff's proposed fiscal adjustment scenario) or an adjustment in the exchange rate level, to facilitate the external adjustment.

35. Staff assesses the external sector position to be substantially weaker than suggested by medium-term fundamentals and desirable policies (Annex V). The CAD was substantially weaker than the norm in 2018 by around 15 percent of GDP (or an exchange rate more appreciated from its equilibrium by around 30 percent). The CA-gap is likely to remain wide under high oil prices and infrastructure spending, but the completion of large infrastructure projects and structural reforms would help to mostly close the CA-gap over the medium term.

Authorities' Views

36. The MMA assesses the monetary policy stance as appropriate, not contributing to imbalances against low inflation and a lack of FX market pressures. The parallel market premium has declined steadily since 2017 and stabilized at low levels more recently. Current credit growth is well

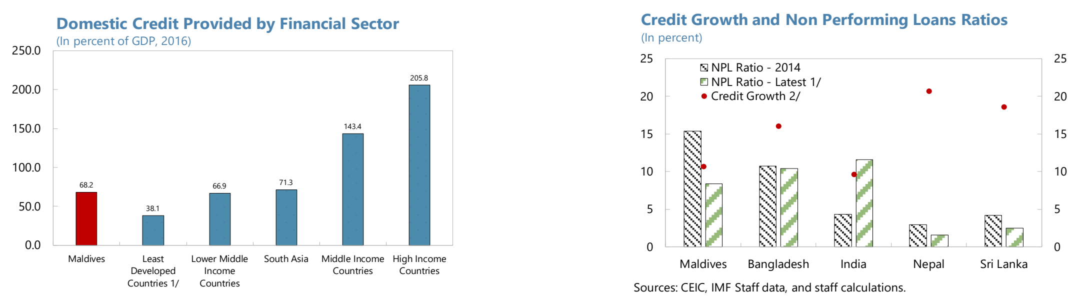
[3] In calibrating the basket, the possible effects on raising the Rufiyaa cost of debt repayments and on agents' (unhedged) balance sheets, should be considered. Despite banks' balanced balance sheets, bank prudent lending, and extending dollar-denominated loans only to dollar earners, a depreciation could raise the exchange rate risk for dollar-denominated debt of unhedged households and corporates.

paced and is conducive to higher financial integration. The MMA noted that market-based auctioning of government securities requires fiscal discipline and an overhaul of the financial infrastructure, currently underway. They confirmed that the implementation of the Strategic Plan aims to modernize the monetary policy and the FX operations frameworks – it includes monetary instruments based on OMOs, and a review of the current exchange rate regime in order to maintain exchange rate stability. The MMA stressed the continued need for IMF TA support to help it meet its strategic goals. Improvements in the fiscal and external balances will help ease the exchange rate restrictions and MCPs.

B. Safeguarding Financial Stability and Enhancing Financial Inclusion

37. Current credit growth should not raise concerns about financial sector vulnerability, but staff recommends continued vigilance as the credit gap has closed recently. Credit growth has been driven by lower NPLs and an accommodative monetary policy stance since 2015. Credit to the private sector has averaged 11.8 percent over the past three years, bringing Maldives private sector credit to GDP ratio to 28.7 percent, still well below its peers. Following prudential guidelines, bank lending is not highly concentrated, NPLs are low, and banks require large collateral with sufficient down payment in insuring against default. In case of sharp increases in housing loans and exposure of pension savings for some households, ratcheting up monitoring would be recommended, with specific sector-related prudential measures enforced.

Maldives: Financial Sector Developments



Source: World Bank, *World Development Indicators*.
1/ UN Classification.

Sources: CEIC, IMF Staff data, and staff calculations.
1/ BGD (Jun-18), MDV (Sep-18), IND (Mar-18), NPL (Jul-18), LKA (Dec-17).
2/ Average 2015/16-2017/18.

38. The authorities are taking welcome steps to safeguard financial stability. Staff acknowledges that the authorities have tightened macroprudential tools, including ensuring adequate capital buffers by upgrading capital adequacy regulations for risk-weight calculations, planning the introduction of the liquidity regulation framework following Basel III in 2019, and improving banks' loan classification and revising provisioning rules to comply with the International Financial Reporting Standards by mid-2019. Staff encourages continuing monitoring of financial stability risks, addressing supervision data gaps and making progress on introducing a comprehensive crisis management framework by operationalizing a bank resolution framework and aligning the MMA's lender of last resort policy. Staff also acknowledges the current plans to amend FX regulations in 2020, with stricter requirements for licensed exchange bureaus.

39. Good progress has been achieved in improving financial inclusion following an upgrade of the payment system and financial literacy. This said, the appropriate institutional, legal, and regulatory framework must be set up to enable a more efficient financial and payment system. Staff welcomes the formulation of the NFIS aimed at facilitating access to affordable financial services and encourages further collaboration with the Alliance for Financial Inclusion in providing access to expert advice and peer-to-peer learning. Caution must be exercised in managing the operations of the prospective Small and Medium-sized Enterprise (SME) Development Financial Corporation and the MMA credit guarantee scheme to avoid large losses. Staff welcomes the progress made in setting up the Credit Information Bureau and plans to improve the frequency and quality of information and its expanded use by lenders and consumers.

Authorities' Views

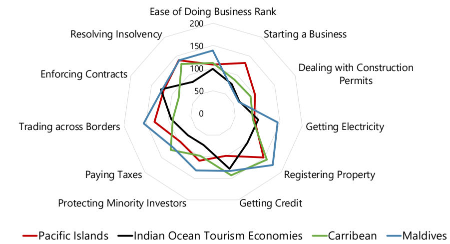
40. There is a continuous and significant improvement in policies strengthening financial stability and increasing inclusiveness. The MMA is improving reporting standards, drafting new liquidity regulation, improving on-site and off-site supervision, and increasing operational capacity at the MMA. The credit guarantee scheme is under review to mitigate risks and improve its effectiveness. The collection and dissemination of credit information are satisfactory and credit reports are widely used by institutions. The MMA also noted that the payment system development project it initiated, will also facilitate financial inclusion.

C. Policies to Promote Sustainable and Inclusive Growth

41. The new government's manifesto laid out an ambitious economic development plan to promote inclusive growth. The National Development Strategy (NDS) of the new government is to seek time-bound, multi-year sectoral plans linked to the budget, aimed at prioritizing resource allocations and increasing competitiveness. The government is seeking scope for growth in a variety of activities, including agriculture directed at the tourism sector, and investment in fisheries to increase the value added of exports. Staff acknowledges the ambitious economic reform agenda carried out by the Ministry of Economic Development (MED), MOF and MNPI and emphasizes the need to act with diligence, especially through the legislative process. Diversification should be managed gradually with appropriate financing secured, particularly for SMEs where scope to promote gender equality is high with large women participation. Promoting inclusiveness should seek to improve targeted social protection and housing affordability programs; enhance transportation links and women's safety when commuting between islands; improve energy reliability across atolls; address skills gaps via improving the quality of education and promote technical and vocational training; encourage the adoption of financial technology; and advance fiscal policies that shift tax policies toward more progressive revenue sources.

42. Staff recognizes the commitment of the MED to implement new initiatives that raise private investment, including FDI. Private investment should be encouraged to enhance market competition and productivity, diversify the economy, and support sustained and resilient growth in the Maldives. An improved overall business environment, complemented with a review of legislation to limit opportunities for corruption and regulatory measures to lower costs of starting and doing business is essential to achieve higher and sustained growth targets. Staff endorses MED's efforts to align the legal framework of foreign investment with international best practices to protect property rights and facilitate FDI inflows in priority sectors, as well as having in place a one-stop-shop for investors in 2020.

Ease of Doing Business Indicators
(Maldives and Comparator Country Groups, Median, Ranking out of 190)



Note: Indian Ocean Tourism Economies are Mauritius, Seychelles, Maldives and Sri Lanka
Source: World Bank's Ease of Doing Business Indicators.

43. Data provision. Timely and reliable data are identified as a priority for the government as it seeks to identify data shortcomings and propose remedial actions. More frequent publication of fiscal and debt outturns and the planned implementation of the enhanced General Dissemination System by launching a National Summary Data Page are important steps to improve data quality and dissemination and ultimately to better guide policymaking. The government has stressed the role of 'Open Data Policy' in assisting to fight corruption and gaining public trust. Scope for improving the quality of national accounts (NA), CPI, external accounts, and government finance statistics (GFS), including transitioning to GFSM 2014, is supported by IMF TA. Data gaps are sought to be reduced via enhanced interagency data sharing, in particular with MIRA, while respecting confidentiality.

44. Technical assistance and surveillance. The surveillance agenda, supported by extensive TA, will help deepen monetary and exchange rate analysis and reforms, strengthen PFM, support tax policy analysis and modernize tax administration, and integrate surveillance with TA (Annex VI).

Authorities' Views

45. The new government has redefined the NDS with an increased focus on decentralization, economic diversification, and integration of tourism with other industries. A holistic approach is taken with respect to raising standards of living in the atolls and ensuring provision of services and sustainable economic activity. Several initiatives have improved data availability and reporting in NA, price indices, and GFS.

D. Strengthening Governance

46. Steps to strengthen anti-corruption measures fall within the government's strategic priorities. Staff supports plans to enhance the budgetary and operational independence of the Anti-Corruption Commission (ACC) and its investigative powers, and welcomes measures that will serve to strengthen governance and reduce corruption as part of the new government's NDS. Specifically, staff encourages the new government to carry out its timebound action plan related to fighting corruption including by putting in place committees to launch investigations, and pushing amendments to laws that will ensure their functional independence.

47. Overall, governance and institutions need to be strengthened in a broad range of areas. Significant governance vulnerabilities exist in fiscal governance, the regulatory framework, the rule of law, and Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) (Figure 6). As noted above, staff encourages the authorities to push ahead with PFM control, SOE oversight, and a medium-term tax policy strategy; to improve the business environment; and to align the legal framework with best practices to protect property rights and facilitate FDI inflows in priority sectors. With respect to AML/CFT, staff emphasizes the need to ensure that proceeds of corruption are prevented from entering the financial sector and are confiscated with offenders subject to dissuasive sanctions (facilitated by the criminalization of acts of corruption in line with the United Nations Convention Against Corruption (UNCAC)), and that international cooperation facilitate action against corrupt officials and their assets. The amendment of the AML Act is a priority in this regard and the authorities are seeking assistance to ensure the revised Act is in line with the Financial Action Task Force (FATF) 2012 Standard.

Authorities' Views

48. The new government is committed to strengthening governance, combating corruption, and ensuring transparency. More stringent policies related to the issuance of sovereign guarantees are sought, and the frameworks for conducting public investment and SOE operations are being revised. Combating financial crimes is also a priority. The government is drafting new regulations and strengthening institutions, including the independence of investigative offices. To better combat financial crimes, the MMA continues to strengthen its AML capacity, including by improving the legal framework and increasing resources for the independent Financial Intelligence Unit. With respect to financial sector oversight, initiatives are also being taken by the MMA to strengthen corporate governance requirements and risk management practices.

STAFF APPRAISAL

49. Economic outlook and risks. Growth has been strong but is expected to moderate somewhat over the medium term. Headline inflation is contained. The outlook is subject to significant downside risks, including those stemming from a lack of fiscal adjustment that leaves public debt high and buffers low and from contingent liabilities associated with SOE external borrowing guaranteed by the government, as well as to external risks related to tighter global financial conditions and weaker global growth dampening tourism activity.

50. Debt sustainability. The risk of external and overall debt distress is high in the Maldives. Staff recommends fiscal consolidation to put public debt on a downward path, developing the domestic debt market to allow longer tenors, and ensuring that the authorities are selective about externally-financed projects.

51. External imbalances. The external position is assessed to be substantially weaker than the level consistent with fundamentals and desirable policies. International reserves remain at low levels with limited resilience built to respond to shocks. This calls for urgent action for sustaining macro stability.

52. Fiscal policies. Imbalances remain despite strong economic activity. The fiscal position leaves little room to allow countercyclical fiscal policies. To reduce fiscal deficits and put the debt-to-GDP ratio on a clear downward path, staff recommends a balanced fiscal adjustment relying on revenue measures and tighter current spending control. Fiscal adjustment should safeguard fiscal sustainability, create fiscal space to support productive investment and respond to adverse shocks, and support external stability. Fiscal adjustment should be complemented by continued PFM reforms and proper management of contingent liabilities, including limiting sovereign guarantees and tackling the budgetary pressures from SOE activities – a priority of the new government.

53. Macro-financial policies. Financial sector oversight is broadly appropriate. The authorities have taken welcome steps to safeguard financial stability by following through on prudential guidelines. Banks' capital positions remain strong with improved asset quality, strong profitability, with diversified lending across different sectors. Credit growth remains strong but should not raise concerns about financial sector vulnerability, although staff recommends continued vigilance as the credit gap has closed recently.

54. Monetary and exchange rate policies. Tighter monetary setting is called for. Together with fiscal consolidation, it would contribute to narrowing the CAD and preserving foreign reserves. Staff sees merit in eventually shifting the exchange rate target to a composite basket peg from the current peg to the US dollar to increase resilience to exogenous shocks. Fiscal consolidation and structural reforms would help narrow the CA-gap over the medium term. Staff supports a well-sequenced implementation of the 2018-2022 strategic plan, supported by Fund TA.

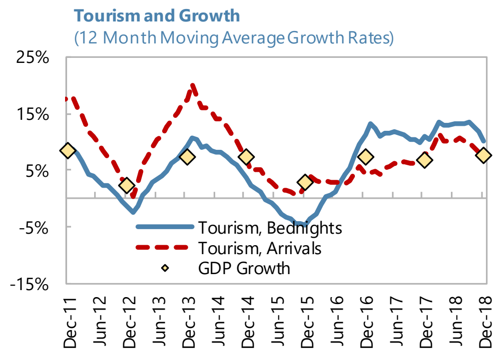
55. Structural reforms. To enhance productivity growth, the authorities should accelerate implementation of reforms aimed at enhancing the role of private sector, diversifying the economy, boosting competitiveness while supporting inclusive growth, including by exploring options for small business finance. Priorities should include enhancing transportation links, addressing skills gaps, and better targeting social protection policies. Strengthening the legal and regulatory environment would improve the business climate, encourage investment, and reduce informality.

56. Governance and corruption. Fiscal governance should be further strengthened through modernizing revenue administration, and PFM and procurement reforms focused on increasing spending efficiency, improving transparency, and reducing opportunities for corruption. Improving the regulatory environment and strengthening the rule of law and property rights would improve private sector efficiency through higher investment. Renewed momentum on tackling corruption is commendable but further advances are needed to improve the anti-corruption framework and institutions and strengthen AML/CFT compliance.

57. It is recommended that the next Article IV consultation takes place on the standard 12-month cycle.

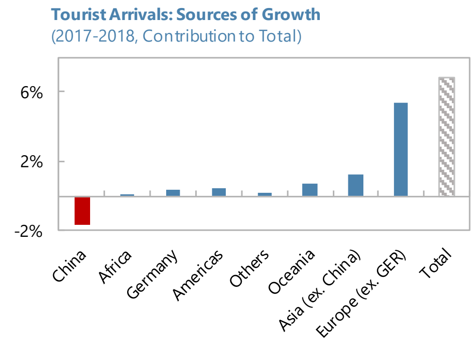
Figure 1. Maldives: Summary of Recent Developments

Strong growth in tourist arrivals and length of stays has supported growth....



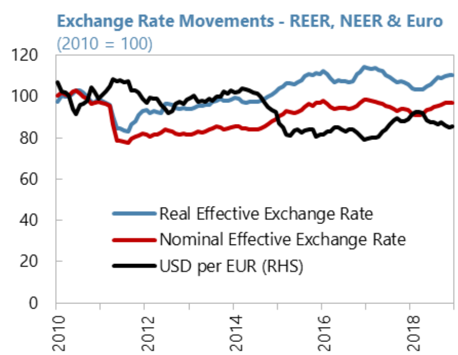
Sources: Maldivian Authorities

.... with arrivals from Europe being the strongest contributor.



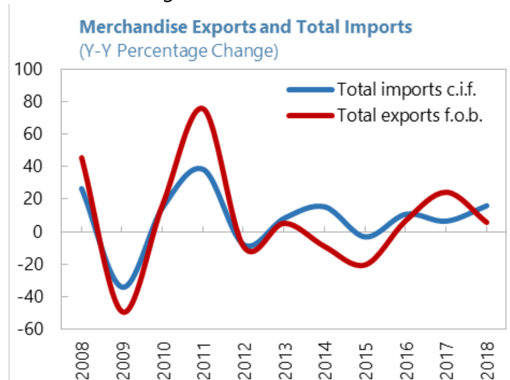
Sources: Maldivian Tourist Authority and Staff Calculations.

The REER has been appreciating generally since the devaluation in 2011.



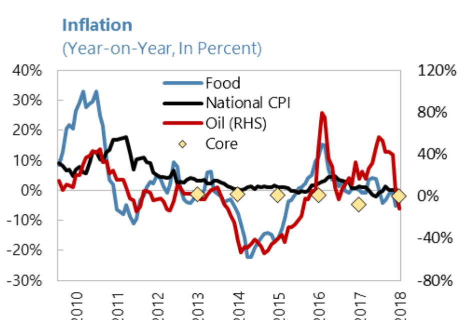
Sources: Maldivian Authorities and Staff Calculations.

Import growth has been picking up while export growth has been slowing.



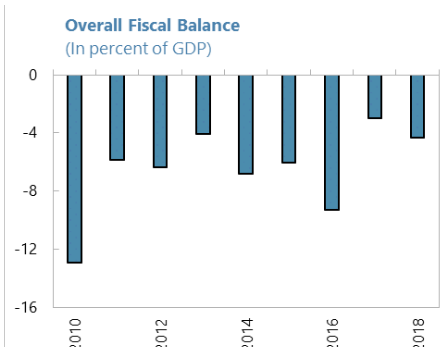
Sources: Maldivian Authorities and Staff Calculations.

CPI inflation has been weak despite higher global oil prices in 2018.



Sources: Maldivian Authorities, WEO and Staff Calculations.

The fiscal deficits have been volatile but generally elevated.

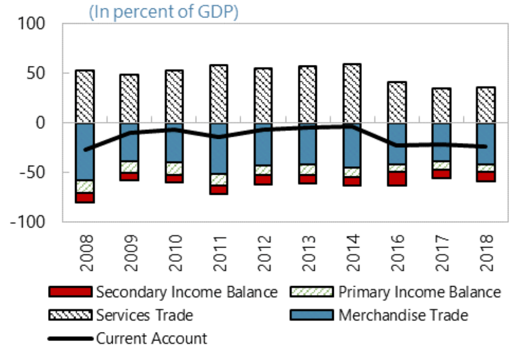


Sources: Maldivian Authorities and Staff Calculations.

Figure 2. Maldives: External Sector Developments

The CAD remained wide in 2018…

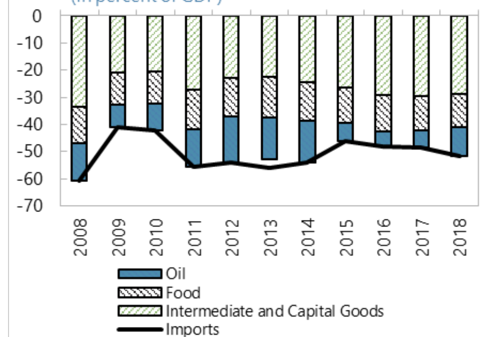
Current Account
(In percent of GDP)



Sources: Maldivian Authorities and Staff Calculations.

…driven by a pickup in infrastructure investment.

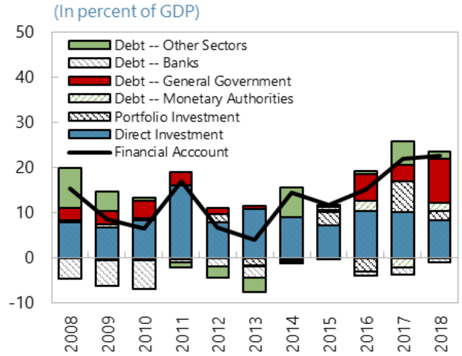
Import Composition
(In percent of GDP)



Sources: Maldivian Authorities and Staff Calculations.

Debt has become more important in financing the CAD…

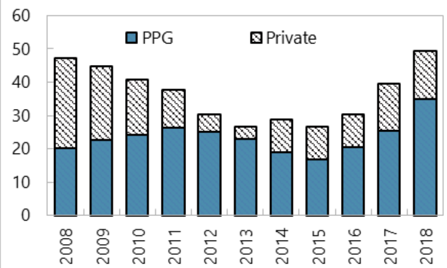
Financial Account
(In percent of GDP)



Sources: Maldivian Authorities and Staff Calculations.

…especially public and publicly guaranteed external debt.

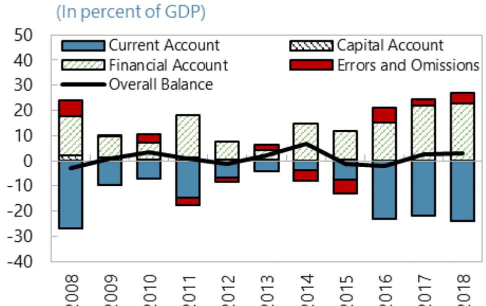
External Debt
(In percent of GDP)



Sources: Maldivian Authorities and Staff Calculations.

The overall balance remained positive…

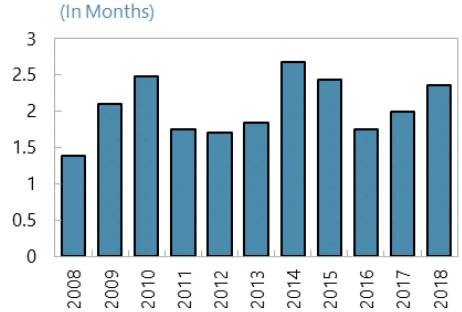
Balance of Payments
(In percent of GDP)



Sources: Maldivian Authorities and Staff Calculations.

… moderately increasing low foreign reserve levels.

Gross Reserves / GNFS Imports
(In Months)

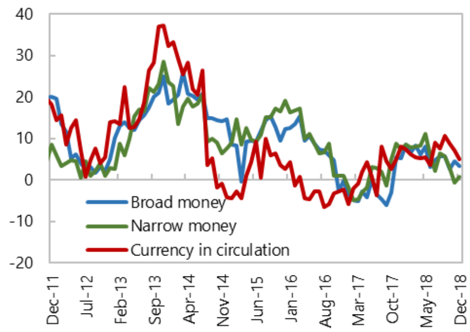


Sources: Maldivian Authorities and Staff Calculations.

Figure 3. Maldives: Money and Credit Developments

Money growth has been lower than in recent years…

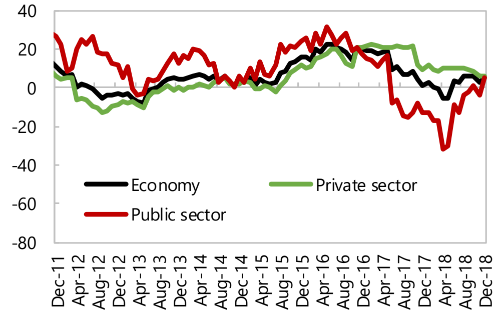
Monetary Aggegates
(Year-on-year change, in percent)



Sources: Maldivian authorities; and IMF staff estimates

…with private credit growth moderating only slightly following strong growth in previous years….

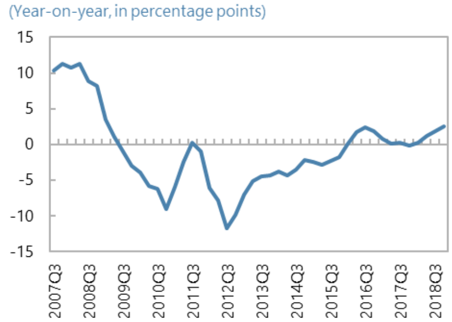
Credit
(Year-on-year change, in percent)



Sources: Maldivian authorities; and IMF staff estimates.

…and still growing above nominal GDP…

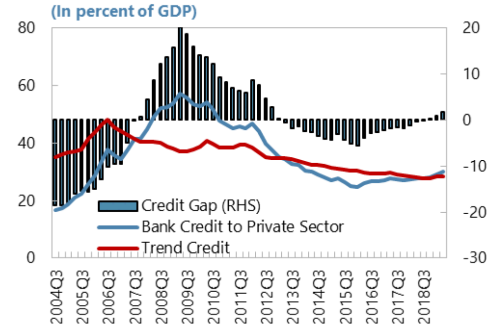
Change in Private Credit to GDP Ratio
(Year-on-year, in percentage points)



Sources: MMA and IMF Staff Calculations.

…with the negative credit gap, opened at the Global Financial Crisis, closing recently.

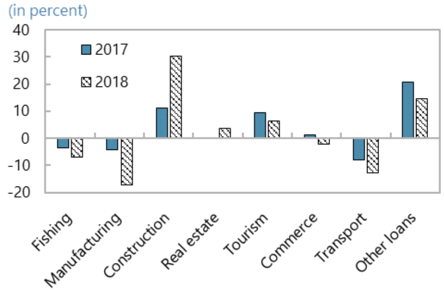
Credit Gap
(In percent of GDP)



Source: MMA and IMF Staff Estimates.

Credit to construction is growing fast in 2018…

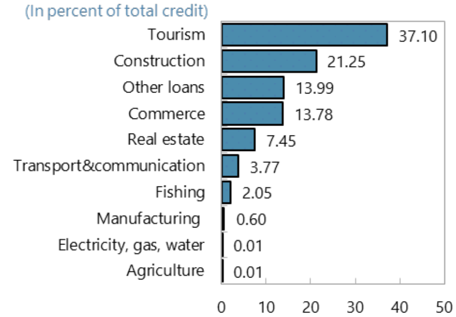
Loan Growth by Sector
(in percent)



Notes: Number on chart indicates share of total in Dec 18.
Sources: MMA and IMF Staff Calculations

…with tourism as the top recipient of credit, followed by commerce and construction.

Sectoral Composition of Private Credit, 2018
(In percent of total credit)

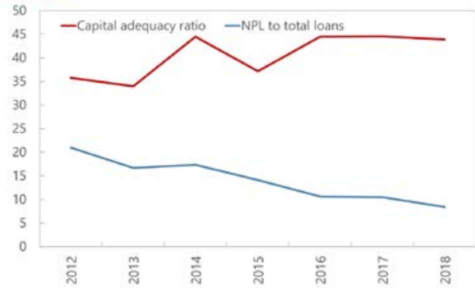


Sources: Authorities data and IMF staff calculations.

Figure 4. Maldives: Financial Developments

Systemwide NPL and capital adequacy have significantly improved…

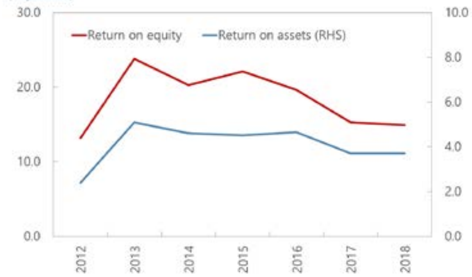
Commercial Banks' Capital and Credit Quality Indicators
(In percent)



Sources: Maldives Authorities

…with profitable banks…

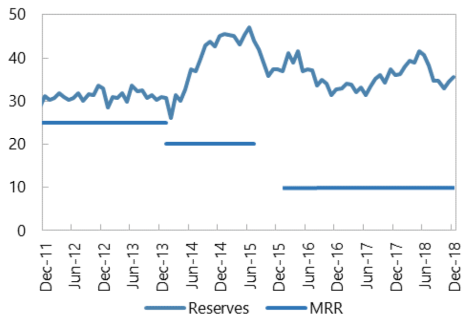
Commercial Banks Profitability Indicators
(In percent)



Sources: Maldivian authorities

…holding reserves well above the Minimum Reserve Requirements (MRR)…

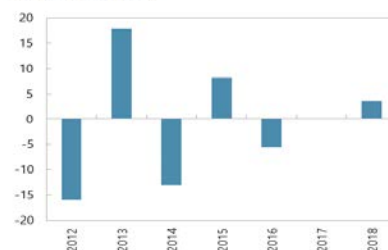
Commercial Banks' Reserves
(In percent of total deposits)



Sources: Maldivian authorities; and IMF staff estimates.

Loans to real estate are volatile, with moderate growth in 2018…

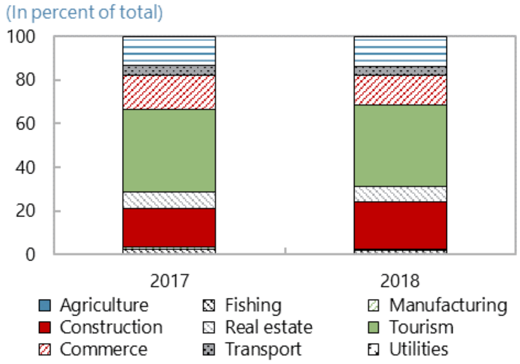
Real Estate Loan Growth
(In percent, year on year)



Note: 2017 value not shown due to large break in series reflecting methodological revisions.
Sources: MMA and IMF Staff Calculations

-…with no evident signs of a sector-specific credit boom.

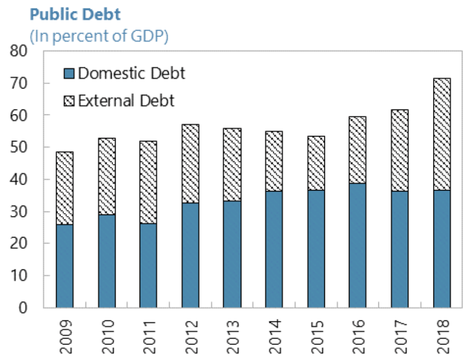
Sectoral Distribution of Credit
(In percent of total)



Sources: MMA and IMF Staff Calculations.

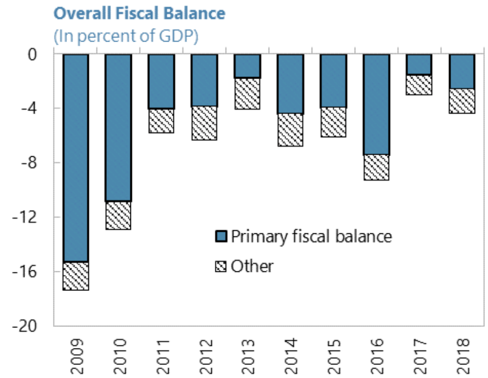
Figure 5. Maldives: Fiscal Developments

Public debt has been gradually increasing….



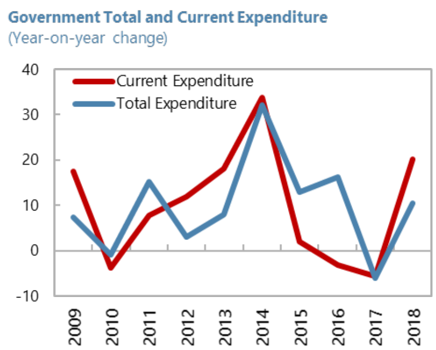
Sources: Maldivian authorities; and IMF staff estimates.

…reflecting large fiscal deficits.



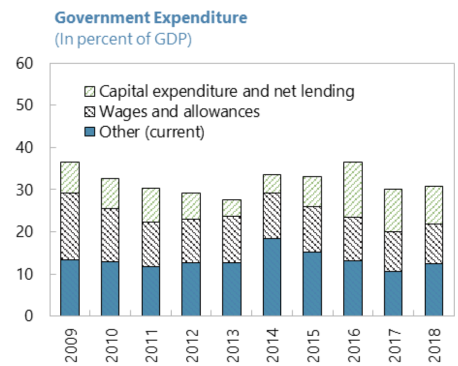
Sources: Maldivian authorities; and IMF staff estimates.

Growth in spending accelerated in 2018…



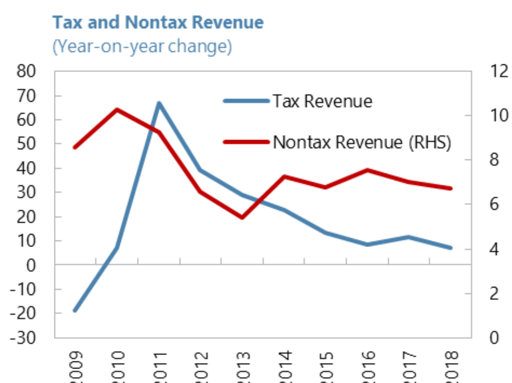
Sources: Maldivian authorities; and IMF staff estimates.

…reflecting higher current spending and continued high capital spending.



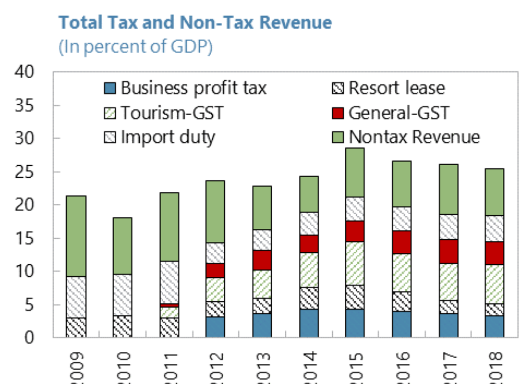
Sources: Maldivian authorities; and IMF staff estimates.

Tax revenue growth has been declining in recent years…



Sources: Maldivian authorities; and IMF staff estimates.

… resulting in a falling revenue-to-GDP ratio.

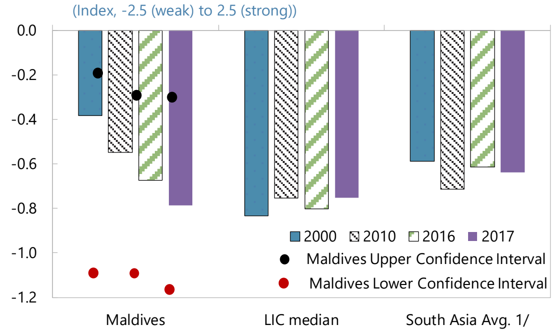


Sources: Maldivian authorities; and IMF staff estimates.

Figure 6. Maldives: Governance Indicators

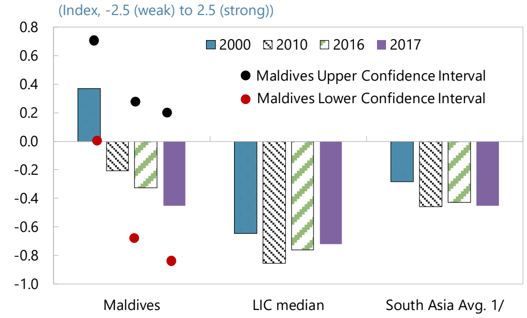
Control of Corruption

(Index, -2.5 (weak) to 2.5 (strong))



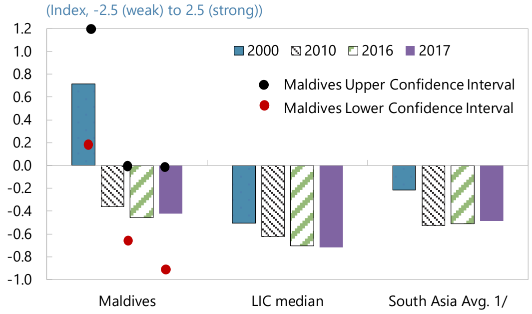
Government Effectiveness

(Index, -2.5 (weak) to 2.5 (strong))



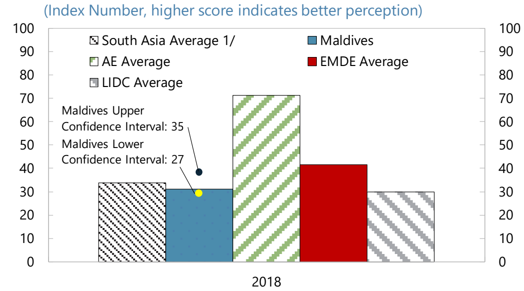
Regulatory Quality

(Index, -2.5 (weak) to 2.5 (strong))



Corruption Perceptions Index, 2018

(Index Number, higher score indicates better perception)



Sources: World Governance Indicators, Transparency International, and IMF staff calculations.

1/ Includes Bangladesh, India, Maldives, Nepal, Pakistan, and Sri Lanka. Use of these indicators should be considered carefully, as they are derived from perceptions-based data. In addition, governance indicators on corruption should not be interpreted as providing independent confirmation of one another. Ranges are for a 90 percent confidence interval; intervals for peer groups are negligible.

Table 1. Maldives: Selected Economic Indicators, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
					Proj.			
Output and prices			(Annual percentage change)					
Real GDP	7.3	6.9	7.5	6.5	6.0	5.5	5.5	5.5
Inflation (end-of-period) 1/	1.8	2.2	0.5	2.1	2.4	2.5	2.6	2.6
Inflation (period average) 1/	0.8	2.3	1.4	1.5	2.3	2.5	2.5	2.5
GDP deflator	0.1	3.2	2.0	2.0	2.4	2.5	2.5	2.5
Central government finances			(In percent of GDP)					
Revenue and grants	27.3	27.1	26.5	26.0	26.0	25.8	25.8	25.8
Expenditure and net lending	36.6	30.1	30.8	31.0	31.5	31.0	30.7	30.4
Overall balance	-9.3	-3.0	-4.3	-4.9	-5.5	-5.2	-4.9	-4.6
Overall balance excl. grants	-9.6	-3.3	-4.8	-5.6	-6.1	-5.7	-5.5	-5.0
Financing	9.3	3.0	4.3	4.9	5.5	5.2	4.9	4.6
Foreign	5.9	4.1	3.9	2.4	2.4	1.5	-1.9	-0.1
Primary balance	-7.4	-1.5	-2.6	-3.0	-3.2	-2.6	-2.2	-1.8
Public and publicly guaranteed debt	59.4	61.6	71.4	76.8	80.7	83.1	81.5	81.4
Monetary accounts			(Annual percentage change)					
Broad money	-0.2	5.2	3.4	8.6	8.6	8.1	8.1	8.0
Domestic credit	19.7	1.7	5.2	4.4	6.0	5.8	5.9	5.9
Balance of payments			(In percent of GDP, unless otherwise indicated)					
Current account	-23.2	-21.9	-23.9	-19.5	-15.1	-13.4	-11.4	-9.8
Of which:								
Exports	5.8	6.6	5.9	5.7	5.9	6.1	6.1	5.7
Imports	-47.6	-45.8	-48.2	-43.4	-40.8	-39.7	-38.7	-35.8
Tourism receipts (in nonfactor services, net)	56.9	56.4	54.9	58.1	59.2	60.6	62.0	57.4
Income (net)	-7.8	-8.1	-7.7	-9.8	-9.6	-9.3	-8.7	-8.0
Current transfers	-14.3	-9.2	-9.5	-9.2	-9.0	-8.8	-8.7	-8.0
Capital and financial account (including e&o)	21.0	24.4	27.1	16.4	15.6	15.1	11.1	10.3
Of which:								
General government, net	5.9	3.7	9.8	3.6	2.4	1.5	-1.9	-1.8
Banks and other sectors, net	-0.1	3.5	0.7	2.8	1.7	1.8	1.7	1.5
Overall balance	-2.2	2.5	3.2	-3.1	0.5	1.7	-0.3	-0.2
Gross international reserves (in millions of US$; e.o.p.)	467	586	754	576	609	725	706	913
In months of GNFS imports	1.8	2.0	2.4	1.8	1.9	2.1	1.9	2.4
Memorandum items:								
GDP (in millions of rufiyaa)	67,837	74,866	82,101	89,158	96,817	104,706	113,236	122,310
GDP (in millions of U.S. dollars)	4,402	4,858	5,328	5,789	6,283	6,795	7,348	7,937
Tourism bednights (000')	7,771	8,596	9,472	10,230	11,048	11,932	12,887	13,917
Tourist arrivals (000')	1,286	1,386	1,553	1,677	1,811	1,956	2,113	2,282
Tourism bednights (% change)	6.1	10.6	10.2	8.0	8.0	8.0	8.0	8.0
Tourist arrivals (% change)	4.2	7.8	12.0	8.0	8.0	8.0	8.0	8.0
Dollarization ratio (FC deposits in percent of broad money)	48.5	48.7	48.8	…	…	…	…	…

Sources: Maldivian authorities and IMF staff projections.
1/ CPI-Male definition.

Table 2a. Maldives: Central Government Finances, 2016–23
(In millions of Rufiyaa)

	2016 Actual	2017 Actual	2018 Prel.	2019 Budget	2019	2020	2021 Proj.	2022	2023
Total revenue and grants	18537	20259	21757	23340	23224	25139	27056	29213	31582
Revenue (excluding privatization receipts)	18348	20042	21384	22155	22652	24567	26484	28641	31010
Tax revenue	13219	14743	15803	16506	16929	18353	19829	21456	23262
Import duties	2487	2799	3122	3184	3149	3294	3510	3782	4021
Airport service charge	538	696	645	706	646	698	754	814	879
Business profit tax (BPT)	2748	2677	2711	2885	2969	3265	3520	3791	4074
Remittance Tax	15	114	102	109	124	156	196	205	215
Goods and services tax (GST)	6249	6882	7686	8038	8362	9090	9842	10682	11704
Of which: General GST	2328	2683	2903	2999	3152	3423	3702	4004	4324
Tourism GST	3921	4199	4783	5039	5210	5667	6140	6679	7379
Tourism tax ($6 green tax) 1/	623	706	811	893	896	1022	1103	1191	1287
Other	560	868	728	692	783	828	906	991	1082
Nontax revenue	5114	5265	5537	5649	5663	6142	6631	7159	7721
Grants	188	217	373	1185	572	572	572	572	572
Expenditure and net lending	24836	22502	25309	27342	27619	30491	32458	34814	37165
Current expenditure	15858	14956	17985	18529	19238	21249	23133	25129	27123
Of which: Salaries and allowances	6962	6972	7688	7964	8349	9066	9805	10603	11453
Administrative Services	1653	1597	1765	1989	1982	2152	2328	2517	2719
Social welfare contributions	2160	1701	2274	1565	2155	2364	2505	2659	2820
Repairs and maintenance	312	212	213	277	270	359	441	520	586
Subsidies and transfers	1608	1797	2645	2850	2739	2940	3163	3405	3661
Interest	1286	1097	1440	2002	1753	2256	2673	3093	3438
Other	1878	1580	1960	1882	1990	2113	2218	2331	2446
Capital expenditure	8614	8014	7376	8631	8460	9328	9418	9785	10150
Net lending	364	-62	-186	-182	-101	-109	-117	-126	-136
Overall balance	-6300	-2243	-3552	-4002	-4395	-5352	-5402	-5601	-5583
Overall balance, excluding grants	-6488	-2460	-3926	-5187	-4967	-5924	-5974	-6173	-6155
Financing	6300	2243	3552	4002	4395	5352	5402	5601	5583
External	3995	3042	3176	3796	2137	2298	1600	-2155	-135
Domestic	2305	-799	376	207	2258	3054	3802	7756	5718
of which: SDF contribution 1/	0	-337	-1315	-706	-1200	-1200	-1200	3850	1540
Memorandum items:									
Current balance	2490	5771	3399	4629	3414	3318	3350	3512	3887
Primary balance	-5014	-1146	-2112	-2001	-2642	-3096	-2729	-2508	-2145
Current primary balance	3776	6868	4840	6630	5167	5574	6024	6605	7325

Sources: Maldivian authorities; and IMF staff projections.
1/ Transfers to the Sovereign Development Fund are recorded as negative domestic financing, and withdrawals as positive financing.

Table 2b. Maldives: Central Government Finances, 2016–23

(In percent of GDP, unless otherwise specified)

	2016 Actual	2017 Actual	2018 Prel.	2019 Budget	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.
Total revenue and grants	27.3	27.1	26.5	25.9	26.0	26.0	25.8	25.8	25.8
Revenue (excluding privatization receipts)	27.0	26.8	26.0	24.6	25.4	25.4	25.3	25.3	25.4
Tax revenue	19.5	19.7	19.2	18.3	19.0	19.0	18.9	18.9	19.0
Import duties	3.7	3.7	3.8	3.5	3.5	3.4	3.4	3.3	3.3
Airport service charge	0.8	0.9	0.8	0.8	0.7	0.7	0.7	0.7	0.7
Business profit tax (BPT)	4.1	3.6	3.3	3.2	3.3	3.4	3.4	3.3	3.3
Remittance Tax	0.0	0.2	0.1	0.1	0.1	0.2	0.2	0.2	0.2
Goods and services tax (GST)	9.2	9.2	9.4	8.9	9.4	9.4	9.4	9.4	9.6
Of which: General GST	3.4	3.6	3.5	3.3	3.5	3.5	3.5	3.5	3.5
Tourism GST	5.8	5.6	5.8	5.6	5.8	5.9	5.9	5.9	6.0
Tourism tax ($6 green tax)	0.9	0.9	1.0	1.0	1.0	1.1	1.1	1.1	1.1
Other	0.8	1.2	0.9	0.8	0.9	0.9	0.9	0.9	0.9
Nontax revenue	7.5	7.0	6.7	6.3	6.4	6.3	6.3	6.3	6.3
Grants	0.3	0.3	0.5	1.3	0.6	0.6	0.5	0.5	0.5
Expenditure and net lending	36.6	30.1	30.8	30.3	31.0	31.5	31.0	30.7	30.4
Current expenditure	23.4	20.0	21.9	20.5	21.6	21.9	22.1	22.2	22.2
Of which: Salaries and allowances	10.3	9.3	9.4	8.8	9.4	9.4	9.4	9.4	9.4
Administrative Services	2.4	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Social welfare contributions	3.2	2.3	2.8	1.7	2.4	2.4	2.4	2.3	2.3
Repairs and maintenance	0.5	0.3	0.3	0.3	0.3	0.4	0.4	0.5	0.5
Subsidies and transfers	2.4	2.4	3.2	3.2	3.1	3.0	3.0	3.0	3.0
Interest	1.9	1.5	1.8	2.2	2.0	2.3	2.6	2.7	2.8
Other	2.8	2.1	2.4	2.1	2.2	2.2	2.1	2.1	2.0
Capital expenditure	12.7	10.7	9.0	9.6	9.5	9.6	9.0	8.6	8.3
Net lending	0.5	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Overall balance	-9.3	-3.0	-4.3	-4.4	-4.9	-5.5	-5.2	-4.9	-4.6
Overall balance, excluding grants	-9.6	-3.3	-4.8	-5.8	-5.6	-6.1	-5.7	-5.5	-5.0
Financing	9.3	3.0	4.3	4.4	4.9	5.5	5.2	4.9	4.6
External	5.9	4.1	3.9	4.2	2.4	2.4	1.5	-1.9	-0.1
Domestic	3.4	-1.1	0.5	0.2	2.5	3.2	3.6	6.8	4.7
of which: SDF contribution 1/			-1.6	-0.8	-1.3	-1.2	-1.1	3.4	1.3
Memorandum items:									
Current balance	3.7	6.8	4.1	5.1	3.8	3.4	3.2	3.1	3.2
Primary balance	-7.4	-1.5	-2.6	-2.2	-3.0	-3.2	-2.6	-2.2	-1.8
Current primary balance	5.6	8.3	5.9	7.4	5.8	5.8	5.8	5.8	6.0
Public and publicly guaranteed debt	59.4	58.4	71.4	...	76.8	80.7	83.1	81.5	81.4
Domestic	38.9	36.2	35.1	...	36.2	37.7	39.7	40.1	40.6
External (excl. IMF and currency swaps by MMA)	20.5	22.2	34.8	...	38.2	40.0	40.7	37.8	36.7
GDP (in millions of rufiyaa)	67,837	74,866	82,101	90,188	89,158	96,817	104,706	113,236	122,310

Sources: Maldivian authorities; and IMF staff projections.

1/ Transfers to the Sovereign Development Fund are recorded as negative domestic financing, and withdrawals as positive financing.

Table 3. Maldives: Monetary Accounts, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
					Proj.			
				(In millions of rufiyaa, e.o.p.)				
Net foreign assets	7,790	10,292	10,532	13,914	14,590	16,552	16,433	19,762
Maldives Monetary Authority, net	5,248	8,603	9,801	8,537	9,083	10,905	10,638	13,850
Assets	7,182	9,041	11,531	8,884	9,392	11,180	10,883	14,068
Liabilities	-1,934	-438	-1,730	-347	-309	-275	-245	-218
Commercial banks, net	2,542	1,689	731	5,378	5,508	5,647	5,795	5,912
Net domestic assets	22,646	21,715	22,557	22,019	24,429	25,647	29,204	29,532
Domestic credit	36,002	36,627	38,516	40,197	42,588	45,052	47,723	50,563
Public sector	16,981	14,760	14,877	14,583	14,832	15,089	15,373	15,674
Central government (net)	13,430	11,722	12,385	12,581	12,782	12,987	13,216	13,452
Public enterprises	3,551	3,037	2,492	2,002	2,050	2,102	2,157	2,223
Private sector	18,591	21,295	22,969	24,943	27,086	29,293	31,679	34,218
Other items (net)	-13,356	-14,911	-15,959	-18,178	-18,159	-19,405	-18,519	-21,031
Broad money	30,436	32,007	33,089	35,933	39,020	42,199	45,637	49,294
Narrow money	13,467	14,471	14,580	15,833	17,193	18,594	20,109	21,720
Currency	2,695	2,914	3,057	3,057	3,057	3,057	3,057	3,057
Demand deposits	10,772	11,558	11,523	12,776	14,136	15,537	17,052	18,663
Quasi-money	16,968	17,536	18,509	20,100	21,827	23,605	25,529	27,574
				(Annual percentage change, unless otherwise indicated)				
Broad money	-0.2	5.2	3.4	8.6	8.6	8.1	8.1	8.0
Narrow money	1.0	7.5	0.7	8.6	8.6	8.1	8.1	8.0
Domestic credit, net	19.7	1.7	5.2	4.4	6.0	5.8	5.9	5.9
Central government	17.1	-12.7	5.7	1.6	1.6	1.6	1.8	3.6
Public enterprises	137.8	-14.5	-18.0	-19.7	2.4	2.5	2.6	3.0
Private sector	10.5	14.5	7.9	8.6	8.6	8.1	8.1	8.0
				(In percent of GDP)				
Broad money	44.9	42.8	40.3	40.3	40.3	40.3	40.3	40.3
Narrow money	19.9	19.3	17.8	17.8	17.8	17.8	17.8	17.8
Domestic credit, net	53.1	48.9	46.9	45.1	44.0	43.0	42.1	41.3
Central government	19.8	15.7	15.1	14.1	13.2	12.4	11.7	11.0
Public enterprises	5.2	4.1	3.0	2.2	2.1	2.0	1.9	1.8
Private sector	27.4	28.4	28.0	28.0	28.0	28.0	28.0	28.0
				(In millions of U.S. dollars)				
Gross foreign assets of MMA	467	586	754	576	609	725	706	913
Usable reserves	199	206	290	202	218	276	267	370
Commercial banks NFA	165	110	47	349	357	366	376	384
Commercial banks forex open position, net	571	536	575	587	602	617	633	646
Memorandum items:								
Velocity	2.2	2.3	2.5	2.5	2.5	2.5	2.5	2.5
Money multiplier	3.4	3.0	2.9	2.9	2.9	2.9	2.9	2.9
Reserve money (in millions of rufiyaa, e.o.p.)	8,978	10,683	11,530	12,522	13,597	14,705	15,903	17,177

Sources: Maldivian authorities; and IMF staff projections.

Table 4. Maldives: Balance of Payments, 2016–23
(In millions of U.S. dollars, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023
		Est.			Proj.			
Current account	-1,023	-1,064	-1,275	-1,129	-948	-911	-835	-781
Balance of goods and nonfactor services	-51	-225	-357	-28	218	321	438	573
Trade balance	-1,839	-1,908	-2,257	-2,180	-2,192	-2,281	-2,391	-2,523
Exports (f.o.b.)	256	318	312	332	373	418	452	477
Domestic exports	140	231	228	246	285	327	358	384
Re-exports	117	87	84	86	88	91	94	96
Imports (f.o.b.)	-2,095	-2,227	-2,569	-2,512	-2,565	-2,698	-2,843	-2,999
Tourism-related	-346	-362	-383	-444	-491	-544	-602	-665
Other	-1,749	-1,864	-2,186	-2,068	-2,074	-2,155	-2,241	-2,334
Of which: Construction	-282	-336	-363	-353	-308	-314	-321	-329
Nonfactor services, net	1,788	1,683	1,900	2,152	2,411	2,602	2,830	3,095
Of which: Travel receipts	2,506	2,742	2,923	3,361	3,718	4,115	4,556	5,035
Income, net	-344	-392	-411	-567	-603	-632	-636	-679
Current transfers, net	-629	-447	-507	-534	-564	-599	-636	-674
Receipts	45	62	50	37	37	37	37	37
Payments	-674	-509	-557	-571	-601	-636	-673	-712
Capital and financial account	673	1,073	1,211	952	981	1,027	815	987
Financial account	673	1,073	1,211	952	981	1,027	815	987
Of which: 1/								
Foreign direct investment, net	457	493	452	530	577	649	684	725
Portfolio investment, net	-132	329	98	150	150	150	150	150
Other investment, net	348	252	661	272	255	227	-18	112
Monetary authorities 2/	99	-100	100	-100	0	0	0	0
General government	259	181	523	208	149	104	-140	-9
Of which: Disbursements of loans	309	247	567	349	312	294	292	251
Amortization	-50	-66	-45	-140	-163	-190	-432	-260
Banks	104	37	40	-4	-2	16	14	14
Other sectors 3/	-110	133	-1	168	107	107	107	107
Errors and omissions	254	110	233	0	0	0	0	0
Overall balance	-96	120	168	-177	33	116	-19	207
Gross international reserves (increase: -)	97	-119	-168	177	-33	-116	19	-207
Use of Fund credit, net	-1	-1	-1	0	0	0	0	0
Financing gap 4/	0	0	0	0	0	0	0	0
Memorandum items:								
Gross international reserves (stock; e.o.p.)	467	586	754	576	609	725	706	913
In months of GNFS imports	1.8	2.0	2.4	1.8	1.9	2.1	1.9	2.4
In percent of short-term debt at remaining maturity	205	175	458	203	189	199	113	196
Usable reserves (stock; e.o.p.)	199	206	290	202	218	276	267	370
In percent of short-term debt at remaining maturity	88	62	176	71	68	76	43	79
Current account (in percent of GDP)	-23.2	-21.9	-23.9	-19.5	-15.1	-13.4	-11.4	-9.8
GNFS balance (in percent of GDP)	-1.2	-4.6	-6.7	-0.5	3.5	4.7	6.0	7.2
Exports (volume, percent change)	9.1	22.6	-2.1	4.4	12.5	11.2	7.9	5.3
Imports (volume, percent change)	18.3	0.4	11.9	-2.6	1.9	4.4	5.1	5.2
Tourism: bednights (percent change)	6.1	10.6	10.2	8.0	8.0	8.0	8.0	8.0
Tourism: travel receipts (percent change)	-2.5	9.4	6.6	15.0	10.6	10.7	10.7	10.5
External debt (in percent of GDP) 4/	30.3	39.5	49.3	56.6	58.7	59.7	56.9	55.9
of which: External PPG	20.5	25.4	34.8	38.2	40.0	40.7	37.8	36.7
Debt service (in percent of domestic GNFS exports)	4.2	5.3	7.6	11.4	13.3	13.9	18.5	14.1
Exchange rate (rufiyaa per U.S. dollar; average)	15.4	15.4	15.4	…	…	…	…	…
GDP (in millions of U.S. dollars)	4,402	4,858	5,328	5,786	6,283	6,795	7,348	7,937

Sources: Maldivian authorities; and IMF staff projections.

1/ There are no capital transfers. -9.8

2/ MMA liabilities include swaps with the RBI.

3/ These flows include external borrowing of the private sector.

4/ Public and private external debt includes IMF, but excludes domestic foreign-currency denominated debt.

Table 5. Maldives: Selected Financial Soundness Indicators, 2011–2018
(In percent, unless otherwise specified)

	2011	2012	2013	2014	2015	2016	2017	2018
Capital								
Regulatory capital to risk-weighted assets	30.3	35.8	34.0	44.5	37.2	44.5	44.6	44.2
Tier 1 capital to risk-weighted assets	26.3	30.1	30.0	34.5	30.0	38.3	36.3	35.9
Capital to total assets	18.8	20.2	19.3	21.3	20.5	23.7	24.4	23.9
Asset quality								
Nonperforming loans (gross) to total loans (gross)	19.4	21	16.7	17.4	14.1	10.6	10.5	8.9
Nonperforming loans (net of provisioning) to regulatory capital	35.2	16.5	2.4	11.1	3.0	2.4	3.3	2.4
Earnings and profitability								
Return on assets	2.6	2.4	5.1	4.6	4.5	4.7	3.7	3.7
Return on equity	14.4	13.2	23.8	20.3	22.1	19.6	15.3	15.5
Liquidity								
Liquid assets to total assets	27.9	28.3	34.1	43.4	43.1	48.4	44.3	43.1
Assets of Banks (rufiyaa billions)	19.4	20.3	24.1	27.6	30.9	31.0	32.5	33.4
Deposits of banks (rufiyaa billions)	17.2	17.9	20.9	24.5	27.7	27.7	29.1	30.0

Source: IMF Statistics Department

Annex I. 2017 Article IV Recommendations and Related Policy Actions

2017 Article IV Recommendations	Related Policy Actions
Fiscal Policy	
Growth-friendly fiscal adjustment based on revenue measures and spending containment to keep the primary deficit at 4.4 percent of GDP in 2017 and achieve primary surplus by 2020, with public debt at 60 percent of GDP by 2022.	Primary deficit in 2017 fell to 1.5 percent of GDP, reflecting lower current and capital expenditure. However, no revenue measures were implemented and the spending cutback was partly reversed in 2018, with the overall deficit rising again and primary deficit projected at 3 percent of GDP deficit in 2020.
Need to strengthen PFM, have realistic budget envelope and clear sustainability anchors and fiscal strategy.	Progress has been made in implementing a significant number of the 2016 PIMA recommendations. The new Ministry of National Planning and Infrastructure is aiming to further improve public investment management.
Monetary and Exchange Rate Policy	
Tighten monetary policy through gradual increase in MRR and in remuneration rate on rufiyaa deposits to mitigate pressures on the peg. Re-start the market-based auctioning of liquidity.	No changes have been made to monetary policy stance. The MMA sees the stance as appropriate, with low inflation, absence of FX market pressure and relatively moderate credit growth. However, as part of its 2018-22 Strategic Plan, the MMA is modernizing monetary policy framework, including the re-introduction of open market operations to manage liquidity.
Gradually move towards an import-weighted currency composite to support the buildup of reserves.	With the IMF TA support, the authorities are reviewing the current exchange rate regime in order to maintain exchange rate stability.
Financial Stability and Structural Reforms	
Develop a market-based yield curve for government securities and encourage the development of a secondary market.	No progress achieved thus far. However, the implementation of the MMA Strategic Plan should create conditions for progress in these areas as well.
Carefully monitor rapid private credit growth to housing and construction, with the support of prudential measures on housing.	Credit growth is not raising concerns about financial sector vulnerability and following MMA prudential guidelines, bank lending has not been concentrated in specific sectors.
Continue supporting financial inclusion and rationalize the SME credit program to address fiscal risks.	Further progress in improving financial inclusion has been achieved, following the upgrade of the payment system and financial literacy improvement. National Financial Inclusion Strategy has been formulated.
Climate Change and Data	
Integrate risk-reduction and disaster-response programs into the core budget.	Authorities is considering participating in the Climate Change Assessment Program that can help integrate climate change impact and policy responses in the budget and the macro framework.
Improve data collection	With the help of IMF TA, several initiatives have improved data availability in national accounts and government statistics including GFSM 2014 reporting, improved CPI, PPI, and GSP statistics.

Annex II. Risk Assessment Matrix 1/

Source of Risk	Location of Source	Relative Likelihood	Time Horizon	Expected Impact	Direction of Impact	Inputs for Assessment	Main Impacts → Recommended Policy Actions
Failure to reduce fiscal deficits, continued debt accumulation and reserve drawdown	Domestic	M	ST, MT	M – H	↓	DSA alternative scenario	High deficit and increasing debt would call into question fiscal sustainability. → Moderate growth-friendly fiscal adjustment to bring the fiscal deficit and public debt to GDP ratio down over the medium term. Fiscal adjustment should also contribute to faster current account deficit reduction.
Sharp tightening of global financial conditions 1/	External	M	ST	M – H	↓	DSA alternative scenario	Higher cost of financing, weaker balance of payments and possible depreciation pressures, weaker consumption. → Tighten fiscal policy while protecting pro-growth and pro-poor spending. Tighten monetary policy to support the exchange rate peg and protect the foreign reserves.
Rising protectionism and retreat from multilateralism 2/	External	H	ST, MT	M	↓	Staff assessment	Slower export growth and tourism and FDI inflows, leading to weaker current account balance and lower growth potential. → Accelerate productivity-enhancing structural reforms and diversification of the economy, reduce barriers to trade and inward FDIs.
Slowdown in growth in China and Europe	External	M- H	ST, MT	M – H	↓	Staff assessment	Sharper slowdown in China would adversely affect tourism arrivals from China and thus result in weaker tourism revenues, with adverse impact on tax revenues and growth. → Promote diversification of tourism and the economy more generally.
Improved efficiency of public investment	Domestic	M	MT, LT	M	↑	PIMA, Staff assessment	According to PIMA assessment, Maldives is lagging behind in terms of efficiency of public investment, reflecting problems with project selection, implementation and assessment. . → Progress in improving the public investment efficiency could provide a boost to growth in the medium term.

1/ Sharp tightening of global financial conditions causes higher debt service and refinancing risks for the sovereign and SOEs with external borrowing, contributing to increased balance of payments pressures and weaker growth. Tighter financial conditions could be triggered by a sharper-than-expected increase in U.S. interest rates (prompted by higher-than-expected inflation) or the materialization of other risks.

2/ Global imbalances and fraying consensus about the benefits of globalization lead to trade wars and spreading isolationism and decline in international trade growth. This threatens the global trade system, regional integration, labor mobility, as well as global and regional policy and regulatory collaboration. In the short term, increased uncertainty about growth triggered by escalating trade tensions leads to increased financial market volatility. Negative consequences for growth are, in turn, exacerbated by adverse changes in market sentiment and investment.

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 of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("L" (low) is meant to indicate a probability below 10 percent, "M" (medium) a probability between 10 percent and 30 percent, and "H" (high) a probability of 30 percent or more). 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.

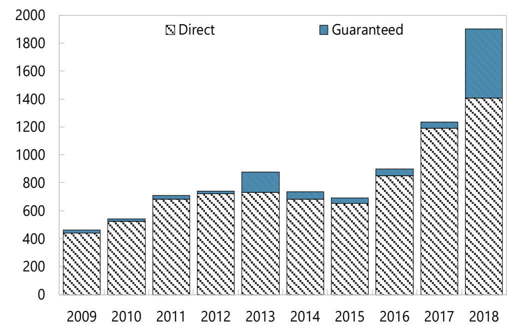
Annex III. State-Owned Enterprises

1. State-owned enterprises (SOEs), defined as companies with full or partial ownership by the Government of Maldives (GoM), have played an important role in the economy. To some extent, the large role of SOEs reflects the geographical uniqueness of the Maldives – an archipelago of dispersed islands, each often with a small number of inhabitants and high per capita costs of delivering public services under limited possibilities to achieve efficient scale of operations. Beyond provision of services on the outer islands, SOE activities extend into housing development, airport operations, banking, electricity generation and distribution, imports of goods, export of fish, air transport, and operation of the ferry system.

2. Many SOEs have not generated profits, requiring continuous budgetary support. In the early 2010s, the authorities prepared a far-reaching reform of the SOE sector, categorizing enterprises into three categories: (i) SOEs to be privatized; (ii) SOEs to be closed; and (iii) SOEs to be restructured and retained in state ownership. However, facing strong political opposition, privatization did not proceed as planned with only one SOE (Dhiraagu Telecom Company) privatized in 2011 and all subsequent privatization efforts abandoned.

3. SOE problems are perennial. The new government in 2018 has attached a priority to improve their performance and reduce inefficiencies which have placed a significant burden on limited budgetary resources, with financing of operational costs such as wages often disguised as capital injections. In addition, the increased enterprise external borrowing in recent years, with large government guarantees, has created substantial fiscal risks to the government.

PPG External Debt
(in millions of USD)



Sources: Data from authorities.

4. To improve the performance of SOEs and reduce related fiscal risks and budget leakages, the government has sought a three-pronged approach. This entails: (1) improving data reporting on SOE activities, including public investment undertaken, external borrowing, and debt repayment—the Privatization and Corporation Board (PCB) at MOF is seeking to improve the monitoring of major SOEs by publishing their annual and quarter financial data; (2) improving the oversight and efficiency of SOEs—the 2016 PIMA report has provided key recommendations, including strengthening the oversight of public investment undertaken by SOEs; and (3) reassessing the role of SOEs in the economy, with possible divesture of some while enhancing the private sector role in seeking improved efficiency and profitability, based on the Privatization and Corporation Act of 2013 framework for SOEs privatization.

Annex IV. Fiscal Adjustment Scenario

1. Under staff's baseline fiscal projections, the fiscal deficit declines only moderately to around 5 percent of GDP in the medium term, and the public and publicly guaranteed (PPG) debt-to-GDP ratio remains above 80 percent of GDP. Under the baseline, the room for a fiscal response to adverse shocks would be limited, fiscal sustainability would remain uncertain, and vulnerability to adverse debt shocks high. Relatively loose fiscal policy would also make it more difficult to strengthen Maldives' weak external position.

Table 1. Baseline and Adjustment Scenarios

	Baseline Scenario						Alternative Scenario					
	2018	2019	2020	2021	2022	2023	2018	2019	2020	2021	2022	2023
Real GDP growth (percent)	7.5	6.5	6.0	5.5	5.5	5.5	7.5	6.5	5.6	5.2	5.3	5.4
Primary current expenditure growth (percent)	0.0	5.7	8.6	7.7	7.7	7.5	0.0	5.7	5.5	5.3	7.3	7.1
Government revenue (percent of GDP)	26.0	25.4	25.4	25.3	25.3	25.4	26.0	25.4	27.1	27.0	27.0	27.0
Current expenditure (percent of GDP)	21.9	21.6	21.9	22.1	22.2	22.2	21.9	21.5	21.4	21.0	20.9	20.7
Capital expenditure (percent of GDP)	9.0	9.5	9.6	9.0	8.6	8.3	9.0	9.5	9.6	8.8	8.4	8.0
Fiscal balance (ex. grants, percent of GDP)	-4.8	-5.6	-6.1	-5.7	-5.5	-5.0	-4.8	-5.6	-3.8	-2.7	-2.2	-1.5
Primary balance (percent of GDP)	-2.6	-3.0	-3.2	-2.6	-2.2	-1.8	-2.6	-3.0	-0.8	0.3	0.8	1.4
Debt-stabilizing primary balance (percent of GDP)	7.2	2.4	0.7	-0.2	-3.8	-1.9	7.2	2.4	0.7	-0.1	-3.7	-1.7
Current account balance (percent of GDP)	-23.9	-19.5	-15.1	-13.4	-11.4	-9.8	-23.9	-19.5	-13.6	-10.7	-8.6	-6.8
Public debt (percent of GDP)	71.4	76.8	80.7	83.1	81.5	81.4	71.4	76.8	78.6	78.2	73.6	70.5

Source: Staff calculation

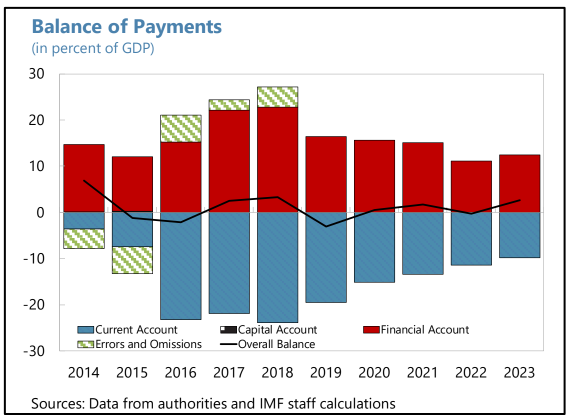
2. Staff recommends a fiscal adjustment scenario to reduce the deficit and put the debt ratio on a declining path. It consists of a combination of revenue measures and current expenditure cuts, while preserving productive infrastructure investment to limit the negative impact on growth. Under the adjustment scenario, the fiscal deficit would decline from a projected 5.6 percent of GDP in 2018 to 1.5 percent of GDP by 2023, and the primary balance would reach a 1.4 percent of GDP surplus by 2023. PPG debt would decline from 77 percent of GDP projected in 2019 to 70 percent of GDP in 2023.

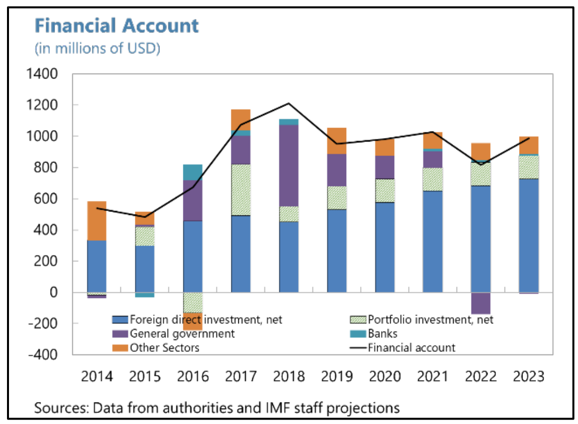
3. Revenue measures (around 1½ percent of GDP) include the introduction of the PIT in 2020 (with the full revenue impact phased in over two years), increase in the G-GST rate from 6 to 7 percent, increase in the airport service charge from US$25 to US$50 per traveler, and the introduction of a user fee for the new Hulhumale bridge. The adjustment scenario also assumes moderate gains from improved tax administration. Spending measures (1½ percent of GDP) include public service reform resulting in wage bill savings, reduction of subsidies, and continued reform of the health insurance system (Aasandha) resulting in lower government spending on healthcare. In addition, the adjustment has a modest reduction in capital expenditures in percent of GDP, although capital spending continues to grow moderately in nominal terms. Reform of public investment management is expected to increase investment efficiency, which should boost productivity and mostly offset the adverse growth impact of fiscal consolidation. Finally, compared to baseline, the adjustment scenario produces an improvement of the current account balance by about 3 percent of GDP.

Annex V. External Sector Assessment

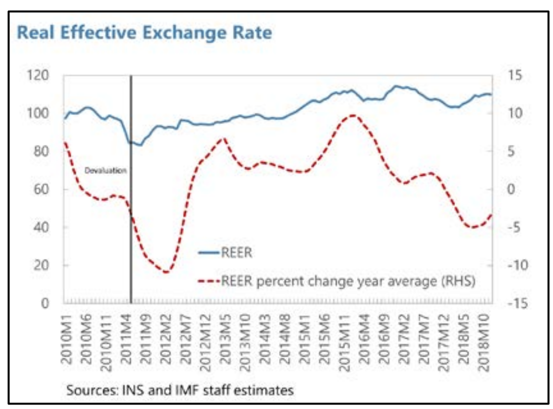
The external position in the Maldives is substantially weaker than fundamentals suggest. As a small open economy, the Maldives is susceptible to shocks from global growth and financial conditions. Mounting pressure in the external sector is caused by an elevated current account deficit (CAD), an appreciating real effective exchange rate (REER), and low reserve buffers. Staff supports a gradual move to a currency basket peg.

1. The external position of the Maldives has deteriorated since the 2017 Article IV. As the authorities ramped-up infrastructure investment, the CAD remained elevated and is estimated at 24 percent of GDP in 2018. The deficit is increasingly financed by external debt, making the Maldives more susceptible to changes in global financial conditions. PPG external debt increased by 10 percent of GDP in 2018 and is projected to rise to 40 percent of GDP before moderating (DSA Appendix).





2. The REER has generally appreciated since the last devaluation in 2011. The average REER in 2018 was about 15 percent more appreciated than the average during 2011-12. Pressure on the exchange rate would be alleviated by expanding the supply of FX in the official markets through the reforms proposed by Fund TA and endorsed by the MMA Strategic Plan, including the enforcement of currency regulation.



3. The IMF's revised EBA-lite CA and REER models[1] indicate that the Maldives' external position is substantially weaker than fundamentals and the REER is significantly more appreciated than the equilibrium REER.

- **CA approach.** The cyclically-adjusted CA is estimated at -23.2 percent of GDP in 2018. This compares with a multilaterally consistent cyclically-adjusted CA-norm of -8.3 percent of GDP[2] leading to a CA-gap of -14.9 percent of GDP. The elasticity of the trade balance with respect to changes in the REER is estimated at -0.5 indicating that the REER would need to depreciate by about 30 percent to close the CA-gap. The surge in infrastructure, and the impact on imports, is projected to unwind only over the medium-term.

CA approach	
CA-Actual	-23.9%
Cyclical Contributions (from model)	-0.7%
Cyclically adjusted CA	-23.2%
CA-Norm	-9.5%
Cyclically adjusted CA Norm	-8.8%
Multilaterally Consistent Cyclically adjusted CA Norm	-8.3%
CA-Gap	-14.9%
of/which Policy gap	-2.70%
Elasticity	-0.50
REER Gap	30%
CA-Fitted	-12.2%
Residual	-0.12
Natural Disasters and Conflicts	0.0%

- **Policy gap.** In the CA-model, the CA-norm is divided into the fitted value from the panel regression (fundamentals) and the policy gap. The policy gap is the difference between current and desirable level of policies.[3] Benchmarks for the target policy levels were used for all variables except the cyclically-adjusted fiscal balance where we calibrate the target to be consistent with the objective of bringing public debt to 50 percent of GDP by 2028. The desirable fiscal policy stance is consistent with a cyclically-adjusted fiscal deficit of 3 percent of GDP which is tighter than the current level by 2.5 percent of GDP. The policy gap is -2.7 percentage points of the CA-gap with the bulk of the contribution coming from the public health expenditure variable.

Policy gap	**-2.70%**
Fiscal Policy	-0.26%
Public Health Expenditure	-3.51%
Change in Reserves	-0.05%
Private Credit Level	0.21%
Private Credit Growth	0.26%
Capital Control	0.65%

[1] The following changes have been made to the EBA-lite models: (i) aid and remittances are no longer explanatory variables in CA and REER regressions and data on outward migration is used instead; (ii) shocks, such as from natural disasters and armed conflicts, are explicitly incorporated in the models; (iii) social insurance policies are explicitly incorporated; and (iv) the models separate cyclical factors from structural financial policies. Given the Maldives' exposure to shocks from natural disasters, the change under (ii) has important implications.

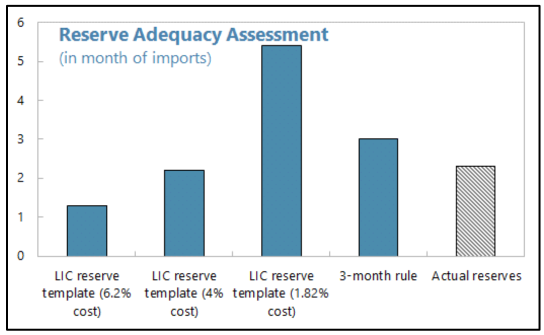
[2] CA-norm is derived from a CA panel regression on economic fundamentals, policy variables, and cyclical factors.

[3] Exact calculation of policy gap is "{(current policy level of the country) - (desirable policy level of the country)} - {(current policy level of world average) - (desirable policy level of world average)}.

- **Index REER approach.** This approach estimates the REER gap at 22.6 percent, though less emphasis should be placed on this methodology as data limitations constrain output from the model. As in the CA approach, benchmarks were used for optimal policies. Since fiscal policy is not a factor in the index REER approach, optimal fiscal policy does not play a role in the policy gap.

REER approach	
Ln(REER) Actual	4.66
Ln(REER) Fitted	4.41
Ln(REER) Norm	4.43
Residual	0.25
REER Gap	22.6%
Policy Gap	-2%
Natural Disasters and Conflicts	-0.1%

- **Gross international reserves are estimated at 2.4 months of imports in 2018 and remain below suggested norms.** Applying the "Assessing Reserve Adequacy" (ARA) tool for credit-constrained economies with fixed exchange rate regimes to the Maldives indicates an adequate level of reserves ranging from 1-to-6 months of imports depending on the cost used.[4] The commonly used cost of holding reserves (6.2 percent) suggests that reserves covering only one month of imports is adequate, reflecting high exports and FDI. Given the Maldives' susceptibility to natural disasters and increasing reliance on private external flows to finance the CAD, a target for reserves of three months of import coverage is recommended.



- **Concerns about the competitiveness of the Maldives' exports go beyond the level of the real exchange rate**. Weaknesses in the regulatory framework, including appeal procedures and trade facilitation, make for a difficult business environment that has been holding back foreign and domestic investment. The new government is embarking on policies and initiatives to address impediments to private-sector led growth.

4. The external position in the Maldives is substantially weaker than fundamentals suggest. Both the EBA-lite CA and REER methodologies confirm this. The unwinding of large infrastructure projects will help readjust the CAD, though this must be complemented by implementing structural reforms that improve competitiveness, building reserve buffers, and modernizing the exchange rate framework.

[4] The Maldives is assessed to be "credit constrained" for this exercise given that it does not regularly borrow from international capital markets – defined as at least one issuance of bonds per year in the last five years – and is not rated to be "investment grade."

Annex VI. Technical Assistance and Surveillance

1. In recent years, the Maldives has received a significant amount of Technical Assistance (TA), traditionally from headquarters, and recently from the South Asian Regional Technical Assistance and Training Center (SARTTAC), in Delhi. To ensure that the TA provided to Maldives closely matches the policy priorities identified by the Fund surveillance, the country team has been coordinating closely with the HQ and SARTTAC TA teams. In further integrating surveillance and capacity development, the findings and recommendations of TA missions have played an integral role in Fund surveillance documents, shaping final policy recommendations. A clear advantage of TA-surveillance integration is focusing otherwise general policy recommendations (e.g., increase tax revenues) on specific suggestions (e.g., what taxes to introduce and how to design the tax parameters).

2. The Maldives' current policy priorities identified in surveillance include fiscal consolidation to reduce fiscal deficits and public debt; modernizing the monetary policy framework to improve monetary policy transmission; reforming the FX market and exchange rate regime to reduce dollarization and improve external competitiveness; and strengthening public investment management to ensure that the ongoing large infrastructure investment improve the Maldives' economic performance.

3. Regarding fiscal consolidation, the Fund is presently providing TA on both tax policy (identifying new sources of revenues, including the introduction of the PIT) and tax administration, to further improve the MIRA's capacity, including in international tax transactions, and to strengthen compliance risk management.

4. On modernization of the monetary policy framework, the Fund is supporting the MMA's 2018–22 Strategic Reform Plan. Specifically, the Fund has started providing TA in three areas: (i) modernization of MMA governance, including strengthened operational independence; (ii) monetary and FX policy in support of more active and effective monetary policy, de-dollarization, and development of a functional FX market; and (iii) financial sector supervision and regulation.

5. Finally, the Fund has been actively involved in assisting the authorities in improving the planning, budgeting, and implementation of public investment projects to address the shortcomings identified in the 2016 PIMA Report. Rigorous project appraisal and scrutiny should improve project selection, reduce waste, and support longer-term economic growth and fiscal and external sustainability – key surveillance priorities.

INTERNATIONAL MONETARY FUND

MALDIVES

April 30, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Asia and Pacific Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of February, 2019)

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	2.42	31.48

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
ESF Arrangements	0.51	2.42

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				
	2019	2020	2021	2022	2023
Principal	0.41	0.10			
Charges/Interest	0.05	0.06	0.06	0.06	0.06
Total	**0.46**	**0.16**	**0.06**	**0.06**	**0.06**

[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 (FX) at the official rate which leads to the Maldives Monetary Authority (MMA) rationing its supply of FX to commercial banks. This results in a channeling of FX 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 FX 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 2017 Article IV consultation was concluded by the Executive Board on October 20, 2017.

Technical Assistance

FAD: FAD's 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 and tax policy and tax administration. A joint IMF/WB-led PEFA assessment was carried out in February 2014 to gauge progress made since the 2009-2011 PFM Action Plan and identify remaining weaknesses at the time. As a follow-up to the PEFA, FAD in collaboration with the World Bank, developed a Public Financial Management Reform Plan (PFMRP) for the Government of Maldives (GoM) 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 were carried out since FY14, which focused on developing a cash management manual for the GoM 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 has also focused on 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, which purpose was to identify, and propose improvements in, PFM practices that are associated with efficient public investment. October 2017 TA mission reviewed progress with the strategic priorities in the Maldives Inland Revenue Authority (MIRA) 2015–19 Strategic Plan. The January 2018 mission focused on budget formulation and public investment management. A follow-up mission on Strengthening Public Investment Management took place in June 2018. In July 2018, a TA mission MIRA focused on developing a risk management framework. A Tax Policy TA took place in February 2019, to asses the overall design of taxation in the Maldives and identify reform options to support revenue, efficiency and equity. Also, in February 2019, concurrent tax administration missions took place to advice MIRA on the development of the 2020-24 Strategic Plan and develop MIRA's risk framework and improve the skills of staff.

LEG: In October 2003 provided TA on the revision of the 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 FX 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 FX market. The Department also provided advice on deposit insurance schemes during 2014. Banking supervision (March) and FX 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 FX 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 2017, two HQ missions covering accounting and auditing framework for MMA, and two SARTTAC missions establishing the work plan for monetary operations and banking supervision took place. Four TA missions took place during 2017-18 as part of the multi-year TA program to enhance the supervisory capacity of the Insurance Division of the MMA. In December 2018, a multitopic TA took place to formulate a TA roadmap to support MMA's reforms, including central bank governance, monetary and FX operations and financial sector supervision and regulation. In January 2019, TA mission assisted the authorities in the application of International Financial Reporting Standard 9 – Financial Instruments and reviewing progress in the strengthening of their Internal Audit and Enterprise Risk Management practices. In February 2019, an external expert visited Maldives to advise the MMA governor on strengthening the MMA governance and internal organization.

***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 in February 2017. April 2018 external sector statistics SARTTAC mission assessed data reliability and assisted in improving specific BOP components, advised on further developments in source data and statistical techniques to address existing data gaps., August 2018 SARTTAC mission has provided GFS and public sector debt statistics (PSDS) training - the onset of a broader SARTTAC training and technical assistance effort to enable the Maldives to improve and strengthen its fiscal reporting. January 2019 SARTTAC mission on GFS and PSDS focused on strengthening compilation and dissemination of the statistics in line with internationally accepted statistical standards. February 2019 SARTTAC missions assisted with the updating of the consumer price index and developing experimental annual GDP estimates by expenditure at current prices for 2017.

Safeguards Assessment

In line with the Fund's safeguards assessments policy, an assessment of the MMA was concluded in March 2010. In addressing Fund’s recommendations, the MMA appointed an external auditor and strengthened controls over foreign payments through the automation of the authorization process. A Chief Internal Auditor was also appointed, while capacity in the internal audit function has continued to improve. 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.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

Information on the activities of other IFIs in Maldives can be found at:

https://www.worldbank.org/en/country/maldives

https://www.adb.org/countries/maldives/main

STATISTICAL ISSUES

(As of March 2019)

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 were 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, the authorities are preparing independent estimates of GDP by expenditure, and comparing them with estimates of GDP by economic activity to assess the statistical discrepancy and the quality of the two measures. Significant discrepancies remain. 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. STA is also providing technical assistance to improve the Production Price Index (PPI) and rebase both the PPI and the CPI by 2019.
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 being reconciled 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 is operational.

MMA 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. Maldives also reports data on some key series and indicators of the financial access survey (FAS), including the two indicators of the U.N. Sustainable Development Goals.
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 and intensive TA 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. An STA e-GDDS mission is scheduled to take place in middle June to assist the authorities publish essential macroeconomic data through a National Summary Data Page (NSDP)	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 April 16, 2019)					
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	March 2019	March 2019	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	February 2019	March 2019	D	D	D
Reserve/Base Money	February 2019	March 2019	W	W	M
Broad Money	February 2019	March 2019	W	W	M
Central Bank Balance Sheet	February 2019	March 2019	W	W	M
Consolidated Balance Sheet of the Banking System	February 2019	March 2019 Sep 2017	W	W	M
Interest Rates[2]	February 2019	March 2019	W	W	M
Consumer Price Index	January 2019	March 2019	M	W	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2018	March 2019	A	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2018	March 2019	A	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2018	March 2019	A	M	M
External Current Account Balance	2018	March 2019	A	M	M
Exports and Imports of Goods and Services	2018	March 2019	M	M	M
GDP/GNP	2018 Q3	March 2019	A,, Q	M	M
Gross External Debt	2018	March 2019	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 2019 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

April 30, 2019

Approved By
Ranil Salgado and Lalita M. Moorty (IDA)

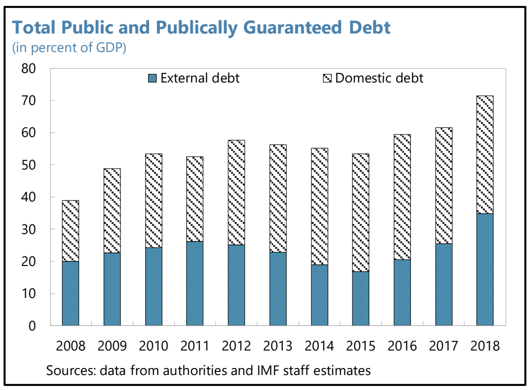
Prepared by the staffs of the International Monetary Fund and the International Development Association.

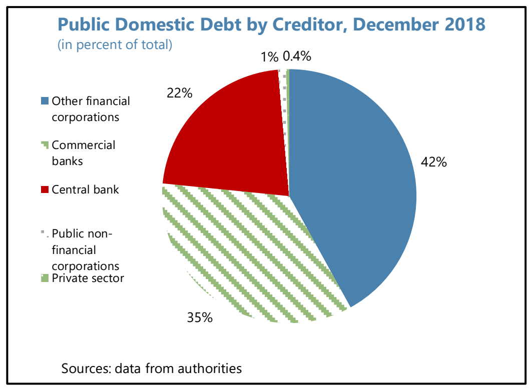
Maldives Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress:	High
Overall risk of debt distress:	High
Granularity in the risk rating:	Sustainable
Application of judgement:	No

The risk of external debt distress in the Maldives remains high. External public and publicly-guaranteed debt increased by 10 percent of GDP in 2018 leading all indicators, except the debt-to-exports ratio, to breach their thresholds under the baseline. The authorities are predominantly financing their infrastructure investment scale-up with external debt, some of which is guaranteed. The debt profile is susceptible to rollover risks from outstanding international sovereign bonds and financing pressures from amortizations of guaranteed loans for major infrastructure projects. A Sovereign Development Fund has been set up with resources allocated to mitigate anticipated liquidity pressures. This along with the winding down of large-scale infrastructure supports an assessment that debt is sustainable. Public domestic debt remains elevated and around half of it is composed of short-term Treasury bills. 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.

BACKGROUND AND DEVELOPMENTS ON DEBT

1. **Total public and publicly-guaranteed (PPG) debt in Maldives increased by 10 percent of GDP in 2018 and stood at around US$3.8 billion in 2018, approximately 72 percent of GDP.** The increase in public sector debt was due to external PPG debt associated with major infrastructure projects. Disbursements in 2018 were exceptionally high because of an overlap of ending (i.e., bridge, airport runway, housing) and starting (notably, new housing development and airport terminal) projects. About 50 percent of public sector debt is domestic and most of it is denominated in local currency. Domestic debt is held by financial institutions including finance and insurance companies, pension funds, and other fund accounts (42 percent), commercial banks (35 percent), and the Maldives Monetary Authority (MMA) (22 percent).[1] Short-term domestic debt accounts for around half of total domestic debt. The domestic debt market is not fully developed, and the authorities have received TA on formulating a Medium-Term Debt Management Strategy (MTDS).[2] They plan to issue securities with longer maturities, though work on this has not begun.





2. **External PPG debt recorded around US$1.9 billion in 2018.** The recent expansion in infrastructure investment has been financed with external debt. Investment in transportation, housing, and electricity has aimed at filling an infrastructure gap and increasing growth potential, especially from tourism. Around 60 percent of external PPG debt is owed to bilateral official creditors.[3] Of bilateral debt, 83 percent is owed to China. This is equivalent to US$928 million or about 50 percent of PPG external debt, of which US$403 million is guaranteed. Guaranteed external debt increased markedly in 2018 with the bulk owed to China in association with housing projects carried out by the Housing Development Corporation, a state-owned enterprise (SOE). The terms on most guaranteed debt are non-concessional.[4] Sovereign bonds were issued in 2017 and 2018, totaling US$350 million (6.6 percent of 2018 GDP), on commercial

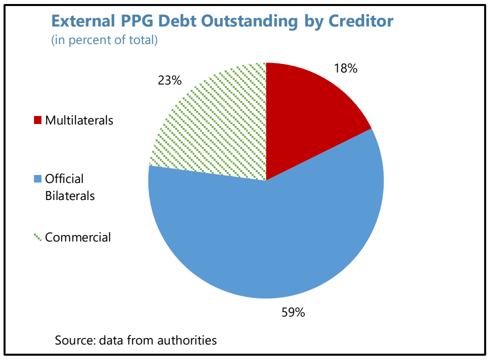
[1] This is a conversion of the outstanding debt held by the MMA in the Ways and Means account into a long-term Treasury bond in December 2014.

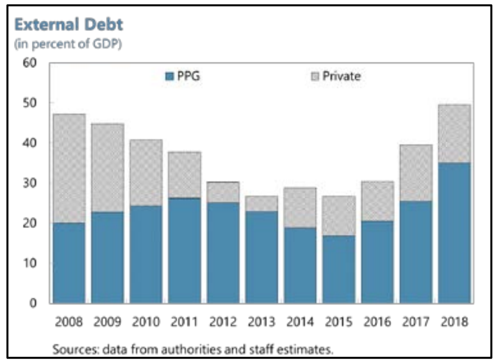
[2] A Debt Management Performance Assessment (DeMPA) evaluation is being finalized and the results of the assessment are expected to help the Government of Maldives (GoM) to design a medium-term reform plan.

[3] Debt outstanding to EXIM China and EXIM India (buyers' credit lending) is included in bilateral debt. External PPG debt to bilateral creditors is owed mostly to China, 83 percent, followed by other non-Paris Club members, 8 percent.

[4] Debt outstanding from state-owned Chinese banks is categorized as bilateral, at non-concessional terms, given that the grant element is below 35 percent.

lending terms. External debt is mostly denominated in U.S. dollar (53 percent), renminbi (19 percent), and SDR (17 percent).





3. **The Fund's debt sustainability analysis includes PPG external [5] and domestic debt.** Public debt includes debt of the central government, including guarantees to SOEs, and debt of the central bank. Public debt does not include non-guaranteed debt of SOEs as they can borrow without the guarantee of the government.

Subsectors of the public sector	Sub-sectors covered
Central government	X
State and local government	
Other elements in the general government	
o/w: Social security fund	
o/w: Extra budgetary funds (EBFs)	
Guarantees (to other entities in the public and private sector, including to SOEs)	X
Central bank (borrowed on behalf of the government)	X
Non-guaranteed SOE debt	

The country's coverage of public debt	The central government plus social security, central bank, government-guaranteed debt			
	Default		Used for the analysis	Reasons for deviations from the default settings
Other elements of the general government not captured in 1.	0	percent of GDP	0.0	
SoE's debt (guaranteed and not guaranteed by the government) 1/	2	percent of GDP	2.0	
PPP	35	percent of PPP stock	0.0	
Financial market (the default value of 5 percent of GDP is the minimum value)	5	percent of GDP	5.0	
Total (2+3+4+5) (in percent of GDP)			7.0	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

BACKGROUND ON MACRO FORECASTS

4. **Despite strong growth and stable inflation, external imbalances in the Maldives have worsened compared to the last Debt Sustainability Analysis (DSA).**

[5] External debt in this DSA is defined by currency criterion.

- **Current account (CAD).** The non-interest CAD is projected at 23 percent of GDP in 2018, around 8 percent of GDP higher than previously projected. The larger deficit is due to higher imports related to increased implementation of large infrastructure projects, which was largely financed by an increase in PPG external debt. Because of the higher CAD, the adjustment over the medium term is more accelerated as SOE projects come to an end. CAD adjustment also benefits from higher tourist arrivals which are projected to grow at 8 percent over the medium term compared to 5.5 percent.

- **Fiscal balance.** Preliminary outturns for 2018 shows a lower primary deficit reflecting mainly lower current spending compared to the previous DSA – this includes lower spending on salaries and allowances, administrative services, and social welfare. However, given the absence of new revenue measures and the assumption of a more moderate decline in capital spending, the current fiscal projection shows a slower medium-term decline in the primary deficit compared to the previous DSA. Domestic financing is projected to cover around 60 percent of gross financing needs over the medium term. Maldives will continue to receive grants from bilateral and multilateral partners, while the magnitude is smaller than concessional borrowing and declines over the medium-term.

Change in Macro Assumptions

	2018	2019	2020	2021	2022	2023
Real GDP growth (in percent change)						
Current	7.5	6.5	6.0	5.5	5.5	5.5
Previous	4.7	4.8	5.0	5.0	5.0	4.6
Inflation						
Current	2.0	2.0	2.4	2.5	2.5	2.3
Previous	2.0	2.0	2.4	2.5	2.5	2.3
Primary fiscal deficit (in percent of GDP)						
Current	2.6	3.0	3.2	2.6	2.2	1.8
Previous	4.6	3.3	2.5	1.9	0.8	0.9
Non-interest current account deficit (in percent of GDP)						
Current	23.0	18.0	13.0	11.2	9.3	8.0
Previous	15.4	14.7	12.5	11.0	8.4	9.0

- **Growth and inflation.** Growth was higher than anticipated in 2018 due to strong performance in the tourism sector and a pickup in construction related to large infrastructure projects. Over the medium term, growth is slightly higher than projected in the last DSA driven by improvements in the tourism sector against better infrastructure.

5. **The new realism tools suggest that the macroeconomic projections are reasonable and consistent with historical patterns and those observed in other LICs.** The three-year change in the primary balance is at the median of the distribution of planned fiscal adjustments in the sample of Fund-supported programs in low-income countries since 1990. The primary deficit will increase relative to the trough in 2017. Planned public investment is greater than previously projected as implementation rates for existing projects have increased. The larger contribution of government capital to projected growth, compared to the previous DSA, reflects greater public investment. Current projections are reasonably close

to estimates of the historical contribution. Growth in 2019 is projected lower than values implied by a range of fiscal multipliers because construction on infrastructure projects, financed outside the budget and not reflected in the fiscal deficit, will slow down.

EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

6. The debt carrying capacity of the Maldives remains weak. Maldives' Composite Indicator (CI) score is calculated to 2.48, and the country has 'weak debt carrying capacity'. CI is based on a weighted average of several factors such as the country's real GDP growth, remittances, international reserves, and world growth and the CPIA score, and the calculation of the CI is based on 10-year averages of the variables, across 5 years of historical data and 5 years of projection, and the corresponding CPIA.

Debt Carrying Capacity	Weak

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintages
Weak	Weak 2.48	Weak 2.44	Weak 3.18

Note: Until the April 2019 WEO vintage is released, the two previous vintages ago classification and corresponding score are based solely on the CPIA per the previous framework.

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.177	1.22	49%
Real growth rate (in percent)	2.719	5.231	0.14	6%
Import coverage of reserves (in percent)	4.052	19.344	0.78	32%
Import coverage of reserves^2 (in percent)	-3.990	3.742	-0.15	-6%
Remittances (in percent)	2.022	0.000	0.00	0%
World economic growth (in percent)	13.520	3.579	0.48	19%
CI Score			2.48	100%
CI rating			Weak	

7. External debt sustainability

- **PPG external debt-to-GDP** stood at around 35 percent in 2018 and is projected to increase to 41 percent of GDP by 2021 before declining to 33 percent in 2028. Strong FDI flows put external debt on a declining path over the medium term despite a CAD. FDI flows to the Maldives have been historically strong, averaging 9 percent of GDP between 2007 and 2018, and are projected to remain so over the medium term. FDI flows are mostly associated with the tourism sector.

- **Financing pressures** are set to increase as amortization repayments on large infrastructure projects are coming due. Debt service indicators are projected to increase, peaking in 2022 because of the US$250 million repayment of a bullet sovereign bond issued in 2017. This represents an important rollover risk considering the possible change in investors' appetite for Maldivian debt under tightening global financial conditions. The Sovereign Development Fund (SDF) was set up to mitigate these rollover risks. In this vein, earmarked funds are built from the Airport Development Fee, revenue from revisions to fees and services provided in the main International Airport, the sovereign guarantee fees, and dividends from the Maldives Airports Company Limited, to repay external loans. Accumulated funds as of end 2018 were US$125 million. Staff projects the SDF to sufficiently cover the international sovereign bond obligations coming due, backed by a government instituted policy of weekly revenue earmarking to the Fund. This supports staff judgment that debt is sustainable.

- **Exports of goods and services** are 60 percent of GDP, making the stress test associated with exports the most severe, along with the combination shock. Market financing, through the issuance of bonds stands at US$350 million to date, around 18 percent of the outstanding PPG external debt. The relatively small share limits risks from external financing shocks so the potential for heightened liquidity needs remains moderate (Figure 3). Gross financing needs surpass their threshold due to the large share of short-term debt in domestic debt issuance.

8. Overall public debt sustainability. Public sector debt stood at an estimated 72 percent of GDP in 2018. Domestic public debt is an important source of financing in the Maldives and is projected to remain so. Despite favorable automatic debt dynamics, the primary deficit will contribute to an increase in public debt over the medium-term reaching 83 percent of GDP in 2021. Staff recommends an ambitious fiscal adjustment that would achieve a primary surplus of 1.4 percent of GDP and would gradually lower public debt to 70 percent of GDP by 2023. The adjustment would reduce fiscal risks, and is designed to minimize the adverse impact on economic growth. Staff also recommends developing the domestic debt market by lengthening debt maturity and minimizing rollover risks from short-term debt.

9. Tailored stress tests for natural disasters, contingent liabilities, and market financing are relevant for the Maldives. The Maldives is susceptible to a host of natural disasters and has issued two sovereign bonds (amounting to US$350 million). The tailored stress tests were kept to their pre-set, default calibrations, and they are not the most extreme shocks for any of the indicators. The most extreme shocks are the combination shock and the shock to exports for the PPG external debt indicators, and the shock to growth for the public debt indicators.

ASSESSMENT

10. The Maldives has a high risk of external debt distress and a high overall risk of debt distress. The debt-to-exports ratio does not breach its threshold under the baseline, but the remaining external debt indicators do. Risks stem from the elevated public debt and the rollover risks from sovereign bonds. The SDF helps mitigate these risks and the projected decline in externally-financed SOE projects puts a cap on these risks, supporting a sustainable granular risk rating. Staff recommends fiscal consolidation to put public debt on a downward path, developing the domestic debt market to allow longer tenors, and ensuring that the authorities are selective about externally-financed projects and that new external debt is contracted on concessional terms, to the extent possible.

AUTHORITIES' VIEWS

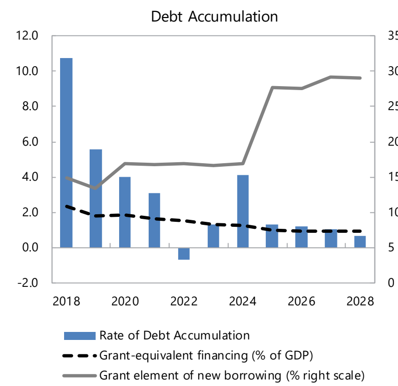
11. The authorities recognize the risk that high public debt poses. The new administration is focusing on close oversight of the issuance of government guarantees and has been publishing data on government guarantees on the Ministry of Finance's website for increased transparency. They maintain that institutional weaknesses are not the primary cause for the increase in government-guaranteed debt owed to China but reflect rather decisions by the previous administration, to finance large infrastructure projects. They emphasized the role of the SDF in mitigating financing risks over the medium term and intend to continue building up funds for repaying debt.

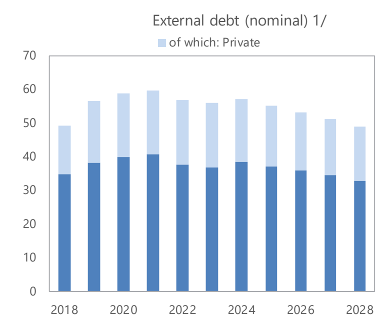
Table 1. Maldives: External Debt Sustainability Framework, Baseline Scenario, 2015-2038

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028	2038	Historical	Projections
External debt (nominal) 1/	26.7	30.3	39.5	49.3	56.6	58.7	59.7	56.9	55.9	49.0	29.6	35.3	54.8
of which: public and publicly guaranteed (PPG)	16.8	20.5	25.4	34.8	38.2	40.0	40.7	37.8	36.7	33.0	19.3	22.3	37.0
Change in external debt	-2.2	3.7	9.2	9.8	7.3	2.1	1.0	-2.8	-1.0	-2.2	-0.6		
Identified net debt-creating flows	-2.7	11.0	8.9	12.7	7.4	2.8	0.9	-1.0	-2.2	-3.5	-4.2	-0.2	0.4
Non-interest current account deficit	7.3	23.1	21.7	23.0	18.0	13.0	11.2	9.3	8.0	5.4	0.6	12.3	10.5
Deficit in balance of goods and services	-9.2	1.2	4.6	6.7	0.5	-3.5	-4.7	-6.0	-7.2	-10.2	-15.8	-6.8	-5.4
Exports	76.7	71.5	67.7	65.3	65.7	65.6	65.7	65.7	65.5	66.0	67.1		
Imports	67.6	72.7	72.3	72.0	66.2	62.1	61.0	59.7	58.3	55.8	51.3		
Net current transfers (negative = inflow)	8.5	14.3	9.2	9.5	9.2	9.0	8.8	8.7	8.5	7.7	7.8	9.3	8.5
of which: official	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other current account flows (negative = net inflow)	7.9	7.7	7.9	6.7	8.2	7.5	7.2	6.6	6.7	7.9	8.6	9.8	7.4
Net FDI (negative = inflow)	-7.3	-10.4	-10.1	-8.5	-9.2	-9.2	-9.6	-9.3	-9.1	-7.3	-3.7	-9.5	-8.7
Endogenous debt dynamics 2/	-2.7	-1.7	-2.7	-1.7	-1.4	-1.0	-0.8	-1.0	-1.1	-1.6	-1.1		
Contribution from nominal interest rate	0.2	0.1	0.2	1.0	1.6	2.1	2.2	2.0	1.8	1.0	0.4		
Contribution from real GDP growth	-0.8	-1.8	-1.9	-2.7	-2.9	-3.2	-3.0	-3.0	-2.9	-2.6	-1.5		
Contribution from price and exchange rate changes	-2.1	0.0	-0.9	...	...	...	...	...	...	...	...		
Residual 3/	0.4	-7.3	0.3	-3.0	-0.1	-0.7	0.1	-1.8	1.2	1.2	3.6	-1.1	0.5
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		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	25.4	33.0	35.5	36.3	36.5	33.1	31.9	28.4	14.5		
PV of PPG external debt-to-exports ratio	...	...	37.5	50.4	54.0	55.4	55.5	50.4	48.6	43.0	21.6		
PPG debt service-to-exports ratio	5.9	4.5	0.3	2.8	6.1	7.2	7.5	12.0	7.8	3.4	2.1		
PPG debt service-to-revenue ratio	17.3	12.0	0.7	7.1	15.8	18.5	19.6	31.2	20.1	8.6	5.1		
Gross external financing need (Million of U.S. dollars)	350.8	752.1	763.9	1157.4	880.8	700.9	622.8	770.3	520.1	293.7	-50.5		
Key macroeconomic assumptions													
Real GDP growth (in percent)	2.9	7.3	6.9	7.5	6.5	6.0	5.5	5.5	5.5	5.5	5.5	5.2	5.8
GDP deflator in US dollar terms (change in percent)	7.9	0.1	3.2	2.0	2.0	2.4	2.5	2.5	2.3	2.0	2.0	4.8	2.2
Effective interest rate (percent) 4/	0.8	0.5	0.7	2.7	3.4	4.0	4.0	3.6	3.4	2.2	1.5	1.0	2.9
Growth of exports of G&S (US dollar terms, in percent)	-4.7	0.1	4.5	5.8	9.3	8.4	8.4	8.0	7.8	7.8	7.8	6.7	7.9
Growth of imports of G&S (US dollar terms, in percent)	0.5	15.5	9.9	9.2	-0.2	1.9	6.2	5.8	5.5	6.5	6.7	9.4	5.6
Grant element of new public sector borrowing (in percent)	...	...	...	14.9	13.4	16.9	16.8	16.9	16.7	29.1	29.0	...	20.5
Government revenues (excluding grants, in percent of GDP)	26.1	27.0	26.8	26.0	25.4	25.4	25.3	25.3	25.4	26.1	27.9	23.5	25.6
Aid flows (in Million of US dollars) 5/	41.3	12.2	14.1	103.6	84.3	150.1	149.2	154.7	141.0	202.4	411.8		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	2.3	1.8	1.8	1.6	1.5	1.3	0.9	0.8	...	1.4
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	17.9	19.4	23.1	23.2	23.4	23.7	38.7	33.6	...	28.3
Nominal GDP (Million of US dollars)	4,098	4,402	4,858	5,328	5,786	6,283	6,795	7,348	7,937	11,451	23,896		
Nominal dollar GDP growth	11.0	7.4	10.4	9.7	8.6	8.6	8.1	8.1	8.0	7.6	7.6	10.2	8.1
Memorandum items:													
PV of external debt 7/	...	...	39.5	47.4	53.9	55.1	55.5	52.2	51.0	44.4	24.9		
In percent of exports	...	...	58.4	72.6	81.9	84.0	84.4	79.6	77.9	67.2	37.0		
Total external debt service-to-exports ratio	11.0	6.0	6.1	11.1	9.8	11.2	11.4	15.9	11.7	6.7	4.2		
PV of PPG external debt (in Million of US dollars)			1233.9	1755.6	2052.4	2283.6	2477.6	2432.2	2529.0	3253.2	3467.8		
(PVt-PVt-1)/GDPt-1 (in percent)				10.7	5.6	4.0	3.1	-0.7	1.3	0.7	0.9		
Non-interest current account deficit that stabilizes debt ratio	9.5	19.4	12.5	13.2	10.6	10.9	10.3	12.1	9.0	7.6	1.2		

Definition of external/domestic debt	**Currency-based**
Is there a material difference between the two criteria?	**No**





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 exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

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

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

6/ 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).

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

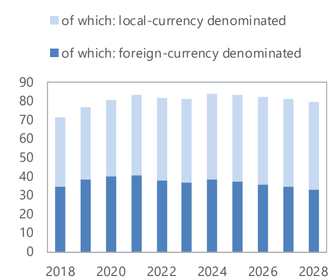
8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

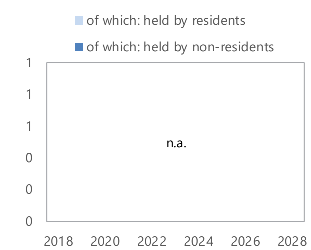
Table 2. Maldives: Public Sector Debt Sustainability Framework, Baseline Scenario, 2015-2038
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028	2038	Historical	Projections
Public sector debt 1/	53.4	59.4	61.6	71.4	76.8	80.7	83.1	81.5	81.4	79.6	53.8	53.7	80.5
of which: external debt	16.8	20.5	25.4	34.8	38.2	40.0	40.7	37.8	36.7	33.0	19.3	22.3	37.0
Change in public sector debt	-1.8	6.0	2.2	9.8	5.4	3.9	2.4	-1.6	-0.1	-1.7	-2.0		
Identified debt-creating flows	0.6	5.6	-2.6	-0.9	0.7	1.3	0.9	0.3	-0.1	-1.5	-2.9	2.4	-0.3
Primary deficit	3.9	7.4	1.5	2.6	3.0	3.2	2.6	2.2	1.8	0.6	-1.4	6.1	1.9
Revenue and grants	27.1	27.3	27.1	26.5	26.0	26.0	25.8	25.8	25.8	26.4	28.1	24.3	26.1
of which: grants	1.0	0.3	0.3	0.5	0.6	0.6	0.5	0.5	0.5	0.3	0.2		
Primary (noninterest) expenditure	31.1	34.7	28.6	29.1	29.0	29.2	28.4	28.0	27.6	27.1	26.7	30.5	28.0
Automatic debt dynamics	-3.4	-1.8	-4.1	-3.5	-2.2	-1.9	-1.7	-2.0	-1.8	-2.1	-1.5		
Contribution from interest rate/growth differential	-2.3	-1.9	-3.8	-3.5	-0.6	-1.8	-1.6	-1.9	-1.8	-2.2	-1.6		
of which: contribution from average real interest rate	-0.7	1.7	0.0	0.8	3.8	2.6	2.6	2.4	2.4	2.0	1.4		
of which: contribution from real GDP growth	-1.5	-3.6	-3.8	-4.3	-4.3	-4.4	-4.2	-4.3	-4.3	-4.2	-2.9		
Contribution from real exchange rate depreciation	-1.1	0.2	-0.3	...	...	...	...	...	...	...	...		
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	-0.7	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 contingent liabilities (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		
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 debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	-2.4	0.4	4.8	10.7	3.0	2.5	1.5	-1.9	-0.1	-0.1	0.9	0.2	1.8
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	61.6	69.5	74.0	77.1	78.9	76.8	76.5	75.0	49.1		
PV of public debt-to-revenue and grants ratio	...	...	227.7	262.4	284.1	296.8	305.3	297.9	296.3	283.7	174.7		
Debt service-to-revenue and grants ratio 3/	72.6	69.3	70.5	76.7	70.8	64.9	61.1	82.8	86.4	69.8	47.1		
Gross financing need 4/	21.6	24.5	20.7	21.1	17.4	15.3	13.4	15.7	19.0	16.9	10.5		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	2.9	7.3	6.9	7.5	6.5	6.0	5.5	5.5	5.5	5.5	5.5	5.2	5.8
Average nominal interest rate on external debt (in percent)	1.3	0.8	1.0	4.2	4.8	6.0	5.8	5.3	5.2	3.2	2.3	1.6	4.4
Average real interest rate on domestic debt (in percent)	-1.9	5.1	0.4	0.9	3.5	3.2	3.2	3.2	3.5	3.9	3.9	-0.3	3.3
Real exchange rate depreciation (in percent, + indicates depreciation)	-6.0	1.0	-1.6	...	...	...	...	...	...	...	...	-2.8	...
Inflation rate (GDP deflator, in percent)	7.9	0.1	3.2	2.0	2.0	2.4	2.5	2.5	2.3	2.0	2.0	6.7	2.2
Growth of real primary spending (deflated by GDP deflator, in percent)	3.0	19.9	-12.0	9.3	6.2	6.6	2.9	3.9	3.9	5.2	5.5	4.2	5.3
Primary deficit that stabilizes the debt-to-GDP ratio 5/	5.7	1.4	-0.7	-7.2	-2.4	-0.7	0.2	3.8	1.9	2.3	0.7	2.1	0.3
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Currency-based**
Is there a material difference between the two criteria?	**No**

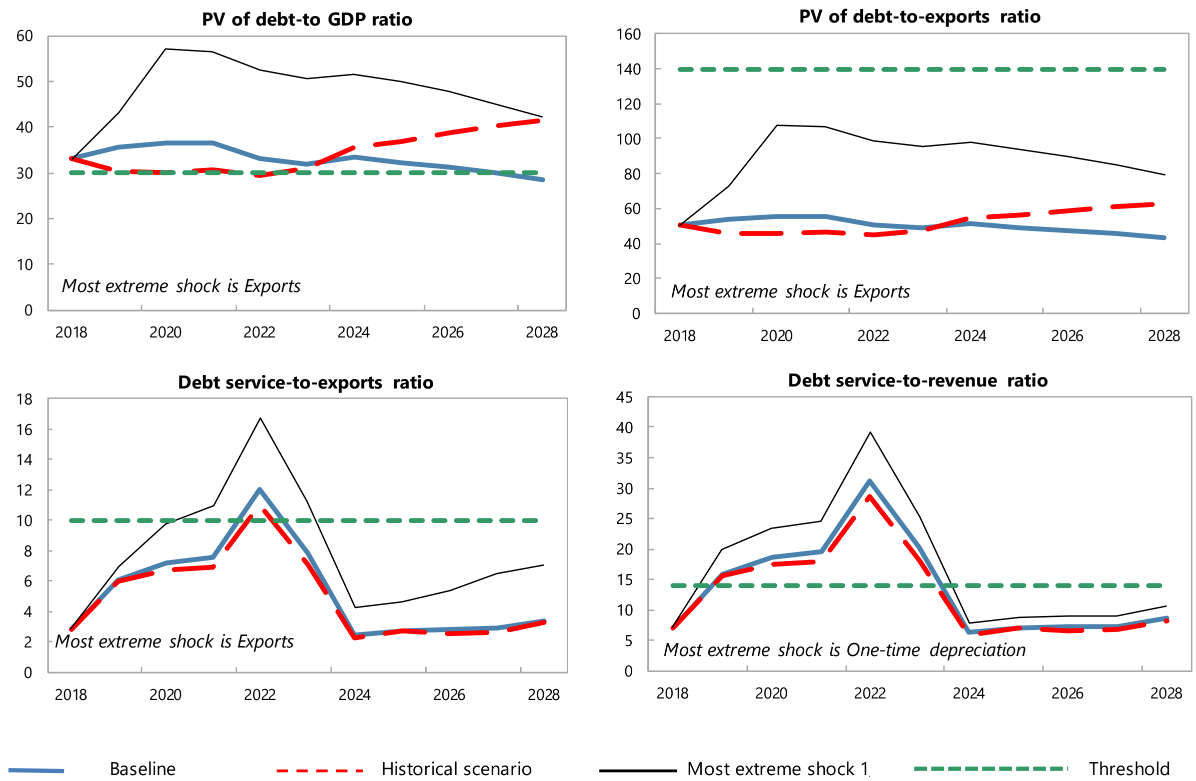
Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.
1/ Coverage of debt: The central government plus social security, central bank, government-guaranteed debt. Definition of external debt is Currency-based.
2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.
4/ 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 and other debt creating/reducing flows.
5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.
6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Figure 1. Maldives Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2018-2028



Customization of Default Settings	Size	Interactions
Tailored Tests		
Combined CLs	No	
Natural Disasters	No	No
Commodity Prices 2/	n.a.	n.a.
Market Financing	No	No

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	3.0%	3.0%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	20	20
Avg. grace period	6	6

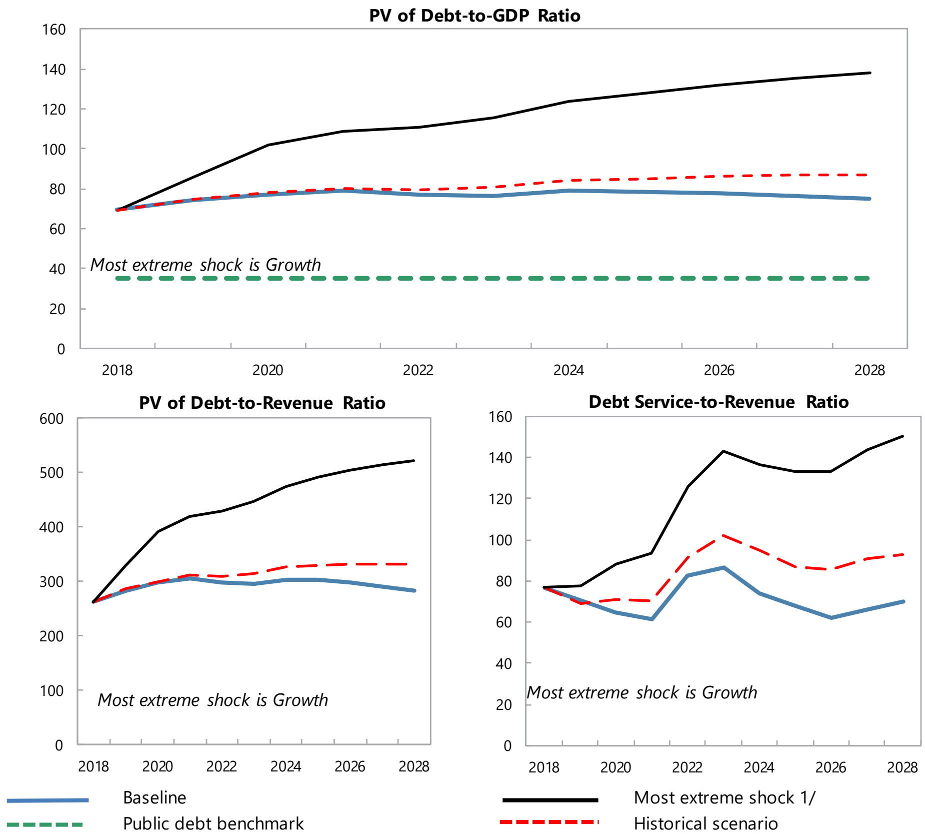
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2028. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Maldives: Indicators of Public Debt Under Alternatives Scenarios, 2018-2028



Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	23%	23%
Domestic medium and long-term	43%	43%
Domestic short-term	35%	35%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	3.0%	3.0%
Avg. maturity (incl. grace period)	20	20
Avg. grace period	6	6
Domestic MLT debt		
Avg. real interest rate on new borrowing	3.8%	3.8%
Avg. maturity (incl. grace period)	5	5
Avg. grace period	3	3
Domestic short-term debt		
Avg. real interest rate	3%	3.0%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in or before 2028. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Table 3. Maldives: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2018-2028

(In percent)

	Projections 1/										
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
PV of debt-to GDP ratio											
Baseline	**33**	**35**	**36**	**36**	**33**	**32**	**33**	**32**	**31**	30	28
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2038 2/	**33**	**30**	**30**	**31**	29	**31**	**36**	**37**	**39**	**40**	**42**
B. Bound Tests											
B1. Real GDP growth	**33**	**39**	**44**	**44**	**40**	**38**	**40**	**39**	**37**	**36**	**34**
B2. Primary balance	**33**	**40**	**46**	**48**	**46**	**47**	**50**	**50**	**49**	**49**	**48**
B3. Exports	**33**	**43**	**57**	**56**	**52**	**50**	**52**	**50**	**48**	**45**	**42**
B4. Other flows 3/	**33**	**39**	**44**	**44**	**40**	**39**	**40**	**39**	**37**	**35**	**33**
B5. One-time 30 percent nominal depreciation	**33**	**45**	**45**	**45**	**41**	**39**	**41**	**40**	**38**	**37**	**35**
B6. Combination of B1-B5	**33**	**46**	**50**	**51**	**47**	**45**	**47**	**46**	**44**	**42**	**40**
C. Tailored Tests											
C1. Combined contingent liabilities	**33**	**37**	**40**	**41**	**40**	**40**	**43**	**43**	**43**	**43**	**43**
C2. Natural disaster	**33**	**39**	**41**	**43**	**41**	**42**	**45**	**46**	**46**	**46**	**46**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**33**	**40**	**42**	**42**	**39**	**37**	**38**	**36**	**34**	**33**	**31**
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	50	54	55	55	50	49	51	49	47	45	43
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2038 2/	50	46	46	47	45	47	54	56	58	61	63
B. Bound Tests											
B1. Real GDP growth	50	54	55	55	50	49	51	49	47	45	43
B2. Primary balance	50	61	70	73	70	71	75	75	75	74	73
B3. Exports	50	73	108	107	99	96	98	94	90	85	79
B4. Other flows 3/	50	60	67	67	61	59	61	59	56	54	50
B5. One-time 30 percent nominal depreciation	50	54	54	54	49	48	50	48	46	45	42
B6. Combination of B1-B5	50	68	66	77	71	69	71	69	66	63	60
C. Tailored Tests											
C1. Combined contingent liabilities	50	57	61	63	61	62	66	66	66	65	65
C2. Natural disaster	50	60	64	66	64	66	71	71	71	71	70
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	50	55	57	58	53	51	52	49	47	45	42
Threshold	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	3	6	7	8	**12**	8	2	3	3	3	3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2038 2/	3	6	7	7	**11**	7	2	3	3	3	3
B. Bound Tests											
B1. Real GDP growth	3	6	7	8	**12**	8	2	3	3	3	3
B2. Primary balance	3	6	7	8	**13**	9	3	4	4	4	5
B3. Exports	3	7	10	**11**	**17**	**11**	4	5	5	7	7
B4. Other flows 3/	3	6	7	8	**12**	8	3	3	3	4	4
B5. One-time 30 percent nominal depreciation	3	6	7	8	**12**	8	2	3	3	3	3
B6. Combination of B1-B5	3	7	9	10	**15**	10	4	4	5	5	5
C. Tailored Tests											
C1. Combined contingent liabilities	3	6	7	8	**12**	8	3	3	3	3	4
C2. Natural disaster	3	6	8	8	**13**	8	3	3	4	4	4
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	3	6	7	8	**13**	**11**	8	7	5	3	3
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	7	**16**	**19**	**20**	**31**	**20**	6	7	7	7	9
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2038 2/	7	**16**	**17**	**18**	**29**	**18**	6	7	7	7	8
B. Bound Tests											
B1. Real GDP growth	7	**17**	**22**	**23**	**37**	**24**	7	8	9	9	10
B2. Primary balance	7	**16**	**19**	**21**	**33**	**22**	8	9	10	11	13
B3. Exports	7	**16**	**20**	**23**	**35**	**23**	9	10	11	13	**14**
B4. Other flows 3/	7	**16**	**19**	**21**	**32**	**21**	7	8	9	10	11
B5. One-time 30 percent nominal depreciation	7	**20**	**23**	**25**	**39**	**25**	8	9	9	9	11
B6. Combination of B1-B5	7	**17**	**23**	**25**	**39**	**26**	9	10	12	12	13
C. Tailored Tests											
C1. Combined contingent liabilities	7	**16**	**19**	**20**	**32**	**21**	7	8	9	9	10
C2. Natural disaster	7	**16**	**19**	**20**	**32**	**21**	8	9	9	9	11
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	7	**16**	**19**	**21**	**33**	**29**	**20**	**18**	13	7	8
Threshold	14	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

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

3/ Includes official and private transfers and FDI.

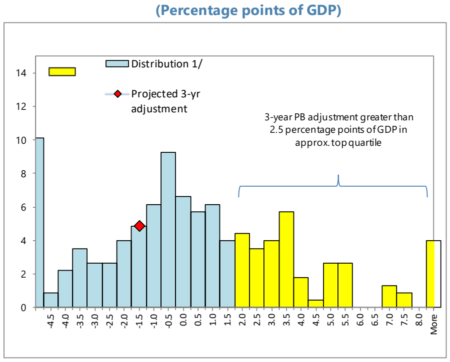
Table 4. Maldives: Sensitivity Analysis for Key Indicators of Public Debt, 2018-2028

	Projections 1/										
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
PV of Debt-to-GDP Ratio											
Baseline	**70**	**74**	**77**	**79**	**77**	**77**	**79**	**78**	**78**	**77**	**75**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2038 2/	**70**	**75**	**78**	**80**	**80**	**81**	**84**	**85**	**86**	**87**	**87**
B. Bound Tests											
B1. Real GDP growth	**70**	**86**	**102**	**109**	**111**	**116**	**123**	**128**	**132**	**136**	**138**
B2. Primary balance	**70**	**83**	**96**	**97**	**95**	**95**	**98**	**98**	**97**	**97**	**95**
B3. Exports	**70**	**81**	**96**	**97**	**94**	**93**	**95**	**94**	**92**	**90**	**87**
B4. Other flows 3/	**70**	**78**	**85**	**86**	**84**	**83**	**85**	**85**	**84**	**82**	**80**
B5. One-time 30 percent nominal depreciation	**70**	**81**	**81**	**81**	**77**	**75**	**76**	**75**	**73**	**72**	**69**
B6. Combination of B1-B5	**70**	**80**	**90**	**93**	**91**	**92**	**96**	**97**	**97**	**97**	**97**
C. Tailored Tests											
C1. Combined contingent liabilities	**70**	**80**	**83**	**85**	**83**	**83**	**86**	**86**	**86**	**86**	**85**
C2. Natural disaster	**70**	**85**	**88**	**90**	**88**	**88**	**92**	**92**	**92**	**92**	**91**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**70**	**74**	**78**	**80**	**78**	**78**	**80**	**78**	**77**	**76**	**74**
Public debt benchmark	35	35	35	35	35	35	35	35	35	35	35
PV of Debt-to-Revenue Ratio											
Baseline	262	284	297	305	298	296	304	302	297	291	284
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2038 2/	262	287	300	311	309	314	326	329	331	332	331
B. Bound Tests											
B1. Real GDP growth	262	329	391	419	428	446	474	491	504	514	522
B2. Primary balance	262	320	368	376	369	368	377	376	373	367	360
B3. Exports	262	310	368	374	364	360	366	362	354	342	329
B4. Other flows 3/	262	299	326	333	325	323	329	326	320	312	302
B5. One-time 30 percent nominal depreciation	262	313	314	314	299	292	294	289	282	272	262
B6. Combination of B1-B5	262	306	347	359	354	357	370	373	372	370	366
C. Tailored Tests											
C1. Combined contingent liabilities	262	308	320	328	321	322	332	332	330	326	321
C2. Natural disaster	262	324	337	347	341	342	353	354	353	350	345
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	262	286	300	311	304	302	307	302	296	289	281
Debt Service-to-Revenue Ratio											
Baseline	77	71	65	61	83	86	74	68	62	66	70
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2038 2/	77	69	71	70	92	102	95	87	85	91	93
B. Bound Tests											
B1. Real GDP growth	77	78	88	93	126	143	137	133	133	144	151
B2. Primary balance	77	71	83	88	106	120	116	108	101	105	109
B3. Exports	77	71	66	64	85	89	76	70	66	71	75
B4. Other flows 3/	77	71	65	62	84	87	75	69	64	68	72
B5. One-time 30 percent nominal depreciation	77	69	71	72	100	108	92	84	81	88	90
B6. Combination of B1-B5	77	70	73	82	105	116	108	103	100	105	108
C. Tailored Tests											
C1. Combined contingent liabilities	77	71	81	75	99	114	107	96	91	97	101
C2. Natural disaster	77	72	87	79	102	120	113	102	96	103	107
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	77	71	66	62	85	95	87	79	67	66	70

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

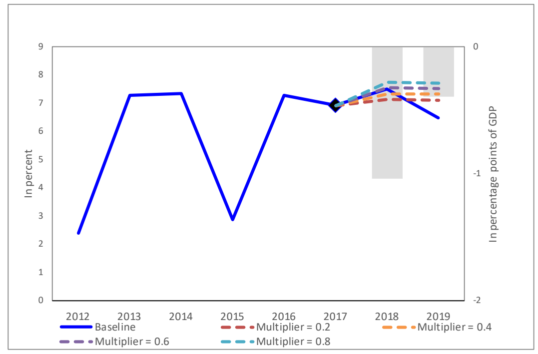
Figure 3. Maldives: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



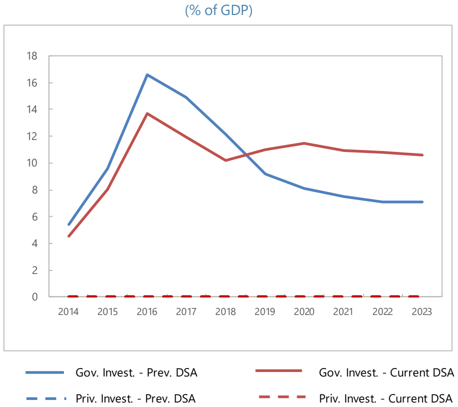
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(% of GDP)



Contribution to Real GDP growth
(percent, 5-year average)

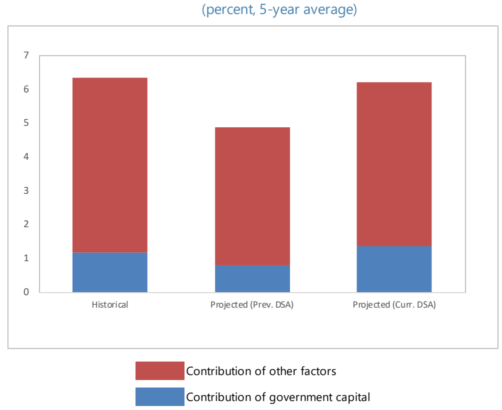
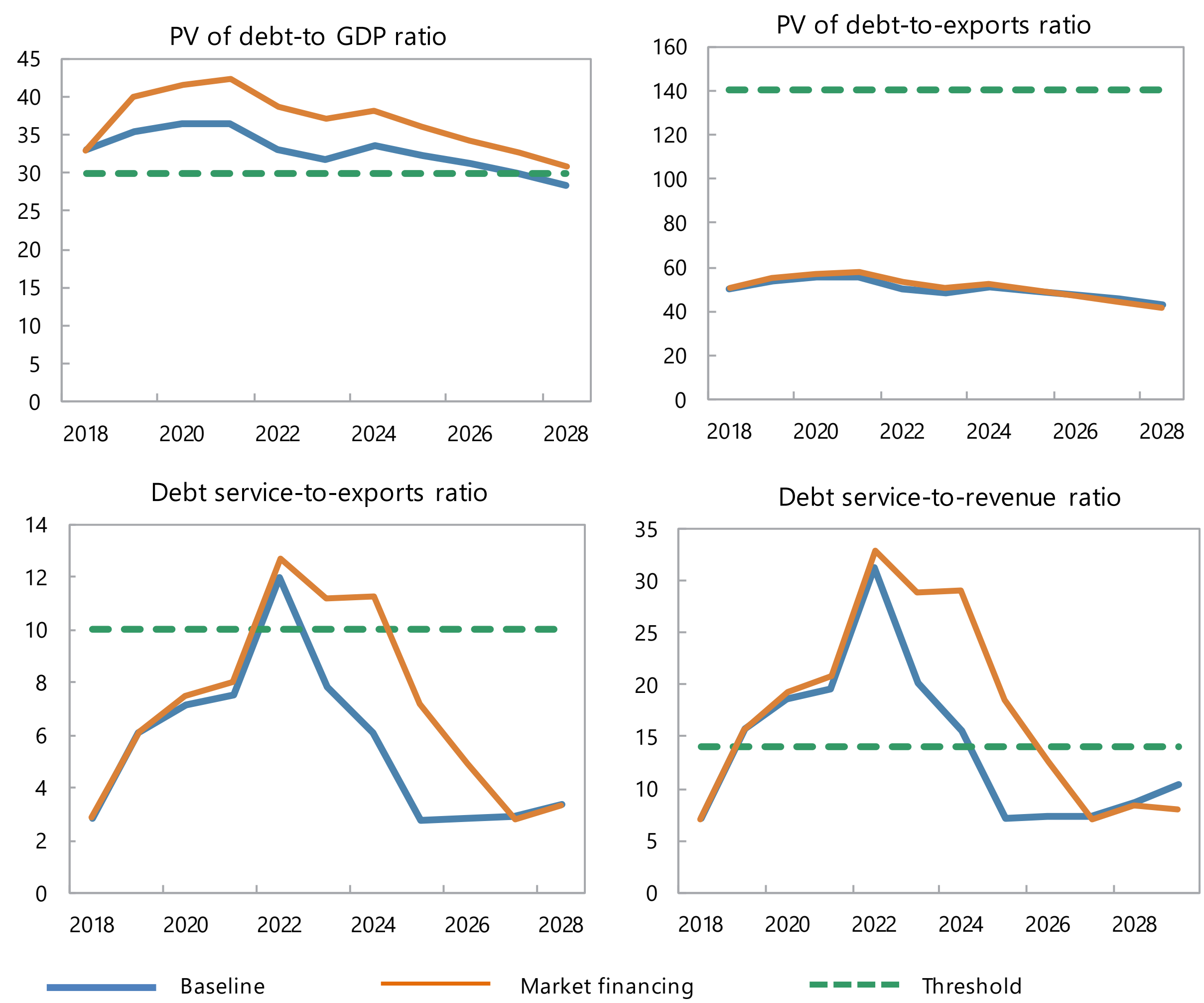


Figure 4. Maldives: Market-Financing Risk Indicators

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	21	350
Breach of benchmark	Yes	No
Potential heightened liquidity needs	Moderate	

1/ Maximum gross financing needs (GFN) over 3-year baseline projection horizon.
2/ EMBI spreads correspond to the latest available data.



Sources: Country authorities; and staff estimates and projections.

Statement by Sami Geadah, Alternate Executive Director for Maldives; and Maya Choueiri, Senior Advisor to Executive Director
May 29, 2019

Background

1. Maldives has a population of around 436 thousand people, widely-dispersed across about 190 distant islands. The economy has undergone a remarkable transformation over the past three decades, largely due to the development of a dynamic high-end tourism sector, reflected in robust growth and considerable development of the country's infrastructure and connectivity. Real GDP growth over 2011-17 averaged 6.1 percent per annum. It was about 7.5 percent in 2018, reflecting robust growth in tourism, wholesale, retail, and construction supported by new resort development, infrastructure, and housing projects. Growth is projected to remain strong in 2019.

2. Climate change, high on the government's agenda, is an existential threat to the Maldives as over 80 percent of the land is less than one meter above sea level and is accordingly under threat from rising sea levels. The additional challenges associated with the country's dispersed geography include difficult service delivery and limited opportunities for job creation and economic diversification. To respond to these challenges, the government initiated a development strategy, focusing notably on the Greater Malé region. The strategy entailed investments in larger islands to improve basic service delivery, protect households from the impact of climate change and natural disasters, and create economic opportunities. The implementation of this strategy translated into construction and infrastructure spending as major drivers for economic growth.

3. The authorities are seeking to strike a balance between much needed investments to close infrastructure gaps—potentially allowing to increase resilience to climate change, boost tourism, and ease constraints in service delivery—and managing the temporary widening of the fiscal and external deficits associated with these investments. The new government is committed to maintaining macroeconomic stability and adjusting policies to manage risks and put public finances on a more sustainable footing. While the Maldives ranks better than peers in poverty and inequality, the authorities are aware that more efforts are needed to ensure inclusive growth. The new government also aims to fight corruption and improve the quality of growth by encouraging greater private sector involvement. The National Development Strategy focuses on decentralization, economic diversification, and integration of tourism with other industries.

External Sector

4. The authorities consider that high current account deficits (CADs) reflect temporary increases in imports associated with large infrastructure projects. Accordingly, they assess external sector risks to be balanced as growing tourism proceeds and the unwinding of large infrastructure projects should reduce the CAD starting this year. The CAD remained high in

2018, reflecting sizeable imports associated with public infrastructure projects and resort investments (10 new resorts opened in 2018 and another 20 resorts are expected to open in 2019).The CAD is projected to decline to 19.5 percent of GDP in 2019, as major infrastructure projects start to unwind, and it is expected to decline to below 10 percent of GDP over the medium term, as estimated by staff.

5. The EBA-lite models used by staff indicate that the current account (CA) norm is estimated at around 9 percent of GDP leading to a CA-gap of 15 percent. The authorities stressed during the mission that the CA-gap would be reduced substantially, if adjusted for the temporary spike in infrastructure spending that is estimated at 8 percent of GDP. They would have appreciated inclusion of this important adjustment in the external sector assessment, as they had requested.

6. Staff estimates that foreign exchange reserves, which increased markedly to 2.4 months of imports at end-January 2019, are below IMF reserve adequacy metrics. The authorities reiterate their view that assessing the adequacy of reserves in terms of import coverage may not be suitable for the Maldives, considering the large capital imports related to infrastructure projects and imports by the tourism sector. In any event, the Maldives Monetary Authority (MMA) is implementing a comprehensive reform plan aimed at building reserves buffers. The plan includes provision of incentives to hold domestic currency, support de-dollarization, strengthen foreign exchange market operations, and enhance the effectiveness of foreign exchange intervention. The MMA is also considering larger and longer-term swap arrangements with the Reserve Bank of India for emergency liquidity assistance.

7. The authorities do not agree with staff's assessment that important external financing challenges exist (¶14). In addition to building reserve buffers to alleviate financing pressures associated with the repayment of outstanding debt from major infrastructure projects, the authorities established in 2017 a Sovereign Development Fund (SDF) to serve as a fiscal reserve for the amortization of sovereign bonds coming due in 2022 and 2023. The SDF is financed mainly by airport development fees and airport service charges. The SDF balances reached US$124 million at end-February 2019, covering 35 percent of the sovereign bonds.

Fiscal Policies and Reforms

8. The authorities fully concur with staff that fiscal consolidation is needed to strengthen fiscal sustainability and increase fiscal buffers. Several expenditure-reduction measures were taken in 2016 and 2017. Social spending was increased in 2018 given the need for inclusive growth policies. The new government is committed to reducing the deficit by boosting revenues and cutting inefficient spending, while actively seeking new sources of financing at favorable terms. Although tax revenues are in line with comparator countries, the authorities intend to introduce a personal income tax in 2020 and to strengthen tax administration. They take note of staff's advice on additional tax reforms. They do not favor increasing the General Sales Tax, as it is regressive and would adversely impact SMEs, which is contrary to the government's policy on

inclusive growth. They are also concerned that an increase in the airport service charge would negatively affect the guesthouse sector, which is important for the economies of non-resort islands. They consider that further fiscal adjustment should focus on addressing spending inefficiencies and leakages in the health care system, reforming subsidies, and enhancing the procurement policies and efficiency of State-Owned Enterprises (SOEs), which are a priority for the new government.

9. Fiscal reforms have continued with the establishment of a Tax Policy Unit at the Ministry of Finance aimed at strengthening capacity in analyzing and designing tax policies. Public financial management (PFM) measures have also progressed. In addition to budget preparation and better commitment control and cash management, the authorities improved the budget process by reducing expenditure reallocations. Important progress was also made in implementing the IMF 2016 Public Investment Management Assessment recommendations, which will also help reduce vulnerabilities to corruption. Other public sector reforms include the Civil Services Commission's completion of human resources audits of line ministries. The reform aims 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.

10. The authorities recognize the risk that high public debt poses. The new administration is closely scrutinizing government guarantees and has been regularly auditing and publishing data on government guarantees on the Ministry of Finance's website. Recently the government expanded the coverage of public debt to include guaranteed debt. The authorities emphasize the role of the SDF in mitigating financing risks over the medium term and intend to continue building up funds for repaying debt.

Monetary and Financial Sector Policies

11. The MMA is grateful for the IMF's technical assistance in support of its comprehensive reform plan and it stresses the need for continued support of its efforts to modernize the monetary policy and the foreign exchange operations frameworks.

12. The MMA assesses the monetary policy stance as appropriate and does not see the need for monetary policy tightening in the absence of inflation and foreign exchange market pressures. The parallel market premium had indeed declined steadily in light of MMA decisions in 2016 and 2017 to increase foreign exchange sales. In the event of exchange market or inflation pressures, the MMA stands ready to activate alternative monetary instruments based on open market operations, if needed.

13. The authorities consider that current credit growth is well-paced. While private credit has grown above nominal GDP last year, it reflected financial deepening, with lending mainly geared to productive investment and no sign of sector-specific credit booms, as acknowledged by staff. Moreover, financial stability risks are low, given by banks' high capitalization, reserves

exceeding the minimum reserve requirements, high profitability, declining nonperforming loans, and nearly total provisioning for specific loan losses. In addition, currency risk is limited, as banks extend foreign currency loans primarily to borrowers with income in foreign currency.

14. The MMA has continued to take measures aimed at strengthening financial stability and inclusion. It is improving reporting standards, drafting new liquidity regulations, improving on-site and off-site supervision, and increasing its operational capacity. The credit guarantee scheme is under review to mitigate risks and improve its effectiveness. The collection and dissemination of credit information are satisfactory and credit reports are widely used by institutions. The MMA also noted that the payment system development project will also facilitate financial inclusion. With regards to financial sector oversight, initiatives are also being taken to strengthen corporate governance requirements and risk management practices. To better combat financial crimes, the MMA continues to strengthen its AML/CFT capacity, including by improving the legal framework and increasing resources for the independent Financial Intelligence Unit.

15. The authorities welcome the opportunity to have an open and candid exchange of views with staff on their current policies. However, they regret the high frequency of IMF mission chief turnover, especially given their unique risks, vulnerabilities and operating context. They also highly appreciate the IMF's valuable technical assistance and the support provided by the Resident Representative Office based in Sri Lanka. To ensure deeper knowledge of the Maldivian institutions and stronger engagement with the IMF, the authorities would like to reiterate their call for a Maldivian national to be employed in the Resident Representative Office, and possibly based in Malé. The authorities welcome the IMF's continued focus on issues of relevance to small states.