INTERNATIONAL MONETARY FUND

MALDIVES

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

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Public debt is already very high by international standards and without fiscal adjustment would be on an unsustainable path. The 2015 Budget, included in the baseline, puts in place fiscal measures to reduce the primary deficit but these are not sufficient to stabilize the debt ratio. And there is a risk of expenditure overruns. Maldives public debt problem is largely a domestic one—total public and publicly guaranteed debt is expected to have reached 74.6 percent of GDP in 2014 while public external debt is 27.7 percent of GDP (mainly with multilateral and bilateral creditors). Under the authorities' current policies, public debt continues to rise (104 percent of GDP in 2034) and domestic financing reaches 76 percent of GDP in 2034. A staunch fiscal adjustment effort is needed; otherwise Maldives would face a high risk of overall debt distress driven largely by domestic debt vulnerabilities.[1]

Fiscal policy mistakes and shocks to tourism exports or foreign direct investment are key risks that could trigger debt distress. To place public debt on a firmly downward path, staff proposes an additional focus on expenditure restraint and public financial management reforms which, together with a further rise in Tourism Goods and Services Tax (TGST), would place debt ratios on a sustainable path. Overall Maldives is judged to face a moderate risk of external debt distress, based on an assessment of public external debt, but a heightened overall risk of public debt distress, reflecting the significant and high vulnerabilities related to domestic debt. There are also potential additional risks to external debt if the increase in public debt is financed to a greater extent from external sources than currently assumed.

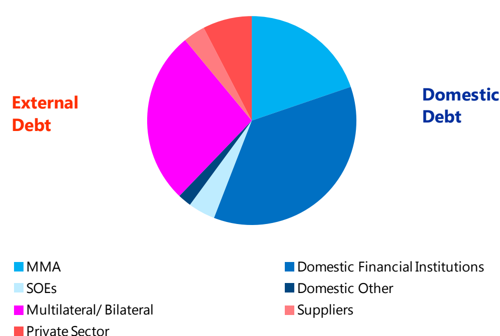
[1] In 2011, Maldives was classified as a medium performer in terms of policies and institutions by the World Bank's Country Policy and Institutional Assessment (CPIA), averaging 3.28 over 2011–13. The indicative thresholds for medium performers are 40 percent for the PV of the debt to GDP ratio, 150 percent for the debt to exports ratio, 250 percent for the PV of the debt to revenue ratio, 20 percent for the debt service to exports ratio and 20 percent for the debt service to revenue ratio. Thresholds are applicable to public and publicly guaranteed (PPG) external debt (not to total PPG debt).Previously Maldives was rated as a high risk of external debt distress, the change in risk rating reflects net repayments of private external debt since the previous assessment and a much lower private external debt stock.

RECENT DEBT DEVELOPMENTS

Total public debt has risen rapidly since the 2004 tsunami from around 36 percent of GDP in 2004 to 74.6 percent of GDP in 2014, excluding domestic arrears, above the 60 percent limit in the Fiscal Responsibility Law (Figure 2 and Table 3).[1,2] The increase initially reflected additional expenditure needs in the aftermath of the tsunami but more recently additional recurrent spending on wages, social welfare, and subsidies. Under the baseline scenario, public debt would remain on a rising path over the medium term.

Public debt is held mainly by domestic banks, the Maldives Monetary Authority (MMA) and official multilateral and bilateral creditors (text figure)**.**

The economy has relied heavily on the issuance of treasury bills and monetization as well as external borrowing to finance deficits. There has also been a buildup in domestic arrears which are estimated at 6.3 percent of GDP in 2013. The DSA baseline assumes the authorities clear these arrears going forward over a period of five years.



The stock of external debt is substantially lower than previously projected but has been on a rising trajectory. Between 2011 and 2013, net repayments of external public and publicly guaranteed external debt and revised data for the private external debt have reduced the estimated level of external debt in 2013 from 98 percent of GDP projected in the 2013 debt sustainability analysis to 32 percent of GDP; PPG external debt is now estimated at 27.6 percent in 2013 down from 44 percent of GDP in the 2013 DSA. Private external debt is now estimated to be just 5 percent of GDP in 2013 substantially lower than the projection of 53 percent in the previous DSA—this reflects revisions to the external accounts which have also reduced the scale of the current account deficit and lower net flows than projected in the past two years. However, these data are still estimates and remain uncertain. With an open capital account and little reporting private sector external debt data are subject to large errors and there are likely to be further revisions to debt estimates.

Taken together private external debt and total public debt are estimated at about $ 1.8 bn (67 percent of GDP) in 2013.

[1]Public debt is defined as the net debt of the non-financial public sector comprising central government, State Owned Enterprises, publicly guaranteed debt and net of government deposits. It does not include domestic arrears.

[2] Since the 2013 Article IV Staff Report nominal GDP has been revised upwards. The authorities have adopted market price GDP as their aggregate (instead of gross value added at basic prices). The revision raises the level of nominal GDP by 13 percent in 2013.

MACROECONOMIC ASSUMPTIONS

The macroeconomic assumptions underlying this DSA have been updated based on developments in 2013 and 2014. At the time of the IMF's 2013 Article IV consultation, official data pointed to very large current account and fiscal deficits. Two years on, the picture is somewhat different: a recovery in tourism is supporting real growth and Maldives is performing well compared to peers; substantial data revisions paint a less worrying picture of the current account (with deficits of 10.6 percent of GDP in 2012 and 6.5 percent of GDP in 2013); external debt estimates are lower; and while the large fiscal deficit has continued to widen following increases in recurrent spending, measures in the 2015 Budget and earlier increases in taxes, including the Tourism Goods and Services Tax (TGST) should help to rein in the deficit. The primary deficit is therefore projected to narrow–but not sufficiently to bring debt ratios down.

Consistent with these developments, the main changes in the macroeconomic assumptions in the 2014 DSA compared to those contained in the IMF's 2013 Article IV Staff Report are: (i) a lower non-interest current account deficit; (ii) a smaller but still sizeable primary deficit; (iii) a lower starting point for external debt; and (iv) a somewhat stronger growth path (accompanied by slightly higher FDI) reflecting a stronger tourism performance and a somewhat lower probability attached to a twin deficit crisis (which would hit confidence and permanently damage growth prospects).

The baseline scenario is built on current policies, including the Authorities 2015 Budget measures. This includes the green tax on tourism (replacing the bednights tax), increases in import duties, better targeting of subsidies, and a public employment freeze. The baseline does not include estimates for revenues from the Special Economic Zones (SEZs). It also does not include any compensation amount from the arbitration ruling over the airport concession.[3]

Debt SustainabilityAnalysis: Macroeconomic Assumptions 2014-2034

IMF 2013 and 2014 Article IV Reports	2013	2014
(Annual percentage change)		
Real growth	4.1	4.5
Inflation	4.6	3.5
(In percent of GDP)		
Current Account (non interest)	25.5	4
FDI	8.4	8.6
Primary Deficit	8.9	2.4

Key assumptions: Overall, the baseline macroeconomic assumptions are a little stronger than the previous DSA.[4] The baseline macro scenario includes significant fiscal adjustment but the primary balance does not improve sufficiently to prevent a rising debt profile.

- *Real GDP growth.* Fiscal adjustment has a mild negative effect on growth in the short run, slowing to 4–4¼ percent in 2016–17 and averages 4.5 percent over 2020–34 a slower pace than the average of the past ten years (around 6.5 percent) which included the initial rapid

[3] In 2012 the authorities cancelled the airport concession contract with GMR and Malaysia Airports Berhad to upgrade and operate Malé airport. Arbitration ruled in favor of GMR. Maldives Airport Company Limited (MACL) paid $4mn in immediate costs. Agreement on a final settlement has yet to be reached.

[4] The baseline scenario in the DSA assumes that the stabilized exchange rate regime holds.

development of the tourism sector; estimates of potential output growth (are around 5 percent).[5] The tourism sector initially continues to experience a recovery driven by expansion from new markets (especially China) and a gradual pick up in core markets. New resorts are likely to be developed and the development of the airport could substantially add to capacity, sustaining growth into the medium term.[6]

- *Inflation.* GDP deflator inflation remains low over the next two years reflecting lower oil prices and generally weaker global commodity prices partly offset by higher import duties and then rises to around 3.5 percent—close to its long run average.

- *The current account.* Substantial data revisions have reduced current account deficit compared to the previous DSA.[7] The non interest current account deficit narrows in 2015 to 3.7 percent of GDP with lower oil prices and narrows a little to 3.4 percent of GDP in 2019 with improving tourist receipts and some restraint on import demand from the authorities' planned fiscal adjustment. Thereafter the current account deficit widens a little. Reserves levels strengthen by 2019.

- *The fiscal deficit.* The primary deficit (under the baseline), improves by 3.7 percentage points in 2015 significantly boosted by the temporary impact of bringing forward the timing of extension of resort licenses; and in 2016 revenues strengthen with the full year effect of higher import duties and the imposition of the green tax. Further consolidation is expected thereafter from gradual expenditure restraint, lowering the primary deficit to around 2.4 percent of GDP. But this is less than the stabilizing primary deficit (0.8 percent of GDP) and public debt ratios still continue to drift upwards—reaching 104 percent of GDP in 2034.

- *Financing.* In the recent past, the bulk of the deficit financing has been met from domestic sources, in particular through the domestic banking system and the pension fund. Interest rates had risen sharply in the primary market for T-bills in 2012 and 2013. But, from mid 2014 the government has replaced the auction system with a 'tap system' (of fixed interest rates) which lowered interest costs by about 200bp on average across maturities. This temporarily stabilized interest cost on domestic debt. And thus far demand for T-bills has been sustained by the banking sector, against a backdrop of weak lending conditions (with banks reluctant to lend to sectors where NPLs built up during the crisis). However if debt rises, lower yields may not be sustained and with global interest rates expected to rise, Maldives yields are assumed to remain high over the forecast period. In the debt sustainability analysis it is

[5] The real growth measure used in this report is gross value added at basic prices.

[6] Around three quarters of activity is directly or indirectly linked to tourism. Maldives is a high end tourist destination with around 60 percent of resorts in the 5 star and plus category, and demand is relatively price and income inelastic. The authorities expect to lease ten new resorts a year. A second runway at the airport will also add to capacity.

[7] Revisions to the balance of payments data are consistent with IMF technical assistance advice. Revisions substantially reduced the current account deficits from around 20 percent of GDP to single digits in 2012 and 2013.

assumed that the bulk of financing is sourced domestically.[8] However, as the debt ratio rises this may not be sustainable—and raising external financing may become difficult.

- Non debt creating financial flows. With limited lending opportunities, Maldives banks have paid down debt and increased assets abroad since the global financial crisis, leading to a steady financial account outflow (of around 4 percent of GDP). These outflows are expected to continue and contribute to the residual in the external DSA.

EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

External debt sustainability. Under the baseline scenario, with a smaller current account deficit to be financed, the present value of external debt falls back a little to 26.7 percent of GDP and the external burden remains comfortably below the thresholds. However, the improvement is in part because it is assumed that the authorities continue to finance public debt predominantly from domestic sources—a shift in financing mix towards greater external borrowing is an upside risk to the external DSA. Furthermore, the external debt path is vulnerable to export shocks, a combined shock to exports, GDP growth, US dollar GDP deflator and non-debt creating flows, and a scenario where data reverts to historical averages (of a larger current account deficit and slightly weaker growth). In the historical averages scenario two thresholds would be breached, and a third rises close to the threshold.

Public debt sustainability. Public debt is already at a very high level and, even if the measures in the 2015 Budget are effectively implemented, debt ratios continue to rise and are in breach of the benchmark. Under the baseline, the PV of public debt rises from 70 percent of GDP in 2014 to 99 percent of GDP in 2034. Domestic debt is also highly vulnerable to shocks to the primary balance and to growth (and there are downside risks to non tourism activity for example if domestic arrears continue to build). Shocks to public debt or fiscal slippage or a lower growth trajectory than expected easily push debt onto an unsustainable path.

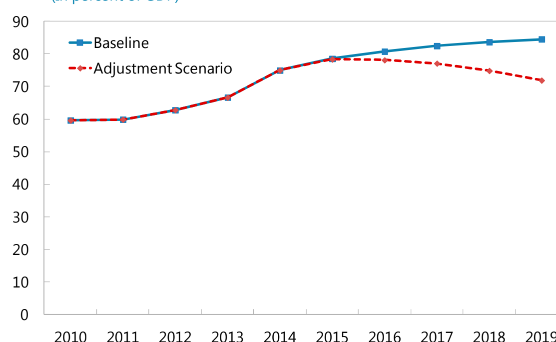
ASSESSMENT

Current policies still lead to rising public debt levels and further adjustment is needed to build buffers and reduce the risk of public debt distress. The DSA therefore points to the need for additional fiscal consolidation measures in the near term.

[8] In Maldives while such large domestic financing may have a small effect crowding out domestic activity, it is unlikely to affect tourism (which accounts for around three-quarters of activity in Maldives directly and indirectly), since the resorts typically obtain their financing from abroad. The impact on growth is not as adverse as for other economies.

IMF staff's view is that further fiscal measures are needed to firmly place debt on a downward path and this should entail better expenditure control and public financial management reforms. Staff would recommend a further fiscal adjustment effort of around 3 percent of GDP over five years. This could be accomplished through greater expenditure restraint, focusing on control of the wage bill, containing rising healthcare costs, and finding savings on transport and communications. A further rise in the TGST rate from 12 to 15 percent would also help to underpin revenues. Such an adjustment path would help to stabilize debt by 2016 and then begin to bring the debt ratio down (see text figure).

Public Debt: Baseline vs. Adjustment Scenarios, 2010–2019
(In percent of GDP)



Sources: Maldives authorities; and IMF staff estimates.

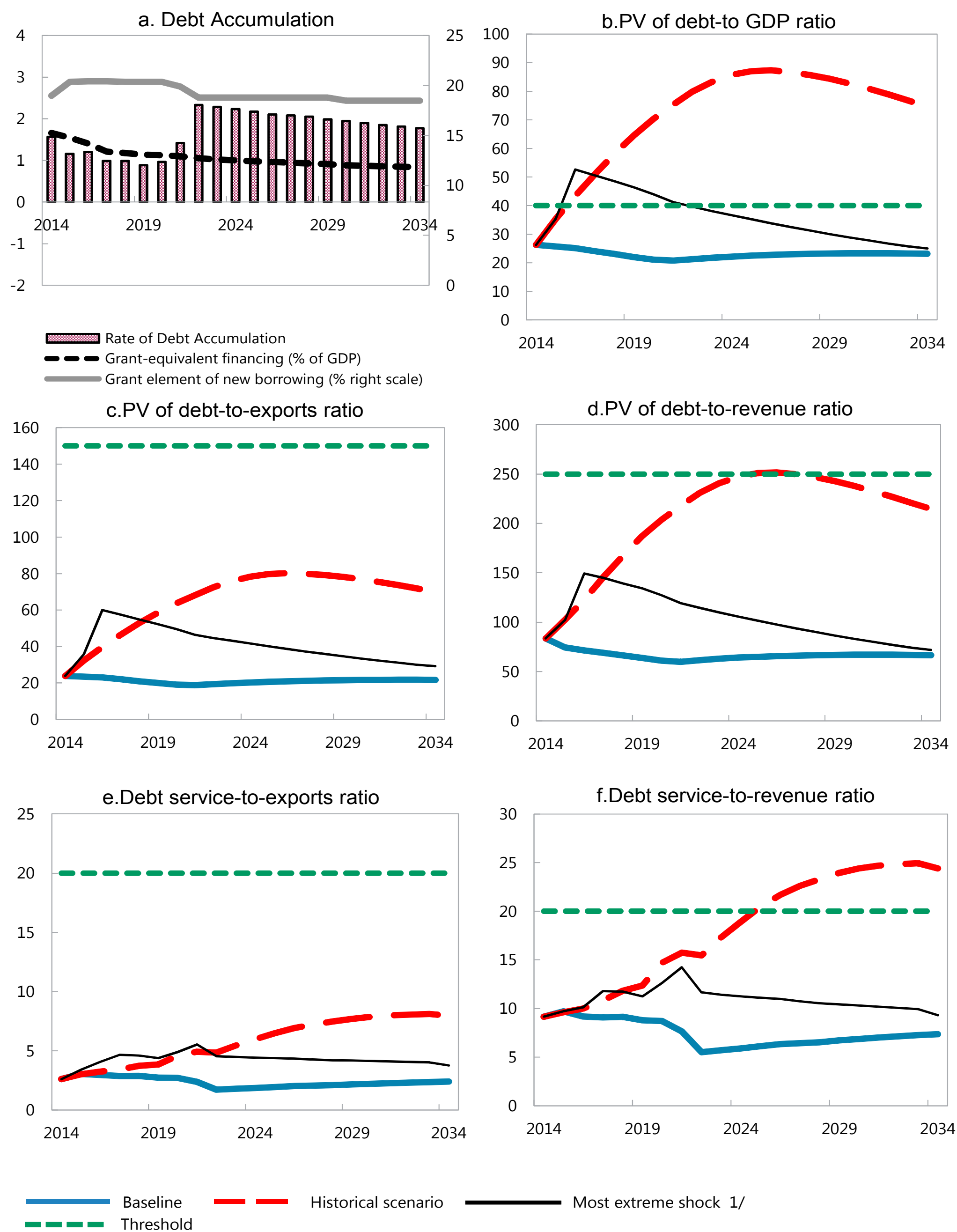
Even with a sustained fiscal consolidation effort, Maldives has a high level of public debt and would remain vulnerable for a number of years. A deterioration of public finances, or external shocks to tourism earnings and foreign direct investment, or a dent to confidence against a backdrop of rising fiscal pressure are all important risks.

External risk rating. Overall, Maldives is judged to face a moderate risk of external debt distress, based on an assessment of public external debt, but a heightened overall risk of debt distress, reflecting the significant and high vulnerabilities related to domestic debt. In addition, as public debt rises there is a risk that domestic financing sources become sated and financing has to be sought from external sources, thus worsening the external debt outlook. The lowering of the risk rating from high to moderate largely reflects data revisions and the much lower private external debt stock in the current DSA compared to projections of the previous DSA—there were significant net repayments of private external debt during 2011–13.

AUTHORITIES' VIEWS

The authorities were of the view that the measures in the 2015 Budget would deliver bigger savings and larger revenue increases than projected by staff (especially related to revenues from the acquisition of SEZs and resort licenses). They expected the public employment freeze would generate substantial savings on the wage bill. They expected these to be sufficient to bring debt ratios down without the need for further revenue raising or other measures. Nonetheless, they concurred with the external risk rating, though they judged the risks from the shock scenarios to be lower than assessed by staff.

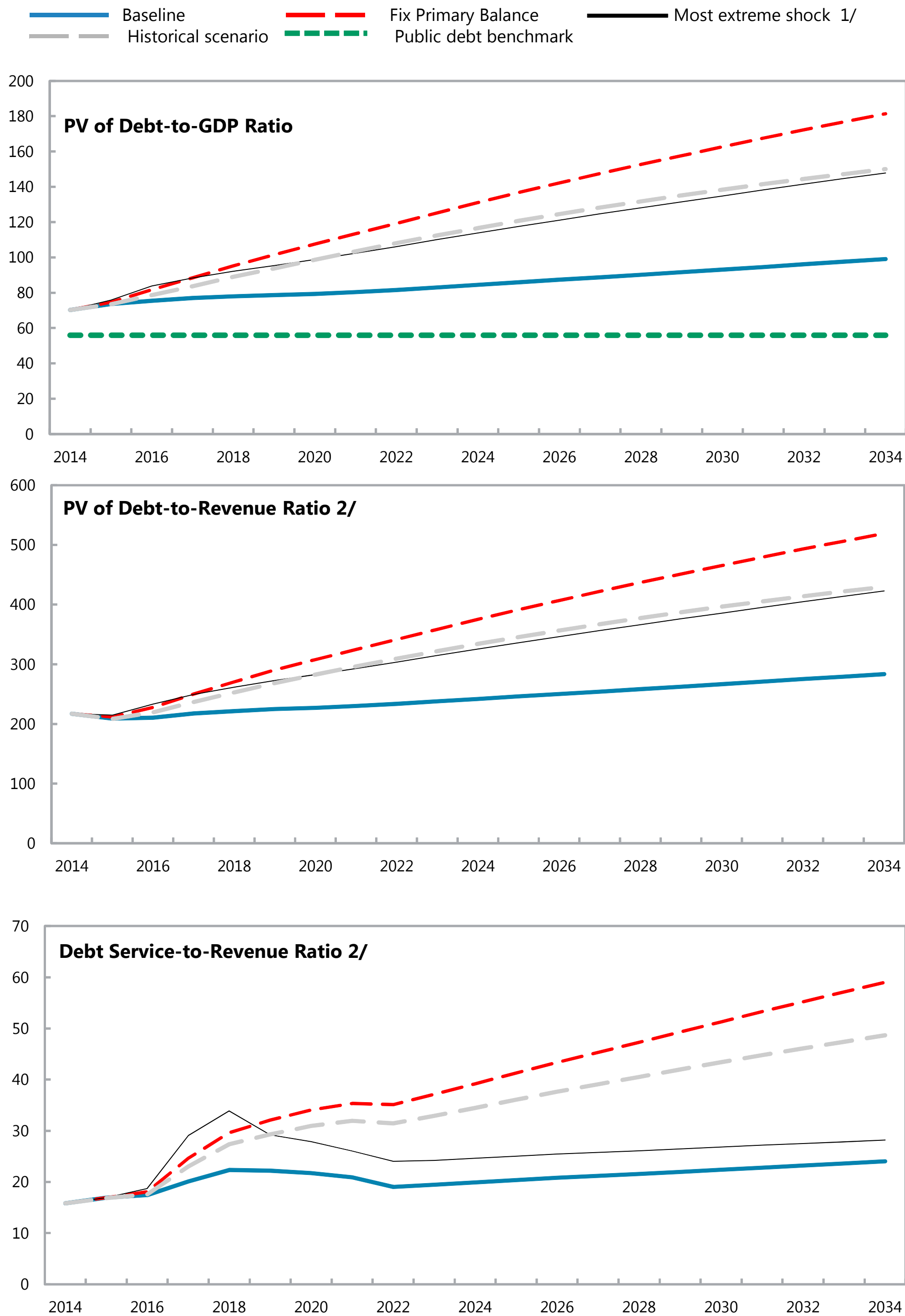
Figure 1. Maldives Baseline Scenario: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios , 2014–2034 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b. it corresponds to a Exports shock; in c. to a Exports shock; in d. to a Exports shock; in e. to a Exports shock and in figure f. to a Exports shock

Figure 2. Maldives Baseline Scenario: Indicators of Public Debt Under Alternative Scenarios, 2014–2034 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2024.
2/ Revenues are defined inclusive of grants.

Table 1. Maldives: External Debt Sustainability Framework, Baseline Scenario, 2011–34 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-2019 Average	2024	2034	2020-2034 Average
External debt (nominal) 1/	**42.6**	**34.3**	**32.2**			**34.3**	**33.8**	**33.6**	**32.8**	**32.0**	**31.0**		**31.2**	**32.0**	
of which: public and publicly guaranteed (PPG)	29.6	28.5	27.6			27.7	27.6	27.5	26.9	26.4	25.7		26.9	28.5	
Change in external debt	-2.7	-8.3	-2.2			2.1	-0.5	-0.2	-0.8	-0.8	-1.0		0.3	-0.1	
Identified net debt-creating flows	0.0	-1.8	-8.9			-6.4	-10.3	-8.8	-9.0	-8.8	-8.2		-6.0	-3.0	
Non-interest current account deficit	**16.8**	**9.7**	**5.9**	**14.0**	**7.3**	**7.4**	**3.7**	**4.8**	**4.2**	**3.8**	**3.4**		**3.6**	**5.0**	4.0
Deficit in balance of goods and services	-5.5	-10.6	-17.8			-17.1	-21.7	-19.9	-20.3	-20.8	-21.1		-20.7	-17.8	
Exports	104.4	95.5	105.0			110.1	109.8	109.2	109.6	110.2	110.3		109.5	106.6	
Imports	98.9	84.9	87.3			93.0	88.1	89.2	89.3	89.4	89.1		88.8	88.8	
Net current transfers (negative = inflow)	10.4	10.2	10.6	5.8	7.4	10.9	11.5	11.3	11.3	11.4	11.4		11.5	11.5	11.5
of which: official	-2.0	-0.9	-0.3			-1.4	-1.0	-0.6	-0.5	-0.4	-0.4		-0.3	-0.1	
Other current account flows (negative = net inflow)	11.9	10.1	13.0			13.6	13.9	13.5	13.2	13.2	13.1		12.7	11.4	
Net FDI (negative = inflow)	**-18.2**	**-9.0**	**-13.4**	**-8.7**	**4.3**	**-13.3**	**-13.7**	**-13.8**	**-13.3**	**-12.6**	**-11.6**		**-9.3**	**-7.8**	-8.6
Endogenous debt dynamics 2/	**1.4**	**-2.5**	**-1.4**			**-0.5**	**-0.2**	**0.1**	**0.1**	**0.0**	**0.0**		**-0.3**	**-0.3**	
Contribution from nominal interest rate	1.3	0.9	0.7			1.1	1.4	1.4	1.4	1.4	1.3		1.0	1.0	
Contribution from real GDP growth	-2.9	-0.5	-1.5			-1.5	-1.6	-1.2	-1.3	-1.3	-1.4		-1.3	-1.3	
Contribution from price and exchange rate changes	2.9	-2.9	-0.6			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-2.7**	**-6.5**	**6.8**			**8.5**	**9.8**	**8.6**	**8.2**	**7.9**	**7.3**		**6.3**	**3.0**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	30.8			32.9	32.0	31.3	30.0	28.7	27.4		26.5	26.7	
In percent of exports	...	...	29.4			29.9	29.1	28.6	27.4	26.1	24.8		24.2	25.0	
PV of PPG external debt	**...**	**...**	**26.2**			**26.3**	**25.7**	**25.2**	**24.1**	**23.1**	**22.0**		**22.2**	**23.1**	
In percent of exports	**...**	**...**	**25.0**			**23.9**	**23.4**	**23.1**	**22.0**	**20.9**	**19.9**		**20.3**	**21.7**	
In percent of government revenues	**...**	**...**	**92.6**			**83.6**	**74.5**	**71.3**	**69.0**	**66.3**	**63.7**		**64.1**	**66.5**	
Debt service-to-exports ratio (in percent)	**8.9**	**8.7**	**7.2**			**6.2**	**7.2**	**6.7**	**6.5**	**5.7**	**5.4**		**3.8**	**3.7**	
PPG debt service-to-exports ratio (in percent)	**3.1**	**3.1**	**2.8**			**2.6**	**3.1**	**3.0**	**2.9**	**2.9**	**2.7**		**1.9**	**2.4**	
PPG debt service-to-revenue ratio (in percent)	**12.7**	**11.8**	**10.5**			**9.2**	**9.7**	**9.2**	**9.1**	**9.1**	**8.8**		**5.9**	**7.4**	
Total gross financing need (Millions of U.S. dollars)	337.5	334.2	52.7			65.8	-3.0	9.9	-3.9	-29.1	-29.6		-17.0	298.3	
Non-interest current account deficit that stabilizes debt ratio	19.5	18.0	8.0			5.3	4.1	5.0	5.1	4.6	4.3		3.2	5.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.5	1.3	4.7	6.2	8.3	5.0	5.0	3.9	4.2	4.4	4.6	4.5	4.5	4.4	4.5
GDP deflator in US dollar terms (change in percent)	-6.1	7.2	1.8	3.9	4.8	0.7	1.5	3.0	4.1	4.2	4.1	2.9	3.5	3.5	3.5
Effective interest rate (percent) 5/	3.0	2.4	2.1	3.5	1.7	3.5	4.2	4.4	4.5	4.5	4.5	4.3	3.6	3.4	3.6
Growth of exports of G&S (US dollar terms, in percent)	21.0	-0.6	17.1	8.5	13.1	10.9	6.3	6.4	8.9	9.3	9.1	8.5	7.8	7.8	8.0
Growth of imports of G&S (US dollar terms, in percent)	36.4	-6.7	9.5	8.5	23.4	12.7	0.9	8.5	8.5	8.9	8.6	8.0	8.1	8.1	8.2
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	19.0	20.4	20.4	20.4	20.4	20.4	20.2	18.8	18.5	18.9
Government revenues (excluding grants, in percent of GDP)	25.5	25.1	28.3			31.4	34.6	35.3	34.9	34.8	34.5		34.7	34.8	34.7
Aid flows (in Millions of US dollars) 7/	88.0	51.9	-14.2			26.9	24.8	29.8	26.7	27.4	29.4		29.8	41.3	
of which: Grants	47.5	23.9	7.6			26.9	22.1	19.4	16.3	16.0	17.8		17.8	17.8	
of which: Concessional loans	40.5	28.1	-21.8			0.0	2.7	10.3	10.4	11.4	11.6		12.0	23.5	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.7	1.5	1.4	1.2	1.2	1.1		1.0	0.8	1.0
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			35.2	32.5	30.8	29.3	28.3	29.0		24.4	21.2	23.6
Memorandum items:															
Nominal GDP (Millions of US dollars)	2332	2534	2699			2855	3043	3258	3534	3843	4188		6267	13664	
Nominal dollar GDP growth	0.0	8.7	6.5			5.8	6.6	7.1	8.5	8.7	9.0	7.6	8.1	8.1	8.2
PV of PPG external debt (in Millions of US dollars)			708.2			750.5	783.4	819.9	852.0	886.9	920.8		1392.2	3162.7	
(PVt-PVt-1)/GDPt-1 (in percent)						1.6	1.2	1.2	1.0	1.0	0.9	1.1	2.2	1.8	1.9
Gross workers' remittances (Millions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	26.2			26.3	25.7	25.2	24.1	23.1	22.0		22.2	23.1	
PV of PPG external debt (in percent of exports + remittances)	...	...	25.0			23.9	23.4	23.1	22.0	20.9	19.9		20.3	21.7	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.8			2.6	3.1	3.0	2.9	2.9	2.7		1.9	2.4	

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 (for Maldives bank placements abroad 4 percent of GDP); and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

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

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

6/ Historical averages and standard deviations are generally derived over the 6 years-- the years surrounding the 2004 Tsunami are excluded as it is a one off exceptional event.

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

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

Table 2. Maldives: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34

(In percent)

	Projections							
	2014	2015	2016	2017	2018	2019	**2024**	2034
PV of debt-to GDP ratio								
Baseline	26	26	25	24	23	22	**22**	23
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	26	35	43	51	58	65	**86**	75
A2. New public sector loans on less favorable terms in 2014-2034 2	26	27	27	26	26	26	**29**	35
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	26	27	28	27	26	24	**25**	26
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	26	35	53	51	49	46	**37**	25
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	26	27	28	26	25	24	**24**	25
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	26	31	36	34	33	31	**28**	24
B5. Combination of B1-B4 using one-half standard deviation shocks	26	34	46	45	43	41	**34**	27
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	26	37	36	34	33	31	**32**	33
PV of debt-to-exports ratio								
Baseline	24	23	23	22	21	20	**20**	22
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	24	32	40	47	53	59	**78**	70
A2. New public sector loans on less favorable terms in 2014-2034 2	24	24	25	24	24	23	**27**	33
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	24	23	23	22	21	20	**20**	22
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	24	36	60	57	55	52	**42**	29
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	24	23	23	22	21	20	**20**	22
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	24	28	33	31	30	28	**25**	22
B5. Combination of B1-B4 using one-half standard deviation shocks	24	31	42	41	39	37	**31**	25
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	24	23	23	22	21	20	**20**	22
PV of debt-to-revenue ratio								
Baseline	84	74	71	69	66	64	**64**	67
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	84	102	123	146	167	187	**247**	215
A2. New public sector loans on less favorable terms in 2014-2034 2	84	77	76	76	75	74	**84**	102
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	84	79	79	76	73	71	**71**	74
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	84	102	149	145	139	134	**106**	72
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	84	78	78	76	73	70	**70**	73
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	84	89	101	98	94	90	**80**	69
B5. Combination of B1-B4 using one-half standard deviation shocks	84	98	132	128	123	118	**99**	76
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	84	106	101	98	94	90	**91**	94

Table 2. Maldives: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34 (continued)

(In percent)

				Debt service-to-exports ratio				
Baseline	3	3	3	3	3	3	**2**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	3	3	3	3	4	4	**6**	8
A2. New public sector loans on less favorable terms in 2014-2034 2	3	3	3	3	3	3	**2**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	3	3	3	3	3	3	**2**	2
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	3	3	4	5	5	4	**4**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	3	3	3	3	3	3	**2**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	3	3	3	3	3	3	**3**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	3	3	3	4	4	4	**3**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	3	3	3	3	3	3	**2**	2
				Debt service-to-revenue ratio				
Baseline	9	10	9	9	9	9	**6**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	9	10	10	11	12	12	**19**	24
A2. New public sector loans on less favorable terms in 2014-2034 2	9	10	9	9	9	9	**7**	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	9	10	10	10	10	10	**7**	8
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	9	10	10	12	12	11	**11**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	9	10	10	10	10	10	**6**	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	9	10	10	10	10	10	**8**	8
B5. Combination of B1-B4 using one-half standard deviation shocks	9	10	11	12	12	11	**10**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	9	14	13	13	13	12	**8**	10
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	15	15	15	15	15	15	**15**	15

Sources: Country authorities; and staff estimates and projections.

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

Table 3. Maldives: Public Sector Debt Sustainability Framework, Baseline Scenario, 2011–34

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate					Projections				
	2011	2012	2013	Average 5/	Standard Deviation 5/	2014	2015	2016	2017	2018	2019	2014-19 Average	2024	2034	2020-34 Average
Public sector debt 1/	59.5	61.7	63.0			74.6	75.5	77.9	79.8	81.2	82.1		89.2	104.4	
of which: foreign-currency denominated	31.7	29.8	28.2			30.6	27.6	27.5	26.9	26.4	25.7		26.9	28.5	
			34.9			44.1	47.9	50.4	52.9	54.9	56.5	0.0	62.3	75.9	
Change in public sector debt	0.1	2.2	1.4			11.6	0.9	2.4	1.9	1.4	0.9		1.6	1.5	
Identified debt-creating flows	0.7	3.0	4.0			8.2	3.6	2.3	1.8	1.3	0.9		1.5	1.4	
Primary deficit	4.5	4.8	5.3	7.8	5.1	8.7	4.5	3.2	2.9	2.0	1.9	3.9	2.4	2.4	2.4
Revenue and grants	27.6	26.0	28.6			32.4	35.3	35.9	35.4	35.2	34.9		34.9	34.9	
of which: grants	2.0	0.9	0.3			0.9	0.7	0.6	0.5	0.4	0.4		0.3	0.1	
Primary (noninterest) expenditure	32.1	30.8	33.9			41.0	39.8	39.1	38.3	37.2	36.8		37.3	37.4	
Automatic debt dynamics	-2.8	-1.8	-1.3			-0.5	-0.9	-0.9	-1.1	-0.7	-0.9		-0.9	-1.0	
Contribution from interest rate/growth differential	-5.3	-0.2	-1.2			-0.7	-0.9	-0.6	-0.6	-0.2	-0.4		-0.5	-0.6	
of which: contribution from average real interest rate	-1.7	0.6	1.5			2.4	2.6	2.2	2.6	3.2	3.2		3.2	3.7	
of which: contribution from real GDP growth	-3.6	-0.8	-2.8			-3.0	-3.5	-2.9	-3.2	-3.4	-3.6		-3.8	-4.3	
Contribution from real exchange rate depreciation	2.5	-1.6	-0.1			0.2	0.0	-0.3	-0.5	-0.5	-0.5		...	...	
Other identified debt-creating flows	-1.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-1.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-0.6	-0.8	-2.6			3.4	-2.7	0.1	0.1	0.1	-0.1		0.1	0.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	61.7			70.3	73.6	75.5	77.0	78.0	78.6		84.5	99.0	
of which: foreign-currency denominated	...	...	26.9			26.3	25.7	25.2	24.1	23.1	22.0		22.2	23.1	
of which: external	...	...	26.2			26.3	25.7	25.2	24.1	23.1	22.0		22.2	23.1	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	36.5	37.8	41.5			47.1	51.8	54.2	56.5	58.5	60.0		66.0	79.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	215.6			217.2	208.7	210.5	217.6	221.4	225.1		241.9	283.5	
PV of public sector debt-to-revenue ratio (in percent)	...	...	217.7			223.7	213.1	214.1	220.5	224.1	227.9		243.9	284.6	
of which: external 3/	...	...	92.6			83.6	74.5	71.3	69.0	66.3	63.7		64.1	66.5	
Debt service-to-revenue and grants ratio (in percent) 4/	17.6	20.8	18.0			15.8	16.9	17.5	20.1	22.4	22.2		19.9	24.0	
Debt service-to-revenue ratio (in percent) 4/	19.0	21.6	18.1			16.3	17.3	17.8	20.3	22.6	22.5		20.1	24.1	
Primary deficit that stabilizes the debt-to-GDP ratio	4.5	2.6	3.9			-2.9	3.6	0.8	1.0	0.6	1.0		0.8	0.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.5	1.3	4.7	5.5	5.4	5.0	5.0	3.9	4.2	4.4	4.6	4.5	4.5	4.4	4.5
Average nominal interest rate on forex debt (in percent)	1.3	1.4	1.3	2.0	0.9	2.7	3.8	4.0	4.1	4.2	4.1	3.8	3.1	3.1	3.2
Average nominal interest rate on domestic debt (in percent)	6.8	9.5	7.3	6.8	2.7	6.8	6.3	6.8	8.5	9.6	9.4	7.9	8.7	8.5	8.6
Average real interest rate (in percent)	-3.1	1.0	2.6	0.6	2.5	3.9	3.7	3.1	3.4	4.2	4.1	3.7	3.8	3.8	3.8
Average real interest rate on foreign-currency debt (in percent)	-2.1	-1.6	-1.4	-1.7	0.7	-1.3	-1.4	-1.7	-1.9	-1.9	-1.9	-1.7	-1.9	-1.9	-1.9
Average real interest rate on domestic debt (in percent)	-5.5	2.4	5.2	0.6	5.2	6.0	4.7	3.6	4.2	5.3	5.0	4.8	5.0	4.8	4.9
Real exchange rate depreciation (in percent, + indicates depreciation)	8.8	-5.2	-0.3	-1.5	5.2	0.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	13.0	7.0	2.0	6.3	4.1	0.7	1.5	3.0	4.1	4.2	4.1	2.9	3.5	3.5	3.5
Growth of real primary spending (deflated by GDP deflator, in percent)	0.7	-2.7	15.2	1.9	5.9	27.1	1.8	2.1	2.2	1.3	3.6	6.4	4.5	4.4	4.6
Grant element of new external borrowing (in percent)	...	...	...	...	...	19.0	20.4	20.4	20.4	20.4	20.4	20.2	18.8	18.5	...

Sources: Country authorities; and staff estimates and projections.

1/ Public debt is defined here as the net debt of the non-financial public sector comprising the central government, SOEs, and publicly guaranteed debt. It is net of government deposits (3 percent of GDP). It does not include domestic arrears.

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

3/ Revenues excluding grants.

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

5/ Historical averages and standard deviations are generally derived over the past 6 years-- the years around the 2004 Tsunami are excluded as they are a one off exceptional event.

Table 4. Maldives: Sensitivity Analysis for Key Indicators of Public Debt, Baseline Scenario, 2014–34

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
PV of Debt-to-GDP Ratio								
Baseline	70	74	76	77	78	79	85	99
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	70	74	79	84	89	94	117	150
A2. Primary balance is unchanged from 2014	70	75	82	88	95	101	131	181
A3. Permanently lower GDP growth 1/	70	72	76	79	83	86	113	196
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	70	76	84	88	92	95	114	148
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	70	79	89	91	91	91	95	107
B3. Combination of B1-B2 using one half standard deviation shocks	70	78	87	89	91	92	102	121
B4. One-time 30 percent real depreciation in 2015	70	82	83	84	85	85	90	106
B5. 10 percent of GDP increase in other debt-creating flows in 2015	70	80	82	83	84	84	90	103
PV of Debt-to-Revenue Ratio 2/								
Baseline	217	209	211	218	221	225	242	284
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	217	208	219	237	253	269	334	430
A2. Primary balance is unchanged from 2014	217	212	228	250	271	290	375	519
A3. Permanently lower GDP growth 1/	217	204	211	224	235	247	322	559
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	217	215	233	250	262	273	326	423
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	217	223	249	256	259	261	273	306
B3. Combination of B1-B2 using one half standard deviation shocks	217	220	242	252	258	264	291	347
B4. One-time 30 percent real depreciation in 2015	217	232	232	238	241	243	259	302
B5. 10 percent of GDP increase in other debt-creating flows in 2015	217	227	229	235	239	242	257	295
Debt Service-to-Revenue Ratio 2/								
Baseline	16	17	17	20	22	22	20	24
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	16	17	18	23	27	29	34	49
A2. Primary balance is unchanged from 2014	16	17	18	25	30	32	39	59
A3. Permanently lower GDP growth 1/	16	17	18	21	24	25	30	59
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	16	18	19	24	28	29	31	43
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	16	17	19	29	34	29	25	28
B3. Combination of B1-B2 using one half standard deviation shocks	16	17	19	27	32	29	27	34
B4. One-time 30 percent real depreciation in 2015	16	19	21	25	28	28	26	33
B5. 10 percent of GDP increase in other debt-creating flows in 2015	16	17	19	29	26	26	23	26

Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

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

IMF Executive Board Concludes 2014 Article IV Consultation with Maldives

On February 11, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Maldives.

The Maldives real economy has picked up. Growth is estimated to have reached 5 percent in 2014 with stronger tourism activity driven by a rapid expansion from Asian markets and a tepid recovery from Europe. Staff expects growth to be around 5 percent in 2015. Weaker import prices have pushed down inflation to low levels (1.1 percent in November 2014). Higher tourism exports and subdued global food and fuel inflation have helped reduce the current account deficit to around 8.4 percent of GDP in 2014; and following significant data revisions, the current account is now substantially smaller than previously estimated. Lower oil prices have improved the outlook for the current account and inflation in 2015. Gross official reserves have risen to around $614mn (2.8 months imports). Financial soundness indicators are slowly improving, monetary conditions are loose, but credit growth is subdued at just 0.5 percent year on year to November 2014.

However, persistent and growing fiscal deficits have driven up the public debt ratio to a high level. The fiscal deficit increased to an estimated 7.8 percent of GDP in 2013 and, following increases in recurrent spending, the deficit is likely to have widened further in 2014. Sustained primary deficits have led to an increase in the public debt level from 52 percent in 2009 to 75 percent of GDP in 2014.

The 2015 budget includes a number of important measures to rein in the fiscal deficit through revenue raising measures (imposing a green tax, acquiring fees from Special Economic Zones and raising import duties) and expenditure restraint through a public employment freeze and better targeting of subsidies. However, further fiscal adjustment measures would be needed to place debt ratios firmly on a downward path.

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[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.

Growth is expected to remain relatively strong in the near term, though the fiscal adjustment envisaged in the 2015 Budget will have a mildly negative effect on growth. There is also some upside potential if lower oil prices are sustained. However, with limited policy buffers, the economy is vulnerable to fiscal slippages and inward spillovers. In the event of large fiscal overruns relative to the authorities' targets, borrowing costs and monetization could increase, which would weaken the external position.

Over the medium term, while the tourism sector is expected to remain the locomotive for growth in Maldives, economic diversification to reduce youth unemployment, and improving the efficiency of public service provision remain key issues. The government has several long run strategies: (i) developing regional hubs and improving transport connectivity which could also encourage voluntary resettlement, and would enable higher quality service provision (though such a change will take many years); (ii) developing Special Economic Zones to diversify jobs into off-port shipping services, IT, financial services industries and tourism-support activities such as traditional fisheries and small-scale agriculture; (iii) undertaking infrastructure development, in particular of the airport, to add to capacity; and (iv) reducing the environmental impact of tourism and reliance on oil imports by developing renewable energy.

Executive Board Assessment[2]

Executive Directors welcomed that Maldives has reached middle-income status, with a pickup in the real economy driven by tourism activity, a moderation in inflation, a marked lowering of the fiscal deficit from its peak in 2009 aided by tax measures, and a stronger reserves position. Although Maldives's outlook is favorable, it shares many of the challenges of other small states, and risks remain, particularly in the fiscal sector.

Directors welcomed the authorities' commitment to fiscal consolidation and the plans contained in the 2015 budget, including raising revenues, improving the targeting of subsidies, and a temporary halt in public sector hiring. Nevertheless, they noted that some of these measures will have only a temporary effect, and that further, durable fiscal adjustment, with a focus on expenditure restraint, will be needed to place the public debt-to-GDP ratio on a downward path over the medium term, consistent with the Fiscal Responsibility Law. Improvements in public financial management and addressing domestic arrears need to support the fiscal consolidation efforts.

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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.

Directors welcomed the improvements to the external sector statistics, in line with IMF technical assistance recommendations, which point to significantly smaller current account deficits than previously estimated. They considered the stabilized exchange rate regime as appropriate for Maldives. Directors welcomed the increase in official reserves, and recommended continued strengthening of the official reserves position.

Directors welcomed the authorities' commitment to avoiding the monetization of the fiscal deficit, which will help direct monetary policy at supporting the exchange rate regime and build buffers. They supported plans to make greater use of market-based financing for government debt, including by developing the government securities market. Directors welcomed the improvement in financial soundness indicators, and called for continued efforts to strengthen financial supervision, including measures to ensure uniform high standards for institutions that decide to operate in special economic zones.

Directors agreed that public service delivery and economic diversification are key medium-term objectives. They welcomed the proposals for establishing regional hubs and improving inter-island connectivity. Directors stressed that strict ring-fencing of tax exemptions for special economic zones will be necessary to preserve the tax base. They also emphasized that scaling up infrastructure investment should be implemented efficiently in order to boost growth potential.

Directors welcomed the significant recent improvements in macroeconomic statistics, and encouraged the authorities to continue to strengthen data quality and availability, including adopting a statistics law to enhance data provision, to assist policy decisions.

Table. Maldives: Selected Economic Indicators, 2011–15

Population (in 1,000; 2012 est.)	331				
GDP per capita (in U.S. dollars; 2012 est.):	6,675				
Quota (in million SDRs):	10.0				

	2011	2012	2013	2014	2015
			Est.	Proj.	
Output and prices	(Annual percentage change)				
Real GDP (gross value added at basic prices)	6.5	1.3	4.7	5.0	5.0
Inflation (end-of-period) 1/	16.7	5.4	3.1	1.2	0.4
Inflation (period average) 1/	11.3	10.9	4.0	2.5	0.3
GDP deflator	8.6	6.8	-0.9	0.7	1.5
Central government finances					
Revenue and grants	27.6	26.0	28.6	32.4	35.3
Expenditure and net lending	34.1	33.7	36.5	44.0	43.4
Overall balance	-6.6	-7.6	-7.8	-11.6	-8.1
Overall balance excl. grants	-8.6	-8.6	-8.1	-12.6	-8.8
Primary balance	-4.5	-4.8	-5.3	-8.7	-4.6
Public and publicly guaranteed debt	59.9	62.8	66.7	75.0	78.6
Monetary accounts	(Annual percentage change, unless otherwise indicated)				
Broad money	20.1	6.4	16.8	14.2	6.6
Domestic credit	11.3	-2.4	3.9	5.4	5.0
Balance of payments	(In percent of GDP, unless otherwise indicated)				
Current account	-18.1	-10.6	-6.5	-8.4	-5.0
Of which:					
Exports	14.9	12.4	12.3	12.9	10.3
Imports	-73.6	-62.2	-63.1	-68.0	-62.4
Tourism receipts and nonfactor services, net	64.2	60.4	68.6	72.1	73.8
Income (net)	-13.2	-11.0	-13.7	-14.7	-15.2
Current transfers	-10.4	-10.2	-10.6	-10.9	-11.5
Capital and financial account (including e&o)	17.5	9.4	8.9	17.0	12.2
Overall balance	-0.7	-1.2	2.4	8.6	7.2
Gross international reserves (in millions of US$; e.o.p.) 2/	335	305	368	614	832
In months of GNFS imports	1.7	1.7	1.9	2.8	3.7
Memorandum items:					
GDP (in millions of rufiyaa)	35,931	38,943	41,569	43,971	46,863
GDP (in millions of U.S. dollars)	2,332	2,534	2,699	2,855	3,043

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

1/ CPI-Male definition.

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

Statement by Hazem Beblawi, Executive Director for Maldives and Wafa F. Abdelati, Senior Advisor February 11, 2015

At the outset, we would like to thank staff for their insightful analysis, constructive discussions, and well-written reports. The Maldives' authorities highly value the expert advice of the Fund, much of which they agree with, and the effective technical assistance, which they have consistently implemented. They consider the report to reflect positively on developments in the Maldives and particularly appreciate staff's recognition of the specific structural challenges that Maldives faces due to its small population disbursed among so many different islands. This Article IV discussion comes at a time of large data revisions, which places the country in a much better position compared with the alarming assessment in the last report. The authorities fully appreciate staff's difficult position of working with substantial data revisions. However, it is important to underscore that these data revisions are due only to improvements in compilation and coverage, which are based on the recommendations of technical assistance provided by the Fund. The authorities are grateful for the Fund's continued support in improving macroeconomic statistics as well as other areas of technical assistance.

Background. The Maldivian economy is heavily dependent on fisheries and tourism, which have been the major sources of growth, foreign exchange earnings and government revenues. Maldives' economy grew rapidly in the two decades prior to the December 2004 Tsunami, powered by successful development of its tourism sector. Per capita incomes rose to upper middle income levels and social conditions improved commensurately. However, the country was severely hit by a series of natural disasters and external shocks — the tsunami, the 2007-2008 food and fuel crisis, and the subsequent global financial crisis. As a result, the pace of economic activity has been uneven in the past decade and macroeconomic management has been somewhat complicated by the process of political transition to democracy. A sharp slump in tourist activity in 2009 and then again in 2012 reflected the slowdown in Europe, whose share fell from two thirds to one third of tourist arrivals to the Maldives. The picture is more positive now. The real economy is picking up driven by a recovery in tourism activity[1] due to the expansion of new Asian markets, the fiscal position has improved, inflation is very low, and banking soundness has improved.

Fiscal revenue, which is highly dependent on tourism, declined by about 10 percentage points of GDP between 2007 and 2009, and the public sector wage bill surged following the 2008 elections, which prompted the authorities to seek a Stand-By Arrangement in December 2009. At that time, the central government fiscal deficit was estimated at around 30 percent of GDP and a drastic fiscal consolidation was targeted under the program. In the event, the program was interrupted after the first review, mainly because staff was uncertain that the

[1] More recently, Chinese tourists have continued to grow and now constitute the largest single source country for the Maldives. See "Changing Dynamics in the Maldivian Tourism Industry: Chinese Tourists and Average Length of Stay" by: Azeema Adam and Aishath Zara Nizar, *MMA Research Papers,* Volume 1 Number I, June 2014.

authorities' policies could deliver the envisaged reduction in the fiscal deficit. Nevertheless, the objectives of the 2009 program were largely achieved, particularly with respect to raising sustainable budget revenues, reducing the overall and primary fiscal deficit, and significantly raising international reserves. This experience underscores the authorities' commitment to implement significant reforms, even without a program and while going through political transitions. Moreover—as aptly highlighted in the staff report—the recent balance of payments revisions point to a considerably lower current account deficit than previously believed.

Fiscal Policy. The authorities intend to build on the recent fiscal consolidation. The primary fiscal deficit was reduced from 17 percent of GDP in 2009 to 5½ percent of GDP in 2013 according to staff's estimates (or 2½ percent according to preliminary estimates of the Ministry of Finance), which is a remarkable achievement by any measure. It also far surpasses the episodes of large fiscal consolidation presented by staff in Box 4. This was achieved by introducing a General Sales Tax in 2011 and later broadening its base and raising the rate, a new Business Profits Tax in July 2011, as well as raising duties and some charges. However, the introduction of the universal health program and other social welfare contributions, which were considered a social priority, have since then contributed to rising current spending and crowding out capital expenditures.

The 2015 Budget targets an ambitious further consolidation. Revenue measures include a "green tax" to be levied tourists instead of the bednights tax, raising import duties on some zero rated items, new resorts licenses and land acquisition fees from the Special Economic Zones. Meanwhile, a public employment freeze will be implemented and electricity and food subsidies will be cut, seizing the opportunity of low global oil and food prices and identifying steps to improve targeting. The authorities expect this package to eliminate the primary deficit and set debt on a downward and sustainable path as stipulated in the Fiscal Responsibility Act, introduced in 2013, which aims to limit public debt to 60 percent of GDP, down from the current level of 75 percent of GDP.

In any case, the authorities are keen to review local government pay structures, and they view a public pay body as potentially helpful to ensure consistency of wages and salaries across public service and to move in the direction of public service reform. The authorities consider strengthening public financial management a key priority that will contribute to achieving fiscal sustainability. They attach high importance to reducing the long-standing stock of government arrears and preventing further accumulation. They are accordingly requesting additional technical assistance from the Fund, particularly in the area of the fiscal chart of accounts and budget execution. Additional revenue measures *could* be considered, if needed. The staff suggests that the authorities undertake additional fiscal measures equivalent to 3 percent of GDP, which would be manageable. The authorities may out-perform staff's fiscal projections as has been the case in the past[2].

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[2]The authorities targeted an overall fiscal deficit of 4 percent in 2013, and the last staff report had projected a deficit exceeding 16 percent of GDP, but staff's latest estimate places it at under 8 percent.

External Sector Assessment. The authorities welcome staff's revised external sector assessment. They view the current exchange rate regime to be suitable for Maldives given the high degree of openness and seasonality of tourism revenues. Past exchange rate devaluations have been unsuccessful (of which the latest is the 2011 experience) as the rapid inflation pass-through offset the impact of the nominal exchange rate devaluation. Continuing to improve the fiscal position is seen as the best way to sustain the exchange rate within its current band. The authorities particularly appreciate the additional background work prepared by staff to better understand the functioning of the foreign exchange market and revise balance of payments estimates, consistent with the authorities' previous requests. For their part, the authorities have begun to collect more regular information on the operations of exchange bureaus.

Monetary and Financial Policies. The Maldives Monetary Authority (MMA) remains committed to its objectives of maintaining price stability and an adequate level of international reserves, while promoting non-inflationary economic growth. Although monetary aggregates have been growing rapidly as the MMA accumulates reserves, private sector credit growth has remained subdued as banks are cautious in extending new credit. The authorities consider the reduction of the minimum reserve requirement necessary given its unusually high level[3] and the handling of the government's overdraft the best way to facilitate achievement of the targets under the Fiscal Sustainability Law. The policy stance was eased in 2014 in response to macroeconomic conditions, including very low inflation. The MMA stopped monetizing the deficit since April 2014, and monetary policy decisions have not been influenced by government finance considerations. The MMA continues to absorb liquidity through its overdraft facility while it has only temporarily stopped conducting Open Market Operations. Steps are being considered to deepen and develop the Treasury bill market and to introduce longer term instruments. Financial soundness indicators continue to improve as the strengthening of loan portfolios reflects a revival in the tourism and construction sectors.

Medium term prospects. The authorities are optimistic that medium-term growth will pick up following the development of the new airport, implementation of current plans to improve infrastructure, and investments in the Special Economic Zones. Diversifying the economy beyond tourism and creating employment opportunities is a high priority. These plans are intended to boost growth potential and will help build buffers against external shocks. The authorities are well aware of the external vulnerabilities faced by all small open tourist-dependent states. The risks outlined in the Matrix are plausible but appear to be over-stated. The tourism sector has out-performed other peers and Maldives has a broad spectrum of source countries and still substantial unmet demand by international visitors.

In closing, we welcome the shift to a more positive staff assessment, which reflects important policy achievements, favorable economic developments, and data revisions as recommended

[3] Effective from 20th February 2014, the Minimum Reserve Requirement was reduced from 25 percent to 20 percent of the average local and foreign currency deposits, excluding interbank liabilities and L/C margin deposits.

by the Fund. We look forward to continued close engagement with the Fund as the authorities tackle remaining challenges.

Table 1. Maldives--Staff's Data Revisions Since the Last Article IV Report
(in Percent, Million Rufiya, Million $, or Percent of GDP as indicated)

	2008	2009	2010	2011	2012	2013 Est.	2014 Est.	2015 Proj.
Real GDP growth - Jan 2013	12.2	-3.6	7.1	7.0	3.5	3.8	4.0	4.1
Real GDP growth - Jan 2015	12.2	-3.6	7.1	6.5	1.3	4.7	5.0	5.0
Old GDP (million of Rufiya)- 2013	24,213	25,403	27,316	31,447	34,012	36,774	40,640	44,560
New GDP (million of Rufiya)- 2015	27,108	27,729	29,855	35,931	38,943	41,569	43,971	46,863
CG Fiscal deficit in Rufiya mn-2013	-2719	-5219	-4275	-3547	-4555	-5994	-5194	-5547
CG Fiscal deficit in Rufiya mn-2015	-2719	-5219	-4275	-2360	-2972	-3253	-5111	-3803
CG Deficit as % GDP - Jan 2011	17.1	-29.0	-17.9	-21.3	-18.8			
CG Deficit as % GDP - Jan 2013	-11.2	-20.5	-15.7	-11.3	-13.4	-16.3	-12.8	-12.4
CG Deficit as % GDP - Jan 2015	-10.0	-18.8	-14.3	-6.6	-7.6	-7.8	-11.6	-8.1
Primary balance as %GDP-Jan 2013	-10.1	-18.1	-13.2	-9.0	-10.7	-12.4	-9.0	-8.7
Primary balance as %GDP-Jan 2015	-9.0	-16.6	-12.1	-4.5	-4.8	-5.3	-8.7	-4.6
BoP Current account-in $ mn -Jan 2013	-612	-221	-197	-437	-585	-646	-700	-743
BoP Current account-in $ mn -Jan 2015	-610	-226	-190	-423	-270	-176	-241	-152
Current account as % of GDP -Jan 2013	-32.4	-11.1	-9.2	-20.5	-26.5	-27	-26.5	-25.7
Current account as % of GDP-Jan 2015	-28.8	-10.4	-8.1	-18.11	-10.6	-6.5	-8.4	-5.0
GDP $ - Jan 2013	1892	1985	2134	2132	2209	2388	2639	2893
GDP $ - Jan 2015	2118	2166	2332	2332	2534	2699	2855	3043
Total domestic public debt-Ruf mn-2013	5,036	7,972	10,175	12,220	14,218	15,590	17,899	20,268
Total domestic public debt --2015	5,036	7,833	9,666	10,754	12,919	14,746	19,370	22,443
External PPG debt ($mn) 2013	472	555	630	703	866	1,064	1,252	1,462
External PPG debt ($mn) 2015	456	538	630	689	722	744	790	841
Private external debt $ mn - 2013	516	501	600	800	1,023	1,271	1,562	1,867
Private external Debt $ mn - 2015	616	517	426	304	148	124	189	189
Public+external private debt $ mn 2013	1,381	1,679	2,025	2,363	2,812	3,347	3,977	4,645
% of GDP	73.0	84.6	94.9	110.8	127.3	140.2	150.7	160.5
Public+external private debt $ mn 2015	1,466	1,667	1,812	1,691	1,709	1,826	2,238	2,487
% of GDP	69.2	76.9	77.7	72.5	67.4	67.7	78.4	81.7