INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/283

MALDIVES

September 2019

2012 ARTICLE IV CONSULTATION—PUBLIC INFORMATION NOTICE; 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 2012 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 February 20, 2013 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 February 20, 2013, following discussions that ended on November 12, 2012, 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 January 22, 2013.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Maldives.

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International Monetary Fund
Washington, D.C.

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Public Information Notice (PIN) No. 13/79
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International Monetary Fund
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IMF Executive Board Concludes 2012 Article IV Consultation with Maldives

On February 20, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Maldives.[1]

Background

The economy slowed last year. After averaging almost 7 percent for several years, growth is expected to have declined to 3½ percent in 2012, driven by slower tourism, offset partly by strong construction, fishing, and fisheries-related manufacturing. Looking ahead, a modest recovery in tourism is forecast, and GDP growth should reach 4 percent by 2014. Risks to growth, however, are clearly to the downside and relate to a further weakening of market appetite for government paper, a sharp widening of the parallel-market premium, and a weakening of tourist arrivals, for either global economic or domestic political reasons.

Inflation was elevated on account of high commodity prices and tax increases but should come down rapidly in the baseline scenario. The introduction of the general goods and services tax (GGST) in October 2011 and a rate increase in January 2012, as well as high commodity prices, have kept headline inflation high. It eased to 5½ percent at end-year and is expected to drop further to 4½ percent in the medium term, as one-off effects disappear and commodity prices stabilize.

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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. 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.

Fiscal policy has remained accommodative. The 2012 budget targeted a 9 percent of GDP deficit but the outturn was around 12½ percent of GDP in cash terms, and higher if unpaid bills are accounted for. The financing climate has been severe, with Treasury bill subscriptions weak, the government having to rely on a special loan from the state bank and on a dollar bond privately placed with a high-net-worth Maldivian, and new arrears (possibly on the order of Rf 1 billion, or 3 percent of GDP) accumulating. The 2013 budget incorporates a number of important adjustment measures, but not enough to prevent a continued increase in the debt ratio, which already stands at over 80 percent of GDP, excluding arrears, and contingent liabilities in the financial sector pose possible fiscal risks as well.

The balance of payments is weak, with the current account deficit estimated at over 25 percent of GDP over the medium term. Reserves have, however, held up better than expected so far, as it appears that the parallel market in foreign exchange is meeting some of the demand for dollars, at a modest premium of under 10 percent. Gross reserves stand at about $330 million (around two months of imports) while usable reserves are around $110 million and could drop sharply further given a pending debt repayment of $50 million in February.

Monetary policy is relatively easy, but private credit is shrinking. The real policy rate was negative and excess rufiyaa liquidity remains substantial at 5 percent of deposits. Nonetheless, banks are not responding, in part because lending is heavily dollarized. Faced with limited lending opportunities—fund the government, or fund a tourism-dominated private sector—banks are taking little advantage of either and repaying their foreign funding lines instead. To meet its financing needs, the government has frequently and successfully pressured the MMA not to conduct OMO auctions so as to channel more funds toward T-bills. The government has also pushed for a lower minimum reserve requirement (MRR). Finally, direct monetization of the deficit has occurred on a large scale.

Financial supervision has been weak, particularly with regard to the state bank. Several commercial banks remain out of compliance with prudential norms on single borrower exposures and NOPs, and NPL ratios have been rising as the loan book has shrunk. MMA decided in 2012 to provide across-the-board regulatory forbearance on provisioning requirements for the next three years, which has led to misleadingly comfortable capital ratios at some banks.

The government's strategy for medium-term development centers around voluntary population consolidation. The authorities intend to establish 15 regional island centers, with attractive hospitals, schools, and other amenities, and to provide residents of smaller, neighboring islands with free housing and other incentives to induce them to move; there would be no forcible relocation. The long-term goal is to reduce the number of populated islands from 198 to around 100, which the authorities feel would yield fiscal savings, reduce unemployment, support commerce, and release islands for redevelopment as resorts. Economic diversification is another key focus for the medium term. The government wants to develop job opportunities in new, labor-intensive economic sectors, such as off-port shipping services, IT, and financial services. This would absorb labor from a downsized public service and reduce Maldives' current vulnerability to a downturn in tourism demand. The authorities are also keen to develop the capital market, though progress to date has been limited. Over the longer term, coping with the adverse effects of climate change, including sea-level rise, will be the key challenge for Maldives.

Executive Board Assessment

Executive Directors commended the authorities' efforts to manage the difficult economic situation. Directors expressed concern, however, about the continued rise in public and external debt and decline in reserves, and stressed that decisive adjustment measures are needed to revert to a sustainable growth path.

Taking note of significant progress in fiscal adjustment, Directors welcomed the fiscal measures taken in the 2013 budget, including the increase in tourism taxation and the establishment of the Pay Commission to review salaries in the public sector. Nonetheless, they noted that deficits would decline only modestly over time and called for additional measures, including further increases in tourism taxes and greater expenditure restraint under appropriate safeguards for vulnerable groups.

Most Directors saw merit in an adjustment strategy that deploys multiple policy instruments. They discussed alternative policy mixes that would effectively achieve external adjustment and rebuild official reserves, including devaluation, fiscal consolidation, and monetary tightening. All Directors stressed that improving the quality of balance of payments statistics is critical for informed policymaking in this area.

Directors agreed that monetary policy should be tightened substantially and urged that pressures to ease monetary conditions, including through deficit monetization, be resisted. In addition, the operational framework of the Maldives Monetary Authority should be reformed to better absorb liquidity, help underpin the value of the rufiyaa, and facilitate market financing of the government.

Directors called for strengthened financial sector supervision and a winding down of across-the-board regulatory forbearance for banks. They recommended moving toward a more forward-looking, risk-based supervisory regime, adopting legislation against money laundering, and postponing plans to introduce deposit insurance at this juncture. Directors agreed that an independent assessment of a troubled bank remains a high priority.

Directors acknowledged Maldives's significant structural challenges. They took note of the plans for voluntary relocation of people, which, by reducing dispersion, could lower the costs of administration and service provision. More broadly, Directors supported plans for diversifying the economic base toward new activities.

Directors took note of the authorities' interest in a Fund program. Most considered that a staff-monitored program would boost the credibility of the authorities' plans. A few Directors, stressing immediate balance-of-payments needs, were of the view that a new financial arrangement with the Fund would be more appropriate.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Table 1. Maldives: Selected Economic and Vulnerability Indicators, 2007–15 (Baseline Scenario)

Population (in 1,000; 2009 est.) 315
GDP per capita (in U.S. dollars; 2009 est.): 6,305
Quota (in million SDRs): 10.0

	2007	2008	2009	2010	2011	2012	2013	2014	2015
						Est.		Proj.	
Output and prices			(Annual percentage change)						
Real GDP	10.6	12.2	-3.6	7.1	7.0	3.5	3.8	4.0	4.1
Inflation (end-of-period) 1/	8.9	8.9	5.4	6.9	16.7	5.4	4.7	4.5	4.4
Inflation (period average) 1/	6.8	12.0	4.5	6.1	11.3	10.9	4.6	5.1	4.4
GDP deflator	7.0	9.3	8.9	0.4	7.5	4.5	4.2	6.2	5.3
Central government finances			(In percent of GDP)						
Revenue and grants	38.4	30.8	22.6	23.9	31.0	28.8	32.4	31.1	30.3
Expenditure and net lending	42.0	42.0	43.1	39.6	42.3	41.4	48.7	43.9	42.8
Overall balance 2/	-3.6	-11.2	-20.5	-15.6	-11.3	-12.6	-16.3	-12.8	-12.4
Overall balance excluding grants	-8.9	-13.4	-22.2	-16.2	-13.7	-14.0	-18.5	-14.3	-14.0
Financing	3.6	11.2	20.5	15.6	11.3	12.6	16.3	12.8	12.4
Foreign 3/	3.5	3.1	5.4	7.5	3.8	7.7	7.9	7.4	7.3
Of which: Privatization receipts	0.0	0.0	2.0	4.4	0.0	0.0	0.0	0.0	0.0
Domestic	0.1	8.1	15.1	8.1	7.5	4.9	8.4	5.4	5.2
Of which: Privatization receipts	0.2	0.2	0.0	0.1	1.2	0.0	0.0	0.0	0.0
Public and publicly guaranteed debt	45.3	45.7	58.6	65.7	72.4	79.6	85.4	90.1	94.7
Domestic	18.1	20.8	31.4	37.2	38.9	41.8	42.4	44.0	45.5
External (excluding IMF and currency swaps by MMA)	27.2	24.9	27.2	28.4	33.5	37.8	43.0	46.1	49.3
Monetary accounts			(Annual percentage change, unless otherwise indicated)						
Broad money	24.1	21.8	14.4	14.6	20.0	9.2	8.4	…	…
Domestic credit	44.7	35.2	14.0	4.7	11.2	-1.8	4.6	…	…
Of which: To private sector	49.4	29.7	-4.1	-2.3	5.9	-7.9	-4.5	…	…
NFA of commercial banks (in millions of US$, e.o.p.)	-341	-371	-345	-264	-120	52	82	…	…
Net open forex position of commercial banks (in millions of US$, e.o.p.)	73	175	195	172	201	…	…	…	…
Balance of payments			(In percent of GDP, unless otherwise indicated)						
Current account	-14.7	-32.4	-11.1	-9.2	-20.5	-26.5	-27.0	-26.5	-25.7
Of which:									
Exports	14.8	17.5	8.5	9.2	16.2	15.0	13.7	13.3	12.9
Domestic	7.0	6.7	3.8	3.4	6.0	6.5	6.3	5.9	5.7
Re-exports	7.8	10.9	4.7	5.8	10.3	8.5	7.4	7.4	7.2
Imports	-84.6	-87.2	-54.5	-58.2	-80.9	-82.1	-78.7	-74.0	-70.1
Nonfactor services, net	80.8	64.0	57.7	63.7	68.6	65.7	63.0	60.2	58.0
Capital and financial account (including e&o)	19.6	28.8	12.2	13.4	19.8	25.1	24.3	22.0	20.7
Of which:									
General government, net	2.4	3.2	3.6	3.1	3.6	7.7	4.7	2.2	1.7
Banks and other sectors, net	23.0	6.5	4.5	8.5	7.8	6.5	10.4	11.0	10.5
Additional donor financing catalyzed by an SMP	…	…	…	…	…	…	…	…	…
Overall balance	4.9	-3.6	1.0	4.2	-0.7	-1.4	-2.7	-4.5	-5.0
Financing gap 4/	0.0	0.0	0.0	0.0	0.0	0.0	3.2	5.2	5.6
Gross international reserves (in millions of US$; e.o.p.) 5/	308	241	261	350	335	304	317	333	350
In months of GNFS imports	2.3	1.4	2.1	2.5	1.8	1.6	1.6	1.6	1.6
In percent of short-term debt at remaining maturity	91	78	91	103	72	50	41	36	33
Usable reserves (in millions of US$; e.o.p.) 6/	172	106	112	144	137	99	106	115	124
In percent of short-term debt at remaining maturity	51	33	39	42	29	16	14	12	12
External debt 6/	64	52	53	58	71	86	98	107	115.1
Medium- and long-term	48	40	44	48	57	69	79	87	93.1
Short-term	16	12	10	10	13	16	19	20	21.9
In percent of domestic GNFS exports	59	56	65	65	70	91	107	122	135.2
External debt service (in percent of domestic GNFS exports)	6	7	7	7	8	12	16	20	22.8

Exchange rate (rufyiaa/US$, e.o.p.)	12.8	12.8	12.8	12.8	15.4	15.4	…	…	…
Memorandum items:									
GDP (in millions of rufyiaa)	19,737	24,213	25,403	27,316	31,447	34,012	36,774	40,640	44,560
GDP (in millions of U.S. dollars)	1,542	1,892	1,985	2,134	2,132	2,209	2,388	2,639	2,893

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

1/ CPI-Male definition.

2/ Arrears were accumulated in 2011 and 2012, and are assumed to be cleared by 2013.

3/ Reflects BOP financing gap shown below.

4/ Assumed financing to keep GIR from falling below end-2012's months of import coverage.

5/ 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.

6/ Includes IMF but excludes domestic foreign-currency denominated debt.

INTERNATIONAL MONETARY FUND

MALDIVES

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

January 22, 2013

KEY ISSUES

Maldives' fiscal position is weak, and its external reserves are critically low. The country has a long history of fiscal and external imbalances. The debt ratio is above 80 percent of GDP, and deficits above 10 percent. This loose fiscal stance has contributed to current account deficits of over 25 percent of GDP and sustained pressure on reserves, which has been compounded recently by large debt repayments. Gross reserves could drop to $250 million (1½ months of imports) by February, with the freely usable portion falling to just $50 million.

Macroeconomic policies need adjustment. The authorities have taken important steps in the 2013 budget to reduce the fiscal deficit, but further consolidation is needed, both to ensure debt sustainability and to strengthen the balance of payments. That latter goal would be aided by a devaluation, combined with a restrictive incomes and subsidy policy, which would address the current overvaluation of the rufiyaa and help to curb imports. Monetary tightening would help to prevent the need for a further devaluation. Financial supervision, particularly with regard to the state bank, also needs strengthening.

The authorities have expressed interest in a new Fund program. The last arrangement, approved in December 2009, went off track after the First Review and formally expired at the end of last year. Given that track record, a Staff Monitored Program could be the appropriate starting point for any renewed engagement, but in order to begin discussions, there would need to be a clear commitment on the authorities' part to implementing a comprehensive set of policy adjustments.

Approved By
Masahiko Takeda and Masato Miyazaki

The 2012 Article IV consultation discussions took place in Malé during October 30–November 12. The staff team comprised Messrs. Mathai (head), Molagoda, Tapsoba (all APD), and Jamaludin (SEC), as well as Kashiwase (FAD) and Million (SPR) for part of the mission each. Mr. Dalesio and Mmes. Isnawangsih and Loucks assisted in the preparation of this report.

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APPENDIXES

CONTEXT

1. **Maldives suffers from chronic fiscal and external imbalances.** In the wake of the December 2004 tsunami, government spending rose sharply, and with large civil service wage increases awarded just before and after the historic 2008 elections, the fiscal deficit rose to above 20 percent of GDP the following year. Given the island nation's heavy import dependence, large fiscal deficits quickly translated into balance of payments difficulties, which were exacerbated by a decline in tourism as global conditions weakened. As the currency peg was maintained, reserves at the Maldives Monetary Authority (MMA) fell sharply. An IMF-supported program of around $90 million was approved in December 2009 and included significant, frontloaded measures, but went off track by mid-2010. A 20 percent devaluation in April 2011, accompanied by monetary tightening, helped stave off problems, but did not provide a lasting solution, as the fiscal position was not improved.

2. **Hard-currency reserves are currently under pressure.** Although this is the tourism high season, gross international reserves have fallen to about $300 million (around two months of imports), and freely usable reserves stand at around $100 million, after the December repayment of a $50 million bond. Another $50 million bond matures in February, implying a further sharp decline in reserves. Staff have been warning of acute downside risks since early last year, but the effect of loose fiscal policy on the balance of payments has been mitigated by the authorities' debt financing and accumulation of arrears (which have helped, *ceteris paribus*, to restrain private-sector imports); and dollar demand, in any case, has been met partly in the parallel market, and at a modest premium. Conditions could, however, change for the worse, especially if the authorities rely increasingly on monetization to finance the fiscal deficit (see Box 1).

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

A. Real sector

3. **The economy slowed last year.** After averaging almost 7 percent for several years, growth is expected to have declined to 3½ percent in 2012. This poor performance was driven by tourism, as the effects of continued weak conditions in Europe, Maldives' largest market, and international travel advisories stemming from political uncertainty early in the year were offset only partly by buoyancy later on in the Chinese segment. While overall tourism disappointed, construction, fishing, and fisheries-related manufacturing all performed well.

4. **A modest recovery is now expected, subject to substantial downside risks.** The economy is driven largely by tourist arrivals, and with the world economy slowly improving, and assuming domestic political conditions remain stable, growth should tick up this year and reach 4 percent by 2014. Risks, however, are firmly to the downside, as laid out in the Risk Assessment Matrix (see Appendix I). Some of the principal concerns include a further weakening of market appetite for government paper, a sharp widening of the parallel-market premium, and a weakening of tourist arrivals, for either global economic or domestic political reasons.

Box 1. Does Maldives Face a Possible Crisis?

For close to a year, staff have been concerned that Maldives' loose fiscal policy could trigger a currency crisis in the very near term. But no such crisis has materialized, at least so far. Maldives' fiscal and external indicators are very weak by any standard: the deficit and debt ratios are large, domestic financing is increasingly unavailable, the rufiyaa is substantially overvalued according to CGER analyses, and reserves are at worryingly low levels. But at the same time, the store shelves are well stocked, suggesting that importers are finding dollars, perhaps through the parallel market, and the premium in that market appears to remain relatively modest. So what is happening?

One explanation is that the government's accumulation of domestic arrears may have imposed a cash crunch on the private sector and thus dampened its imports, offsetting at least part of the import stimulus provided by loose fiscal policy. But arrears cannot be accumulated forever, and if arrears clearance is financed via MMA monetization, then national imports could rise quickly, reserves could collapse, and the parallel-market premium could blow out.

Another possibility is that the parallel market is flush with dollars and easily able to cater to the demand for imports. The balance of payments may be mis-estimated—while the introduction of the *ad valorem* TGST clarified the true size of tourism receipts, and thus of the entire current account, data on the capital account remain subject to substantial uncertainty.

The sentiment that the economy as a whole does not suffer from any external imbalance was echoed by several of the mission's interlocutors. It was contradicted, however, by reports from the State Trading Organization—charged with importing the nation's basic food, fuel, and other essentials—of difficulties in finding dollars, as well as by some businessmen's complaint that banks are willing to extend rufiyaa loans but not dollar loans (there would be little difference if the currencies could be freely converted). At the same time, if dollar shortages really were pervasive, then it seems unlikely that the parallel-market premium would remain low and stable; it would instead increase to the higher levels seen in both 2009 and 2011, when macro pressures last came to a head.

The situation is thus not entirely clear. It seems risky, however, to assume that arrears financing can continue forever, just as it is unlikely that the parallel market is a bottomless well of dollars. Staff advise rapid and comprehensive policy adjustment on an urgent basis.

5. Inflation was elevated on account of high commodity prices and tax increases, but should come down rapidly in the baseline scenario. Maldives' currency peg has historically kept it from significant inflation problems. By the same token, the April 2011 devaluation was passed through to domestic prices almost fully, causing inflation to surge to nearly 21 percent y/y by the end of that year. While the devaluation effect is no longer in play, the introduction of the general goods and services tax (GGST) in October 2011 and a rate increase in January 2012, as well as high commodity prices, have kept headline inflation high. It should, however, have eased to 8 percent by end-2012 and—since the baseline scenario assumes no change in the exchange rate—is expected to drop to 4½ percent in the medium term, as one-off effects disappear and commodity prices stabilize.

B. Fiscal and external sectors

6. Fiscal policy has remained accommodative. The 2012 deficit is likely to have exceeded the budget target of 9 percent of GDP and reached around 13½ percent of GDP in cash terms, or higher if unpaid bills are accounted for. The financing climate has also been severe, with treasury bill subscriptions weak, the government having to rely on a special loan from the state bank and on a dollar bond privately placed with a high net-worth Maldivian, and new arrears building up (possibly on the order of Rf 1 billion, or 3 percent of GDP).[1] The 2013 budget incorporates important adjustment measures, but not enough to prevent a continued increase in the already high debt ratio (see Appendix II), and contingent liabilities in the financial sector pose possible fiscal risks as well.[2]

7. The balance of payments is weak, though reserves have held up better than expected so far. The current account deficit is estimated at over 25 percent of GDP during 2012–15, and CGER methodologies suggest rufiyaa overvaluation of 16 to 28 percent (see Appendix III).[3] The overall BOP deficit exceeded $260 million in 2012, but reserves fell by much less as the parallel market met some of the dollar demand, and at a modest premium of around 10 percent. An anticipated $25 million in budget support from India was never received, the State Bank of India did not roll over its $50 million government bond that fell due in December, and it may not roll over another similar bond maturing in February. Reserves may face serious pressure ahead. This pressure would be magnified by any compensation paid in connection with the December 2012 reversal of the airport privatization.[4] Multilateral and bilateral donors are engaged in the Maldives[5] and are concerned by the macroeconomic situation, but none has stepped forward with a firm offer of additional support.

[1] Firm data are not available on the extent of arrears. A strategy is needed to audit and pay the government's late bills, and the authorities have expressed interest in having further technical assistance (TA) in public financial management.

[2] These include the possible costs of bank recapitalization as well as of the implicit insurance of deposits at some banks.

[3] It would be analytically helpful to distinguish the total imports of the resort sector—which operates quite independently of the rest of the economy—but the available data do not permit such a breakdown.

[4] In mid-2010, President Nasheed's government, assisted by the IFC, awarded a 25-year contract to upgrade and operate the Malé international airport to a joint venture of the Indian GMR Group and Malaysia Airports Berhad (MAHB). The $511 million deal, which included an upfront $78 million payment to government, was controversial from the beginning, and for a number of reasons. On November 27, 2012, the government announced that it would cancel the concession within seven days, and after some legal challenges, the airport was handed back on December 8, without any disruption to flight operations. The government has said it will pay compensation, but with the company claiming $800 million, the issue is now under arbitration.

[5] The accompanying Informational Annex details the activities of the World Bank and Asian Development Bank.

C. Monetary and financial sectors

8. Monetary policy is relatively easy, but private credit is shrinking. The real policy rate is negative and excess rufiyaa liquidity remains substantial at 5 percent of deposits.[6] Nonetheless, banks are not responding, in part because lending is heavily dollarized. Faced with limited lending opportunities—fund the government, or fund a tourism-dominated private sector—banks are taking little advantage of either and repaying their foreign funding lines instead. The appetite to lend to the private sector has been curbed by deteriorating asset quality, difficulties in loan recovery, the need to comply with the MMA's single-borrower and net-open-position (NOP) limits, plus internal guidelines on sectoral exposures. Private-sector credit shrank 10 percent y/y by November 2012.

9. Concerns over the fiscal deficit have limited banks' appetite for further government exposure, which in turn has led to pressure for monetary easing. Treasury bill auctions have routinely been undersubscribed, particularly for longer maturities. To meet its financing needs, the government has frequently and successfully pressured the MMA not to conduct open-market operations (OMO) auctions so as to channel more funds toward T-bills. The government has also pushed for a lower minimum reserve requirement (MRR)—which currently stands at a very high 25 percent—to the same end. Finally, direct monetization of the deficit has occurred on a large scale.[7] Despite these pressures, MMA generally managed to keep reserve money close to its targets.

10. Financial supervision has been weak, particularly with regard to the state bank. Several commercial banks remain out of compliance with prudential norms on single-borrower exposures and NOPs, and NPL ratios have risen as lending has shrunk. MMA provided across-the-board regulatory forbearance in 2012 on provisioning requirements for the next three years, though some banks did not require it. As a result of this forbearance, some operating profits from last year, and improper accounting of deferred tax assets, the Bank of Maldives (BML) reports full compliance with provisioning requirements and a capital adequacy ratio above the minimum threshold of 12 percent. But with proper accounting and no forbearance, the bank's CAR falls to just 7 percent, matching the finding of the 2011 onsite examination that the bank is critically undercapitalized.[8] The BML petitioned to declare an interim dividend, but the MMA refused.

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[6] More than half of this, however, resides with the Maldives Islamic Bank, which finds few sharia-compliant avenues for investment.

[7] While the agency agreement between the MMA and government signed in September 2009 required ways-and-means financing to be brought below Rf 100 million by the end of each month, violations became commonplace in the second half of 2012. Furthermore, in December, the MMA paid off the government's maturing $50 million bond held by SBI, and the balance of the public bank account (PBA) fell to a deficit of more than Rf 1 billion. Of this, Rf 800 million was subsequently converted into a special treasury bond held by MMA.

[8] The weak capital position reflects a history of some bad loans to the tourism sector, particularly in the wake of the tsunami.

D. Medium-term issues

11. The government's strategy for medium-term development centers around voluntary population consolidation. The authorities intend to establish 15 regional island centers with attractive infrastructure and amenities, and to provide residents of neighboring islands with incentives to induce them to move; there would be no forcible relocation. Initial consultations with both home and host populations have been positive. The long-term goal is to halve the number of populated islands (to around 100). This would:

- yield fiscal savings, as service provision would not need to be duplicated on so many islands;[9]
- reduce unemployment, which has been stubbornly high partly because of the existing dispersal of the labor force;
- support commerce—a shop is estimated to need a population of 30,000 to survive; and
- release a set of islands suitable for redevelopment as resorts.

12. Economic diversification is another medium-term focus. The government is keen to develop new, labor-intensive sectors, such as off-port shipping services, IT, and financial services. This would absorb labor from a downsized public service and reduce Maldives' current vulnerability to a downturn in tourism demand. Within tourism, the authorities and the industry plan to continue developing resorts at a moderate pace and tailoring their offerings to the growing Asian market. There appears to be some debate about whether Maldives should remain a predominantly luxury destination or instead diversify into the middle-market as well. As for the fishing sector, producing and marketing value-added items is a major thrust. The authorities are also keen to develop the capital market, though progress to date has been limited.[10] Finally, over the longer term, coping with the adverse effects of climate change, including sea-level rise, will be the key challenge for Maldives.

POLICY DISCUSSIONS

13. The mission discussed alternative macroeconomic scenarios. The baseline shows that under existing policies, debt would rise and large financing gaps would emerge (see Tables 1–4 and text chart). The scenario implicitly assumes that those gaps are filled[11] and Maldives muddles

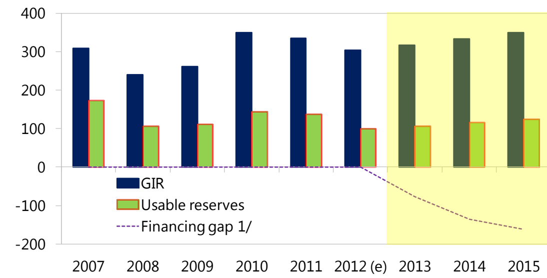
[9] The annual wage bill for island councilors alone is close to 1 percent of GDP, but beyond this there are substantial costs of duplicating water, electricity, and other types of infrastructure on small islands. Staff do not have an estimate, but it seems that fiscal savings would be substantial and larger than the cost of inducing people to move.

[10] Trading on the Maldives Stock Exchange remains low and there are few listings, although several companies are considering IPOs. The authorities are trying to position Maldives as an Islamic finance center; however, the country's limited financial infrastructure, small pool of professionals, weak corporate governance and disclosure practices, low savings, and limited financial literacy, all represent major structural challenges to capital market development.

[11] Gaps could be filled either by new external financing or by dollars supplied in the parallel market. Indeed, in 2012, the BOP deficit was far larger than the decline in reserves, possibly because of parallel market supply; this is shown as a large entry for errors and omissions (which are anyway typically large in Maldives given the relatively weak external statistics, particularly on the capital and financial account). For future years, parallel market financing could play a role in filling some of the projected financing gaps.

through, but if financing is not found, Maldives could face a collapse of reserves, and perhaps more importantly, a sharp reduction in dollar availability in the parallel market. The premium would widen dramatically, a devaluation would be forced, imports would fall, interest rates would rise, growth would slow, and inflation would spike. In a sense, then, the baseline is itself a risk scenario. The mission also presented an adjustment scenario, in which fiscal and monetary tightening, a devaluation, and a Fund Staff Monitored Program (SMP) catalyze additional donor financing, eliminate financing gaps, and deliver an orderly resolution of imbalances with sustained policy implementation.[12]

International Reserves
(In millions of US dollars)



Sources: Maldivian authorities; and IMF staff estimates.
1/ Assumed financing to keep GIR from falling below end-2012's months of import coverage.

A. Fiscal policy

14. There was agreement that substantial fiscal consolidation is needed. The mission suggested bringing the deficit down steadily to stabilize the debt ratio by 2016. This still involves a high debt-GDP ratio, which clearly would have to be addressed over the medium term, but staff were also cognizant of the importance of setting realistic and achievable goals. The authorities saw the path as insufficiently ambitious, noting that financing constraints were severe and might not permit the "realistic" pace of consolidation favored by the mission. Staff suggested that changes in monetary policy and operations could facilitate domestic financing, while policy adjustment and possible Fund engagement could help trigger additional external financing (see below). The authorities passed a budget that calls for the deficit to fall sharply, though staff expect the budget policies to imply a deficit substantially higher than they envisage (see below).

15. The mission suggested measures to reduce the deficit while minimizing the impact on growth and on vulnerable groups. While expenditures are more the problem than revenues, the mission and the authorities agreed that there was scope to increase taxes on tourism—in particular, to raise the tourism GST (TGST) to 15 percent by mid-2013 while not allowing the bed tax to expire—as Maldives' luxury-oriented sector faces price-inelastic demand and is taxed much less than in similar destinations.[13] Staff note the importance of balancing revenue and expenditure adjustment, and in that context, other measures discussed included:

[12] The devaluation actually worsens the debt ratio, both by boosting the rufiyaa value of external debt (Table 1a of the DSA in Appendix II estimates the 2011 devaluation to have increased the debt ratio by 4½ percent of GDP), and by compressing productive imports and slowing growth (by more than 2 percentage points in 2013). It is nonetheless a key tool to address the external imbalance.

[13] Tourists in 2012 paid 6 percent TGST on their accommodation and related services plus an $8 nightly tax (a few percent extra, in this luxury market). The TGST was previously legislated to increase to 8 percent on January 1, 2013, while the bed tax was to expire at end-2013. The total tax burden is far smaller than in comparator tourism-dependent economies, who tax in the 15-20 percent range. Furthermore, demand in Maldives' luxury segment is likely to be price-inelastic—recent World Bank analysis suggests an elasticity of -0.41, lower than in other countries—

(continued)

- selectively reversing duty reductions;
- further rationalizing Aasandha costs;[14]
- targeting electricity subsidies to the needy; and
- freezing salaries and wages.

Staff also strongly supported targeting subsidies on staple foods, establishing a Pay Commission to harmonize conditions across the public service, having fewer paid councillors per island, and embarking on civil-service reform guided by the government's detailed jobs analysis.

16. The 2013 budget passed by the Majlis included some important fiscal measures, but was weaker than staff's adjustment scenario. The TGST was increased to 12 percent as of mid-2013, but the bed-night tax was eliminated at the same time, six months ahead of schedule. The GGST base was broadened slightly, the airport departure charge increased from $18 to $25 per passenger, and a Pay Commission established. The spending envelope, including on Aasandha and subsidies, was required to shrink in nominal terms, but does not appear to be fully supported by the policy measures needed to generate those savings. Thus, while the budget shows the deficit falling from 13½ percent of GDP in 2012 to just 4 percent in 2013, staff expect it to stay flat, or even rise to around 16¼ percent of GDP if one includes arrears clearance of 3 percent of GDP (see text table).[15] Deficits would decline in 2014 and beyond, but not enough to prevent debt from rising. Staff thus suggested the need for additional measures, especially given election-year fiscal risks, while continuing to clear arrears as in the baseline (see text chart and table). Fiscal measures averaging around 2 percent of GDP each year would stabilize the debt by 2016, albeit at still high levels relative to GDP. Looking forward, further measures (such as those discussed in paragraph 15) would still be needed.

Maldives: 2013 Budget vs. Staff's Projections

	Budget	Staff's Proj. 1/	Difference
Total revenue and grants	32.8	32.4	0.4
Revenue	31.3	30.2	1.1
Grants	1.5	2.2	-0.7
Expenditure and net lending	36.8	48.7	-11.9
Current expenditure	26.2	37.4	-11.2
Capital expenditure	10.9	11.7	-0.8
Net lending	-0.3	-0.3	0.0
Overall balance	-4.0	-16.3	12.3
Overall balance, excluding grants	-5.5	-18.5	13.0

Sources: Maldivian authorities; and IMF staff estimates and projections.
1/ Including 3 percent of GDP arrears clearance.

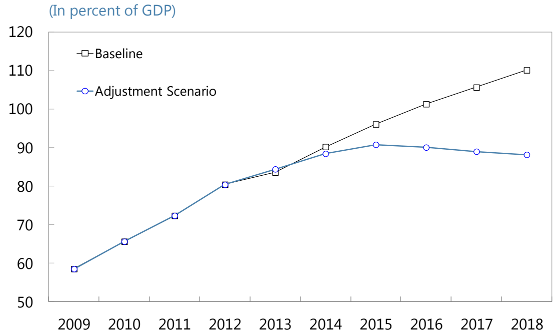
which implies both that the incidence of increased tourism taxation would be largely on foreigners and that the growth impact would be limited.

[14] Aasandha is the universal health insurance scheme introduced in 2012. Savings could be achieved by, for instance, implementing cost sharing at public hospitals, moving away from fee-for-service reimbursement, using generic drugs, and controlling payments to foreign hospitals.

[15] The large gap between the budget and staff's projection is driven by three factors. First, arrears clearance of 3 percent of GDP is in staff's numbers but not the budget (and this helps explain, as shown in Tables 2a–2c, the rise in many spending line items from 2012 to 2013). Second, the Majlis imposed expenditure cuts of around 5 percent of GDP relative to the budget originally proposed by the government; staff see these as unsupported by measures and thus difficult to achieve, and the authorities also expressed some concerns. Third, the authorities revised 2012 spending down by about 3 percent of GDP after the mission, and staff were reluctant to assume that such savings would apply in all future years as well.

Public Debt: Baseline vs. Adjustment Scenarios, 2009–18

(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

Fiscal Adjustments, 2013–16 1/

(In percent of GDP; relative to the baseline scenario)

	2013	2014	2015	2016	Description of Fiscal Measures (FM)
Total adjustments	**1.5**	**2.4**	**3.3**	**6.0**	
Revenue	**2.7**	**3.6**	**5.1**	**7.8**	
Import duty	0.9	0.8	0.8	3.5	• FM: Raise the average effective tariff rate from 6.3 to 10 percent in January 2016 (and GE effects) 2/
Bed-night tax	1.4	2.6	2.5	2.4	• FM: Maintain the bed night tax from 2013 onward (and GE effects)
Tourism GST (T-GST)	0.0	0.0	2.2	2.2	• FM: Raise the T-GST rate to 15 percent from 12 percent in Jan. 2015 (and GE effects)
Other	0.4	0.2	-0.4	-0.2	• Impact on other revenues of GE effects
Expenditure	**1.2**	**1.2**	**1.8**	**1.8**	
Wages bill	-0.7	-0.2	0.3	0.5	• FM: Freeze on wage bill in in 2013 (and GE effects)
Other	1.9	1.4	1.5	1.3	• Impact on other expenditures of GE effects
Memorandum items:					
Deficit paths					
Baseline scenario	16.3	12.8	12.6	12.6	
Adjustment scenario	14.8	10.4	9.3	6.6	

Source: IMF staff estimates.

1/ This table shows the difference between baseline and adjustment-scenario deficit paths, reflecting the direct impact of fiscal measures, as well as the indirect impact of general equilibrium (GE) effects caused by a 20 percent devaluation in the adjustment scenario.

2/ The rate was 14 percent prior to the reduction in tariff rates in 2012.

B. External sector policy

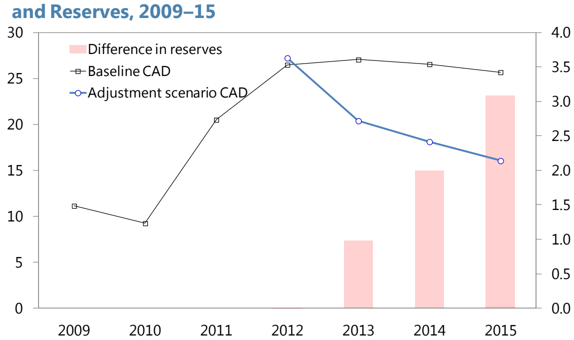
17. There was agreement that Maldives' large current account deficit appears to reflect loose fiscal policy more than an independently overheated private sector. Government spending has a direct import content, but the indirect channels—whereby, for instance, public servants consume imports, or taxes reduce the private sector's capacity to consume and import—seem to be even more important. There is little evidence that the private sector is overheating; indeed, the contraction in private-sector credit indicates the opposite. Staff analysis suggests that a 1 percent of GDP increase in the fiscal deficit leads to a 0.4 percent of GDP increase in the current account deficit (see Appendix IV).

18. The mission recommended a 20 percent devaluation accompanied by wage and subsidy restraint, but the authorities were unanimous in their disagreement. Staff suggested that Maldives' history showed that it was unrealistic to expect fiscal policy alone to bear the brunt of the adjustment and that using multiple instruments would be preferable (see text chart and table). A devaluation would likely be forced in a crisis, and it would be better to guide expectations and devalue in the context of a comprehensive policy package, to *avert* such a crisis. Given the degree of overvaluation suggested by CGER methodologies, a 20 percent adjustment, accompanied by fiscal and monetary tightening, appeared to be appropriate. Staff pointed to the experience of several similar economies (Fiji, Seychelles, Sri Lanka) where exchange-rate adjustment played a useful role (see Appendix V).[16] Given the extent of dollarization in the resorts and the lack of domestic production, a devaluation would work mostly through import compression, and this would require a

[16] Some of those countries, however, had governments that had the power to impose wage restraint even after a devaluation. As discussed below, that may not be the case in Maldives.

firm incomes and subsidy policy to ensure an increase in the real cost of imports.[17] It would be important to have a targeted social assistance scheme in place to shield the most vulnerable in the population.

Effect of Adjustment on Current Account Deficits and Reserves, 2009–15



Sources: Maldivian authorities; and IMF staff estimates.

Reserves, 2013–15
(In millions of U.S. dollars)

	2013	2014	2015
Gross international reserves			
Baseline	317	333	350
Financing gap	77	136	161
Baseline in the absence of financing gap	240	120	-24
Adjustment scenario	412	502	606
Difference	172	382	630
Difference (in months of imports)	1.0	2.0	3.1
Memorandum item:			
Nominal GDP (in U.S. dollars)	2,388	2,639	2,893

Source: IMF staff estimates.

19. The authorities were unanimous in their opposition to devaluation. They argued that repeated devaluations damage credibility and that, with no wage increases since 2009 and elections coming up in 2013, wage restraint would be impossible. They stated that, with fiscal policy the core problem, fiscal consolidation had to be the core solution, and that it would be preferable to cut wages for 20,000 civil servants than to raise the cost of imports for 300,000 Maldivians.[18] The mission again emphasized the importance of complementing the fiscal adjustment with exchange rate and incomes policies to raise credibility of their policies and effectiveness in correcting external imbalances. Staff also raised the possibility of duty increases as an alternative way to compress imports—albeit a way that would simultaneously hurt the resort sector. The authorities had mixed views on whether such increases would be any more politically acceptable than exchange-rate adjustment.

C. Monetary policy

20. The mission and the MMA agreed on the need for monetary tightening to mop up liquidity, keep inflation under control, and support the rufiyaa. The mission suggested increasing the policy rate substantially from 7 percent, while the MMA favored a mere 50-basis-point hike. There was agreement that monetization should be resisted, as should government pressure to limit OMOs. The MMA had some sympathy for reducing the MRR to facilitate government financing but later agreed that no changes should be made for now; staff suggested waiting until an easing cycle was needed. Staff endorsed the MMA's efforts to agree with

[17] While the authorities have only limited influence over private-sector wages, public-sector wage restraint would still be important, given that 10 percent of the population works for the state; also important would be ensuring that food and fuel subsidies not increase automatically.

[18] This suggestion, however, appeared to be a statement more of their greater unwillingness to devalue than to cut nominal wages. Nominal public wage cuts were a central feature of the 2009 program but were reversed by the courts amid much controversy and are unlikely to be a viable option going forward.

government on *daily* monetization limits, to avoid the gaming of month-end limits.[19] And to discourage monetization altogether, the mission recommended that the MMA charge interest greater than the T-bill yield on advances. Staff also urged expedited passage of a revised MMA Act to clarify and strengthen MMA independence.

21. There was agreement that changes to monetary operations could address government financing difficulties and reduce pressures to ease monetary policy. Staff suggested that a higher policy rate itself, if allowed to translate into higher T-bill yields, could increase subscriptions; the MMA, however, doubted banks' willingness to increase their government exposure at any price.[20] Both agreed that relatively minor changes to monetary operations could be helpful, and the authorities requested TA in this area.[21]

D. Financial sector policy

22. Staff called for a firmer approach to financial supervision. Recent forbearance granted on provisioning requirements was not needed by all banks and should be rolled back. The mission urged adoption of measures suggested by the MCM TA mission that was in Malé at the same time to move toward a more forward-looking, risk-based supervisory regime.[22] The MMA was receptive to these ideas but made no firm commitment on rolling back forbearance. Financial supervision will be further strengthened by the adoption of the AML/CFT bill, which is expected to be submitted to Parliament in the first quarter of 2013.

23. The mission urged that particular attention be paid to BML. The bank's operations continue to be supported by inadequate capital, exposing depositors—and ultimately the government, as implicit guarantor of those deposits—to risk. The mission applauded the MMA's decision not to permit BML to declare an interim dividend and urged that this stance be maintained until the bank is in full compliance with prudential regulations. Staff repeated earlier calls for an independent assessment of the bank, given the divergence of views between the MMA and BML. This could set the stage for finding a strategic investor to recapitalize the bank. The authorities agreed that an independent assessment was a priority.

[19] In some recent cases, the stock of MMA financing of the government far exceeded the Rf 100 million limit on the penultimate day of the month, was brought down to below the limit on the last day, and again rose above the limit on the first day of the next month. This sort of violation of the spirit of the agency agreement would be eliminated with daily limits.

[20] The mission noted that BML extended a $300 million special loan to government in 2012, but required a 9 percent rate.

[21] These changes include: (i) developing sharia-compliant instruments to tap idle liquidity at the Maldives Islamic Bank; (ii) introducing a standing repo facility at a non-punitive rate, to reduce banks' disincentive to lock liquidity up in T-bills; (iii) continuing work on a T-bill secondary market.; and (iv) lengthening the reserve maintenance period (which the MMA agreed to consider, but was not fully convinced of). It was agreed that MRR asset eligibility should not be expanded to include cash-in-vault or T-bills.

[22] These include implementing differential minimum CARs for banks depending on their risk profiles, conducting onsite examinations more frequently for weaker banks, using not just days-past-due, but also qualitative information in classifying loans, deducting excess lending above the related-borrower limit from regulatory capital, and meeting banks annually to discuss their plans.

24. Staff suggested that the MMA delay plans to introduce deposit insurance (DI). Staff's view is that the preconditions for DI that accompany the Basel Committee core principles are not met; in particular, with the MMA having insufficient reserves to offer credible insurance on dollar deposits, as is being considered, appropriate macroeconomic conditions are not in place. DI would also carry problems of adverse selection and moral hazard. The MMA continued to see merit in introducing DI, but were waiting for the appropriate time to do it.

E. Other

25. The mission supported the authorities' medium-term development plans and noted the importance of obtaining broad national consensus. It agreed that population consolidation has the potential to reduce the costs of administration and service provision, but it may also have significant social consequences. Ensuring that the program remains fully voluntary—as the authorities emphasized would be the case—is critical, even if this implies greater costs in providing incentives to induce people to move. The mission also endorsed the authorities' plans to diversify the economy while urging that they set realistic goals for capital-market development.

26. There was agreement that Maldives could benefit from a Fund program. Given that Maldives would first need to develop an adequate track record, the mission suggested opting for an SMP, which the authorities welcomed as an opportunity to devise and follow a homegrown solution to its problems. Staff clarified, however, that such a solution would need to be strong and supported by a comprehensive policy package that avoided over-reliance on any one instrument. Staff made clear that strong fiscal adjustment (including an incomes and subsidy policy) should be at the core, supported by devaluation and monetary tightening. Devaluation could possibly be replaced by further fiscal measures. In any event, detailed program issues will be discussed later in a separate negotiating mission, as needed. The authorities requested that their interest in an SMP be mentioned in the mission's concluding press release.

27. Exchange rate arrangement: Since April 2011, the rufiyaa has officially floated in a band of 20 percent on either side of Rf 12.85 per dollar (i.e., between Rf 10.28 and Rf 15.42). In practice, however, the rufiyaa has been virtually fixed at the band's weaker end, and Maldives' exchange rate regime is classified as stabilized. It remains an Article XIV member but maintains an exchange restriction and a multiple currency practice (MCP) under Article VIII, Sections 2(a) and (3), with the MCP arising from the MMA's rationing of foreign exchange and the greater-than-two-percent spread between official and parallel market rates. Staff are in the process of reviewing recently introduced foreign exchange measures. The authorities noted that there would likely be no change on Article VIII issues until underlying imbalances were addressed.

STAFF APPRAISAL

28. While economic conditions have remained relatively stable so far, Maldives' fiscal and external indicators are extremely worrying, and decisive policy action is needed. It is unclear how much longer the parallel market will supply the country's dollar demand, and market appetite for financing the government is already declining. An external or domestic financing crisis could materialize, possibly in the near future, and it is essential that a comprehensive policy response be undertaken now to bolster confidence and prevent a crisis from happening.

29. Fiscal consolidation is key to stabilizing the economy. Without firm action now, Maldives' large debt burden will grow unsustainably, and its already weak balance of payments will weaken further, threatening the peg. The financing environment for government has, in any case, become increasingly challenging and will not sustain continued large deficits. Arrears financing has pernicious effects throughout the economy and must be cleared and then avoided, as must direct monetization by the MMA. And given Maldives' already high level of indebtedness, nonconcessional borrowing would be inadvisable.

30. The authorities deserve credit for introducing a number of important fiscal measures, but more adjustment is needed. Raising tourism taxation, broadening the base of the GGST, increasing the airport departure charge, and raising duties were all important steps, as were the intentions to curb spending on Aasandha and electricity subsidies, and the establishment of a Pay Commission, which will yield important savings over time. The 2013 budget's rosy estimates notwithstanding, it appears that deficits are now on only a modestly declining trajectory, which is not enough to prevent the debt ratio from rising or to restore external balance. More measures are needed, including further increases in tourism taxation, subsidy reform, and rationalization of the public service wage bill, while ensuring that vulnerable groups are shielded. This still involves a high debt-to-GDP ratio, which clearly would have to be addressed over the medium term, but it is important that near-term goals be realistic and achievable.

31. Fiscal adjustment should be accompanied by a substantial devaluation. Loose fiscal policy is at the root of Maldives' fiscal *and external* problems, but political economy constraints argue against too ambitious a path of deficit reduction. Sharing the burden of adjustment across multiple instruments, including a devaluation combined with an incomes/subsidy policy that would help to curb imports, makes sense given the extent of rufiyaa overvaluation and the very weak levels of reserves. Import compression could alternatively be achieved through duty hikes, but such increases would harm the dollar-earning resort sector and are thus a second best.

32. Monetary policy should be tightened and the operations framework reformed to mop up liquidity, keep inflation under control, prevent the need for further devaluation, and facilitate government financing. The policy rate should be increased substantially, and pressures to loosen policy by reducing the MRR, refraining from conducting OMOs, and monetizing the deficit directly should be resisted staunchly. At the same time, a reduction in the Lombard rate and a longer reserve maintenance period could help increase the demand for Treasury bills, as could efforts to develop sharia-compliant instruments and to create a secondary market in government securities. The MMA's preliminary plans coincide with this advice in many respects.

33. Financial supervision, particularly with regard to BML, needs strengthening. The MMA's approach has been to offer forbearance, often on an across-the-board basis, instead of insisting on compliance with prudential requirements and working with individual banks with difficulties to come into compliance as quickly as possible. This should change. It will also be important to move toward a more forward-looking, risk-based supervisory regime, and to quickly adopt the AML/CFT bill. Deposit insurance should not be introduced for the time being. As for the BML, an independent assessment should be obtained as a high priority, possibly setting the stage for bringing in a strategic investor who could recapitalize the bank.

34. The authorities' development plans, focusing on population consolidation and economic diversification, appear sound but need popular consensus to be successful. Population consolidation can dramatically reduce the costs of administration and service provision, but it will be important that this remain a voluntary exercise, as the authorities repeatedly emphasized, to avoid social disruption. The initiative may, over time, provide the scope for public service downsizing, and in that context especially, the authorities are right to focus on developing job opportunities in new, labor-intensive sectors, which will also help reduce Maldives' current vulnerability to a downturn in tourism demand. Given Maldives' structural challenges, capital-market-development goals should be realistic and achievable.

35. The authorities have expressed interest in an IMF program, but will need a firm and comprehensive set of policies in place to proceed. Pursuing fiscal and external adjustment, which the market will anyway require given limited budget financing and declining international reserves, in the context of an IMF program could be helpful. As Maldives would first need to develop a good track record of policy implementation, an SMP could be a first step and could help to catalyze other financing flows. Such a program would need to feature a comprehensive set of policy responses to address Maldives' imbalances.

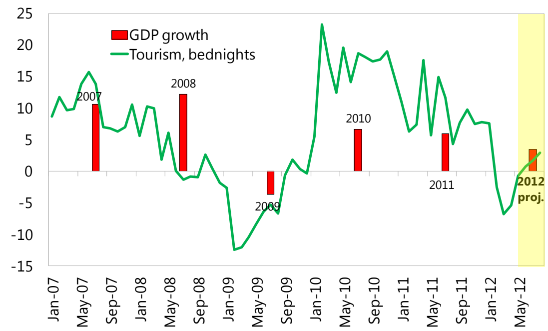
36. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Real and External Sector Developments

Growth is expected to drop in 2012 as domestic political turmoil and the European slowdown are hitting tourism.

Tourism

(Year-on-year growth, in percent)

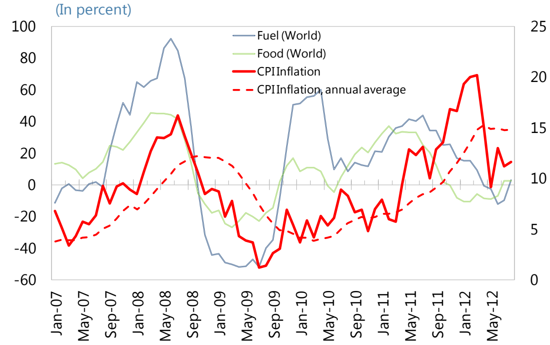


Sources: Maldivian authorities; and IMF staff estimates.

Inflation spiked with the April 2011 devaluation and remains high on account of tax increases and commodity price pressures.

Inflation

(In percent)

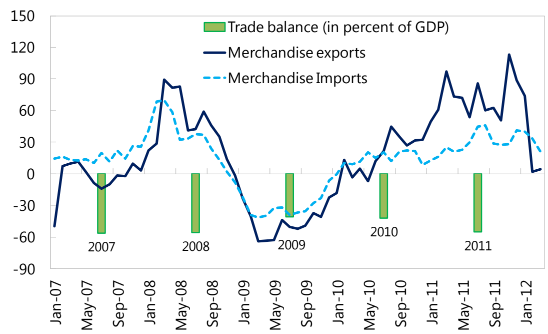


Sources: Maldivian authorities; and IMF staff estimates.

With not only tourism weakening, but the goods trade balance also worsening, driven by oil prices and loose fiscal policy…

Merchandise Exports and Total Imports

(Year-on-year growth, 3mma in percent)

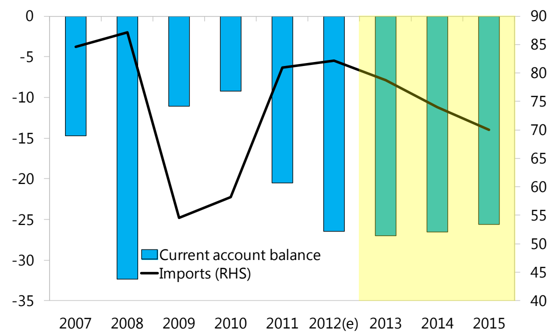


Sources: Maldivian authorities; and IMF staff estimates.

…the current account deficit has widened.

External Current Account

(In percent of GDP)

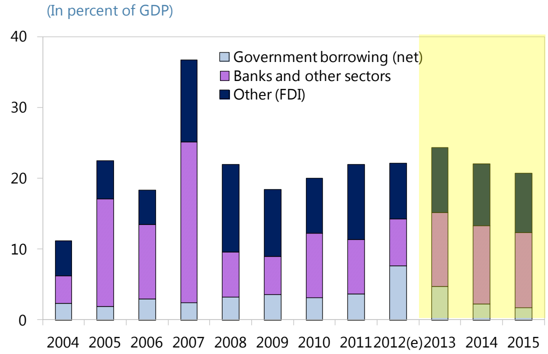


Sources: Maldivian authorities; and IMF staff estimates.

In the absence of sustainably higher capital inflows…

Capital Account

(In percent of GDP)

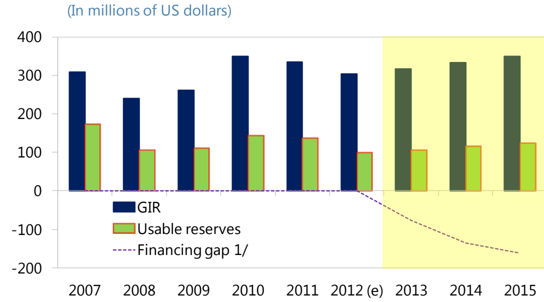


Sources: Maldivian authorities; and IMF staff estimates.

…Maldives would face large financing gaps starting next year, on account of loose fiscal policies in the baseline.

International Reserves

(In millions of US dollars)



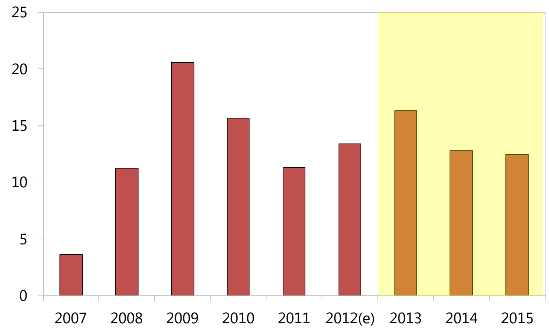
Sources: Maldivian authorities; and IMF staff estimates.

1/ Assumed financing to keep GIR from falling below end-2012's months of import coverage.

Figure 2. Fiscal Developments

On current policies, the fiscal deficit will rise in 2012 and remain bloated into the medium term…

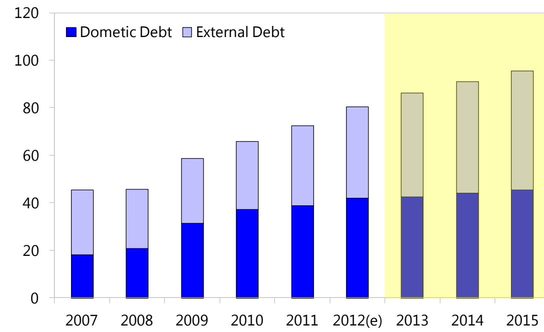
Overall Fiscal Deficit
(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

…leaving debt on an increasing path.

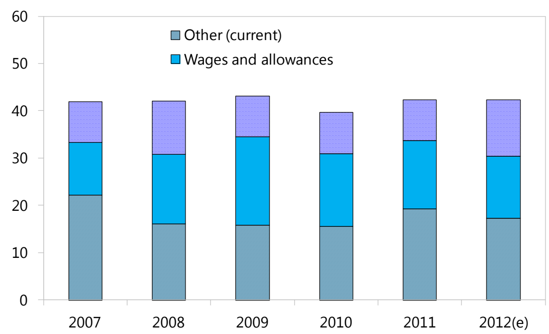
Public Debt
(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

Expenditures have remained high…

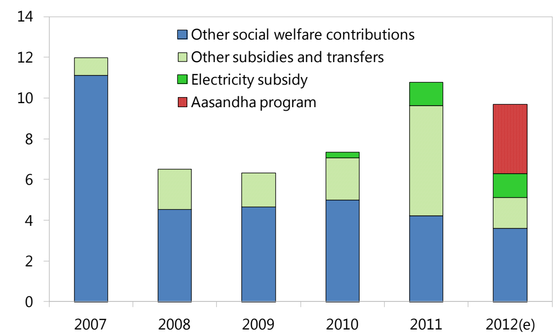
Central Government Expenditure
(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

…reflecting the new universal health insurance scheme as well as other subsidies.

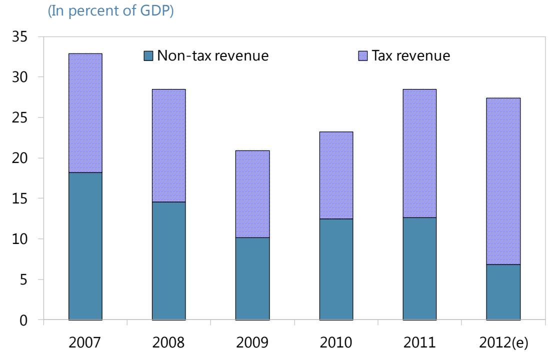
Social Welfare, Subsidies and Transfers
(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

Revenues are expected to drop slightly from 2011 to 2012…

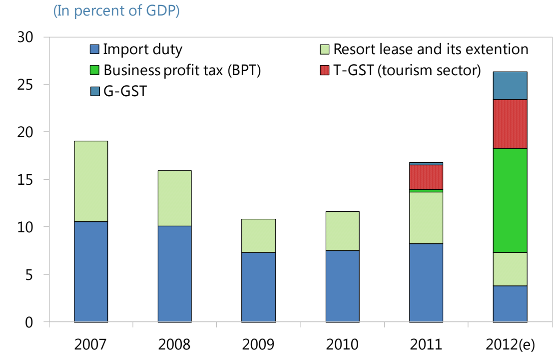
Central Government Revenue
(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

…as new tax streams have been offset by other losses and giveaways.

Major Tax and Non-tax Receipts
(In percent of GDP)



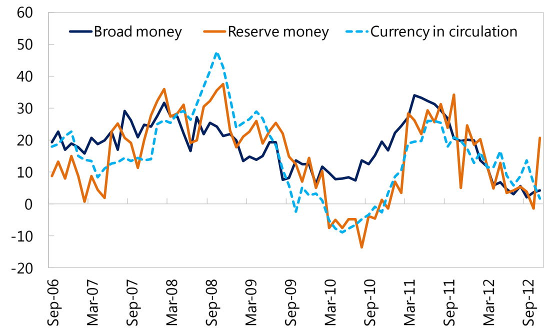
Sources: Maldivian authorities; and IMF staff estimates.

Figure 3. Monetary and Financial Sector Developments

Monetary aggregates have broadly remained muted…

Monetary Variables

(Year-on-year growth, in percent)

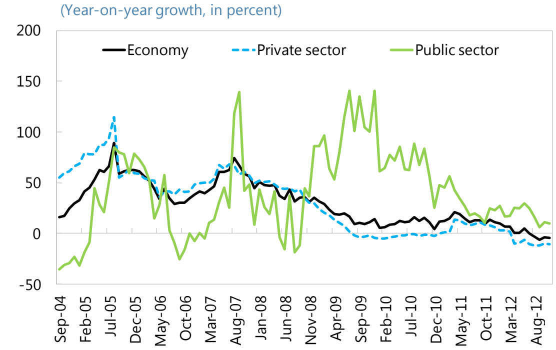


Sources: Maldivian authorities; and IMF staff estimates

…with the public sector crowding out the private sector amid tepid credit growth…

Credit

(Year-on-year growth, in percent)

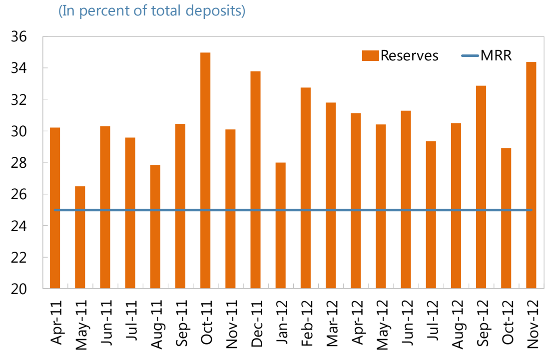


Sources: Maldivian authorities; and IMF staff estimates.

…despite substantial excess liquidity being held by commercial banks.

Commercial Banks' Reserves

(In percent of total deposits)

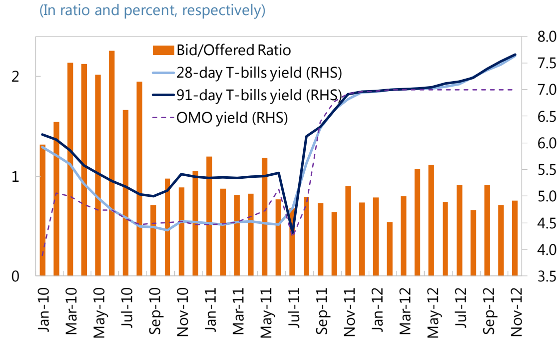


Sources: Maldivian authorities; and IMF staff estimates.

The government is facing increasing difficulty in tapping the securities market.

T-Bills Auctions Activity and Average Yields 1/

(In ratio and percent, respectively)



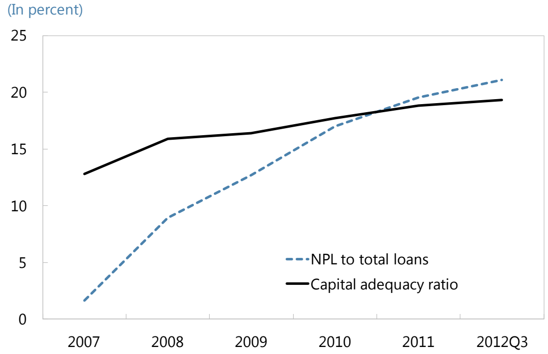
Sources: Maldivian authorities; and IMF staff estimates.

1/ Monthly average of weighted average yields.

NPLs have worsened…

Commercial Banks' Capital and Credit Quality Indicators

(In percent)

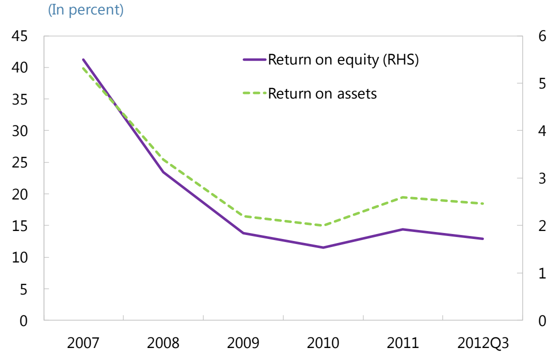


Source: Maldivian authorities.

…and profitability is low.

Commercial Banks' Profitability Indicators

(In percent)



Source: Maldivian authorities.

Table 1. Maldives: Selected Economic and Vulnerability Indicators, 2007–15 (Baseline Scenario)

Population (in 1,000; 2009 est.)	315								
GDP per capita (in U.S. dollars; 2009 est.):	6,305								
Quota (in million SDRs):	10.0								

	2007	2008	2009	2010	2011	2012	2013	2014	2015
						Est.		Proj.	
Output and prices				(Annual percentage change)					
Real GDP	10.6	12.2	-3.6	7.1	7.0	3.5	3.8	4.0	4.1
Inflation (end-of-period) 1/	8.9	8.9	5.4	6.9	16.7	8.0	4.7	4.5	4.4
Inflation (period average) 1/	6.8	12.0	4.5	6.1	11.3	12.3	5.8	5.1	4.4
GDP deflator	7.0	9.3	8.9	0.4	7.5	4.5	4.2	6.2	5.3
Central government finances				(In percent of GDP)					
Revenue and grants	38.4	30.8	22.6	23.9	31.0	28.9	32.4	31.1	30.3
Expenditure and net lending	42.0	42.0	43.1	39.6	42.3	42.3	48.7	43.9	42.8
Overall balance 2/	-3.6	-11.2	-20.5	-15.6	-11.3	-13.4	-16.3	-12.8	-12.4
Overall balance excl. grants	-8.9	-13.4	-22.2	-16.2	-13.7	-14.8	-18.5	-14.3	-14.0
Financing	3.6	11.2	20.5	15.6	11.3	13.4	16.3	12.8	12.4
Foreign 3/	3.5	3.1	5.4	7.5	3.8	7.7	7.9	7.4	7.3
Of which: Privatization receipts	0.0	0.0	2.0	4.4	0.0	0.0	0.0	0.0	0.0
Domestic	0.1	8.1	15.1	8.1	7.5	5.7	8.4	5.4	5.2
Of which: Privatization receipts	0.2	0.2	0.0	0.1	1.2	0.0	0.0	0.0	0.0
Public and publicly guaranteed debt	45.3	45.7	58.6	65.7	72.4	80.4	86.2	90.9	95.5
Domestic	18.1	20.8	31.4	37.2	38.9	41.8	42.4	44.0	45.5
External (excluding IMF and currency swaps by MMA)	27.2	24.9	27.2	28.4	33.5	38.6	52.9	46.9	50.1
Monetary accounts				(Annual percentage change, unless otherwise indicated)					
Broad money	24.1	21.8	14.4	14.6	20.0	9.2	8.4	…	…
Domestic credit	44.7	35.2	14.0	4.7	11.2	-1.8	4.6	…	…
Of which: To private sector	49.4	29.7	-4.1	-2.3	5.9	-7.9	-4.5	…	…
NFA of commercial banks (in millions of US$, e.o.p.)	-341	-371	-345	-264	-120	52	82	…	…
Net open forex position of commercial banks (in millions of US$, e.o.p.)	73	175	195	172	201	…	…	…	…
Balance of payments				(In percent of GDP, unless otherwise indicated)					
Current account	-14.7	-32.4	-11.1	-9.2	-20.5	-26.5	-27.0	-26.5	-25.7
Of which:									
Exports	14.8	17.5	8.5	9.2	16.2	15.0	13.7	13.3	12.9
Domestic	7.0	6.7	3.8	3.4	6.0	6.5	6.3	5.9	5.7
Re-exports	7.8	10.9	4.7	5.8	10.3	8.5	7.4	7.4	7.2
Imports	-84.6	-87.2	-54.5	-58.2	-80.9	-82.1	-78.7	-74.0	-70.1
Nonfactor services, net	80.8	64.0	57.7	63.7	68.6	65.7	63.0	60.2	58.0
Capital and financial account (including e&o)	19.6	28.8	12.2	13.4	19.8	25.1	24.3	22.0	20.7
Of which:									
General government, net	2.4	3.2	3.6	3.1	3.6	7.7	4.7	2.2	1.7
Banks and other sectors, net	23.0	6.5	4.5	8.5	7.8	6.5	10.4	11.0	10.5
Additional donor financing catalyzed by an SMP	…	…	…	…	…	…	…	…	…
Overall balance	4.9	-3.6	1.0	4.2	-0.7	-1.4	-2.7	-4.5	-5.0
Financing gap 4/	0.0	0.0	0.0	0.0	0.0	0.0	3.2	5.2	5.6
Gross international reserves (in millions of US$; e.o.p.) 5/	308	241	261	350	335	304	317	333	350
In months of GNFS imports	2.3	1.4	2.1	2.5	1.8	1.6	1.6	1.6	1.6
In percent of short-term debt at remaining maturity	91	78	91	103	72	50	41	36	33
Usable reserves (in millions of US$; e.o.p.) 6/	172	106	112	144	137	99	106	115	124
In percent of short-term debt at remaining maturity	51	33	39	42	29	16	14	12	12
External debt 6/	64	52	53	58	71	86	98	107	115.1
Medium- and long-term	48	40	44	48	57	69	79	87	93.1
Short-term	16	12	10	10	13	16	19	20	21.9
In percent of domestic GNFS exports	59	56	65	65	70	91	107	122	135.2
External debt service (in percent of domestic GNFS exports)	6	7	7	7	8	12	16	20	22.8
Exchange rate (rufyiaa/US$, e.o.p.)	12.8	12.8	12.8	12.8	15.4	15.4	…	…	…
Memorandum items:									
GDP (in millions of rufyiaa)	19,737	24,213	25,403	27,316	31,447	34,012	36,774	40,640	44,560
GDP (in millions of U.S. dollars)	1,542	1,892	1,985	2,134	2,132	2,209	2,388	2,639	2,893

Sources: Maldivian authorities; and IMF staff estimates and projections.
1/ CPI-Male definition.
2/ Arrears were accumulated in 2011 and 2012, and are assumed to be cleared by 2013.
3/ Reflects BOP financing gap shown below.
4/ Assumed financing to keep GIR from falling below end-2012's months of import coverage.
5/ 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.
6/ Includes IMF but excludes domestic foreign-currency denominated debt.

Table 2a. Maldives: Central Government Finances, 2007–15 (Baseline Scenario)

(In millions of rufiyaa)

	2007	2008	2009	2010	2011	2012	2013		2014	2015
					Est.	Proj.	Budget	Proj.	Proj.	Proj.
Total revenue and grants	7,571	7,457	5,735	6,540	9,747	9,827	12,509	11,906	12,634	13,523
Revenue (excluding privatization receipts)	6,527	6,940	5,313	6,386	8,975	9,344	11,949	11,106	12,001	12,851
Tax revenue	2,905	3,367	2,732	2,931	4,984	6,995	…	8,382	9,141	9,715
Import duties	2,087	2,449	1,849	2,056	2,590	1,287	…	1,693	1,717	1,776
Airport service charge	0	0	2	36	337	324	…	299	313	328
Business profit tax (BPT)	0	0	0	0	35	1,508	…	1,407	1,555	1,705
Goods and services tax (GST)	0	0	0	0	911	2,748	…	4,236	5,143	5,453
Of which: General GST	0	0	0	0	83	987	…	1,214	1,341	1,470
Tourism GST 1/	0	0	0	0	827	1,761	…	3,023	3,802	3,983
Tourism tax ($8 bed tax) 1/	547	567	531	597	751	813	…	374	0	0
Other	271	351	350	242	360	316	…	373	413	453
Nontax revenue	3,586	3,530	2,567	3,405	3,961	2,314	…	2,692	2,827	3,100
SOE profit transfers	789	1,015	677	1,074	833	423	…	675	785	860
Royalties, land, and resort rent	1,854	1,618	1,041	1,264	2,390	1,305	…	1,279	1,287	1,411
Other	943	898	849	1,068	737	586	…	738	755	828
Capital revenue	37	42	14	49	30	35	…	32	34	37
Grants	1,044	517	422	155	772	482	560	800	633	671
Expenditure and net lending	8,283	10,176	10,953	10,815	13,294	14,382	14,046	17,899	17,828	19,069
Current expenditure	6,560	7,463	8,765	8,428	10,598	10,353	9,994	13,737	14,094	14,974
Of which: Salaries and allowances	2,196	3,566	4,743	4,178	4,547	4,504	…	5,090	5,352	5,604
Transportation, communication, and utilities	1,011	1,045	884	865	952	864	…	1,116	1,233	1,352
Social welfare contributions	2,193	1,097	1,179	1,361	1,329	2,371	…	3,311	2,335	2,446
Repairs and maintenance	193	181	138	122	124	128	…	227	251	276
Subsidies and transfers	168	479	422	639	2,053	921	…	1,491	2,188	2,334
Food, medicine and other	113	410	327	390	1,277	266	…	667	702	733
Pensions	55	70	95	249	248	281	…	297	933	1,023
Interest	234	280	618	676	730	925	…	1,423	1,543	1,657
Other	565	815	782	588	863	641	…	1,078	1,191	1,306
Capital expenditure	1,765	2,879	2,339	2,568	3,041	4,154	4,163	4,289	3,861	4,234
Net lending	-42	-166	-151	-181	-344	-126	-111	-127	-127	-139
Overall balance	-712	-2,719	-5,219	-4,275	-3,547	-4,555	-1,536	-5,994	-5,194	-5,547
Overall balance, excluding grants	-1,756	-3,236	-5,640	-4,429	-4,320	-5,037	-2,097	-6,793	-5,827	-6,218
Financing 2/	712	2,719	5,219	4,275	3,547	4,555	1,536	5,994	5,194	5,547
Privatization	37	42	514	1,236	377	0	…	0	0	0
External sources	0	0	502	1,205	0	0	…	0	0	0
Domestic sources	37	42	11	32	377	0	…	0	0	0
External debt	697	748	868	858	1,198	2,604	…	2,912	3,000	3,249
Domestic debt	-22	1,929	3,837	2,181	1,972	1,951	…	3,082	2,195	2,297

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

1/ The bed tax will be eliminated at mid-2013.

2/ Includes unidentified financing.

Table 2b. Maldives: Central Government Finances, 2007–15 (Baseline Scenario)

(In percent of GDP, unless otherwise specified)

	2007	2008	2009	2010	2011	2012	2013		2014	2015
					Est.	Proj.	Budget	Proj.	Proj.	Proj.
Total revenue and grants	38.4	30.8	22.6	23.9	31.0	28.9	32.8	32.4	31.1	30.3
Revenue (excluding privatization receipts)	33.1	28.7	20.9	23.4	28.5	27.5	31.3	30.2	29.5	28.8
Tax revenue	14.7	13.9	10.8	10.7	15.8	20.6	...	22.8	22.5	21.8
Import duties	10.6	10.1	7.3	7.5	8.2	3.8	...	4.6	4.2	4.0
Airport service charge	0.0	0.0	0.0	0.1	1.1	1.0	...	0.8	0.8	0.7
Business profit tax (BPT)	0.0	0.0	0.0	0.0	0.1	4.4	...	3.8	3.8	3.8
Goods and services tax (GST)	0.0	0.0	0.0	0.0	2.9	8.1	...	11.5	12.7	12.2
Of which: General GST	0.0	0.0	0.0	0.0	0.3	2.9	...	3.3	3.3	3.3
Tourism GST 1/	0.0	0.0	0.0	0.0	2.6	5.2	...	8.2	9.4	8.9
Tourism tax ($8 bed tax) 1/	2.8	2.3	2.1	2.2	2.4	2.4	...	1.0	0.0	0.0
Other	1.4	1.5	1.4	0.9	1.1	0.9	...	1.0	1.0	1.0
Nontax revenue	18.2	14.6	10.1	12.5	12.6	6.8	...	7.3	7.0	7.0
SOE profit transfers	4.0	4.2	2.7	3.9	2.7	1.2	...	1.8	1.9	1.9
Royalties, land, and resort rent	9.4	6.7	4.1	4.6	7.6	3.8	...	3.5	3.2	3.2
Other	4.8	3.7	3.3	3.9	2.3	1.7	...	2.0	1.9	1.9
Capital revenue	0.2	0.2	0.1	0.2	0.1	0.1	...	0.1	0.1	0.1
Grants	5.3	2.1	1.7	0.6	2.5	1.4	1.5	2.2	1.6	1.5
Expenditure and net lending	42.0	42.0	43.1	39.6	42.3	42.3	36.8	48.7	43.9	42.8
Current expenditure	33.2	30.8	34.5	30.9	33.7	30.4	26.2	37.4	34.7	33.6
Of which: Salaries and allowances	11.1	14.7	18.7	15.3	14.5	13.2	...	13.8	13.2	12.6
Transportation, communication, and utilities	5.1	4.3	3.5	3.2	3.0	2.5	...	3.0	3.0	3.0
Social welfare contributions	11.1	4.5	4.6	5.0	4.2	7.0	...	9.0	5.7	5.5
Repairs and maintenance	1.0	0.7	0.5	0.4	0.4	0.4	...	0.6	0.6	0.6
Subsidies and transfers	0.9	2.0	1.7	2.3	6.5	2.7	...	4.1	5.4	5.2
Food, medicine, and other	0.6	1.7	1.3	1.4	4.1	0.8	...	1.8	1.7	1.6
Pensions	0.3	0.3	0.4	0.9	0.8	0.8	...	0.8	2.3	2.3
Interest	1.2	1.2	2.4	2.5	2.3	2.7	...	3.9	3.8	3.7
Other	2.9	3.4	3.1	2.2	2.7	1.9	...	2.9	2.9	2.9
Capital expenditure	8.9	11.9	9.2	9.4	9.7	12.2	10.9	11.7	9.5	9.5
Net lending	-0.2	-0.7	-0.6	-0.7	-1.1	-0.4	-0.3	-0.3	-0.3	-0.3
Overall balance	-3.6	-11.2	-20.5	-15.6	-11.3	-13.4	-4.0	-16.3	-12.8	-12.4
Overall balance, excluding grants	-8.9	-13.4	-22.2	-16.2	-13.7	-14.8	-5.5	-18.5	-14.3	-14.0
Financing 2/	3.6	11.2	20.5	15.6	11.3	13.4	4.0	16.3	12.8	12.4
Privatization	0.2	0.2	2.0	4.5	1.2	0.0	...	0.0	0.0	0.0
External sources	0.0	0.0	2.0	4.4	0.0	0.0	...	0.0	0.0	0.0
Domestic sources	0.2	0.2	0.0	0.1	1.2	0.0	...	0.0	0.0	0.0
External debt	3.5	3.1	3.4	3.1	3.8	7.7	...	7.9	7.4	7.3
Domestic debt	-0.1	8.0	15.1	8.0	6.3	5.7	...	8.4	5.4	5.2
Memorandum items:										
Current balance	-0.2	-2.2	-13.6	-7.5	-5.2	-3.0	...	-7.2	-5.1	-4.8
Primary balance	-2.4	-10.1	-18.1	-13.2	-9.0	-10.7	...	-12.4	-9.0	-8.7
Public and publicly guaranteed debt 3/	45.3	45.7	58.6	65.7	72.4	80.4	...	86.2	90.9	95.5
Domestic	18.1	20.8	31.4	37.2	38.9	41.8	...	44.2	44.0	45.5
External (excluding IMF and currency swaps by MMA)	27.2	24.9	27.2	28.4	33.5	38.6	...	52.9	46.9	50.1
GDP (in millions of rufiyaa)	19,737	24,213	25,403	27,316	31,447	34,012	38,153	36,774	40,640	44,560

Sources: Maldivian authorities; and IMF staff estimates and projections.
1/ The bed tax will be eliminated at mid-2013.
2/ Includes unidentified financing.
3/ Arrears are not included.

Table 2c. Statement of General Government Operations, 2007–15 (Baseline Scenario)

(In millions of rufiyaa)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
					Est.	Proj.			
Revenue	7,535	7,414	5,721	6,491	9,717	9,791	11,873	12,600	13,486
Tax revenue	2,905	3,367	2,732	2,931	4,984	6,995	8,382	9,141	9,715
Taxes on income, profits, and capital gains	0	0	0	0	35	1,508	1,407	1,555	1,705
Payable by individuals	0	0	0	0	0	0	0	0	0
Payable by corporations and other enterprises	0	0	0	0	35	1,508	1,407	1,555	1,705
Taxes on goods and services	0	0	0	0	911	2,748	4,236	5,143	5,453
General GST	0	0	0	0	83	987	1,214	1,341	1,470
Tourism GST	0	0	0	0	827	1,761	3,023	3,802	3,983
Taxes on international trade and transactions	2,087	2,449	1,849	2,056	2,590	1,287	1,693	1,717	1,776
Taxes not elsewhere classified	819	918	883	875	1,448	1,452	1,046	726	781
Airport service charges	0	0	2	36	337	324	299	313	328
Tourism ($8 bed tax) 1/	547	567	531	597	751	813	374	0	0
Other	271	351	350	242	360	316	373	413	453
Grants	1,044	517	422	155	772	482	800	633	671
Other revenue	3,586	3,530	2,567	3,405	3,961	2,314	2,692	2,827	3,100
Administrative fees and charges	786	771	750	997	683	525	670	690	757
Interest income	157	127	99	71	54	61	67	65	71
Resort lease rent 2/	1,669	1,403	898	1,106	1,702	1,195	1,118	1,118	1,226
SOEs dividend payments	789	1,015	677	1,074	833	423	675	785	860
Other	185	215	143	158	688	110	161	169	186
Total expenditure	8,289	10,300	11,090	10,947	13,608	14,472	17,994	17,921	19,171
Expense	6,560	7,463	8,765	8,428	10,598	10,353	13,737	14,094	14,974
Compensation of employees	2,196	3,566	4,743	4,178	4,547	4,504	5,090	5,352	5,604
Goods and services	1,748	2,019	1,788	1,561	2,451	1,982	2,922	3,201	3,480
Interest	234	280	618	676	730	925	1,423	1,543	1,657
Subsidies	113	410	327	390	1,277	266	667	702	733
Social benefits	2,248	1,167	1,274	1,610	1,577	2,652	3,608	3,268	3,469
Miscellaneous other expense	21	22	16	13	16	24	26	29	31
Net acquisition of nonfinancial assets	1,729	2,837	2,325	2,519	3,010	4,119	4,257	3,828	4,197
Domestically financed	1,202	1,739	1,587	1,263	1,580	1,931	2,037	2,528	2,772
Capital expenditure (domestically financed)	1,238	1,781	1,601	1,312	1,610	1,967	2,070	2,562	2,809
Capital revenue	-37	-42	-14	-49	-30	-35	-32	-34	-37
Externally financed	527	1,098	738	1,256	1,431	2,188	2,219	1,299	1,425
Capital expenditure (foreign financed)	527	1,098	738	1,256	1,431	2,188	2,219	1,299	1,425
Gross operating balance	975	-49	-3,044	-1,937	-881	-562	-1,864	-1,493	-1,489
Net lending/borrowing (overall balance)	-754	-2,886	-5,369	-4,456	-3,891	-4,681	-6,120	-5,321	-5,685
Net financial transactions	-754	-2,886	-5,369	-4,456	-3,891	-4,681	-6,120	-5,321	-5,685
Net acquisition of financial assets	643	1,046	-292	-1,523	-1,213	126	127	127	139
Domestic	456	273	-61	-197	-1,001	126	127	127	139
Currency and deposits	315	159	50	-204	-751	0	0	0	0
Loans	39	-4	-4	-4	14	126	127	127	139
Account payable	102	117	-96	43	113	0	0	0	0
Equity and investment fund shares	0	0	-11	-32	-377	0	0	0	0
Foreign	187	773	-232	-1,326	-212	0	0	0	0
Currency and deposits	223	-46	261	-211	-96	0	0	0	0
Loans	0	861	9	89	-117	0	0	0	0
Equity and investment fund shares	-37	-42	-502	-1,205	0	0	0	0	0
Net incurrence of liabilities	809	2,542	4,555	2,357	2,123	5,332	9,152	10,372	11,418
Domestic	248	1,708	2,969	903	648	3,498	7,009	7,372	8,168
Currency and deposits	0	0	0	0	0	0	0	0	0
Debt securities	146	168	6,304	906	642	3,498	7,009	7,372	8,168
Treasury bills	140	174	2,121	1,195	642	4,132	7,326	7,689	8,485
Commercial banks	140	177	1,892	716	245	0	0	0	0
Non banks	0	-3	229	479	397	0	0	0	0
Other	0	0	0	0	0	0	0	0	0
Treasury bonds (ways and means account)	6	-6	4,183	-289	0	-634	-317	-317	-317
Loans	102	1,540	-3,334	-4	7	0	0	0	0
Foreign	561	833	1,586	1,454	1,475	1,834	2,142	3,000	3,249
Debt securities	0	0	640	640	260	-770	-770	0	0
Loans	561	833	946	814	1,215	2,604	2,912	3,000	3,249
Statistical discrepancy	*588*	*1,390*	*522*	*577*	*555*	*-525*	*-2,905*	*-4,924*	*-5,593*
Memorandum items:									
Primary balance	-520	-2,606	-4,752	-3,780	-3,161	-3,757	-4,697	-3,778	-4,028
Overall balance excluding grants	290	-2,369	-4,948	-4,302	-3,119	-4,199	-5,321	-4,688	-5,014
Net privatization proceeds	37	42	514	1,236	377	0	0	0	0
Public and publicly guaranteed debt	8,945	11,074	14,877	17,938	22,758	27,360	31,688	36,953	42,571
Domestic	3,570	5,036	7,972	10,175	12,220	14,218	16,254	17,899	20,268
External (excluding IMF and currency swaps by MMA)	5,375	6,038	6,905	7,763	10,538	13,142	19,458	19,054	22,303
GDP at market prices	19,737	24,213	25,403	27,316	31,447	34,012	36,774	40,640	44,560

Sources: Maldivian authorities; and IMF staff estimates and projections.
1/ The bed tax will be eliminated at mid-2013.
2/ It includes lease extension payments in 2011 and 2012.

Table 3. Maldives: Monetary Accounts, 2007–13 (Baseline Scenario)

	2007	2008	2009	2010	2011	2012	2013
						Est.	Proj.
				(In millions of rufiyaa, e.o.p.)			
Net foreign assets	-510	-1,732	-1,339	686	2,873	5,053	5,692
Maldives Monetary Authority, net	3,857	3,022	3,072	4,068	4,726	4,254	4,430
Assets	3,958	3,089	3,350	4,491	5,170	4,704	4,876
Liabilities	-101	-67	-278	-424	-444	-450	-445
Commercial banks, net	-4,368	-4,754	-4,410	-3,382	-1,852	799	1,261
Net domestic assets	10,449	13,842	15,194	15,198	16,184	15,752	16,869
Domestic credit	13,748	18,590	21,187	22,181	24,662	24,221	25,338
Public sector	1,222	2,274	5,462	6,846	8,480	9,415	11,195
Central government (net)	216	896	4,063	5,381	6,811	7,820	9,670
Public enterprises	1,005	1,377	1,399	1,465	1,668	1,595	1,524
Private sector	12,509	16,219	15,554	15,191	16,084	14,806	14,144
Other items (net)	-3,299	-4,748	-5,994	-6,983	-8,479	-8,469	-8,469
Broad money	9,939	12,110	13,855	15,884	19,057	20,805	22,561
Narrow money	4,449	6,098	7,457	7,539	8,187	8,933	9,687
Currency	1,142	1,510	1,541	1,571	1,857	2,424	1,995
Public enterprise and local government deposits	42	11	35	10	60	1	1
Demand deposits	3,265	4,577	5,880	5,958	6,270	6,509	7,691
Quasi-money	5,490	6,013	6,399	8,345	10,870	11,871	12,874
				(Percent change with respect to end of previous year)			
Broad money	24.1	21.8	14.4	14.6	20.0	9.2	8.4
Narrow money	20.0	37.1	22.3	1.1	8.6	9.1	8.4
Domestic credit, net	44.7	35.2	14.0	4.7	11.2	-1.8	4.6
Central government	-57.6	314.1	353.3	32.4	26.6	14.8	23.7
Public enterprises	75.6	37.0	1.6	4.7	13.9	-4.4	-4.4
Private sector	49.4	29.7	-4.1	-2.3	5.9	-7.9	-4.5
				(In percent of GDP)			
Broad money	50.4	50.0	54.5	58.1	60.6	61.2	61.3
Narrow money	22.5	25.2	29.4	27.6	26.0	26.3	26.3
Domestic credit, net	69.7	76.8	83.4	81.2	78.4	71.2	68.9
Central government	1.1	3.7	16.0	19.7	21.7	23.0	26.3
Public enterprises	5.1	5.7	5.5	5.4	5.3	4.7	4.1
Private sector	63.4	67.0	61.2	55.6	51.1	43.5	38.5
				(In millions of U.S. dollars)			
Gross foreign assets of MMA	308	241	261	350	335	304	317
Usable reserves	170	105	114	143	150	99	106
Commercial banks NFA	-341	-371	-345	-264	-120	52	82
Commercial banks forex open position, net	73	175	195	172	201	...	...
Assets	958	1,170	1,215	1,245	1,165	...	...
Liabilities	886	1,002	1,025	1,076	965	...	...
Of which: Forex deposits	452	480	507	609	635	...	...
Memorandum items:							
Velocity	1.99	2.00	1.80	1.72	1.63	1.63	1.63
Money multiplier	2.27	2.25	2.26	2.62	2.52	2.48	2.48
Reserve money (in millions of rufiyaa, e.o.p.)	4,374	5,382	6,144	6,064	7,551	8,373	9,080

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

Table 4. Maldives: Balance of Payments, 2007–15 (Baseline Scenario)

(In millions of U.S. dollars, unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
			Est.				Proj.		
Current account	-227	-612	-221	-197	-437	-585	-646	-700	-743
Balance of goods and nonfactor services	169	-107	232	313	84	-31	-47	-14	24
Trade balance	-1,077	-1,318	-913	-1,045	-1,379	-1,483	-1,552	-1,602	-1,655
Exports (f.o.b.)	228	331	169	197	346	331	327	351	373
Domestic exports	108	126	76	73	127	144	151	157	164
Re-exports	120	206	93	124	219	187	176	195	208
Imports (f.o.b.)	-1,305	-1,649	-1,082	-1,242	-1,725	-1,814	-1,879	-1,953	-2,027
Tourism-related	-314	-343	-206	-236	-328	-317	-327	-349	-372
Other	-991	-1,306	-876	-1,006	-1,397	-1,497	-1,552	-1,605	-1,655
Nonfactor services, net	1,246	1,210	1,145	1,359	1,463	1,452	1,506	1,588	1,678
Of which: Travel receipts	1,515	1,559	1,473	1,713	1,868	1,805	1,883	2,009	2,141
Income, net	-239	-290	-272	-311	-321	-320	-370	-416	-468
Current transfers, net	-156	-215	-181	-199	-200	-234	-229	-271	-299
Receipts	48	20	25	15	45	31	58	46	48
Payments	-204	-235	-205	-214	-245	-265	-287	-317	-347
Capital and financial group	565	414	365	426	467	489	581	581	598
Of which: 1/									
Foreign direct investment, net	132	181	158	156	197	166	221	232	243
Other investment, net	387	182	177	260	241	314	361	349	355
Monetary authorities 2/	-5	-3	16	11	-4	1	0	0	0
General government	36	61	71	67	78	169	112	59	50
Of which: Disbursements of loans	65	98	111	112	138	232	189	136	136
Amortization	-29	-37	-40	-45	-61	-63	-77	-77	-86
Banks	195	30	-27	-80	-48	-55	-30	0	0
Additional donor financing catalyzed by an SMP	0	0	0	0	0	0	0	0	0
Other sectors 3/	160	93	117	262	215	199	279	291	305
Errors and omissions	-263	131	-123	-140	-46	65	0	0	0
Overall balance	76	-68	20	89	-15	-31	-64	-120	-145
Gross international reserves (increase: -)	-76	68	-20	-89	15	31	-12	-17	-17
Use of Fund credit, net	0	-2	5	7	0	0	0	0	0
Financing gap 4/	0	0	0	0	0	0	77	136	161
Memorandum items:									
Gross international reserves (stock; e.o.p.) 2/	308	241	261	350	335	304	317	333	350
In months of GNFS imports	2.3	1.4	2.1	2.5	1.8	1.6	1.6	1.6	1.6
In percent of short-term debt at remaining maturity	91	78	91	103	72	50	41	36	33
Usable reserves (stock; e.o.p.) 2/	172	106	112	144	137	99	106	115	124
In percent of short-term debt at remaining maturity	51	33	39	42	29	16	14	12	12
Current account (in percent of GDP)	-14.7	-32.4	-11.1	-9.2	-20.5	-26.5	-27.0	-26.5	-25.7
GNFS balance (in percent of GDP)	11.0	-5.7	11.7	14.7	4.0	-1.4	-1.9	-0.5	0.8
Exports (volume, percent change)	-7.0	30.5	-44.1	9.6	59.2	-2.7	0.5	9.0	7.2
Imports (volume, percent change)	47.2	7.5	-21.0	2.1	19.6	6.4	6.0	5.5	5.1
Tourism: bednights (percent change)	9.8	2.9	-5.5	16.3	9.1	0.3	3.0	4.8	4.8
Tourism: travel receipts (percent change)	…	2.9	-5.5	16.3	9.0	-3.4	4.3	6.7	6.6
External debt (in percent of GDP) 5/	64.1	52.2	53.2	57.6	70.5	85.5	97.8	106.6	115.1
Medium- and long-term	48.2	40.5	43.6	47.6	57.4	69.3	79.2	86.5	93.1
Short-term	15.8	11.7	9.6	10.1	13.1	16.2	18.6	20.1	21.9
Debt service (in percent of domestic GNFS exports)	5.6	7.1	6.9	7.3	8.4	12.0	15.9	19.6	22.8
Exchange rate (rufiyaa per U.S. dollar; average)	12.8	12.8	12.8	12.8	14.8	…	…	…	…
GDP (in millions of U.S. dollars)	1,542	1,892	1,985	2,134	2,132	2,209	2,388	2,639	2,893

Sources: Maldivian authorities; and IMF staff estimates and projections.
1/ There are no capital transfers or portfolio investments.
2/ MMA liabilities, include allocation of SDR 7.4 million, equivalent to US$11.7 million, made available in Q3 2009, see http://www.imf.org/external/np/tre/sdr/proposal/2009/0709.htm. These are treated as long term liabilities of the MMA.
3/ These flows are treated as non-debt creating, as they mainly reflect intra-company financing for tourism-related projects.
4/Assumes financing to keep GIR from falling below end-2012's months of import coverage.
5/ Includes IMF, but excludes domestic foreign-currency denominated debt.

Table 5. Maldives: Selected Economic and Vulnerability Indicators, 2007–15 (Adjustment Scenario)

Population (in 1,000; 2009 est.)	315
GDP per capita (in U.S. dollars; 2009 est.):	6,305
Quota (in million SDRs):	10.0

	2007	2008	2009	2010	2011	2012	2013	2014	2015
						Est.		Proj.	
Output and prices			(Annual percentage change)						
Real GDP	10.6	12.2	-3.6	7.1	7.0	3.5	1.4	1.6	2.6
Inflation (end-of-period)	8.9	8.9	5.4	6.9	16.7	8.0	25.7	6.9	6.5
Inflation (period average)	6.8	12.0	4.5	6.1	11.3	12.3	24.1	9.0	9.7
GDP deflator	7.0	9.3	8.9	0.4	7.5	4.5	9.9	6.3	5.4
Central government finances			(In percent of GDP)						
Revenue and grants	38.4	30.8	22.6	23.9	31.0	28.9	34.5	34.8	36.2
Expenditure and net lending	42.0	42.0	43.1	39.6	42.3	42.3	49.0	44.9	45.1
Overall balance 2/	-3.6	-11.2	-20.5	-15.6	-11.3	-13.4	-14.5	-10.2	-8.9
Overall balance excluding grants	-8.9	-13.4	-22.2	-16.2	-13.7	-14.8	-17.0	-12.0	-10.5
Financing	3.6	11.2	20.5	15.6	11.3	13.4	14.5	10.2	8.9
Foreign 3/	3.5	3.1	5.4	7.5	3.8	7.7	5.5	2.6	2.1
Of which: Privatization receipts	0.0	0.0	2.0	4.4	0.0	0.0	0.0	0.0	0.0
Domestic	0.1	8.1	15.1	8.1	7.5	5.7	9.0	7.5	6.8
Of which: Privatization receipts	0.2	0.2	0.0	0.1	1.2	0.0	0.0	0.0	0.0
Public and publicly guaranteed debt	45.3	45.7	58.6	65.7	72.4	80.4	84.4	88.5	90.8
Domestic	18.1	20.8	31.4	37.2	38.9	41.8	44.2	48.7	51.9
External (excluding IMF and currency swaps by MMA)	27.2	24.9	27.2	28.4	33.5	38.6	53.3	39.8	38.9
Monetary accounts		(Annual percentage change, unless otherwise indicated)							
Broad money	24.1	21.8	14.4	14.6	20.0	9.2	11.4	…	…
Domestic credit	44.7	35.2	14.0	4.7	11.2	-1.8	0.4	…	…
Of which: To private sector	49.4	29.7	-4.1	-2.3	5.9	-7.9	-5.8	…	…
NFA of commercial banks (in millions of U.S. dollars, e.o.p.)	-341	-371	-345	-264	-120	52	-3	…	…
Net open forex position of commercial banks (in millions of U.S. dollars, e.o.p.)	73	175	195	172	201	…	…	…	…
Balance of payments			(In percent of GDP, unless otherwise indicated)						
Current account	-14.7	-32.4	-11.1	-9.2	-20.5	-28.1	-23.7	-21.6	-19.4
Of which:									
Exports	14.8	17.5	8.5	9.2	16.2	15.0	17.1	16.8	16.6
Domestic	7.0	6.7	3.8	3.4	6.0	6.5	7.6	7.6	7.7
Re-exports	7.8	10.9	4.7	5.8	10.3	8.5	9.5	9.1	8.9
Imports	-84.6	-87.2	-54.5	-58.2	-80.9	-82.1	-88.6	-84.5	-80.6
Nonfactor services, net	80.8	64.0	57.7	63.7	68.6	64.7	74.2	73.6	72.3
Capital and financial account (including e&o)	19.6	28.8	12.2	13.4	19.8	26.7	29.0	25.6	23.7
Of which:									
General government, net	2.4	3.2	3.6	3.1	3.6	2.2	5.5	2.6	2.1
Banks and other sectors, net	23.0	6.5	4.5	8.6	6.7	6.5	9.3	9.6	9.0
Additional donor financing catalyzed by an SMP	…	…	…	…	…	…	4.9	4.5	4.2
Overall balance	4.9	-3.6	1.0	4.2	-0.7	-1.4	5.3	4.0	4.3
Financing gap 4/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross international reserves (in millions of U.S. dollars; e.o.p.) 5/	308	241	261	350	335	304	412	502	606
In months of GNFS imports	2.3	1.4	2.1	2.5	1.8	1.6	2.2	2.6	3.0
In percent of short-term debt at remaining maturity	91	78	91	103	74	51	60	62	67
Usable reserves (in millions of U.S. dollars; e.o.p.) 6/	172	106	112	144	137	99	179	228	285
In percent of short-term debt at remaining maturity	51	33	39	42	30	16	26	28	32
External debt 6/	64	52	53	58	69	83	103	107	110.4
Medium- and long-term	48	40	44	48	57	66	84	87	88.3
Short-term	16	12	10	10	13	16	19	21	22.1
In percent of domestic GNFS exports	59	56	65	65	69	89	99	105	108.8
External debt service (in percent of domestic GNFS exports)	6	7	7	7	8	12	15	18	19.5
Exchange rate (rufyiaa/U.S. dollar, e.o.p.)	12.8	12.8	12.8	12.8	15.4	15.4	…	…	…
Memorandum items:									
GDP (in millions of rufyiaa)	19,737	24,213	25,403	27,316	31,447	34,012	37,906	40,955	44,307
GDP (in millions of U.S. dollars)	1,542	1,892	1,985	2,134	2,132	2,209	2,051	2,216	2,398

Sources: Maldivian authorities; and IMF staff estimates and projections.
1/ CPI-Male definition.
2/ Arrears were accumulated in 2011 and 2012 and are assumed to be cleared by 2013.
3/ Reflects BOP financing gap shown below.
4/ Assumed financing to keep GIR from falling below end-2012's months of import coverage.
5/ 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.
6/ Includes IMF but excludes domestic foreign-currency denominated debt.

APPENDIX I. MALDIVES: RISK ASSESSMENT MATRIX

Risk	Up/Down-side	Likelihood	Impact	Policy Response
Market appetite for government paper weakens markedly (i.e., T-bill undersubscription worsens).	↓	**M**	**H**	Accelerate fiscal adjustment; adjust exchange rate; tighten monetary policy; approach multilateral and bilateral donors for assistance.
General currency crisis, with importers unable to access dollars to finance imports of necessities.	↓	**M-L**	**H**	As above.
Cancellation of airport concession dampens investor sentiment.	↓	**M**	**M**	As above.
Tourist arrivals fall, whether on account of slower global growth or domestic political instability.	↓	**M-L**	**M**	Allow currency to depreciate (fiscal and monetary policy space both limited).
Depositors lose faith in BML, given weak capital.	↓	**M-L**	**M**	MMA's Bank Supervision Department to intervene in short term; also announce medium-term plan, including outside assessment and search for strategic investor.

APPENDIX II. UPDATED DEBT SUSTAINABILITY ANALYSIS USING THE LOW-INCOME COUNTRY FRAMEWORK

This appendix provides an update to the debt sustainability analysis (DSA) prepared in January 2011 (IMF Country Report No. 11/293).[1] *Under the baseline scenario, reflecting current policies, public debt is expected to rise steadily. As a result, the debt path is unsustainable and Maldives continues to face a high risk of public external debt distress.*

1. **Maldives' public debt reached 73 percent of GDP in 2011, an increase of about 6 percentage points since the last DSA.**[2] Debt dynamics remain unsustainable and are driven by excessive borrowings from the domestic market as well as external sources.[3]

2. **The country has relied heavily on the issuance of Treasury bills and external borrowings to finance large and sustained fiscal deficits.** Unmet financing needs, however, exist and have led to monetization of the deficit as well as the accumulation of domestic payments arrears, which the authorities estimate at about RF 1 billion, or 3 percent of GDP, at end-2012 but could be larger. The DSA does not explicitly include arrears in the analysis, given the uncertainty about the stock, but the arrears constitute a significant risk factor, as clearance of these obligations could lead to additional, formal debt that would worsen the profiles beyond what is shown in this appendix. Outstanding public domestic debt reached 39 percent of GDP in 2011. In addition, the country has received external financial assistance primarily from India and China in the form of commercial loans. External public debt stood at about 34 percent of GDP at end-2011. Looking forward, the authorities should formulate a comprehensive debt strategy and should seek additional donor support and increase the share of concessional borrowing for the external public debt, including for SOEs.

3. **Maldives' total debt (total public debt and private external debt) reached an estimated $2.3 billion, or 108 percent of GDP, in 2011.** In dollar terms, this is essentially unchanged from the 2010 DSA baseline, but with the GDP revision in 2011, the debt-GDP ratio has dropped from 143 percent in the full DSA. Private external debt is estimated to be about 35 percent of GDP in 2011.

4. **Total debt is estimated to have grown by over 20 percent to reach $2.8 billion, or 127 percent of GDP, in 2012.** External financing (both public and private) explains a 15 percentage-point increase. The remaining 6 percentage-point increase comes from domestic

[1] Full joint Bank-Fund LIC DSAs are prepared once every three years, with short annual updates in the intermediate years (Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries, 2010). This update was jointly prepared by Fund and Bank staffs.

[2] The introduction of the TGST at the beginning of 2011 showed the tourism sector to be much larger than previously thought. This prompted an upward revision to GDP that year, and the total public debt that was previously reported dropped substantially (from 96 to 67 percent of GDP).

[3] The significant additional debt since 2009 was primarily due to large fiscal slippages in recent years, relative to the path envisaged at the time of the 2010 Article IV Consultation. The 20 percent devaluation in April 2011 also boosted the rufiyaa value of external debt.

financing, mainly through the issuance of Treasury bills. With no privatization receipts expected this year, the fiscal deficit translates directly into growing debt, the former being 1 percent higher than in the 2010 DSA baseline.

5. **The macroeconomic assumptions in the near to medium term are broadly in line with the previous DSA.** Growth is expected to increase modestly to around 3¾ percent next year, with a projected average growth rate for 2014-18 of just above 4 percent, as against the 4½ percent rate assumed previously. The current account deficit is lower than in the previous DSA mainly because of higher-than-initially-projected tourism receipts, but is projected to remain around 26 percent of GDP on average in the medium term.[4] The fiscal deficit is expected to be lower relative to GDP than in the previous DSA. While the government implemented some revenue enhancing measures,[5] it also cut import duty rates substantially, offsetting the gains from new measures. Overly optimistic revenue projections in the approved 2012 budget failed to provide sufficient incentives for containing government spending, resulting in little consolidation of fiscal deficits. Nonetheless, with the upward revision to GDP, fiscal deficits have declined relative to GDP. As such, while this DSA continues to show that debt grows out of control in the baseline, just as in the last DSA, the debt ratio stays at lower levels throughout.

6. **As in the full DSA (IMF Country Report No. 11/293), this DSA update stresses that current policies would lead to extremely large domestic and external financing requirements.** The financing needs cannot realistically be met, and therefore the DSA calls for additional fiscal consolidation measures in the near term.[6] Notwithstanding its impact on narrowing the current account deficits, a devaluation of 20 percent would raise the rufiyaa value of the external debt in Maldives. But if this devaluation were to happen in the context of an adjustment scenario (see text chart and table and paragraph 16), the decline in fiscal deficits in 2014 and beyond would help to bring the debt to a sustainable path, the public debt ratios being stabilized at around 90 percent of GDP in 2016.

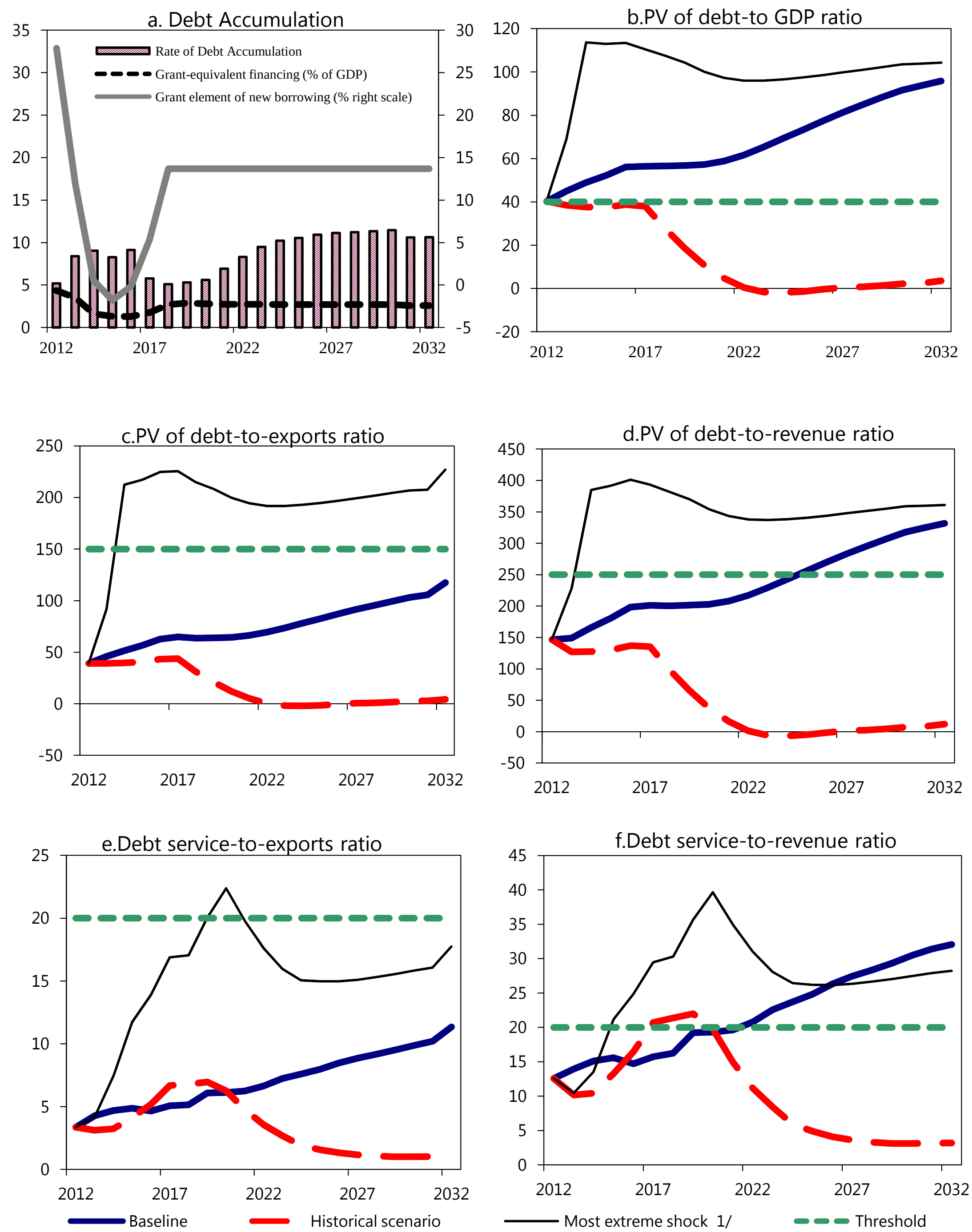
7. **With little relief expected from privatization proceeds, Maldives still confronts a high risk of external public debt distress.** The risk of sudden and disorderly adjustments exists. Further deterioration of public finances and shocks to exports and tourism earnings are important risks.

[4] The baseline scenario in the DSA assumes, for expositional convenience, that the nominal exchange rate peg holds. In practice, however, periodic devaluations would be needed to maintain competitiveness given the inflation differential. In the absence of such adjustments, the current account deficits would be worse than presented in the external DSA, and the paths presented in the baseline and other scenarios can thus be seen as a lower bound.

[5] The government introduced a business profits tax (BPT) and a general goods and services tax (GGST) in October 2011. At the beginning of 2012, the government raised the TGST and GGST rates from 3½ percent to 6 percent.

[6] In the external DSA, the overall balance of payments is in deficit, and reserves eventually turn negative, reflecting unmet financing gaps.

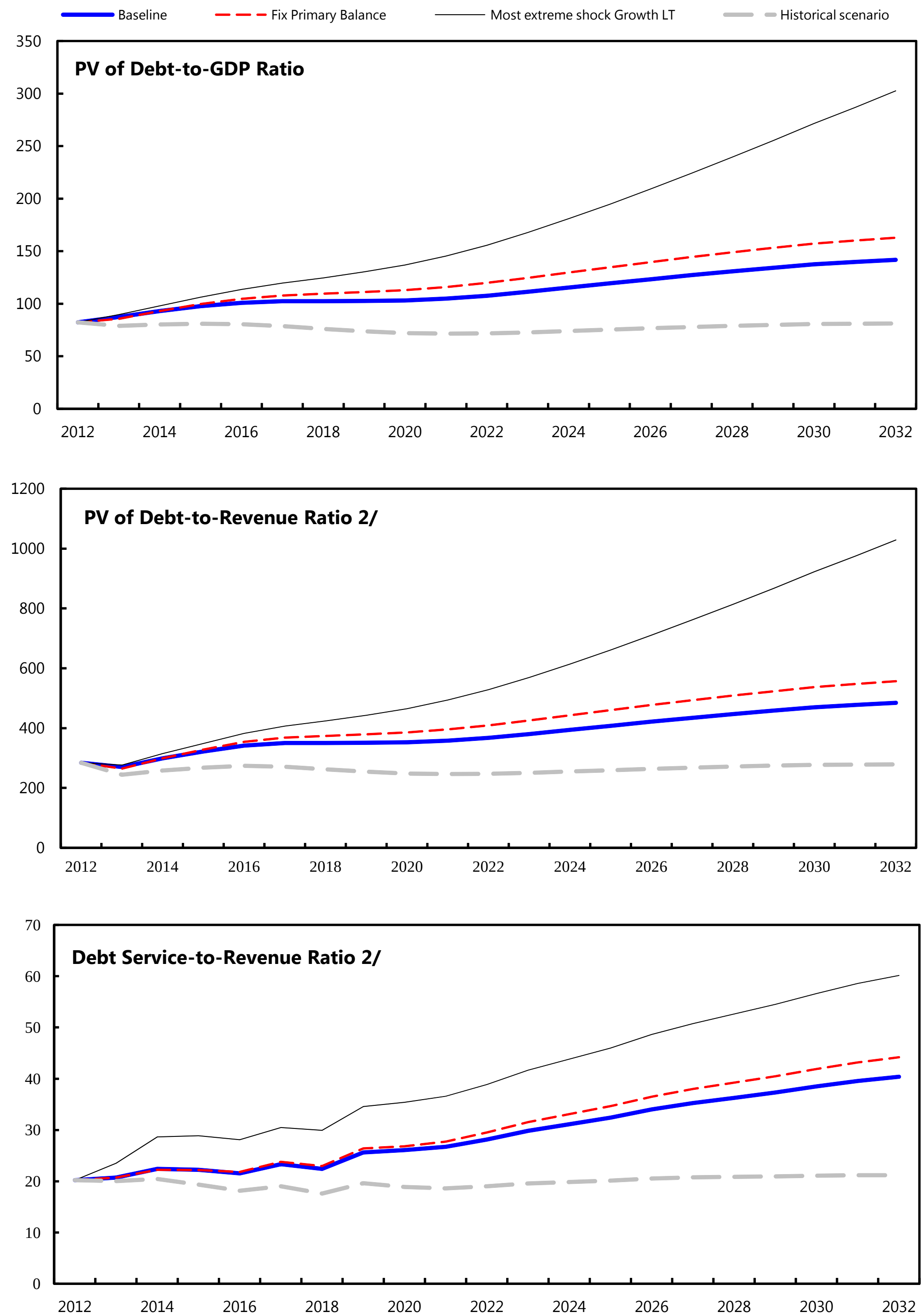
Figure 1a. Maldives: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2012–32 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022. 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 1b. Maldives: Indicators of Public Debt Under Alternative Scenarios, 2012–32 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2022.
2/ Revenues are defined inclusive of grants.

Table 1a. Maldives: Public Sector Debt Sustainability Framework, Baseline Scenario, 2009–32

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2009	2010	2011	Average 5/	Standard Deviation 5/	2012	2013	2014	2015	2016	2017	2012-17 Average	2022	2032	2018-32 Average
Public sector debt 1/	59.4	66.8	73.3			81.0	86.9	91.5	96.0	100.5	104.7		125.5	154.6	
o/w foreign-currency denominated	30.5	33.7	36.9			40.7	45.3	47.5	50.5	55.7	58.7		79.5	108.6	
Change in public sector debt	13.6	7.4	6.5			7.7	5.9	4.6	4.5	4.5	4.2		3.9	1.6	
Identified debt-creating flows	16.4	7.0	7.3			7.9	10.2	4.5	4.4	4.3	4.1		3.7	2.5	
Primary deficit	18.1	13.2	9.0	6.8	5.8	10.7	12.4	9.0	8.7	8.9	8.9	9.8	8.9	8.9	8.9
Revenue and grants	22.6	23.9	31.0			28.9	32.4	31.1	30.3	29.6	29.3		29.3	29.3	
of which: grants	1.7	0.6	2.5			1.4	2.2	1.6	1.5	1.3	1.2		0.9	0.4	
Primary (noninterest) expenditure	40.7	37.1	40.0			39.6	44.8	40.1	39.1	38.4	38.2		38.2	38.2	
Automatic debt dynamics	0.3	-1.7	-0.5			-2.8	-2.2	-4.5	-4.3	-4.6	-4.9		-5.2	-6.4	
Contribution from interest rate/growth differential	2.2	-1.9	-5.0			-1.9	-1.2	-2.5	-2.6	-3.1	-3.3		-3.4	-3.9	
of which: contribution from average real interest rate	0.5	2.0	-0.6			0.6	1.8	0.9	0.9	0.7	0.7		1.4	2.2	
of which: contribution from real GDP growth	1.7	-3.9	-4.4			-2.5	-2.9	-3.4	-3.6	-3.8	-4.0		-4.8	-6.0	
Contribution from real exchange rate depreciation	-1.9	0.3	4.5			-1.0	-1.0	-2.0	-1.7	-1.5	-1.6		...	...	
Other identified debt-creating flows	-2.0	-4.5	-1.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-2.0	-4.5	-1.2			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	-2.7	0.4	-0.8			-0.1	-4.3	0.0	0.1	0.1	0.1		0.1	-0.9	
Other Sustainability Indicators															
PV of public sector debt	...	...	77.0			82.1	87.4	93.0	97.7	100.9	102.4		107.6	141.8	
o/w foreign-currency denominated	...	...	40.6			41.8	45.7	48.9	52.2	56.1	56.5		61.7	95.9	
o/w external	...	...	38.2			40.3	45.1	48.9	52.2	56.1	56.5		61.7	95.9	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	42.4	47.2	46.7			52.4	57.8	54.3	55.6	56.8	56.7		59.3	62.9	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	248.6			284.2	270.1	299.1	321.8	341.2	349.9		367.7	484.5	
PV of public sector debt-to-revenue ratio (in percent)	...	...	270.0			298.9	289.5	314.9	338.6	356.9	364.6		378.8	490.6	
o/w external 3/	...	...	133.8			146.7	149.2	165.7	180.9	198.4	201.1		217.1	331.7	
Debt service-to-revenue and grants ratio (in percent) 4/	19.6	19.1	16.6			20.2	20.7	22.4	22.2	21.6	23.3		28.2	40.4	
Debt service-to-revenue ratio (in percent) 4/	21.2	19.6	18.1			21.2	22.2	23.6	23.4	22.5	24.3		29.0	40.9	
Primary deficit that stabilizes the debt-to-GDP ratio	4.5	5.8	2.4			3.0	6.5	4.4	4.2	4.4	4.8		5.1	7.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	-3.6	7.1	7.0	7.7	8.4	3.5	3.8	4.0	4.1	4.1	4.1	3.9	4.1	4.1	4.1
Average nominal interest rate on forex debt (in percent)	2.2	1.5	1.6	2.4	0.6	1.0	3.6	3.2	3.4	3.1	2.8	2.8	3.5	3.6	3.6
Average real interest rate on domestic debt (in percent)	0.7	7.2	-1.3	0.4	4.3	2.5	2.4	0.4	0.2	0.3	0.7	1.1	0.9	1.4	0.9
Real exchange rate depreciation (in percent, + indicates depreciation)	-7.4	0.9	14.3	-0.3	6.4	-2.7	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	8.9	0.4	7.5	4.7	4.1	4.5	4.2	6.2	5.3	5.0	5.2	5.1	4.6	4.6	4.6
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.0	0.2	0.1	0.2	0.0	0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	27.9	12.1	0.5	-1.8	-0.1	5.3	7.3	13.7	13.7	...

Sources: Country authorities; and staff estimates and projections.

1/ Public debt refers here to the debt of the non-financial public sector, comprising the central government and state-owned enterprises and public-guaranteed .debt. Gross debt is used.

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

3/ Revenues excluding grants.

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

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

Table 2a.: External Debt Sustainability Framework, Baseline Scenario, 2009–32 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Projections									
	2009	2010	2011	Average	Deviation	2012	2013	2014	2015	2016	2017	2012-2017 Average	2022	2032	2018-2032 Average
External debt (nominal) 1/	**53.2**	**57.6**	**72.0**			**85.5**	**97.8**	**106.6**	**115.1**	**124.8**	**131.4**		**160.2**	**177.2**	
o/w public and publicly guaranteed (PPG)	28.0	29.5	34.4			39.2	44.6	47.5	50.5	55.7	58.7		79.5	108.6	
Change in external debt	1.0	4.4	14.3			13.6	12.3	8.9	8.4	9.7	6.6		4.3	-0.4	
Identified net debt-creating flows	0.7	-1.8	11.3			16.6	14.8	14.2	13.3	13.1	12.1		20.6	16.9	
Non-interest current account deficit	**9.8**	**7.3**	**18.0**	**14.2**	**9.5**	**23.7**	**22.8**	**21.6**	**20.0**	**19.5**	**18.3**		**26.8**	**23.0**	25.5
Deficit in balance of goods and services	-11.7	-14.7	-4.0			1.4	1.9	0.5	-0.8	-1.4	-2.3		5.0	3.5	
Exports	86.3	94.0	110.3			102.7	98.4	95.0	92.3	89.6	86.9		88.9	81.6	
Imports	74.6	79.3	106.3			104.1	100.3	95.5	91.5	88.2	84.7		93.8	85.1	
Net current transfers (negative = inflow)	9.1	9.3	9.4	4.9	7.6	10.6	9.6	10.3	10.3	10.6	10.6		10.6	9.7	10.5
o/w official	-1.7	-0.6	-2.5			-1.4	-2.2	-1.6	-1.5	-1.3	-1.2		-0.9	-0.4	
Other current account flows (negative = net inflow)	12.4	12.6	12.5			11.7	11.3	10.9	10.5	10.3	10.0		11.2	9.8	
Net FDI (negative = inflow)	**-8.0**	**-7.3**	**-9.2**	**-6.4**	**2.4**	**-7.5**	**-9.2**	**-8.8**	**-8.4**	**-8.4**	**-8.4**		**-8.4**	**-7.7**	-8.4
Endogenous debt dynamics 2/	**-1.2**	**-1.8**	**2.6**			**0.4**	**1.3**	**1.3**	**1.6**	**2.0**	**2.2**		**2.2**	**1.7**	
Contribution from nominal interest rate	1.3	2.0	2.5			2.9	4.2	4.9	5.6	6.3	6.9		8.1	8.3	
Contribution from real GDP growth	1.8	-3.5	-4.1			-2.4	-3.0	-3.6	-4.0	-4.3	-4.7		-5.9	-6.7	
Contribution from price and exchange rate changes	-4.3	-0.2	4.1			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**0.3**	**6.3**	**3.0**			**-3.0**	**-2.6**	**-5.3**	**-4.9**	**-3.4**	**-5.6**		**-16.3**	**-17.3** 9/	-16.1
o/w 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/	...	...	75.7			86.6	98.3	108.1	116.7	125.2	129.1		142.3	164.4	
In percent of exports	...	...	68.6			84.3	99.9	113.8	126.4	139.8	148.5		160.2	201.5	
PV of PPG external debt	**...**	**...**	**38.2**			**40.3**	**45.1**	**48.9**	**52.2**	**56.1**	**56.5**		**61.7**	**95.9**	
In percent of exports	**...**	**...**	**34.6**			**39.2**	**45.8**	**51.5**	**56.5**	**62.6**	**64.9**		**69.4**	**117.5**	
In percent of government revenues	**...**	**...**	**133.8**			**146.7**	**149.2**	**165.7**	**180.9**	**198.4**	**201.1**		**217.1**	**331.7**	
Debt service-to-exports ratio (in percent)	**6.5**	**6.9**	**7.7**			**11.0**	**14.7**	**18.1**	**21.0**	**22.4**	**25.3**		**28.7**	**32.7**	
PPG debt service-to-exports ratio (in percent)	**2.9**	**2.7**	**3.1**			**3.4**	**4.3**	**4.7**	**4.9**	**4.6**	**5.1**		**6.6**	**11.4**	
PPG debt service-to-revenue ratio (in percent)	**12.1**	**10.8**	**11.9**			**12.6**	**13.9**	**15.1**	**15.6**	**14.7**	**15.7**		**20.8**	**32.0**	
Total gross financing need (Millions of U.S. dollars)	371.4	326.4	581.4			886.8	1027.9	1237.2	1429.2	1621.4	1805.4		3504.3	7654.1	
Non-interest current account deficit that stabilizes debt ratio	8.9	2.8	3.6			10.1	10.5	12.8	11.6	9.7	11.7		22.5	23.3	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-3.6	7.1	7.0	7.7	8.4	3.5	3.8	4.0	4.1	4.1	4.1	3.9	4.1	4.1	4.1
GDP deflator in US dollar terms (change in percent)	8.9	0.4	-6.7	2.9	5.6	0.1	4.2	6.2	5.3	5.0	5.2	4.3	4.6	4.6	4.6
Effective interest rate (percent) 5/	2.6	4.0	4.4	3.7	1.6	4.1	5.4	5.5	5.8	6.0	6.0	5.5	5.6	5.1	5.5
Growth of exports of G&S (US dollar terms, in percent)	-13.1	17.2	17.2	23.6	44.7	-3.5	3.5	6.8	6.5	6.1	6.3	4.3	8.9	0.0	8.5
Growth of imports of G&S (US dollar terms, in percent)	-28.7	14.4	33.9	19.6	22.6	1.4	4.1	5.3	5.0	5.5	5.1	4.4	8.9	-0.1	9.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	27.9	12.1	0.5	-1.8	-0.1	5.3	7.3	13.7	13.7	13.7
Government revenues (excluding grants, in percent of GDP)	20.9	23.4	28.5			27.5	30.2	29.5	28.8	28.3	28.1		28.4	28.9	28.6
Aid flows (in Millions of US dollars) 7/	144.5	-442.2	52.4			31.3	51.9	41.1	43.6	41.0	41.0		45.5	45.5	
o/w Grants	32.9	12.1	52.4			31.3	51.9	41.1	43.6	41.0	41.0		45.5	45.5	
o/w Concessional loans	111.6	-454.3	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			4.3	3.5	1.6	1.3	1.3	1.8		2.7	2.6	2.7
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			36.5	26.4	13.6	11.2	9.5	14.6		18.8	15.6	17.8
Memorandum items:															
Nominal GDP (Millions of US dollars)	1984.6	2134.1	2132.0			2208.6	2387.9	2638.9	2893.5	3163.4	3464.0		5310.1	12478.9	
Nominal dollar GDP growth	4.9	7.5	-0.1			3.6	8.1	10.5	9.6	9.3	9.5	8.4	8.9	8.9	8.9
PV of PPG external debt (in Millions of US dollars)			779.8			890.4	1075.8	1291.5	1509.8	1774.0	1955.9		3274.4	11961.6	
(PVt-PVt-1)/GDPt-1 (in percent)						5.2	8.4	9.0	8.3	9.1	5.8	7.6	8.3	10.6	9.2
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)	...	...	38.2			40.3	45.1	48.9	52.2	56.1	56.5		61.7	95.9	
PV of PPG external debt (in percent of exports + remittances)	...	...	34.6			39.2	45.8	51.5	56.5	62.6	64.9		69.4	117.5	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	3.1			3.4	4.3	4.7	4.9	4.6	5.1		6.6	11.4	

Sources: Country authorities; and staff estimates and projections.

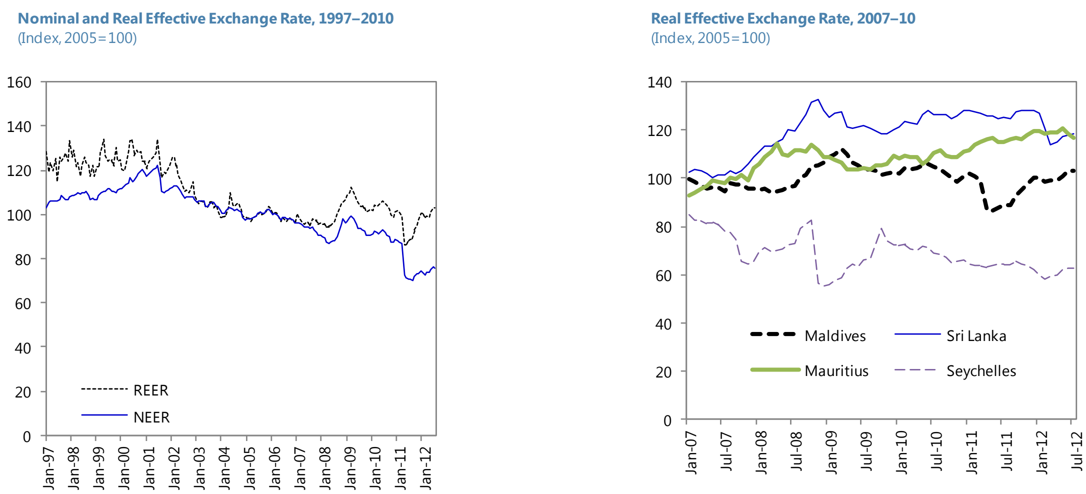
1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; 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 past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).
9/ Large residuals for the outer years are related to substantial data issues in the balance of payments (see informational annex).

APPENDIX III. MALDIVES: EXTERNAL STABILITY ASSESSMENT

Based on CGER analyses, staff find Maldives' external position and real effective exchange rate (REER) to be out of alignment with medium-term fundamentals. There is a need for significant fiscal consolidation accompanied by a devaluation and growth-enhancing structural reforms.

1. **The Maldivian rufiyaa has appreciated in real terms by almost 20 percent since the April 2011 devaluation.** Given the high degree of exchange rate pass-through, the nominal devaluation led to a spike in inflation that quickly eroded the competitiveness gains. Indeed, the recent period of relatively high inflation has unwound the entire real depreciation observed since 2002 (see figure below).

Maldives: Recent Exchange Rate Dynamics



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

2. **CGER methodologies suggest that the current account deficit is far larger than the norm, and that the REER is overvalued by between 16 and 28 percent.** Under baseline policies, the current account will continue to diverge from the medium-term norm, and in the near term, Maldives will face extremely large financing gaps if reserves are to be maintained. As discussed in the main text, staff see the appropriate policy prescription as being fiscal adjustment supported by devaluation.

Maldives: Quantitative Exchange Rate Assessment 1/

	Macroeconomic Balance	External Sustainability
Current account balance (norm)	-12.5	-2.9
Elasticity	0.8	0.8
Baseline scenario		
Current Account Balance (underlying)	-25.2	-25.2
Overvaluation	15.9	28.0

Source: IMF staff estimates and projections.

1/ All figures are based on five year conditional forecasts, and are expressed in percent. Results reported are based on a GMM estimator applied to 184 countries (Vitek 2010). Medium term considered in the assessment is 2017.

3. Despite the recovery of the tourism sector from the global financial crisis, Maldives faces structural challenges going forward (bottom table below). The scope for diversification is limited, the business climate has become less friendly, and spillovers from the potential fiscal/external crisis would likely constrain private-sector-led growth. Again, to improve competitiveness and address the imbalances, fiscal consolidation accompanied by a devaluation and structural reforms is of the essence.

Maldives: Business Climate and Tourism, 2009–12

	Doing Business Indicators Rank		Growth in Tourist Arrivals (In percent)	
	2011	2012	2009	2010
Maldives	78.00	79.00	-4.0	20.7
Mauritius	21.00	23.00	-6.3	7.3
Seychelles	109.00	103.00	-0.6	10.8
Sri Lanka	98.00	89.00	2.3	46.0

Source: World Bank's *2012 Doing Business Indicators* .

APPENDIX IV. ASSESSING THE LINK BETWEEN THE TWIN DEFICITS

1. The idea of twin deficits—viz., that a large fiscal deficit leads to a large external current account deficit (CAD)—is one of the most cherished notions in macroeconomics. The wide empirical literature, however, has come to mixed results, with some studies confirming the association and others showing either reverse causality or no connection at all. In the case of Maldives, fiscal adjustment would be a priority even if there were no effect on the current account, given the constraints to government financing and the high debt ratio. But to the extent that the two deficits *are* related, then fiscal adjustment is additionally helpful and should be pursued even more aggressively. Formulating policy advice on the appropriate extent and pace of fiscal consolidation thus requires a good sense of the link between the twin deficits in Maldives.

2. A natural approach might be to run a VAR including variables such as the fiscal balance, CAD, and growth (thus also allowing an investigation of fiscal multipliers). The results of such an exercise, however, are not very illuminating given the limited data (annual observations starting in 1990) and the structural breaks in the series (e.g., the 2004 tsunami) that make the CAD nonstationary.

3. An alternative strategy would be to consider cross-country data. Endeganew *et al.* (2012) [1] took a panel of 42 selected microstates, including Maldives, and found that the current account appears to be positively associated with the fiscal balance, with a coefficient on the cyclically-adjusted primary balance (in percent of GDP) of around 0.40. The coefficient drops to 0.31 if oil exporters are dropped from the sample or to 0.34 if the sample is broadened to include the global sample of 155 countries. These estimates are substantially below the authorities' own rule of thumb, which suggests that a 1 percent of GDP widening of the fiscal deficit leads to a 0.56 percent of GDP increase in the CAD. To be conservative, staff use a coefficient of 0.40 in constructing its baseline and alternative forecasts.

4. Given that exports are driven by external demand factors, another approach would be to focus on the impact of the fiscal deficit on imports, rather than the overall CAD. Staff's own estimates, however, using Endeganew *et al.*'s panel of 42 countries, uncover no significant relationship here. Nonetheless, there is a significant relationship between *government expenditures* and imports, with a coefficient of 1.09 (and 0.81 even when only current expenditures are considered). Restricting the sample further so as to drop high-income countries like Luxembourg and Iceland and limit attention to 24 highly tourism-dependent states like Maldives, causes the coefficient to drop to 0.72.

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[1] Yehenew Endegnanew, Charles Amo-Yartey, and Therese Turner-Jones "Fiscal Policy and the Current Account: Are Microstates Different?" WP/12/51.

	CAD/Fiscal Bal. link			Imports/Gov. Exp. link	
Source	Authorities	Endegnanew et al. (2012)	Endegnanew et al. (2012)	Staff estimate	Staff estimate
# of countries	1 (MDV)	42	155	42	24
Coeffficient/ correlation	0.56	0.40	0.34	1.09	0.72

APPENDIX V. THE CASE OF SEYCHELLES

Seychelles found itself in the midst of an acute balance-of-payments and public-debt crisis in 2008. Modest reform efforts begun in 2003 had brought about some fiscal adjustment, trade reform, and economic liberalization, but substantial imbalances remained. The rupee was devalued in 2006 and 2007, which boosted inflation, but expansionary fiscal and monetary policies continued to undermine competitiveness. By 2007, the fiscal deficit reached nearly 10 percent of GDP with public debt close to 150 percent of GDP (of which nearly two-thirds was external), and gross official reserves were down to just a few days of import cover.

These problems were exacerbated by the 2008 food and fuel price shocks as well as the global slowdown. Inflation rose further, and GDP growth, which had been strong since 2005 on account of tourism-related earnings and FDI, declined sharply. The current account deficit widened, and the authorities introduced complex exchange controls. Foreign-exchange shortages ensued, dollarization increased, and a parallel foreign-exchange market flourished. At the same time, the balance of payments was financed increasingly by external arrears accumulation. The authorities missed a payment on a privately-placed external debt issue in July 2008 and on a Eurobond payment in October, and Standard & Poor's downgraded Seychelles to "selective default."

The authorities recognized the need for a decisive turn in policies, and they requested Fund assistance in support of a comprehensive reform strategy, which featured:

- liberalization of the exchange regime, involving the elimination of all exchange restrictions and a float of the currency, as well as public wage restraint;
- a significant and sustained tightening of fiscal policy, backed by a reduction in public employment, tax reform and improvements in revenue administration, and the replacement of indirect subsidies with a better targeted safety net;
- a new monetary policy framework focusing on liquidity management via indirect instruments; and
- a boost to private-sector development through further privatization, enhanced fiscal governance, and a review of the tax regime.

These measures opened the door for comprehensive debt restructuring, as creditors recognized that the frontloaded fiscal adjustment, featuring large primary surpluses, was insufficient to place public debt on a sustainable path. As of end-2012, agreements have been signed with all but one creditor.

These policies were largely successful: the exchange rate overshot but then appreciated strongly and has been relatively stable since; the CAD narrowed and reserves were built up; central government finances were brought under control; inflation and interest rates stabilized after an initial spike; and growth dipped but soon recovered. Outstanding challenges include expanding fiscal discipline beyond the central government and strengthening the monetary framework further.

INTERNATIONAL MONETARY FUND

MALDIVES

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 22, 2013

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

CONTENTS

FUND RELATIONS

(As of December 31, 2012)

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

General Resources Account	**SDR Million**	**Percent Quota**
Quota	10.00	100.00
Fund holdings of currency (exchange rate)	16.20	161.96
Reserve Tranche Position	2.00	20.04

SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	7.69	100.00
Holdings	6.89	89.55

Outstanding Purchases and Loans	**SDR Million**	**Percent Quota**
Stand-By Arrangements	8.20	82.00
ESF Arrangements	2.05	20.50

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		
	2013	**2014**	**2015**	**2016**	**2017**
Principal	3.59	4.10	0.82	0.41	0.41
Charges/Interest	0.08	0.04	0.01	0.00	0.00
Total	**3.66**	**4.14**	**0.83**	**0.41**	**0.41**

[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

From March 1, 1982 to June 30, 1985, the Maldivian rufiyaa was pegged to the U.S. dollar. Beginning in July 1985, the exchange rate of the rufiyaa was linked to a trade-weighted basket of currencies, but the exchange rate vis-à-vis the U.S. dollar remained relatively stable until February 1987. On March 1, 1987, the rufiyaa was devalued by 29 percent vis-à-vis the U.S. dollar. From 1987 to 1994, the exchange rate of the rufiyaa was adjusted periodically. Since October 1994, the exchange rate of the rufiyaa remained unchanged at Rf 11.77 per U.S. dollar, until July 25, 2001, when the rufiyaa was devalued to Rf 12.80 per U.S. dollar. Since April 2011, the rufiyaa has officially 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. Maldives continues to avail itself of the transitional provisions of Article XIV, 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, Sections 2(a) of the IMF's Articles of Agreement, arising from the MMA's policy of rationing its supply of foreign exchange to commercial banks. This rationing by a governmental agency has caused the channeling of foreign exchange transactions for current international transactions to the parallel market where transactions take place at an exchange rate that deviates by more than 2 percent from the official exchange rate. The greater-than-2-percent exchange-rate spread gives rise to a 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.

Last Article IV Consultation

The 2010 Article IV consultation was concluded by the Executive Board on February 14, 2011.

Technical Assistance

FAD: In May 2007, a mission conducted a diagnostic review of tax and tariff policy and administration. In October 2008 and April 2009, a series of PFM missions provided peripatetic support for the design and implementation of a new government integrated financial management information system (GIFMIS). A joint mission with the World Bank visited Malé in April–May 2009 to complete a PEFA assessment. A TA mission on tax administration and tax policy took place in September 2010. The mission focused on existing and planned tax administration reforms and the extent of preparedness for new tax regimes. In October 2010, a cash management and fiscal reporting TA mission overlapped with Article IV mission. The mission focused on budgetary management and fiscal accounting and reporting. In December 2011, two missions, one on a follow-up mission on tax administration and the other on assessing the organizational structure, staffing, remuneration and management of Maldives Ministry of Finance (MoFT) took place.

LEG: In October 2003, Mr. Head provided assistance on the revision of the Maldives Monetary Authority Act (MMA Act). A series of missions (March and September 2005, and April 2006) were provided to revamp the banking law. In August 2009, a mission provided assistance on the MMA Act (jointly with MCM). An AML/CFT assessment mission took place in October 2010. A follow-up mission in February 2011 focused on payments law.

MCM: Two missions visited in 2006 on monetary operations, financial market development, and banking issues. In 2007, a series of mission were provided on debt management, monetary policy and financial supervision. In 2008, three missions visited on monetary operations and liquidity management, monetary policy and financial supervision issues. In November 2008 and March/May/August 2009, a series of mission were provided on research capacity building, bank supervision, monetary policy and the MMA act. Two missions visited Malé to advise 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, MCM consecutively conducted missions on the development of debt markets, and on on-site banking supervision. In February 2012, MCM undertook a TA mission on assessing the foreign exchange operations framework.

STA: In November 2005, TA was given on monetary and banking issues. In April 2006, STA provided advice on government finance statistics. In January 2007, STA provided advice on balance of payments statistics. 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 and May 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. Advice on publishing GDP revisions was provided in November 2012.

Safeguards Assessment

A safeguards assessment of MMA was concluded in March 2010. In line with staff recommendations, the MMA has appointed an external auditor, and strengthened controls over foreign payments through the automation of the authorization process. The authorities also indicated that they are planning to appoint an internal auditor shortly. In addition, a new MMA Act is under development with IMF technical assistance to strengthen the MMA's legal framework.

JOINT MANAGEMENT ACTION PLAN[1]

(As of December 2012)

World Bank **International Monetary Fund**

Further to the FY08–12 Country Assistance Strategy framing the Bank Group's involvement in Maldives and the CAS progress report of 2010, an Interim Strategy Note for the period FY13–14 is being prepared, scheduled for Board consideration in Q4 FY13. In view of the current macroeconomic environment in the country, the upcoming ISN will propose a selective program of engagement, likely focused on Public Financial Management, education and renewable energy.

The IMF's blended program approved by the Executive Board in December 2009 went off-track by mid-2010 and formally expired at the end of 2012. The authorities have expressed interest in renewing their program engagement with the IMF, possibly through a Staff Monitored Program. The core of the policy framework is a strong fiscal adjustment to contain aggregate demand and put public finances back on a sustainable path in the medium-term, complemented by devaluation and monetary tightening.

The teams have been holding, and will continue to hold, joint missions and regular briefing meetings on macroeconomic developments. Public financial management is a key area of collaboration for these operations as is utility pricing and social protection, where the Bank is taking the lead on a number of initiatives aimed at improving targeting. The World Bank is also carrying out an important fiscal sustainability technical assistance in FY13 aimed at improving capacity at the Ministry of Finance on budget formulation, cash flow projections and medium term budget framework. This work is carried out in close collaboration with the IMF, which also has a stream of PFM-related TA planned. The Bank is taking the lead on PFM issues, while the IMF focuses on tax issues (e.g., support for implementation of a Goods and Services Tax) and on preparations for a Fiscal Responsibility Law. The Bank will continue to support implementation of a credible MTEF and is undertaking analytical work on the structure of the foreign exchange market together with providing technical assistance supporting the development and implementation of the Government's tourism development plan. The Appendix details the macro-critical activities that the Bank and IMF will work on over the coming year.

[1] Prepared jointly by IMF and World Bank staff.

Appendix. Maldives IMF-World Bank Joint Management Action Plan		
Title	**Products/Activity**	**Expected Date of Delivery**
	I. Mutual Information on Relevant Work Program	
Bank Work Program in the next 12 months	**A. Lending (IDA, Trust Fund)**	
	Pension & Social Protection Administration	FY2015
	Environmental Management	FY2014
	Mobile Phone Banking Project	TBD
	Clean Energy for Climate Mitigation	TBD
	Ari Atoll Solid Waste Management	TBD
	Wetland Conservation and Coral Reef Monitoring for Adaptation to Climate Change	TBD
	Scaling Up Renewable Energy Program in Low Income Countries (SREP) Investment Plan	TBD
	Statistical Capacity Building	TBD
	B. Analytical and Advisory Activities	FY2013
	Youth Development and Gender in Maldives	
	Water Security in the Maldives	
	Assessment of National Health Insurance	
	PSIA on Health and Electricity Subsidy	
	Targeting the Poor in Maldives	
	Maldives Tourism Phase 3	
	Fiscal Sustainability	
	Insurance Regulation and Supervisory Advancement	
	Capacity Development Support for Auditor General's Office	
	Support for MMA on foreign exchange market and regulations	
IMF Work Program in the next 12 months	**A. Missions**	
	Article IV consultation	Oct. 2013
	Staff visit / possible program discussions	Apr. 2013 Apr. 2014 *(SV only)*
	B. Analytical Work	
	The pass through of exchange rate changes to prices in Maldives	Oct. 2010
	Assessing the link between twin deficits	Dec. 2012
	C. Technical Assistance	
	Fiscal issues	
	Revenue administration	2013
	Public finance management	2013
	Monetary issues	
	Operations framework and liquidity management	2013
	II. Request for Work Program Inputs (as needed)	
IMF Request to Bank	Poverty and social impact analysis of the electricity tariff increases Request for assistance in targeting subsidies	FY2010 Ongoing
	III. Agreement on Joint Products	
Joint Products	Debt sustainability analysis	Jan. 2013

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of November 30, 2012)[1]

Asian Development Bank's Strategy

Since the Country Partnership Strategy (CPS), 2007–11, the Asian Development Bank (AsDB) had taken a sequential approach to the provision of AsDB support to the Maldives. AsDB would first concentrate on providing much-needed capacity development assistance, after which it would move to the second phase of assistance to resume investment lending. In 2011, AsDB developed an interim CPS for 2012–13 and thus moved to the second phase of assistance, the resumption of investment lending.

The interim CPS provides a strategic direction for AsDB's operations in the Maldives. It focuses on developing small- and medium-sized enterprises, energy, and transport sectors. It highlighted key thematic priorities of private sector development and capacity development for policy and project implementation. The interim CPS will also support interventions in human resource development to the government.

Economic Recovery Program Loan

The AsDB Board of Directors approved the Economic Recovery Program (ERP) in December 2009 to support recovery and sustainable growth of the economy over the medium term. ERP became effective on June 8, 2010. The ERP supported specific reform initiatives, including: (i) rationalizing, prioritizing, and aligning public spending with available resources; (ii) broadening the tax base; (iii) reducing economic subsidies; (iv) supporting privatization of state-owned enterprises; (v) strengthening internal audit functions; and (vi) changing the role of the Government in the economy from a provider of all services to an enabler of sustainable and equitable growth. The first tranche of US$16.6 million was disbursed on June 25, 2010. The second tranche of US$16.5 million was disbursed on September 20, 2012.

A technical assistance (TA) loan (US$1.5 million) and TA grant (US$3.25 million) attached to the ERP were designed to enhance Government's capacity in various areas including: (i) strengthening administration of new taxes introduced under the Program; (ii) developing capacity of the Government for implementing new revenue measures, debt management, budget formulation, and expenditure rationalization; (iii) strengthening internal audit procedures; and (iv) providing support for project/program management.

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[1] Prepared by AsDB staff.

Loans and Grants

Since 1981, AsDB has approved 21 loans and grants for public sector projects with a total approved amount of US$169.18 million.

As of November 30, 2012, four loans were active with a net loan/grant amount of US$47.63 million (first table below) comprising two projects in public sector management amounting to US$34.5 million (72.5 percent), one for industry and trade for US$7.07 million (14.8 percent), and one for water and other municipal infrastructure for US$6.06 million (12.7 percent). Two projects under the industry and trade sector were approved on May 25, 2012 and are still awaiting loan effectiveness as of November 30, 2012. These are the loan (US$5.55 million) and grant (US$4.45 million) projects on Inclusive Micro-, Small- and Medium-Sized Enterprise Development.

Contract awards in 2012 totaled US$18.75 million as of November 30, 2012, bringing the cumulative figure to US$53.52 million. Of the 2012 contract awards, US$16.49 million (87.9 percent) went for the ERP Loan, and the remaining US$2.26 million (12.1 percent) for the Private Sector Development Project. Disbursements in 2012 totaled US$19.93 million as of November 30, 2012, bringing cumulative disbursements to US$52.98 million. The disbursement ratio was 84.52 percent.

AsDB's Private Sector Operation has approved cumulatively two projects amounting to US$16.5 million. The amount includes both direct loans and an equity investment.

Technical Assistance

As of November 30, 2012, AsDB approved 62 TA projects for a total amount of US$24.7 million, of which 17 had been project preparatory and 44 had been advisory TA projects addressing institutional strengthening and capacity development.

In terms of TA amount, assistance is largest for public sector management at 52.1 percent for 24 projects, followed by transport and ICT sector at 14.2 percent for 13 projects, industry and trade sector at 7.9 percent for 3 projects, education sector at 7.8 percent for 6 projects, energy sector at 7.1 percent for 7 projects, agriculture and natural resources sector at 4.6 percent for 3 projects, finance sector at 3.7 percent for 4 projects, water and other municipal infrastructure and services sector and multisector at 2.5 percent for 2 projects.

There are six TA projects in the active portfolio with a total amount of $ 5.45 million (second table below). Five of these are capacity development TA and the other one is project preparatory TA.

Public Sector Loans and Grants Portfolio

Loan/ Grant No.	Project Name	Net Amount[1] (in millions of U.S. dollars)
2170	Regional Development Project, Phase II	6.06
2427	Private Sector Development Project(TA Loan)	7.07
2597	Economic Recovery Program	33.06
2598	Capacity Development for Economic Recovery Project	1.44
0290[1]	Inclusive Micro-, Small- & Medium-Sized Enterprise Development (Grant)	4.45
2867[2]	Inclusive Micro-, Small- & Medium-Sized Enterprise Development	5.55

Source: Asian Development Bank.
[1] Net amount as of November 30, 2012.
[2] Not yet effective.

Technical Assistance Portfolio

TA No.	Project Name	Net Amount[1] (in millions of U.S. dollars)
7424	Institutional Strengthening for Economic Management	3.225
7672	Small & Medium Enterprise Development	0.650
7946	Developing the Revenue Administration Management Information System	0.500
8000	Capacity Development for the Maldives Energy Authority	0.400
8070	Strengthening Capacity for Operations Management	0.225
6337–21	Maritime Transport Master Plan	0.450

Source: Asian Development Bank.
[1] Net amount as of November 30, 2012.

STATISTICAL ISSUES

(As of January 2, 2013)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Macroeconomic statistics have improved in recent years, with technical assistance from STA and the Asian Development Bank (AsDB). Remaining shortcomings affect the balance of payments, government finance, and national accounts statistics. The main official statistical publication is the *Statistical Yearbook of Maldives*. APD receives a monthly electronic statistical report, covering a broad range of economic and financial statistics. It also receives, albeit with a lag, the *Quarterly Economic Bulletin* (*QEB*) and the *Annual Report* (*AR*) of the Maldives Monetary Authority (MMA).
Real sector: National accounts statistics are available only on an annual basis and with a considerable lag, though the authorities are working on quarterly GDP. While GDP estimates are made using both the production and expenditure approaches, these estimates are inconsistent. Furthermore, the base year for constant price estimates is 2003, so that recent changes in the structure of the economy are not reflected by the base period weights. The AsDB is assisting the authorities in setting up a framework for compiling more comprehensive national accounts and STA has provided substantial assistance as well. Also, the authorities worked with the assistance of an external consultant on rebasing the national accounts. The CPI was rebased to June 2012=100, with assistance from the AsDB. Weights are based on the 2012 household income and expenditure survey.
Fiscal sector: General government data are reported for publication in the *GFS Yearbook* and the latest published data are for [2009]. Monthly data on revenue and expenditure are available, but the reporting system is new, and its reliability is as yet untested. In particular, the consistency of these data with below-the-line financing numbers provided by the monetary authorities is weak. Data on external debt are subject to reconciliation with creditors. Data on the operations of state enterprises are limited.
Monetary sector: APD receives a weekly electronic report on monetary statistics, 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,* but with a significant lag. There are inconsistencies between monetary and fiscal data regarding the financing of the fiscal deficit due to issues of timing and coverage. An April 2007 STA monetary and financial statistics mission completed the standardized report forms for the central bank and other depository corporations, and developed an integrated monetary database that meets the needs of the MMA, STA, and APD. It became operational in 2010.

External sector: The MMA compiles balance of payments data on an annual basis. There are problems of coverage and measurement in a range of areas. Travel credits (receipts) are now estimated on the basis of tourism GST receipts, which revealed the sector to be much larger than indicated previously by the authorities' small and outdated survey of resorts/hotels. Coverage of foreign direct investment firms is limited, leading to under-reporting. Estimates of distributed and reinvested earnings of direct investment enterprises in the tourism sector remain unsatisfactory, and information on private financial flows is incomplete. Data on the international investment position are incomplete as private sector data are not available. 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 for the nonfinancial private sector. A STA technical assistance mission in January 2007 proposed steps to improve data on direct investment, travel receipts, and a range of other specific items. Official reserves assets are reported weekly with a (variable) one-week lag. Predetermined foreign currency outflows (mainly debt service payments) are known and reported to APD at the time of annual Article IV consultation missions, while other movements of foreign currency assets are not identified.	
II. Data Standards and Quality	
Maldives has participated in the General Data Dissemination System (GDDS) since October 14, 2011.	No data ROSC available.
III. Reporting to STA (Optional)	
The authorities report macroeconomic data to the IMF on a regular and generally timely basis for publication in the *IFS*, *BOPSY*, *and GFSY*.	

Maldives: Table of Common Indicators Required for Surveillance

(As of January 2, 2013)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	12/30/2012	12/31/2012	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/27/2012	12/31/2012	D	D	D
Reserve/Base Money	12/20/2010	12/31/2012	W	W	M
Broad Money	12/20/2012	12/27/2012	W	W	M
Central Bank Balance Sheet	12/20/2012	12/27/2012	W	W	M
Consolidated Balance Sheet of the Banking System	12/20/2012	12/27/2012	W	W	M
Interest Rates[2]	12/24/2012	12/31/2012	W	W	M
Consumer Price Index	11/30/2012	12/4/2012	W	W	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2011	10/26/2012	A	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2011	10/26/2012	A	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2011	10/26/2012	A	M	M
External Current Account Balance	2011	10/26/2012	A	M	M
Exports and Imports of Goods and Services	10/30/2012	12/6/2012	M	M	M
GDP/GNP	2011	12/6/2012	A	M	M
Gross External Debt	2010	1/4/2012	A	M	M
International investment Position[6]	2011	10/26/2012	A	A	A

[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.
[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] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

Statement by Mr. Shaalan on Maldives
Executive Board Meeting
February 20, 2013

After contracting in 2009, the Maldives economy rebounded strongly. GDP growth exceeded 7 percent in 2010 and in 2011, moderating in 2012 as a result of the slowdown in Europe. The fiscal deficit contracted sharply—by 11 percentage points of GDP—during 2009-2011. While strong revenue performance continued in 2012, the deficit is preliminarily estimated to have risen slightly. Inflation rose in 2011 in response to the devaluation, and has remained high as a result of the introduction of the GST in 2011 and the subsequent increase in the rate in early 2012.

Directors will recall that a three-year Standby Arrangement and a 24 month Arrangement under the Exogenous Shocks Facility were approved in December 2009. A key pillar of the program was a reduction in the fiscal deficit from 33½ percent of GDP in 2009 to 4½ percent of GDP in 2012, mainly through new taxes and civil service downsizing[1]. The program went off track following its First Review in March 2010 as the government had difficulties in garnering sufficient support to carry through planned reforms. Spending increased as a result of the introduction of two welfare programs, namely universal health coverage and a disability benefits program, that were considered a priority. A new decentralization law added to the civil service wage bill. It was also not possible to reach agreement on a modified program, partly because of the unsettled political environment which culminated in a change in government in February 2012.

Nevertheless, there was important progress in establishing a modern tax regime. Many of the tax measures envisaged under the program—including a new business profit tax, an ad valorem tourism tax, and a general sales tax—were implemented, yielding higher revenues than had been forecasted. Moreover, despite the suspension of civil service downsizing and wage cuts that had been agreed under the program, the nominal wage bill in 2012 was close to what was projected under the program.

[1] GDP was revised in 2012, following technical assistance from the Fund and Asian Development Bank. As a result, the fiscal deficit excluding grants in 2009 became 25 (not 33½) percent of GDP. The new figure reflects the deficit of 22.2 percent of GDP for 2009 as shown in Table 2b plus prior actions of 2.7 percent of GDP.

Looking forward, the authorities are not convinced of the merits of a currency devaluation, and they consider a faster pace of fiscal consolidation than suggested by staff to be more appropriate. The authorities do not consider that an average annual deficit reduction of 1 percent of GDP in 2013-15 would satisfactorily advance fiscal sustainability. At the same time, the merits of a devaluation are questionable given the small scope for expenditure switching and large pass-through to domestic prices. As staff recognizes, the argument for devaluation is not as robust for the Maldives as for other countries where wage growth can be controlled. Moreover, staff considers it important to have a targeted social assistance scheme to shield the vulnerable from the effects of a devaluation, which is not in place. The authorities believe the devaluation in 2011 resulted in negative repercussions on inflation and the fiscal deficit without helping to reduce the current account deficit.

We also note in this context that an assessment of the appropriate exchange rate level is particularly difficult for the Maldives due to data problems. Foreign exchange is available in the economy and the absence of a large premium in the parallel market suggests that sizeable tourism sector flows are not channeled through the banking system and therefore not reflected in the balance of payments. Accordingly, the implied need for a 20 percent devaluation based on the exchange rate assessment is questionable.

The argument for an SMP rests on "the need to develop a good track record of policy implementation". However, the authorities have demonstrated an ability to implement reforms. The recent tax measures raised revenues to a level higher than the program targets for 2012. In this context, it should be noted that the country has a solid track record in improving living conditions. The World Bank considers the Maldives a development success story and points to its improved social indicators. It is the best-ranked country in the United Nations Development Program's Human Development Index in South East Asia (2011)[2]. The country, classified as one of the poorest 20 countries in the world in the early 1980s, rose to a middle income country with low and declining poverty rates. The authorities are cognizant of the need to place Maldives on solid ground with respect to debt sustainability as a basis to further improve the welfare of its population.

The authorities have indicated that they will not publish the report at this time. They are concerned about the market reaction to the recommendation of a 20 percent devaluation and references to the potential imminence of a crisis. Considerable editing would be required prior to publication which may not be feasible.

Maldives is a beneficiary of Fund technical assistance, which has been used quite effectively. The authorities thank management and staff for this valuable support. They trust that they can continue to count on the Fund to support their efforts at institutional capacity building.

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[2] www.worldbank.org/en/country/maldives/overview.

Finally, I wish to join the authorities in expressing appreciation for the staff team's diligent work and the constructive policy discussions.