INTERNATIONAL MONETARY FUND

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MALDIVES

November 2023

2022 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALDIVES

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2022 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 December 20, 2022 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 November 23, 2022, following discussions that ended on September 26, 2022, 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 November 4, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the International Monetary Fund (IMF) and the International Development Association (IDA).
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Maldives.

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

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2022 Article IV Consultation with Maldives

FOR IMMEDIATE RELEASE

Washington, DC – November 23, 2022: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Maldives.

Maldives' economic activity rebounded strongly from the pandemic-induced contraction, supported by the authorities' decisive policy measures. Real GDP growth recovered sharply to 37 percent in 2021 from the unprecedented contraction of 33.5 percent in 2020, as tourism activities bounced back. Inflation has risen but is contained due to price subsidies. Average headline inflation rose from 0.2 percent (y/y) in 2021 to 2.7 percent in July 2022, mostly reflecting higher costs of energy, food, transportation, and healthcare. Revenue recovery was robust in 2021, but fiscal vulnerabilities remained high. The fiscal deficit remained in double digits, reflecting elevated capital spending, an increased interest burden, and a higher wage bill. Continued support to SOEs added to fiscal vulnerabilities. The banking system remains sound, supported by strong buffers, but risks stem from the sovereign-bank nexus.

The recovery is expected to continue in the near term on the back of strong tourism growth and associated spillovers to related sectors such as transportation and trade. Staff projects GDP grow at 10.5 percent and 6.6 percent in 2022 and 2023 respectively. Inflation is projected to increase further, reaching 4.9 percent in 2023, reflecting the persistence of high costs of energy and food, spending pressures for the 2023 elections, and the one-off impact of the planned goods and services tax hikes in 2023. The fiscal deficit is expected to remain in double digits, despite continued strong revenue performance. The current account deficit is projected to widen to 16.5 percent of GDP in 2022 before gradually moderating over the medium term. The Maldives remains at a high risk of external debt distress and a high overall risk of debt distress. The total public and publicly guaranteed (PPG) debt-to-GDP ratio declined from the pandemic peak of 154 percent of GDP in 2020, aided by the economic recovery, but is expected to remain high over the medium-term. External financing needs are projected to rise and draw on the already thin reserve buffers, increasing debt rollover risks. Dollar shortages have persisted, as reflected in large spreads in the parallel foreign exchange market. Risks to the outlook are tilted to the downside, stemming mostly from a sharp global economic slowdown, high commodity prices, and tighter global financial conditions. A resumption of tourist arrivals from China is an upside risk to growth.

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

Executive Board Assessment[2]

The Executive Board welcomed the rapid economic recovery from the pandemic, underpinned by a swift vaccination rollout, policy support, and a strong rebound in tourism. However, fiscal and external vulnerabilities remain elevated, and risks to the outlook are tilted to the downside, including from a sharp slowdown in key source markets for tourism, high commodity prices, and tighter global financial conditions. Against this background, Directors urged steadfast implementation of comprehensive reforms to reduce vulnerabilities and strengthen economic resilience.

Noting that Maldives is at a high risk of debt distress, Directors stressed that sustained fiscal consolidation relying on both expenditure rationalization and domestic revenue mobilization, and supported by conservative debt management, is the top priority. They emphasized that rationalizing capital spending and subsidies, combined with targeted assistance to the most vulnerable, and SOE reforms will be critical. Directors welcomed significant steps taken by the authorities toward tax and subsidy reforms and called for their swift implementation. They commended the authorities for the recent approval of the General Goods and Services Tax (GST) and Tourism Goods and Services Tax (TGST) reforms. Directors also looked forward to the development of a Medium-Term Revenue Strategy and planned reforms of the Fiscal Responsibility Act. Should downside risks materialize, scarce fiscal resources should be reoriented toward targeted and temporary measures to support the most vulnerable.

Directors advised that the Maldives Monetary Authority (MMA) advances to the government should be gradually phased out to lower pressures on international reserves and prices. MMA should stand ready to further tighten monetary policy should inflationary pressures increase and/or the elevated parallel market premium widen further. Directors also urged implementation of FX reforms.

Directors agreed that financial sector policies should remain vigilant to safeguard financial stability, considering the large exposure of the banking sector to the sovereign and the expiration of pandemic-related lending support schemes. They encouraged continued enhancements in the AML/CFT framework and looked forward to the planned FSAP to help prioritize reforms in the financial sector.

Noting that the Maldives is extremely vulnerable to climate change, Directors stressed the importance of investments in climate-resilient infrastructure to boost prospects for a more inclusive and resilient growth in the medium term. They noted that significant financial support from the international community will be needed for climate adaptation. Directors supported continued Fund technical assistance to enhance public financial management and improve access to climate-related funds. They also stressed the need to further strengthen governance.

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

Table 1. Maldives: Selected Economic and Financial Indicators, 2018–27

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prel.	Proj.					
Output and prices	(Annual percentage change)									
Real GDP	8.1	6.9	-33.5	37.0	10.5	6.6	5.7	6.5	5.9	5.5
Inflation (end-of-period) 1/	0.5	1.7	-2.0	0.2	7.0	3.2	2.0	2.0	2.0	2.0
Inflation (period average) 1/	1.4	1.3	-1.6	0.2	3.9	4.9	2.4	2.0	2.0	2.0
GDP deflator	3.1	-1.1	0.4	1.7	3.9	4.9	2.4	2.0	2.0	2.0
Central government finances	(In percent of GDP)									
Revenue and grants	27.2	26.4	26.4	26.6	28.9	29.6	29.2	28.8	28.7	28.7
Expenditure and net lending	32.5	33.0	49.9	40.9	43.1	39.5	39.0	34.7	33.5	33.0
Overall balance	-5.3	-6.6	-23.5	-14.3	-14.3	-9.9	-9.8	-5.9	-4.8	-4.3
Overall balance excl. grants	-6.3	-7.9	-25.2	-15.6	-15.4	-11.4	-10.6	-6.6	-5.4	-5.0
Financing	5.3	6.6	23.5	14.3	14.3	9.9	9.8	5.9	4.8	4.3
Foreign	7.0	1.1	4.4	6.5	2.8	2.2	1.9	0.5	1.5	-0.2
Domestic 2/	-1.7	5.5	19.2	7.8	11.4	7.7	7.9	5.4	3.3	4.5
of which: Unsecured financing 3/	...	...	...	...	...	1.7	...	...	...	...
Primary balance	-3.5	-4.8	-20.7	-11.7	-11.0	-6.2	-6.1	-2.3	-1.3	-1.0
Public and publicly guaranteed debt	72.0	78.8	154.4	124.3	122.6	117.5	117.7	112.9	107.7	103.2
Monetary accounts	(Annual percentage change)									
Broad money	3.4	9.5	14.2	26.2	14.7	9.8	8.3	8.6	8.1	7.7
Domestic credit	7.6	3.4	34.4	8.8	20.8	9.9	12.2	11.9	11.1	10.8
Balance of payments	(In percent of GDP, unless otherwise indicated)									
Current account	-28.4	-26.6	-35.5	-8.8	-16.5	-15.2	-13.8	-13.6	-9.7	-9.3
Of which:										
Exports	6.4	6.4	6.9	5.5	5.6	5.3	5.2	5.1	5.0	5.0
Imports	-52.2	-49.2	-45.7	-46.0	-51.2	-50.0	-49.2	-48.3	-45.7	-45.3
Tourism receipts (in nonfactor services, net)	57.2	56.4	37.4	66.7	65.0	62.2	62.2	62.2	62.2	62.2
Income (net)	-9.3	-10.0	-8.2	-9.3	-8.2	-8.6	-8.3	-8.0	-7.6	-7.4
Current transfers	-9.3	-10.4	-9.6	-8.1	-8.9	-7.8	-7.3	-7.2	-7.1	-6.9
Capital and financial account (including e&o)	30.7	27.4	41.7	5.3	15.1	13.5	14.2	13.4	8.8	11.4
Of which:										
General government, net	3.0	1.9	4.0	4.0	4.1	0.5	1.9	-0.5	0.6	-0.9
Banks and other sectors, net	17.7	3.5	8.2	-5.0	-1.2	1.0	0.3	0.3	0.3	0.3
Overall balance	2.4	0.7	6.2	-3.4	-1.4	-1.7	0.4	-0.2	-0.9	2.1
Gross international reserves (in millions of US$; e.o.p.)	712	754	985	806	695	582	611	591	510	697
In months of GNFS imports	2.1	3.7	3.4	2.2	1.7	1.3	1.3	1.2	1.0	1.3
Exchange Rate (rufiyaa/US$, e.o.p.)	15.4	15.4	15.4							
Memorandum items:										
GDP (in millions of rufiyaa)	81,586	86,259	57,569	80,192	92,094	103,002	111,526	121,113	130,866	140,884
GDP (in millions of U.S. dollars)	5,294	5,598	3,736	5,204	5,976	6,684	7,237	7,859	8,492	9,142
Tourism bednights (000')	9,477	10,689	3,985	10,073	11,380	11,964	12,994	14,456	15,772	16,997
Tourist arrivals (000')	1,484	1,703	556	1,322	1,626	1,709	1,856	2,126	2,319	2,499
Tourism bednights (% change)	10.2	12.8	-62.7	152.8	13.0	5.1	8.6	11.3	9.1	7.8
Tourist arrivals (% change)	7.1	14.7	-67.4	137.8	23.0	5.1	8.6	14.5	9.1	7.8
Dollarization ratio (FC deposits in percent of broad money)	48.8	52.9	45.8	...	...	...	...	...	...	...

Sources: Maldivian authorities and IMF staff projections.

1/ CPI-Male definition.

2/ Domestic financing includes MMA advances, SDF contribution and India's USD 250 million bond from the State Bank of India branch in Male.

3/ Unsecured financing includes possible new sources of domestic financing or negotiated official bilateral financing as higher external financing costs are limiting options to tap international capital markets.

INTERNATIONAL MONETARY FUND

MALDIVES

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

November 4, 2022

KEY ISSUES

Context. The Maldives' economy is recovering rapidly from the pandemic, underpinned by a strong resumption in tourism on the back of the authorities' rapid vaccine rollout and policy support measures. Fiscal and external vulnerabilities remain elevated due to rising subsidies, high capital spending, and an increased interest burden. The Maldives has a high risk of external debt distress and a high overall risk of debt distress. Inflation has risen but is relatively contained due to price subsidies. Risks to the outlook are tilted to the downside, including a possible sharp slowdown in key source markets for tourism, high commodity prices, and tighter global financial conditions. A resumption of tourist arrivals from China is an upside risk to growth.

Economic Policy Recommendations. The ongoing economic recovery provides an opportunity to swiftly implement a comprehensive set of reforms to reduce fiscal, debt, and external vulnerabilities, and strengthen economic resilience:

- A sustained fiscal consolidation that relies both on expenditure rationalization and domestic revenue mobilization is the top priority. Rationalizing capital spending and subsidies, combined with targeted assistance to the most vulnerable, and a reform of SOEs are critical. The authorities' homegrown reform agenda under the 2023 budget is already taking significant steps in this direction, including through plans for tax and subsidy reform measures, and should be implemented swiftly.
- Maldives Monetary Authority (MMA) advances should be gradually reduced until fully phased out and used as a last resort. MMA should stand ready to further tighten monetary policy should inflationary pressures increase and/or the parallel market exchange rate premium widen.
- Financial sector policies should remain vigilant to safeguard financial stability considering the large exposure of the banking sector to the sovereign and the expiration of pandemic-related lending support schemes.
- Should downside risks materialize, the limited fiscal space would necessitate a reorientation of scarce resources toward targeted and temporary measures to support the most vulnerable.
- Complementary policies, including planned FX reforms, further strengthening of governance, and investment in climate-resilient infrastructure are also needed to boost prospects for a more inclusive and resilient growth in the medium term.

Approved By
Anne-Marie Gulde-Wolf (APD) and Andrea Schaechter (SPR)

Discussions took place in Malé during September 12–26, 2022. The IMF team comprised Tidiane Kinda (Head), Ritu Basu, Emmanouil Kitsios, Yizhi Xu (all APD), Majdeline El Rayess (FAD), and Tubagus Feridhanusetyawan (Resident Representative). Anne-Marie Gulde-Wolf (APD) joined policy discussions and the concluding meeting. Mira Merhi and Ali Abdul Raheem (both OEDMI) joined the mission. Mahmoud Mohieldin (OEDMI) joined the concluding meeting. Gulrukh Gamwalla-Khadivi and Pamela Polec (both APD) collaborated in preparing this report.

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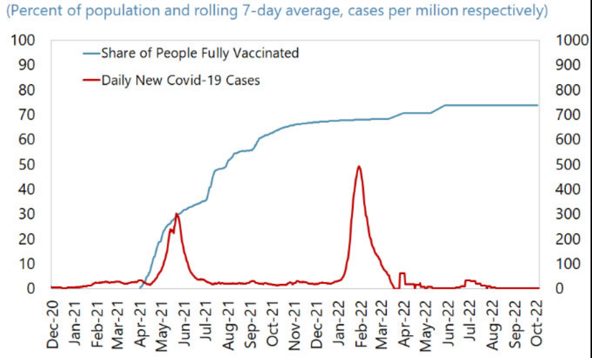
CONTEXT

1. **The Maldives' tourism-dependent economy was hit hard by the pandemic**. Tourism activity collapsed as containment measures, notably temporary border closures, were put in place to contain the spread of the virus.[1] As a result, real GDP contracted by an unprecedented 33.5 percent in 2020. On the back of the authorities' rapid vaccine rollout, the Maldives successfully welcomed back tourists and arrivals have since steadily increased.[2]

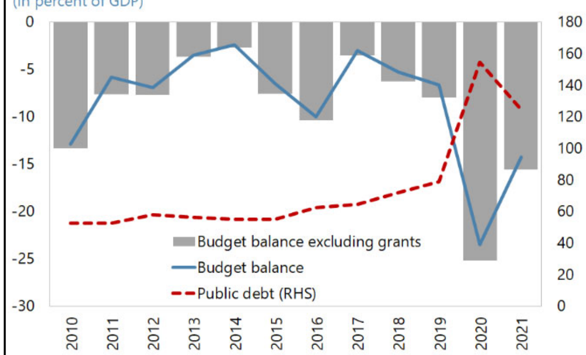
2. **The pandemic has exacerbated pre-existing vulnerabilities**. The infrastructure spending push against stagnant revenue resulted in persistently high fiscal deficits (above 6 percent of GDP) during 2015–19 and higher public debt that reached 79 percent of GDP in 2019 (Box 1). Public finances significantly deteriorated in 2020 as GDP contracted sharply, fiscal measures were implemented to cushion the impact of the pandemic, and capital spending remained elevated during the health crisis. As the Maldives remains highly exposed to climate change, the need for large-scale adaptation investments in a resource constrained context has become more acute.

Maldives: COVID-19 Vaccinations and New Cases
(Percent of population and rolling 7-day average, cases per milion respectively)



Source: Our World in Data.

Maldives: Budget Balance and Grants, 2010-2021
(In percent of GDP)



Sources: Maldivian Authorities; and IMF staff estimates.

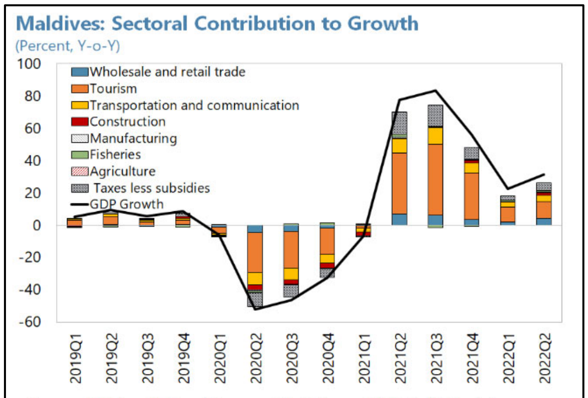
RECENT DEVELOPMENTS: A STRONG RECOVERY BUT VULNERABILITIES REMAIN

3. **Economic activity rebounded strongly from the pandemic-induced contraction, supported by the authorities' decisive policy measures**. Real GDP growth recovered sharply to 37 percent in 2021, as tourism activities bounced back, with total arrivals reaching close to 80 percent of the pre-pandemic level. A structural shift in the top tourist source countries in 2021, from China to India and Russia, provided a strong boost to the sector. The recovery in tourism also

[1] Direct tourism activity, excluding related activities such as transportation, represents one quarter of GDP.

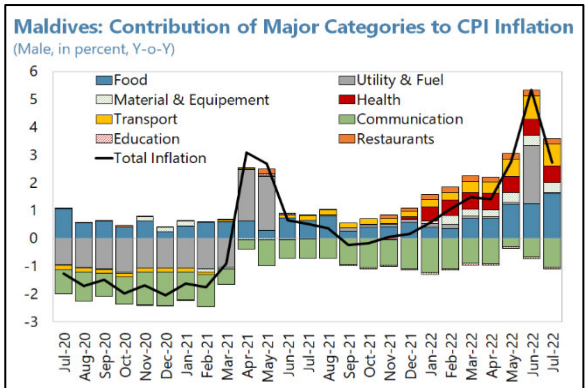
[2] About 74 percent of the population has been fully vaccinated as of October 6th, 2022.

led to positive spillovers to other sectors such as transportation and trade. In addition to a rapid vaccine rollout, the authorities' decisive pandemic support measures, which combined fiscal, monetary, and financial measures targeting entities most impacted by the pandemic, also supported the recovery.[3] The labor market slightly improved as the unemployment rate declined from 6.3 percent in 2020 to 6.1 percent in 2021, though it remains above the 2019 pre-pandemic level (5.3 percent).



Sources: Maldives National Bureau of Statistics; and IMF Staff Calculations.

4. Inflation is on the rise but contained due to price subsidies. Average headline inflation has risen from 0.2 percent (y/y) in 2021 to 2.7 percent in July 2022, mostly reflecting higher costs of energy, food, transportation, and healthcare. The pass-through from the surge in global oil and food prices to domestic prices, in particular energy prices, was limited because of hefty price subsidies provided through the central government budget.[4]



Source: Maldives Monetary Authority; and IMF Staff calculations.

5. Revenue recovery was robust in 2021, but fiscal vulnerabilities remain high. The sharp drop in output and associated decline in fiscal revenues resulting from the pandemic impact on tourism led to a widening of the fiscal deficit to 23.5 percent of GDP in 2020 and a surge in public debt to 154 percent of GDP. Despite a robust recovery in revenue in 2021 (40 percent y/y), the fiscal deficit remained in double digits, reflecting elevated capital

Maldives: Central Government Finances, 2019–21

	2019	2020	2021	2019	2020	2021
	in billions of MVR			in percent of GDP		
Revenue and grants	23.2	15.2	21.4	26.9	26.4	26.6
Expenditure and net lending	29.0	28.8	32.8	33.6	49.9	40.9
Current expenditure	21.4	20.3	24.0	24.8	35.3	29.9
Of which: Salaries and allowances	8.3	8.2	8.7	9.6	14.3	10.8
Administrative Services	1.9	1.6	2.3	2.2	2.8	2.8
Social welfare contributions	3.9	2.5	2.9	4.6	4.4	3.6
Subsidies and transfers	2.3	3.3	4.2	2.6	5.7	5.3
Supplies and consumables	1.6	1.8	2.2	1.9	3.1	2.8
Interest	1.5	1.6	2.1	1.8	2.8	2.6
Capital expenditure	7.6	8.4	8.8	8.8	14.7	11.0
Overall balance	-5.8	-13.5	-11.5	-6.7	-23.5	-14.3
Public debt	68.0	88.9	99.7	78.8	154.4	124.3

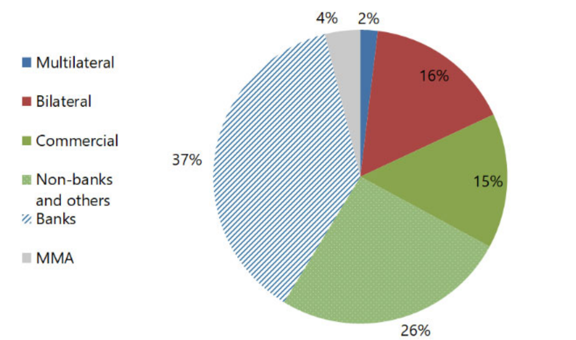
3 Initiated in 2020 as part of the Economic Relief Package, the government continued to support healthcare and provided targeted assistance to entities impacted by the pandemic in 2021. The MMA reduced local and foreign currency minimum required reserve ratios through June 3, 2021, and banks provisioning requirements were temporarily reduced for COVID-impacted loans. Other COVID-related monetary and financial measures in place in 2021 included a US$45 million increase in MMA's FX intervention allocation, and a US$400 million FX swap facility with the Reserve Bank of India that was fully repaid by December 2021. To support FX liquidity, the MMA also placed foreign currency fixed deposits of US$40 million in commercial banks in 2020 and rolled it over until July 2022.

4 The spike in utility price inflation in June 2022 reflects a one-off base effect due to a temporary utility subsidy implemented in June 2021.

spending, an increased interest burden, and a higher wage bill. Continued support to SOEs added to fiscal vulnerabilities.[5]

6. To cover the elevated financing needs, the central government increased the share of external financing, including non-concessional borrowing. External financing rose to cover about a third of total financing needs in 2021, from about 19 percent in 2020, largely driven by bilateral creditors and commercial sources such as the global sukuk issuances.[6] Bank financing continued to underpin most of domestic financing in 2021 (37 percent of total financing), complemented mostly by non-bank financial institutions and others. Covering about 4 percent of total financing, central bank advances supported the budget in 2021.[7] Most bilateral creditors granted a third extension of the debt outstanding under the Debt Service Suspension Initiative (DSSI), which freed about US$66.7 million in 2021 through postponement of debt servicing.

Maldives: Central Government Financing
(In million US dollars)



Sources: Maldives Ministry of Finance; and IMF staff estimates.

7. Maldives' external position was broadly in line with the level implied by fundamentals and desirable policies in 2021, but the parallel market exchange rate premium remained elevated (Appendix I). The current account deficit (CAD) temporarily improved to 8.8 percent of GDP in 2021 (from 35.5 percent of GDP in 2020), mostly driven by higher tourism receipts. However, strong import growth on the back of elevated public investment and higher import costs of fuel, food, and construction materials have been widening the CAD since early 2022, exacerbated by the impact of Russia's invasion of Ukraine. The EBA-lite methodology suggests that the CA was slightly below the norm of -9.4 percent of GDP in 2021, implying an exchange rate overvaluation of about 0.4 percent. Dollar shortages have persisted with significant spreads (around 10 percent) in the parallel foreign exchange market and gross international reserves declined from US$985 million (3.4 months of imports) in 2020 to US$806 million (2.2 months of imports) in 2021, accounting for the IMF's SDR allocation.[8] The implementation of a growth-friendly fiscal consolidation, including a

[5] In 2021, capital contributions to SOEs and rising subsidies amounted to 3.1 and 4.9 percent of GDP, respectively. Capital contributions to SOEs are part of total public capital expenditure.

[6] The global sukuk issuances in March, April, and September 2021 totaled US$500 million. The sukuks were issued at an interest rate of around 10.5 percent with a 5-year maturity (by 2026). Part of the sukuks proceeds were used to roll over 77 percent of a US$250 million Eurobond maturing in 2022 and trading at an interest rate of around 26 percent.

[7] Central bank advances were initiated during the pandemic in 2020 to provide budget support in rufiyaa (MVR) of up to MVR4.4 billion (US$285 million) at 1.5 percent interest rate. MVR2.5 billion (US$162 million) of the advances were converted into a 40-year bond at 2.4 percent annual interest in 2021.

[8] While the shortage in FX exists, it is less acute than during the pandemic months. The parallel market premium remains elevated but declined from about 23 percent in January 2021 to about 11 percent in July 2022. The SDR allocation equivalent to US$29 million were added to reserves in 2021 and used for budget support later in 2022. The authorities have committed to undergo an update safeguards assessment in connection with the RCF disbursement.

moderation of non-priority capital expenditure and better targeting of subsidies, combined with continued recovery of the tourism sector will help improve the external position and support FX reserves.

8. The banking system remains sound, supported by strong buffers, but risks stem from the sovereign-bank nexus. Loan quality has improved as the nonperforming loan ratio has started to decline following a small uptick at the height of the pandemic. The regulatory capital ratio has remained high, supported by strong capital and liquidity buffers in the wake of the pandemic and pandemic-related measures, including loan servicing moratorium and working capital loans. The pandemic-related financial sector measures elapsed, and the banking sector's profitability is rising from the trough of the pandemic. However, the banking sector's exposure to sovereign debt, which increased since the pandemic, represents more than 25 percent of banks' total assets and is significantly above the average in peer countries. While systemic risks from the sovereign-bank nexus could be elevated with potential risks to financial stability, strong buffers of the banking system represent a mitigating factor.[9] Private sector credit has dropped, reflecting the higher net foreign assets holding by commercial banks and possible crowding-out effect from banks' increased exposure to sovereign debt.[10]

9. Ongoing reform plans have the potential to improve the limited traction past Fund advice has had on economic policies (Appendix II). The authorities have initiated steps to implement some important reforms, including raising the tourism and domestic goods and services taxes (TGST and GST respectively) and reforming subsidies. Despite recent initiatives to enhance SOEs' oversight and streamline capital spending, they remain a key source of fiscal vulnerabilities.

OUTLOOK: A CHALLENGING GLOBAL CONTEXT

10. The recovery is expected to continue in the near term. Tourist arrivals were only 4.7 percent below the pre-pandemic level in mid-September 2022.[11] They are expected to steadily rise and exceed the pre-pandemic level by end-2023. The strong recovery in the tourism sector and associated spillovers to related sectors such as transportation and trade are expected to support growth to 10.5 percent and 6.6 percent in 2022 and 2023, respectively. The expansions of the Velana International airport and hotel accommodation capacities, financed mostly through foreign capital

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[9] MMA stress tests suggest that the banking system's strong capital buffers can withstand a hypothetical increase from zero to 100 percent risk weight for government bonds.

[10] The relatively elevated risk-adjusted returns of governments bonds also make them attractive for banks, compared to riskier alternatives such as loans to the private sector, particularly to SMEs.

[11] Tourist arrivals from Russia, which dropped after the war in Ukraine to 5.8 percent of total arrivals (from 19 percent pre-war), have partly recovered since June 2022 and reached 15.6 percent of total arrivals (or 133,309 arrivals) in September 2022. While the decline in arrivals from Russia was initially offset by stronger arrivals from other European countries such as the U.K. and Germany, robust arrivals from Asian countries, particularly India, as they reopen have been supporting the tourism sector. India's share in tourist arrivals increased from about 8 percent pre-war to about 15 percent as of mid-August 2022.

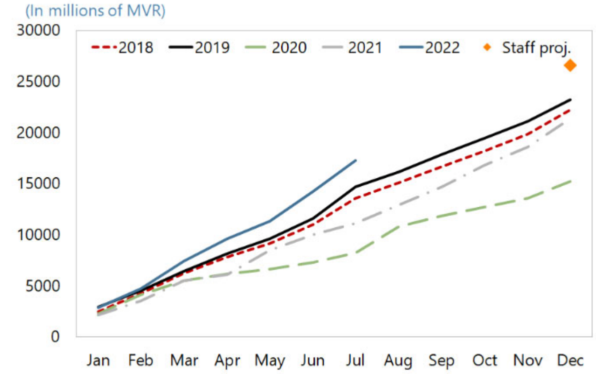
are expected to boost potential growth in a context of declining bank credit to the private sector.[12] The positive impact of increased airport and accommodation capacities on tourist flows and growth is expected to more than offset the negative impulse from the fiscal consolidation in the baseline, considering low fiscal multipliers in small states.[13]

11. Inflation is projected to increase further. The war in Ukraine will also affect the Maldives through higher commodity prices. Average headline inflation is projected to rise to 3.9 percent in 2022, reflecting the persistence of higher costs of energy, food, transportation, and healthcare observed through July 2022, spending pressures for the 2023 elections, and the dissipation of base effects from discounts on telecommunication services. Inflation is projected to increase to about 4.9 percent in 2023, reflecting inflationary pressures from persistently high commodity prices and the impact of the GST and TGST increases.

12. Fiscal vulnerabilities are expected to remain high in the absence of reforms, despite continuing robust revenue growth. The fiscal deficit is expected to remain in double digits in 2022 (14.3 percent of GDP), despite revenue performing strongly and projected to exceed the 2019 pre-pandemic level. The authorities anticipate expenditures to be higher than budgeted, on the back of spending pressures from rising subsidies, sustained high infrastructure spending, increased interest costs, and wage bill reforms. For instance, fuel and healthcare subsidies are projected to exceed budgeted amounts by 1.7 and 1 percent of GDP respectively.[14] Capital spending is expected to rise by 2.2 percent of GDP in 2022 to 13.2 percent of GDP. In the absence of subsidy reforms, total current spending is expected to remain above fiscal revenues in 2023, despite the anticipated increase of the GST and TGST, adding to the concern of high capital spending. High fiscal deficits are expected to persist in the medium-term, contributing to elevated public debt.

Maldives: Revenue and Grants

(In millions of MVR)



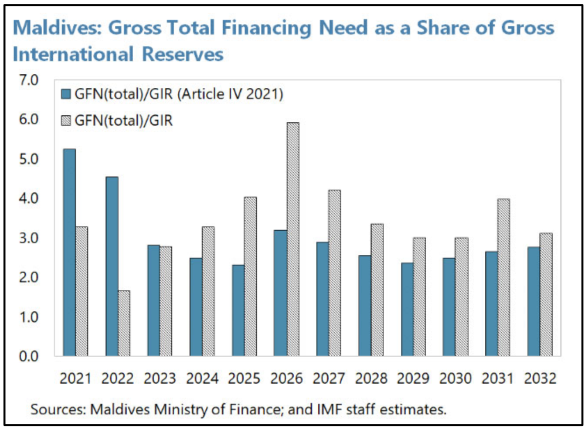
Sources: Maldivian Authorities; and IMF staff estimates.

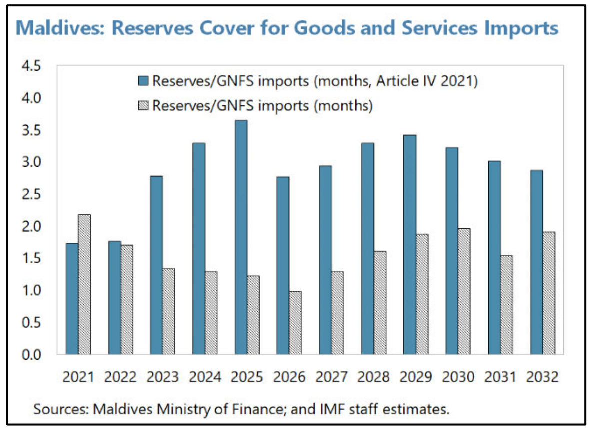
[12] The newly operational runway in Velana International Airport in Male together with the new terminal expected in 2025 will more than double the airport's passenger capacity and help meet higher demand from airlines. In addition, the development of the Hanimaadhoo airport has the potential to catalyze stronger tourism activity outside Greater Male region. Despite the pandemic, more than 10 new resorts opened in 2020 and 2021 and more than a dozen are in the pipeline, representing around 7,000 new beds (7 percent of pre-pandemic capacity).

[13] See Alichi et al. ,2019, https://www.imf.org/en/Publications/WP/Issues/2019/03/26/Fiscal-Policy-Multipliers-in-Small-States-46679. Complementary structural reforms (paragraph 38) would also support growth.

[14] At the current administered price of 7.6 MVR per liter of diesel, significantly lower than in peers, fuel subsidies could reach 2.1 percent of GDP in 2022, compared to 0.4 percent of GDP allocated in the budget. Health subsidies are expected to exceed the budgeted amount by 1 percent of GDP in 2022, reflecting higher retail prices for drug reimbursements as plans to implement maximum retail prices for pharmaceuticals are yet to be implemented.

13. SOEs are adding to fiscal vulnerabilities. The debt service of some externally funded projects through guaranteed debt, for instance in the housing sector, is rising as the projects carry loans with adjustable interest rates linked to the Secured Overnight Financing Rate (SOFR). Without sufficient provisioning, these increased costs further weaken the financial position of related SOEs and could require additional support from the government. At the operational level, in the absence of tariff reform and a strengthening of management, certain sectors such as housing and utilities are facing further deterioration of their financial positions and remain heavily reliant on the central budget. For instance, social housing is not well-targeted based on income eligibility criteria and lease tariff is set at below market price. The delinquency rate for social housing is also elevated at about 37 percent.





14. External financing needs are projected to rise significantly and draw on the already thin reserve buffers, increasing debt rollover risks. The current account deficit is projected to widen to 16.5 percent of GDP in 2022 before gradually moderating over the medium term, reflecting fiscal spending pressures and high import costs. Reserves are expected to further decline to about \$600 million and cover 1.3 months of imports by 2023. Dollar shortages are likely to persist with elevated spreads in the parallel foreign exchange market until tourism exceeds pre-pandemic levels. The banking sector is expected to limit additional exposure to the sovereign while tightening global financial conditions are further constraining external financing options. These financing constraints, together with MMA reaching its limit on advances, could translate into a budget financing gap (unidentified or unsecured financing) of 1.7 percent of GDP in 2023. Without additional official financing, bridging this gap may lead to forced spending cuts or risky financing options.

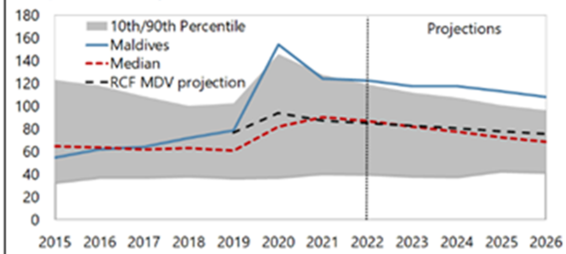
15. The Maldives remains at a high risk of external debt distress and a high overall risk of debt distress (See Debt Sustainability Analysis). Alongside the economic recovery, total public and publicly guaranteed (PPG) debt-to-GDP ratio declined from the pandemic peak of 154 percent of GDP in 2020.[15] However, PPG debt is expected to remain high over the medium term under current policies, mostly reflecting elevated fiscal deficits. Without a sustained fiscal adjustment supported by

[15] Payments of guaranteed debt covered SOEs such as HDC and STELCO.

conservative debt management and continued strong growth, public debt is on an unsustainable path in the baseline scenario.[16] The debt dynamics will remain vulnerable to adverse shocks in growth, interest rates (due to SOFR-linked debt), and the fiscal position. The growing reliance on external financing, including shorter-term commercial debt—e.g., the US$100 million private placement at 7 percent interest rate maturing in 2025 and the $US500 million global sukuks maturing in 2026—is a key source of risk and is making the debt profile more vulnerable to rollover risks.

Maldives: Public Debt among Peers 1/

(In percent of fiscal year GDP)



Sources: World Economic Outlook; and IMF staff calculations.
1/ Peer countries include Cabo Verde, Barbados, Antigua and Barbuda, Jamaica, Sri Lanka, Dominica, Seychelles, St. Vincent and the Grenadines, Mauritius, St. Lucia, Fiji, Grenada, St. Kitts and Nevis, Dominican Republic, the Bahamas, Samoa, Haiti, Vanuatu, Tonga, and Timor-Leste.

16. **Risks to the outlook are tilted to the downside** (Appendix III). A sharp global economic slowdown, including in key source markets for Maldives' tourism, for instance Europe, is a key risk (Appendix IV). Outbreaks of new lethal and highly contagious COVID-19 variants could hit global growth and reduce global tourism activity. Tighter global financial conditions could reduce options for market financing while increasing risks given SOEs' balance sheets vulnerabilities, including SOFR-linked debt. A protracted war in Ukraine could add to inflationary pressures through higher food and energy prices and disruptions to supply chains. A lift of international travel restrictions in China, in the past one of Maldives' largest tourism source countries, is an upside risk to growth. Domestically, the banking sector's large exposure to the sovereign could weigh on banks' capital and ability to lend and pose risks to financial stability in presence of tail shocks. While the authorities are aiming for an ambitious fiscal adjustment, the upcoming 2023 presidential election presents implementation risks and could add to spending pressures. Maldives is significantly exposed to climate change, which could impact longer-term growth prospects.

Authorities' Views

17. **The authorities highlighted that the recovery has exceeded expectations, underpinned by a strong rebound in tourism**. They stressed that decisive policies to swiftly rollout their COVID-19 vaccination campaign and support the tourism sector have allowed Maldives to quickly reopen to tourism. Going forward, the authorities expect stronger growth as they predict significant upside from the opening of the Chinese market. They also expect a higher growth impact of the airport extension, which will increase tourist arrival capacity and help address existing unmet demand from airlines. The authorities agreed that the planned implementation of the goods and services taxes in 2023 will add to inflationary pressures but emphasized that the revenue reforms constitute an integral part of their fiscal reform agenda. The authorities concurred that risks to the outlook are titled to the downside given the darkening global outlook, but highlighted that Maldives has a resilient tourism sector with a diversified set of source countries. They noted that the reduction in

[16] The debt sustainability analysis does not include any financing gap as it assumes that unidentified financing is covered through domestic sources.

the CA gap suggested by the EBA-lite CA methodology in 2021 was temporary and that high commodity prices and associated large import bills are likely to weigh on dollar shortages and maintain high parallel market premiums.

18. The authorities emphasized the role of unanticipated shocks in explaining fiscal vulnerabilities. They explained that total spending is expected to exceed the budgeted amount in 2022 primarily due to higher spending on fuel subsidies as a result of the spike in global commodity prices. The authorities also noted that delays in implementing measures to reduce health insurance costs and a faster implementation of previously stalled projects have contributed to higher spending. The authorities agreed that fiscal vulnerabilities remain elevated but emphasized the need to highlight their commitment to implement an ambitious and homegrown fiscal consolidation plan to rein in fiscal deficits and put public debt on a sustainable path.

POLICIES TO REDUCE VULNERABILITIES

A. Near-Term Policy Mix

19. The ongoing economic recovery provides an opportunity to swiftly implement needed reforms to reduce vulnerabilities. The key objective is debt reduction. Considering that vulnerabilities are interlinked, a comprehensive and coordinated approach across policies will enhance their effectiveness.[17]

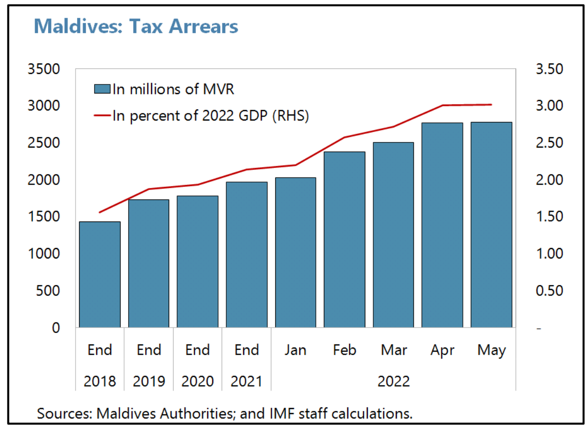
- A fiscal consolidation that relies on expenditure rationalization, in particular capital spending and subsidies, and domestic revenue mobilization is urgently needed. The tighter fiscal stance will reduce financing needs, lower imports and pressures on reserves, and limit potential inflationary pressures from public demand. A swiftly implemented fiscal consolidation will also help prepare for large refinancing needs coming due in 2026. MMA advances should be gradually reduced until fully phased out, and MMA should stand ready to further tighten monetary policy to contain inflationary pressures and the parallel market premium.

- Should downside risks materialize, Maldives has limited fiscal space and should redirect scarce resources toward targeted and time-bound measures to support the most vulnerable, for instance through income support allowances as done during the pandemic. As the debt profile is likely to worsen, securing debt sustainability will remain a priority. The authorities should have a contingency plan ready to address urgent needs, including closing fiscal and balance of payments needs considering the thin reserve buffers (Appendix IV).

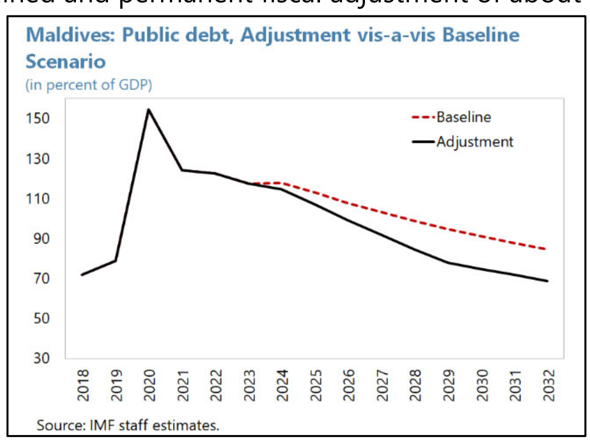
[17] The coordinated approach across policies between the government and the central bank during the early part of the COVID-19 crisis helped enhance the effectiveness of the COVID-19 policy response.

B. Fiscal Policy

20. The authorities have developed an ambitious and homegrown fiscal consolidation strategy to reduce the fiscal deficit and public debt. They plan to adopt measures in the 2023 budget that increase revenue by 2.7 percent of GDP and reduce spending by 3.3 percent of GDP. To mobilize revenue, the authorities are reforming the GST rates, which are lower than in peer countries. The reform, under consideration in parliament, aims to increase the domestic and tourist GST rates from 6 to 8 percent and from 12 to 16 percent, respectively. With the economy rebounding, the authorities also plan to improve tax compliance and reduce the stock of tax arrears that has accumulated during the pandemic. Expenditure saving measures in the authorities' fiscal reform plans include reducing fuel and electricity subsidies, introducing baseline prices for pharmaceuticals and bulk procurement for medical consumables, delaying the next stage of the public salary harmonization to the last quarter of 2023, postponing new capital spending initiatives, and not resorting to costly external market financing. To support fiscal sustainability, the authorities also developed their medium-term fiscal strategy along four anchors: (i) reducing public debt excluding guarantees to less than 100 percent of GDP by 2025, (ii) reducing the primary budget deficit to less than 5 percent of GDP by 2023, (iii) maintaining public debt as a share to GDP on a downward trend, and (iv) reducing recurrent expenditure to levels that do not exceed government revenue by 2023. These planned measures are significant steps in the right direction and should be swiftly implemented. However, further effort is needed to markedly improve the debt trajectory.



21. A reform-based fiscal consolidation is urgently needed to significantly lower public debt. The planned increase of the GST and delays in wage increases and capital spending are included in staff's baseline. In this context, a sustained and permanent fiscal adjustment of about 3 percent of GDP relative to the baseline would significantly reduce vulnerabilities by lowering public debt below 85 percent of GDP by 2028. Under such an adjustment scenario, which is critical and challenging, public debt would decline below 70 percent of GDP by 2032 (below the pre-pandemic level). If fully implemented and sustained, expenditure reforms to reduce fuel, electricity, and healthcare subsidies could help cover the 3 percent of GDP needed fiscal consolidation.



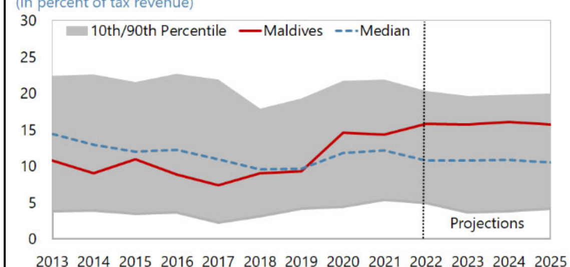
Additional options include reforming SOEs, rationalizing capital spending, improving the targeting of social assistance, and mobilizing additional domestic revenue. Considering that the delay of the public salary harmonization and the postponement of new capital spending are provisional measures with temporary savings, the authorities should make these measures permanent or replace them with permanent compensatory measures once they elapse.[18] The authorities are receiving technical assistance from the Fund to reform subsidies and develop a medium-term revenue strategy (MTRS) to help identify additional revenue sources. As the authorities envisage to pursue their fiscal reform agenda in the medium term, associated additional fiscal savings would help address public debt vulnerabilities. A commitment to a sustained consolidation would reduce financing needs and associated risks, lower pressures on the thin reserves, support the sustainability of the exchange rate peg, and improve market perceptions.

22. The fiscal consolidation strategy should center on both expenditure rationalization and domestic revenue mobilization. The measures should be appropriately designed to render fiscal policy more growth friendly and inclusive in the medium term. Further digitalization of public finance to improve revenue collection and public service delivery, for instance by adopting more advanced GovTech solutions could help increase revenue while enhancing the efficiency of healthcare and education spending (Appendix V).

- **Spending rationalization**. Key measures should focus on rationalizing capital spending, reforming SOEs' to reduce their dependence on the central government budget and improving the targeting of social assistance, including in social housing programs. Rationalizing capital spending promptly, including for SOEs, by prioritizing and spacing out investment projects over time is essential.[19] While the need for capital spending to address threats from climate change is vital, notably for adaptation, tapping into concessional financing and/or grants should be given priority given the difficult fiscal situation (see para. 35). The authorities may consider options such as debt-for-nature swaps as part of an overall fiscal strategy. Rationalizing subsidies while reforming SOEs, together with targeting assistance to the most vulnerable will support the fiscal adjustment and preserve inclusiveness. Reducing the rising interest burden by limiting non-concessional financing of non-priority spending—particularly capital spending—and deepening

Maldives: Interest Expenditure among Peers 1/

(In percent of tax revenue)



Sources: World Economic Outlook; and IMF staff calculations.
1/ Peer countries include Cabo Verde, Barbados, Antigua and Barbuda, Jamaica, Sri Lanka, Dominica, Seychelles, St. Vincent and the Grenadines, Mauritius,St. Lucia, Fiji, Grenada, St. Kitts and Nevis, Dominican Republic, the Bahamas, Samoa, Haiti, Vanuatu, Tonga, and Timor-Leste.

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[18] The baseline does not include fuel, electricity, and health subsidy reductions that the authorities are envisioning in their fiscal strategy as these are not yet legislated and could be difficult to fully implement. These reforms could generate savings of about 1.5 percent of GDP per year. Reforming SOEs combined with a better targeting of social assistance could generate further reduction of subsidies. The baseline assumes a gradual decline in capital spending in line with financing constraints, also reflecting that capital spending plans are unlikely to be financed in the absence of fiscal space.

[19] Maldives' capital spending was close to the top 10th percentile among peer countries in 2021. While Maldives' level of current expenditures was broadly in line peers, recent reforms of the wage bill have significantly increased these outlays. In addition, increased price subsidies in response to higher global food and fuel prices have added further pressures on current spending.

domestic debt markets would help release resources for priority areas.[20] Efforts should continue to contain wage bill pressures following the implementation of the minimum wage structure and public wage harmonization process. An overarching review of all pension schemes, including the unfunded basic and states pensions, will help assess the long-term sustainability of the system and if needed develop required reforms when Maldives is still benefiting from a largely young working age population.

- **Revenue mobilization**. Building on the MTRS, options for additional revenue mobilization to equitably support the fiscal adjustment include (i) reducing tariff exemptions and levying tariffs on the cost, insurance and freight (c.i.f.) instead of the lower free on board (f.o.b.) value of imported goods; (ii) lowering the personal income tax (PIT) thresholds and personal allowance[21]; (iii) raising the top marginal PIT rate to align it with the business profit tax (BPT) rate; (iv) lowering the BPT tax-free threshold and introducing a presumptive regime for businesses that are not registered for GST; (v) implementing other measures such as excises on tobacco, alcoholic products, fuels, and motor vehicles and imposing a carbon levy; (vi) introducing a recurrent property tax; (vii) narrowing the gap between the domestic and tourist GST rates and broadening the GST base to imports, inbound tourism and digital services; and (viii) implementing customs and tax administration reforms.[22] The authorities' MTRS targets an increase in revenue to at least 30 percent of GDP by 2028.

Revenue and spending reform options, 2023-28 1/
(in percent of GDP)

Total estimated revenue impact	8.8
Import duties	3.0
Rationalize duty exemptions and use c.i.f. base	1.3
Excises	1.7
Personal income tax (PIT)	0.5
Business profit tax (BPT)	0.1
Goods and services tax (GST)	2.9
GST rate increase	1.3
GST base broadening	1.6
Property tax	0.5
Carbon levy on fuels	1.4
Customs administration reforms	0.4
Total estimated expenditure savings	7.0
Fuel subsidies	3.0
Electricity subsidies	1.1
Health subsidies	2.9

Source: IMF staff projections.
1/The table provides a comprehensive list of possible reform measures that could be implemented during 2023-28 to raise revenues or reduce spending together with corresponding upper bound estimates. The shaded lines indicate measures for which the authorities plan to take some actions in 2023. Staff baseline already includes some revenue gains from the GST implementation.

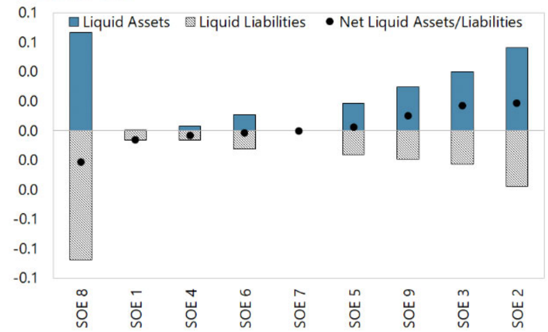
[20] Containing interest expenses is important as they have been rising and are expected to remain above the median of peer countries when expressed as a share to tax or overall revenue.

[21] Reducing the tax-free threshold from MVR 720,000 to MVR 480,000 could generate ½ percent of GDP revenue by expanding the number of potential taxpayers by over 50 percent, while retaining sufficient progressivity in the PIT schedule.

[22] The increase in the tourism (TGST) and domestic (GGST) GST rates from 12 to 16 percent and 6 to 8 percent in 2023 is expected to yield 2¾ percent of GDP revenue, while further increasing the GGST rate to 12 percent by 2026 could increase GST revenue by an additional 1¼ percent of GDP.

23. Swift public sector reform is imperative to reduce fiscal vulnerabilities. Many SOEs suffer from weak corporate governance, are liquidity constrained, and rely excessively on government transfers.[23] In addition, some SOEs face solvency issues in the long run (Box 2). Rationalizing subsidies while gradually adopting and maintaining full cost recovery tariffs for SOEs is essential. Rationalizing fuel, electricity and healthcare costs subsidies is imperative to sustain fiscal consolidation. Energy subsidy rationalization should include a comprehensive reform plan, appropriately phased prices increases and targeted mitigating measures (Appendix VI). Strengthening the mechanism for medicines procurement and expanding the use of generics would help contain pressures on health insurance subsidies. Addressing SOEs vulnerabilities would also require continuing reforms to strengthen their oversight, including enhancing the role of the Privatization and Corporatization Board (PCB) and developing a clear and rational policy for creating new SOEs. Key reforms in the public housing sector, which stands out as major source of contingent liabilities, include improving targeting by using income as an explicit selection criterion, strengthening mechanisms for periodic income verification, leveraging further the private sector in construction and management, and introducing decisive measures to reduce delinqencies in lease payments.[24] The authorities recognize the risks arising from SOEs and initiated measures to monitor and manage these risks, for instance by creating the State Shareholder Management Division with a remit of prioritizing support to SOEs and rationalizing their capital spending.[25] They are also working to reflect lease payments in individual credit history to disincentivize delinquencies. Work is also being initiated, with the support of the World Bank, to strengthen the efficiency and governance of individual SOEs.

Maldives: SOE Liquid Assets and Liabilities, 2021
(Percent of GDP)



Sources: Audited Financial Statements of SOEs; and IMF staff calculations.

24. Accelerating reforms in public financial and investment management would help enhance the credibility and effectiveness of fiscal policy.[26] Priorities in public investment management include (i) developing a more strategic and focused Public Sector Investment Program to strengthen the efficiency of public investment and (ii) preparing a costed medium-term national development strategy that prioritizes growth-enhancing investment within a realistic resource envelope.[27] Improving debt management capacity will help better assess and address debt-related

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[23] Many SOEs rely on government transfers to provide services and repay debt contracted with sovereign guarantees. The sharp rise in commodity prices is worsening this situation as some SOEs have continued to provide goods and services at broadly fixed prices, adding pressure to the government's limited fiscal space.

[24] Public housing programs account for more than half of guaranteed debt.

[25] Work is also under way to strengthen the framework for providing sovereign guarantees.

[26] The 2019 Public Investment Management Assessment (PIMA) identified several weaknesses, including poor planning, weak project appraisal and selection, and the lack of a project pipeline, which combined, result in unrealistic capital budgets and low predictability in investments across the public sector.

[27] The growth dividend from the expansion in capital spending since 2016 has been moderate because of the high import content of mega-projects implemented under the Public Sector Investment Program (PSIP).

risks, including by expanding the institutional coverage of debt reports and developing capacity to monitor SOE debt. The authorities should also urgently develop a multi-year debt management strategy to systematically reduce roll-over and solvency risk. Finalizing the Public Debt Law and completing the reform of the Fiscal Responsibility Act should be part of a broader credible plan that puts debt on a sustainable downward path, including by setting and disclosing realistic numerical targets for the fiscal deficit and public debt to support compliance and boost fiscal credibility.[28]

Authorities' Views

25. The authorities concurred with the need to ensure fiscal and debt sustainability and indicated that their medium-term fiscal policy aims at these objectives. They stressed that, despite limited policy space, they deployed a prompt and comprehensive set of policy responses to help mitigate the socio-economic impact of the pandemic and maintain financial stability. In pursuing a counter-cyclical fiscal policy stance under constraints, the cabinet approved the 2023–25 fiscal strategy with revenue increasing measures of about 3 percent of GDP in 2023 through higher Goods and Services Tax rates and expenditure saving measures of about 3 percent of GDP through reforms of fuel and health insurance subsidies and containment of wage bill pressures. In addition, the authorities indicated that they will not resort to costly external market financing in the near-term and are suspending new major capital spending projects in the next two years to focus on the implementation of existing projects, for which concessional or close-to-concessional funding has been secured. Once fiscal sustainability has improved, the authorities expect a proportional increase in capital spending over the medium term.

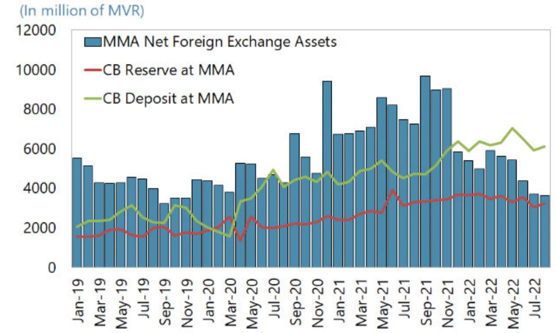
26. The authorities aim to pursue reforms to improve public finances. With the economy rebounding, the authorities are also determined to improve tax compliance and reduce the stock of tax arrears that has accumulated during the pandemic. The authorities consider that significant progress has been made on managing public investment execution to achieve greater transparency. Mechanisms and guidelines have been enhanced, including standardizing the SOEs procurement guidelines, publishing information of large procurements on the Ministry of Finance website, publishing information on small procurements by government agencies in the government gazette, adjusting public finance regulations to facilitate bid protesting mechanism and independent review, and publishing information on ongoing and planned public investments projects.

[28] The numerical targets in the 2013 Fiscal Responsibility Act (3.5 percent of GDP fiscal deficit limit and 60 percent of GDP public debt ceiling) have not been complied with since inception, reflecting unrealistic and multiple fiscal targets, unclear coverage of fiscal aggregates, and inadequate accountability.

C. Monetary and Exchange Rate Policies

27. Monetary policy should tighten starting with a reduction of MMA advances. The monetary policy stance is accommodative and excess liquidity is prevalent in the banking system. Short-term excess liquidity, predominantly in the form of commercial banks' reserves and deposits at MMA, spiked as a result of increased monetary financing (MMA advances) during the pandemic. As planned, MMA advances should be gradually reduced until fully phased out and only used as a last resort, which would lower inflationary pressures and support the sustainability of the exchange rate peg.[29] MMA should stand ready to further tighten monetary policy (for instance through open market operations) should inflationary pressures increase and/or the parallel market exchange rate premium widen.[30] The pace and speed of monetary tightening should remain data dependent.

Maldives: MMA Net Foreign Exchange Assets and Excess Liquidity
(In million of MVR)



Source: Maldives Monetary Authority; and IMF Staff calculations.

28. Excess structural liquidity poses risks to exchange rate stability and requires additional actions. In addition to MMA advances, inadequate local currency liquidity management tools and lack of a secondary market for liquidity-absorbing financial instruments have both contributed to structural liquidity. Operationalizing market-based liquidity management mechanisms (e.g., interest rate corridor) would help absorb structural liquidity although several prerequisites such as incentive mechanism, corridor width design, and collateral designation are needed. As sterilizing excess liquidity could put MMA's profitability under pressure, further technical assistance in this area would help in the design and calibration of appropriate instruments considering sterilization costs. In addition, the MMA should continue to closely monitor FX market developments, in coordination with key FX market participants such as SOEs and commercial banks, with the latter having large open positions in the economy. This includes assessing the implications of the recent quick accumulation of foreign assets by commercial banks and avoiding excess local currency offering by SOEs in the parallel market.[31]

29. A reform of the FX markets is long overdue. This will complement fiscal and monetary reforms to enhance the credibility of the peg. FX availability is prioritized by MMA for repayments of public borrowing, including for SOEs and import of essentials. As such, banks continue to face FX rationing, particularly in period of stress. The authorities are developing a sequenced and gradual

[29] The recent MVR 2.5 billion securitization of MMA advances could create additional liquidity. This increases the risk of steep depreciation that could raise the dollar-denominated debt obligations of unhedged households and corporates against exchange rate risk and further worsen the impact of inflation.

[30] MMA increased the foreign currency minimum reserve requirement (MRR) back to 10 percent effective in October 2022, fully unwinding the remaining pandemic-related monetary and financial support measure.

[31] The boom in tourism and growing FX deposits also led to an increase in banks' holding of foreign assets. These exposures should be monitored closely.

reform strategy, in discussion with key stakeholders in the private and public sectors. The authorities should swiftly finalize and gradually implement their FX reform strategy including to (i) enhance the use of Rufiyaa by implementing both legal and institutional measures such as granting legal tender status only to Rufiyaa (with a few exemptions); (ii) promote alternative financial instruments that are denominated in Rufiyaa and satiate risk appetites and liquidity preferences of large investors (e.g., SOEs), helping monetary policy to better influence structural liquidity in local currency; and (iii) calibrate policies that create a macro-fundamental-driven interest rate wedge in favor of local currency, and actively absorb Rufiyaa liquidity through an effective monetary operational framework to support the peg.[32]

Authorities' Views

30. The authorities agreed that reforming FX markets is essential and are working to implement these reforms to address dollar shortages. MMA is considering open market operations in the future, but the current focus is on using minimum reserve requirements (MMR). MMA regularly conducts liquidity forecasting exercises. To capture Rufiyaa liquidity, the authorities have increased the banking sector's local currency MRR back to 10 percent. As a final step in unwinding COVID-related banking sector support measures, the authorities have reverted the FX MRR back to 10 percent in October 2022. MMA continues to closely coordinate, together with the MoF, SOEs' access to FX for essential needs. The foreign exchange swap agreement under the existing 2019-2022 South Asian Association for Regional Cooperation (SAARC) framework, has been extended through June 30, 2023. The authorities will consider similar arrangements should the need arise in the future. MMA has recently developed a package of measures to reform FX markets, including regulating licensing criteria and conditions for money changers, encouraging the use of the Maldivian Rufiyaa in domestic monetary transactions, and limiting the types of transactions allowed through FX accounts. The authorities plan to roll-out these reforms gradually.

D. Financial Sector Policies

31. As pandemic-related financial support measures elapsed, careful monitoring is needed to avoid a build-up of financial vulnerabilities. Against the backdrop of large downside risks, financial sector policies should remain vigilant to safeguard financial stability as support schemes that helped contain corporate stress during the pandemic expired. Policies should also ensure that credit provision is not unduly tightened, particularly for SMEs. Financial regulators should consider measures (e.g., higher risk weights on sovereign debt or concentration risks) to contain commercial banks' exposure to the sovereign and reduce associated risks of crowding out private sector lending (Appendix VII). Strengthening the financial sector by addressing supervision data gaps and introducing a comprehensive crisis management framework by operationalizing a bank resolution framework and aligning it with the MMA's lender of last resort status remain priorities. The Financial

[32] See "Maldives De-dollarization Strategy in Support of Strengthening the FX Market," Technical Assistance Report, SARTTAC, 2019.

Sector Assessment Program (FSAP), expected to take place in 2023, will lay out priority reforms to further strengthen the financial sector.

32. The authorities should continue to take steps to enhance the effectiveness of the AML/CFT framework, also building towards the upcoming AML/CFT assessment. The authorities have been conducting a national risk assessment (NRA) for AML/CFT purposes that is expected to conclude in the first quarter of 2023. In order to mitigate the risks identified in the NRA and ensure alignment with the Financial Action Task Force (FATF) international standards and prepare for the upcoming 2024 assessment by the Asia/Pacific Group on Money Laundering, the authorities should disclose, as they are planning, the findings of the NRA and roll out legislative and implementation measures to mitigate identified risks. Notably, the authorities described taking measures including (i) conducting the NRA and implementing its recommendations, (ii) amending the AML/CFT Act in line with FATF standards, and (iii) introducing regulations and a supervision regime for Designated Non-Financial Businesses and Professionals (DNFBPs), including real-estate providers and high-value dealers identified at higher risks in the NRA.

Authorities' Views

33. The authorities indicated that the domestic banking system remains resilient with MMA closely monitoring risks to financing stability. They highlighted that the banking system remains stable even as pandemic-related financial sector support measures have elapsed. They emphasized that the banking system's capital and liquidity buffers are ample while nonperforming loans are gradually declining as the economy emerges from the pandemic. MMA's banking sector stress tests reveal that banking sector buffers, notably the high capital adequacy ratio, remain strong against possible shocks arising from credit quality deteriorations, liquidity strains, and sovereign stress.

BUILDING A MORE RESILIENT ECONOMY

A. Climate Change

34. Maldives is significantly exposed to climate change risks, with associated large financing needs. Various national mitigation and adaptation strategic plans have been enacted, including, the 2020 Nationally Determined Contribution (NDC) and the Climate Emergency Act of 2021.[33] However, implementation is lagging,

Maldives Vulnerability to Climate Change	
Key elements highlighting Maldives vulnerability to climate change	80 percent of Maldives' islands are less than one meter above sea level
	90 percent of the islands report flooding annually
	97 percent of the islands report shoreline erosion
	64 percent of the islands report severe erosion
	50 percent of the housing structure are within 100 meters of the coastline

[33] The 2020 Nationally Determined Contribution (NDC) lays out plan to reduce CO2 emissions by 26 percent by 2030 and achieve net zero by 2030. The Climate Emergency Act of 2021 sets out the conditional plans to achieve net-zero emission and large adaptation needs. Other strategic plans include: (i) Climate Emergency Act (2021), (ii) NDC (2020), (iii) Strategic Action Plan 2019-2023 (2019), (iv) Maldives Climate Change Policy Framework (2015), (v) Disaster Management Act (2007), and (vi) National Adaptation Program of Action (2006).

considering large adaptation and mitigation costs, estimated at US$ 8.8 billion (159 percent of 2022 GDP) and US$ 1 billion (18 percent of 2022 GDP) respectively.[34] The Maldives has developed a pipeline of projects totaling US$ 500 million for the Green Climate Fund (GCF), which are part of the Public Sector Investment Program.

35. Access to climate funding remains challenging. Accessing multilateral climate financing mainly through the GCF continues to be challenging, an issue faced by many small islands with limited capacities (Appendix VIII).[35] The hurdles are mainly due to lack of capacity in satisfying the preconditions required by the GCF as well as the cumbersome and complex process of acquiring accreditation and approval of projects. The Maldives should explore where opportunities arise to work with internationally accredited agencies. The direct access to GCF funding is demanding on public financial management (PFM) related requirements, an area where the authorities have requested the Fund's technical assistance.

Authorities' Views

36. The authorities indicated that a large portion of capital spending from domestic resources under the PSIP is allocated to climate projects. The green tax is used for environmental projects. The authorities stressed the urgent need for more climate funding and indicated that climate financing is currently offered at similar financing costs as conventional instruments, despite additional climate conditionalities. The authorities expressed the need for IMF assistance, including through capacity development, to avail concessional climate finance. They raised concerns regarding lengthy requirements and formalities leading to low access to climate funds despite the urgency of climate change.

B. Governance and Other Structural Reforms

37. Efforts should continue to improve governance. Building on recent initiatives to improve governance and reduce risks of corruption, for instance the audits of COVID-19 related spending, the authorities should pursue their efforts, including by disclosing SOEs quasi-fiscal activities and all transactions with the government.[36] Improving the procurement system through the harmonization

[34] The cost of adaptation is based on some sectoral assessments mainly covering the cost of coastal protection in all the inhabited islands. Both adaptation and mitigation costs are provided by the Ministry of Environment, Climate Change and Technology. Some specific and limited revenue measures are in place to fund the climate mitigation and adaptation strategies such as the Maldives Green Tax and the Baa Atoll Conservation Fund. The 2022 budget also approved a potential issuance of green/blue bonds of USD 50 million.

[35] Fouad et al., 2021, Unlocking Access to Climate Finance for Pacific Islands Countries, Departmental Paper number 2021/20.

[36] Audited COVID-19 spending reports are published in English and available through the following links: https://www.audit.gov.mv/AR2057; https://www.audit.gov.mv/AR2048. The Auditor General Office published other audited COVID-19 spending reports in local language.

of procurement guidelines for SOEs and promoting an open and competitive procurement process would help avoid inefficiencies and resource waste while reducing risks of corruption.[37]

38. Complementary policies would help boost prospects for a more inclusive and resilient growth in the medium-term. These include accelerating the implementation of the instant payment system, which would facilitate access to innovative and more affordable financial services and support financial inclusion, while reducing gender gaps in access to finance. The authorities could further support domestic and foreign private investment including, by (i) aligning the legal framework of foreign investment with international best practices to protect property rights; (ii) finalizing the establishment of the one-stop-shop for investors; and (iii) addressing skills gaps, particularly for the youth, through improvements in the quality of education and the promotion of technical and vocational trainings. Encouraging equal opportunity to education across gender will also help promote gender equality while addressing skills gaps.

39. Surveillance-TA integration should continue. The surveillance agenda has been supported by extensive TA, notably on subsidy reform, a medium-term revenue strategy, green public financial management, and enhancement of the Sovereign Development Fund (Table 8).

Authorities' Views

40. The authorities are taking further steps to continuously enhance governance and welcomed the constant support from the IMF on capacity development. Recent measures included the establishment of the State Internal Audit in 2019 to monitor operations of the public sector, the introduction of a Corporate Governance Code for state owned enterprises in 2019, and a Public Finance Circular issued in December 2020 requiring weekly or monthly publication of information on procurement contracts. In September 2022, a new State Shareholding Management Department was created to strengthen the oversight of SOEs. Following the national risk assessment (NRA) for AML/CFT purposes, the authorities have identified risks related to real estate providers and high-value dealers and are working to align domestic regulations with the international standards of the Financial Action Task Force. The authorities plan to roll out legislative and implementation measures to mitigate risks identified in the NRA by end-2022.

STAFF APPRAISAL

41. The Maldivian economy is recovering rapidly from the COVID-19 pandemic, underpinned by a strong rebound in tourism. The authorities' decisive pandemic related actions, including a rapid vaccine rollout and policy support measures combining fiscal, monetary, and financial measures targeting entities most impacted by the pandemic, supported the recovery. Tourism activity is near pre-pandemic levels and the recovery is expected to continue in the near term, although at a slower pace, reflecting the global economic slowdown.

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[37] The list of awarded projects and beneficial owners is available through the following link: https://www.finance.gov.mv/public-procurement/awarded-projects

42. Inflation is on the rise but contained due to price subsidies. Inflation is expected to increase further, reflecting price pressures from persistently high commodity prices, spending pressures for the 2023 elections, and the planned GST rates increases in early 2023.

43. Risks to the outlook are tilted to the downside. Key downside risks include a sharp global economic slowdown, including in key source markets for Maldives' tourism, high commodity prices, and tighter global financial conditions. A resumption of tourist arrivals from China, in the past one of Maldives' largest tourism source countries, is an upside risk to growth.

44. Fiscal and external vulnerabilities remain elevated. Notwithstanding strong revenue growth, the fiscal deficit is expected to remain in double digits in 2022, on the back of rising subsidies, sustained high infrastructure spending, increased interest payments, and wage bill reforms, contributing to elevated public debt. Continued support to SOEs, mostly through subsidies and capital contributions to repay publicly guaranteed debt is adding to fiscal vulnerabilities. Higher external financing costs are limiting options to tap international capital markets in the near term. International reserves are declining due to high food and fuel prices and fiscal spending. Public and publicly guaranteed debt has declined from the pandemic peak, aided by economic recovery. However, without significant fiscal adjustment supported by conservative debt management and continued strong growth, public debt remains on an unsustainable path in the baseline scenario.

45. The authorities' ambitious and homegrown fiscal consolidation plan to reduce public debt should be swiftly implemented. The authorities plan to adopt measures in the 2023 budget that increase revenue by 2.7 percent of GDP and reduce spending by 3.3 percent of GDP. The tax reform, under consideration in parliament, aims to increase the domestic and tourist GST rates. Expenditure reforms include reducing fuel, electricity, and healthcare subsidies and delaying planned wage increases and capital spending. These planned measures are significant steps in the right direction and should be swiftly implemented, while further reforms are designed.

46. A reform-based fiscal consolidation is urgently needed to significantly lower public debt. In addition to the planned increase of the GST and postponement in wage increases and capital spending, which are included in staff baseline, a sustained and permanent fiscal adjustment of about 3 percent of GDP relative to the baseline would reduce public debt below pre-pandemic levels in the medium-term. If fully implemented and sustained, expenditure reforms to reduce fuel, electricity, and health subsidies could help cover the needed adjustment. As the authorities envisage to pursue their fiscal reform agenda in the medium term, ensuing additional fiscal savings would help address public debt vulnerabilities. Key additional measures could include reforming SOEs, rationalizing capital spending, and improving the targeting of social assistance.

47. Monetary policy should tighten starting with a gradual reduction of MMA advances. The tighter fiscal stance will reduce financing needs, including for MMA advances, lower pressures on reserves, and reduce inflationary pressures. MMA should stand ready to further tighten monetary policy should inflationary pressures increase and/or the parallel market exchange rate premium widens.

48. The authorities should continue to remain vigilant to safeguard financial stability. This is important as pandemic-related support schemes that helped contain corporate stress have elapsed and considering the large exposure of the banking sector to the sovereign.

49. Complementary policies, including planned FX reforms, further strengthening of governance, and investment in climate-resilient infrastructure will support resilience. As in previous Article IVs, staff do not recommend approval of existing exchange measures inconsistent with Article VIII Section 2 (a) and Section 3 (see Informational Annex) and advise the MMA to accept the obligations of Article VIII as a measurable goal of its FX market reforms under consideration. Building on recent initiatives to improve governance and reduce risks of corruption, the authorities should pursue their efforts, including by disclosing SOEs quasi-fiscal activities and all transactions with the government. Maldives is significantly exposed to climate change risks and should continue to pursue efforts to access concessional climate funding considering elevated needs for climate-related investments.

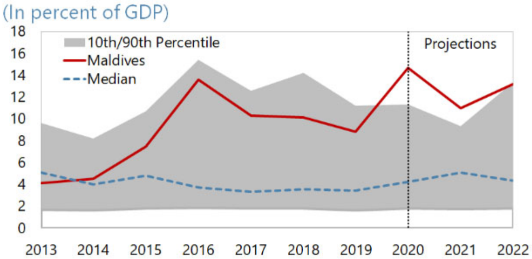
50. It is recommended that the next Article IV consultation takes place on the standard 12-month cycle.

Box 1. Capital Expenditures in the Maldives

To address Maldives' significant development needs capital spending has increased rapidly over the last few years. From about 4 percent of GDP in 2014, capital spending tripled to close to 12 percent of GDP by 2021, driven by the fast rise of multi-year large projects undertaken under the Public Sector Investment Program (PSIP). As a result of this rapid increase, capital spending in the Maldives is now significantly above the median of peer island states, with projects covering a wide range of infrastructure including airports, harbors, bridges, water and sewage, housing development, land reclamation, road construction projects, and transportation networks. Capital spending is financed primarily through debt. While some projects intend to raise productivity and boost growth potential, others aim to reduce social disparities between the capital island Male and outer islands. For instance, a transformative project such as the expansion of the Velana International Airport in Male is expected to double capacity to 3 million arrivals per year and boost tourism activity by accommodating higher demand from airlines. The development of the Hanimaadhoo International Airport, with a capacity of 1.3 million arrivals per year, has also the potential to catalyze stronger tourism activity in northern atolls, outside the Greater Male region. Water and sewage projects aim to provide basic necessities to outer islands, and public housing programs, represent more than half of guaranteed debt projects.

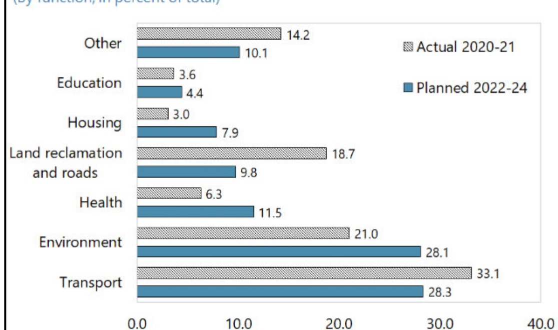
Improving the efficiency and effectiveness of infrastructure spending will help better balance the need for development infrastructure againts limited fiscal space and debt vulnerabilities. The government of the Maldives has been undertaking reforms to strengthen the management of public investment (see paragraph 24), but further effort is needed to improve efficiency and enhance the growth impact of projects while containing fiscal vulnerabilities. These include (i) prioritizing and sequencing critical investments; (ii) strengthening project selection and appraisal by publishing criteria and methodology for selecting and appraising projects; (iii) improving systems to monitor and manage the implementation and execution of projects at central and local government levels; (iv) ensuring that sufficient funds are available and dedicated to rehabilitation and maintenance; (v) establishing a clear legal framework for PPPs; and (vi) putting in place a climate budget tagging system to leverage more climate-related financing. Public investment management can be further enhanced by reporting revisions to awarded contracts and the extra costs being incurred.

Capital expenditure
(In percent of GDP)



Sources: World Economic Outlook; IMF staff calculation.
Notes: Peer countries include Cabo Verde, Barbados, Antigua and Barbuda, Jamaica, Dominica, Seychelles, St. Vincent and the Grenadines, Mauritius, St. Lucia, Grenada, St. Kitts and Nevis, Dominican Republic, the Bahamas, Haiti, Vanuatu, Tonga, and Timor-Leste.

Maldives: Public Sector Investment Program
(By function; in percent of total)



Sources: Maldivian authorities; and IMF staff calculations.

Box 2. Analyzing Fiscal Risks of SOEs

SOEs play an important role in the economy of the Maldives but are a source of risk. SOEs cover strategic sectors such as housing, utilities and transportation. However, many of them continue to be a major source of fiscal risk as they rely excessively on government support, provide goods and services at fixed prices, and undertake a number of quasi-fiscal activities. To understand the magnitude and risk profile of SOEs, a risk analysis was conducted for the nine largest SOEs in terms of assets and liabilities using a template developed by the IMF. The template focuses on a set of financial indicators measuring SOEs' financial health in terms of profitability, liquidity, and solvency to assess their overall risk rating (Table 1).

Table 1. Maldives: Overall Risk Rating of SOEs for 2016-2021

	2016	2017	2018	2019	2020	2021
SOE 1	Very High Risk	Very High Risk	Very High Risk	Very High Risk	Very High Risk	Very High Risk
SOE 2	High Risk	Moderate Risk	Moderate Risk	High Risk	Moderate Risk	Moderate Risk
SOE 3	High Risk	Moderate Risk	Moderate Risk	Moderate Risk	High Risk	High Risk
SOE 4	Low Risk	Low Risk	Low Risk	Moderate Risk	High Risk	High Risk
SOE 5	High Risk	High Risk	High Risk	High Risk	High Risk	High Risk
SOE 6	Moderate Risk	Moderate Risk	Moderate Risk	Moderate Risk	Moderate Risk	Moderate Risk
SOE 7	Very High Risk	High Risk	Moderate Risk	Moderate Risk	Moderate Risk	NA
SOE 8	High Risk	High Risk	High Risk	Moderate Risk	High Risk	High Risk
SOE 9	Low Risk	Moderate Risk	Moderate Risk	Low Risk	Moderate Risk	Low Risk

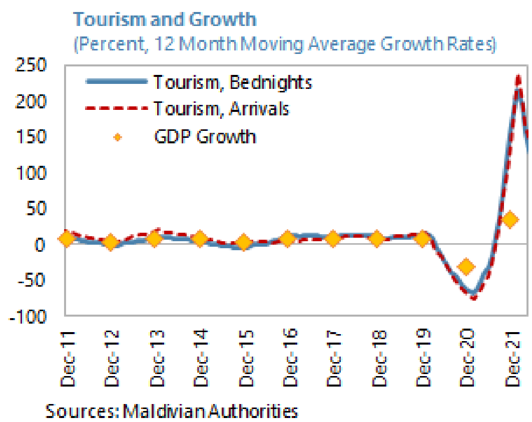
Sources: Audited Financial Statements of SOEs; and IMF staff calculations.

Risks from SOEs have continued to increase, mainly driven by elevated liquidity pressures. Overall, SOEs cannot meet their short-term liabilities using most liquid short-term assets and would require government support. In the longer-term, risks from SOEs are also increasing although to a lesser extent. With 36 percent of GDP (by end of 2021) of loans being already monitored by the government through sovereign guarantees and on-lending operations, around 6 percent of GDP of estimated loans remain outside the government's active monitoring. Any faltering on SOEs' capacity for debt repayment would place an enormous pressure on the weak fiscal position. The government is already providing sizeable support to SOEs, mainly in form of subsidies (3.2 percent of GDP), sovereign guarantees and on-lending (34 percent of GDP by end of 2021), and capital contribution (1.4 percent of GDP) mainly to repay debt contracted with sovereign guarantees.[1]

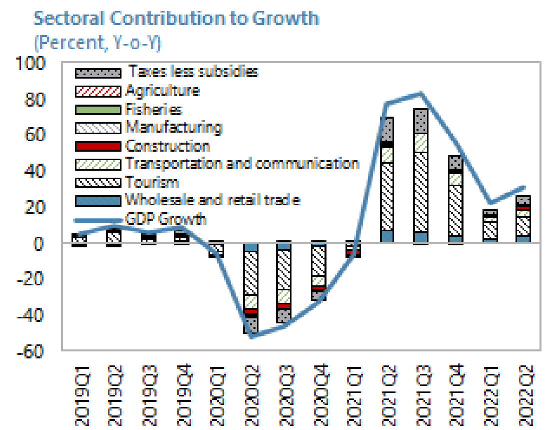
[1] Budget data and staff calculations.

Figure 1. Maldives: Summary of Recent Developments

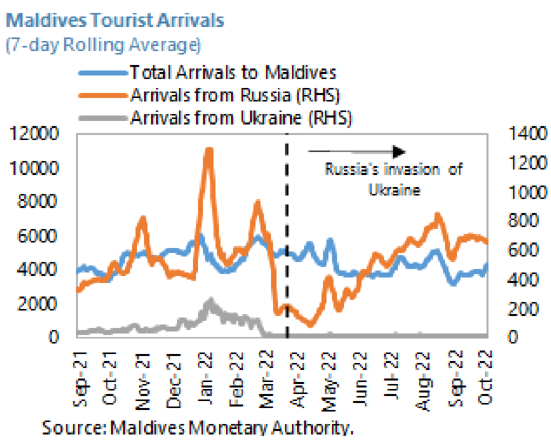
After a contraction due to the COVID-19 crisis, the economy recovered as tourist arrivals rebounded strongly



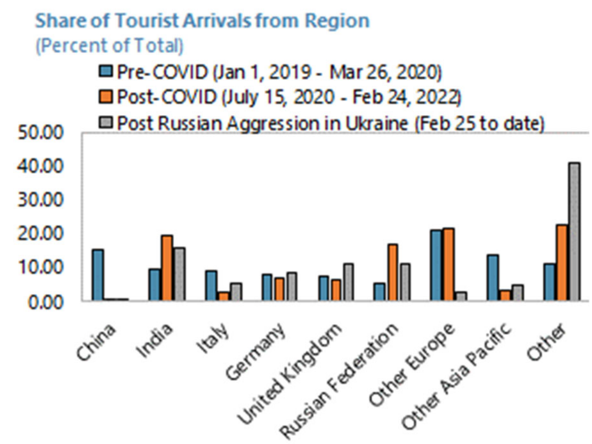
The recovery has been uneven, with the tourism sector and related activities dominating growth.



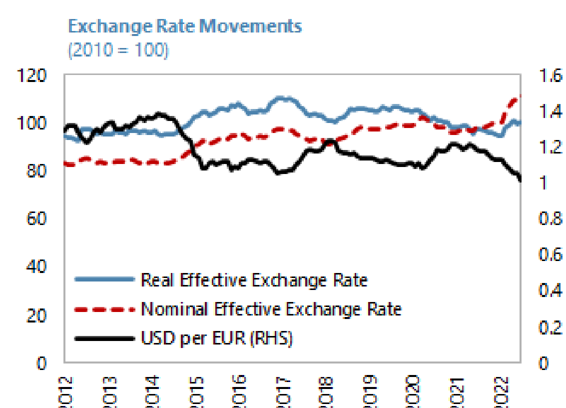
The war in Ukraine has sharply reduced tourist arrivals from Russia and Ukraine…



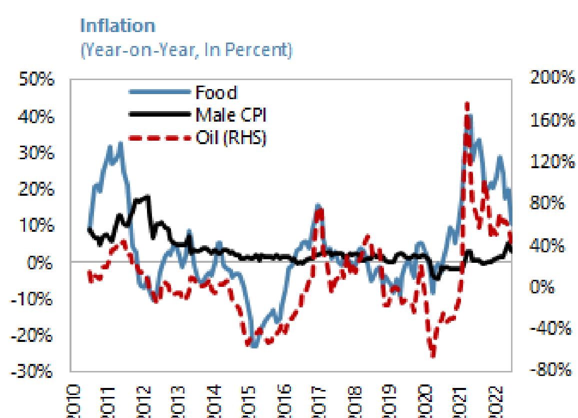
…but a rapid structural adjustment in top tourists source countries provided buffers against the adverse shocks



The NEER has gradually appreciated since 2021, reflecting eased dollar shortage following strong tourist arrivals



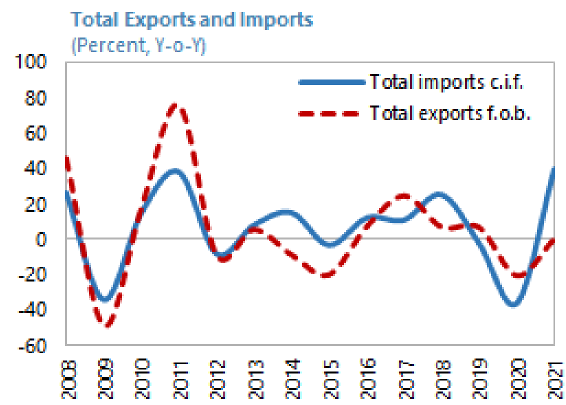
Domestic inflation has risen but remains relatively contained, amid soaring global energy and food prices.



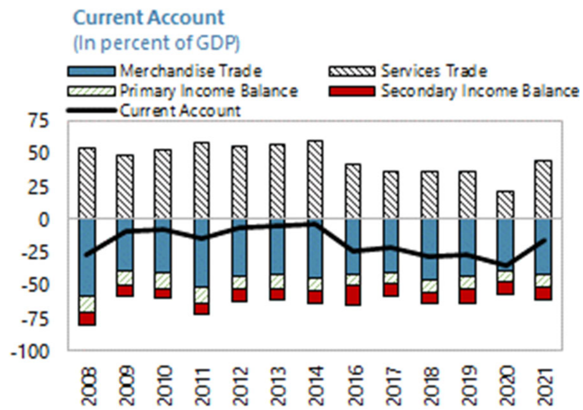
Source: Maldivian Authorities; Maldives National Bureau of Statistics; Maldives Monetary Authorities, WEO; and IMF Staff Calculations.

Figure 2. Maldives: External Sector

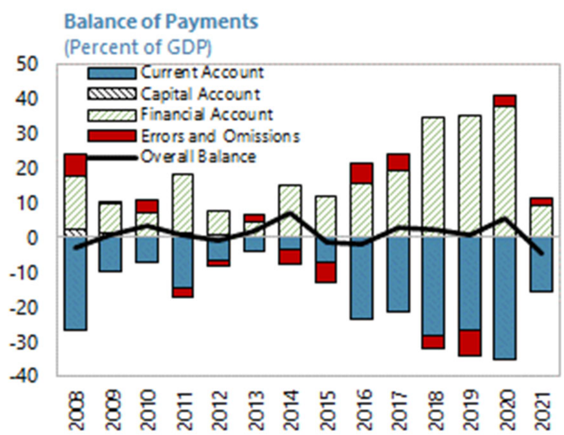
Import costs increased rapidly with global commodity price hikes



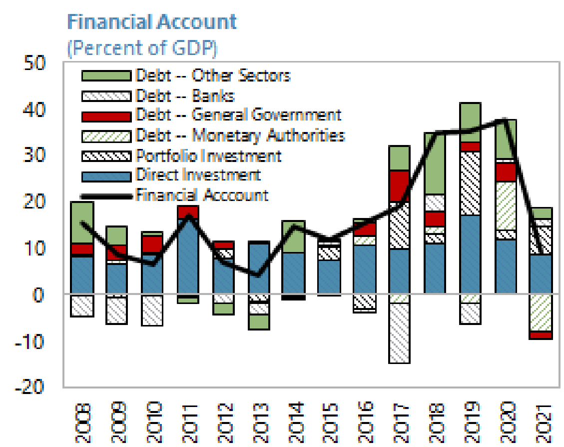
But high tourism receipts have temporarily helped contained the current account deficit



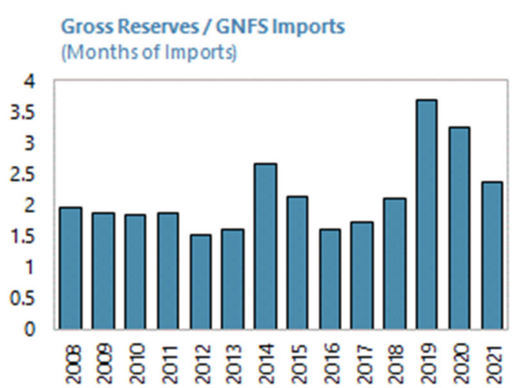
The balance of payments turned negative as COVID financing waned...



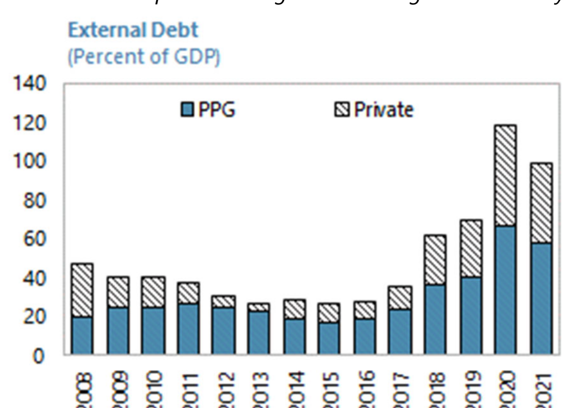
...leading to a higher reliance on commercial global sukuks



Gross international reserves fell to around 2 months of prospective reserve coverage in 2021 ...



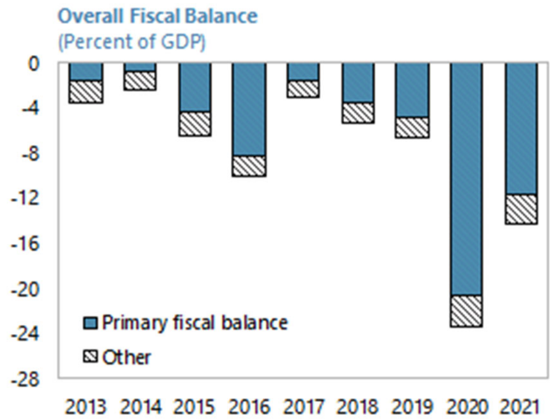
but the external debt-to-GDP ratio improved somewhat due to the unexpected strong tourism led growth recovery.



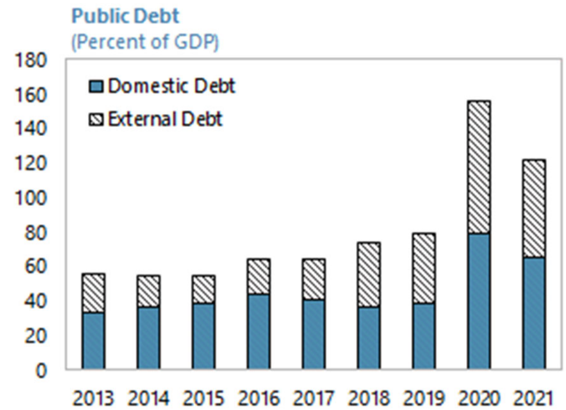
Sources: Maldivian Authorities; and IMF Staff Calculations.

Figure 3. Maldives: Fiscal Sector

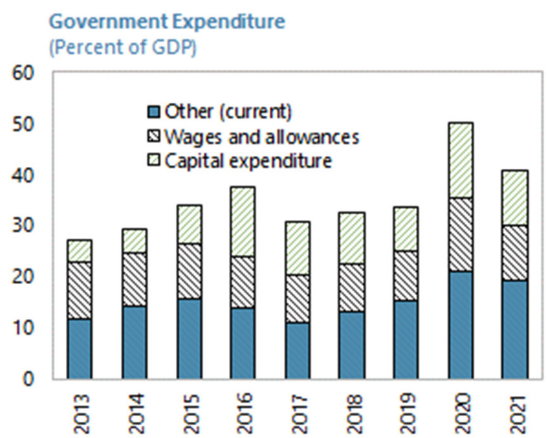
The fiscal deficit reached double digits during the pandemic, from a high level in the years before.



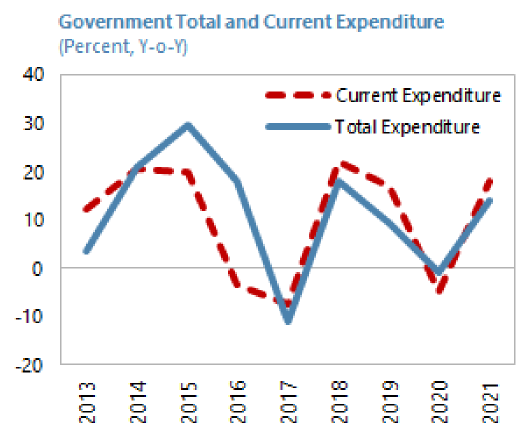
Public debt has remained elevated despite some moderation due to economic rebound in 2021.



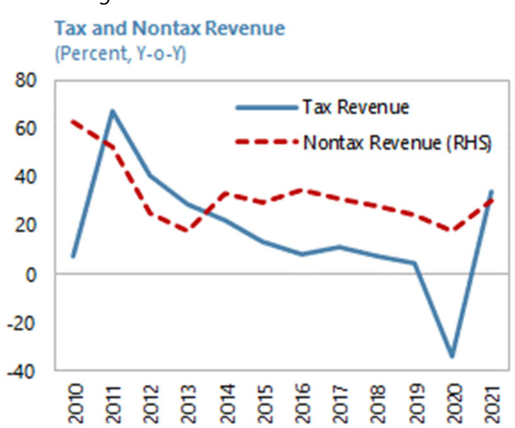
The infrastructure spending push did not subside during the pandemic…



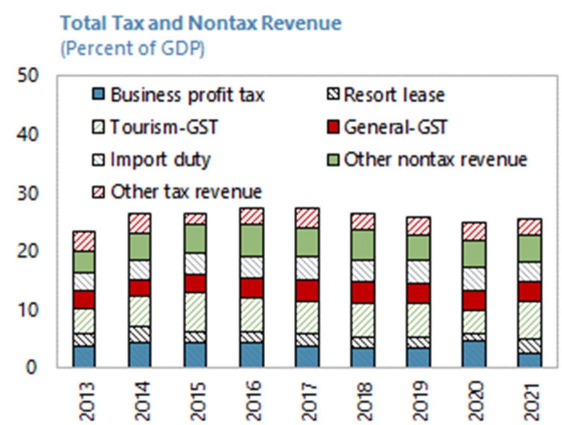
…while current spending rebounded in 2021 after being contained to accommodate priority spending in 2020.



Tax and non-tax revenue partially recovered in 2021, after plummeting in 2020…



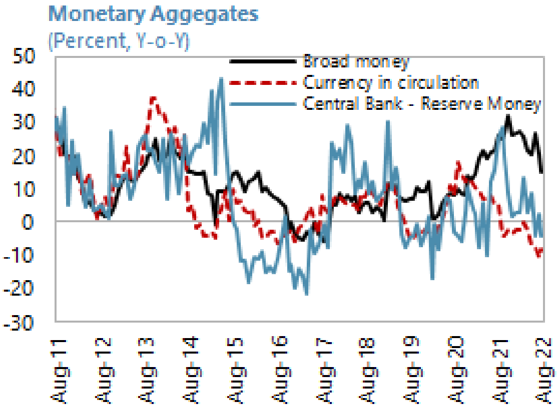
…interrupting the slower revenue growth trend relative to GDP observed after 2017.



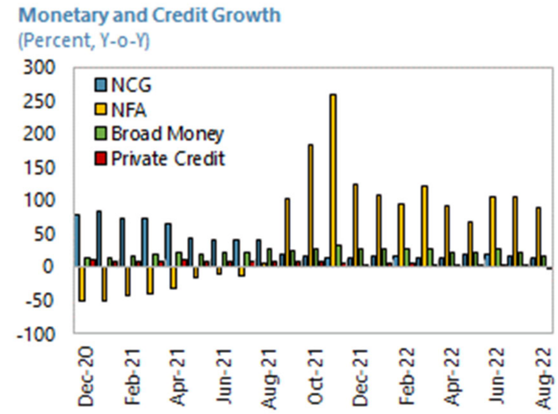
Sources: Maldivian authorities; and IMF staff estimates.

Figure 4. Maldives: Money and Credit Developments

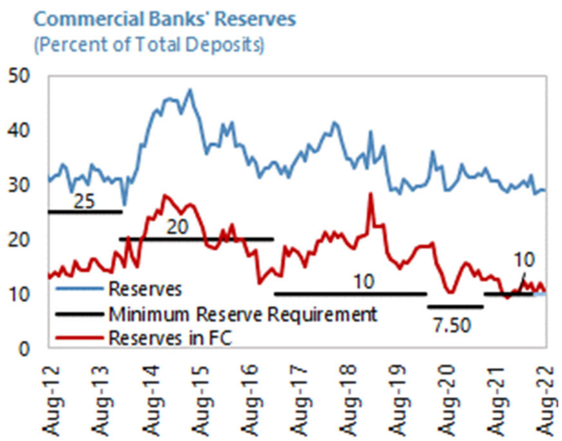
The rapid growth in broad money has slowed but remained high….



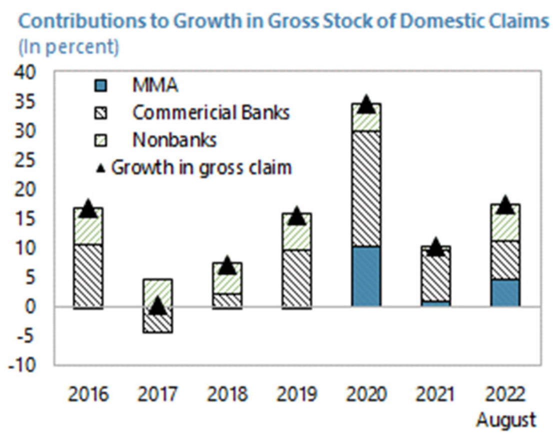
…as the surge in net credit to government slowed.



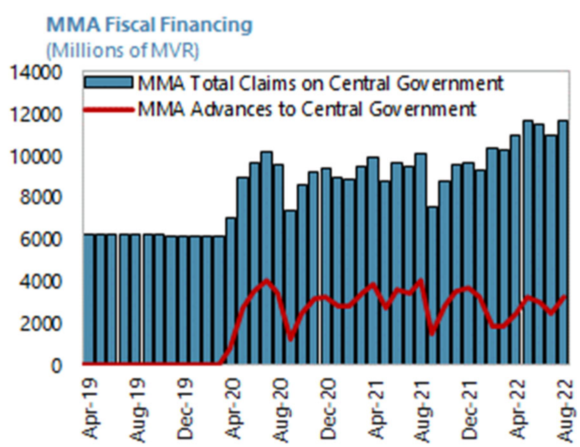
The MMA reversed the previous reduction of the MRR



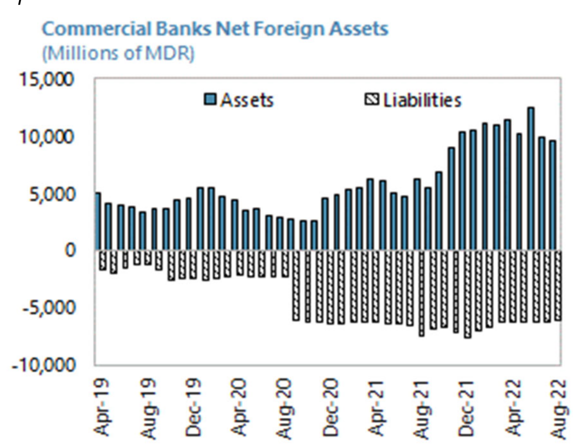
Overall central bank financing increased…



… and MMA advances to the central government remain outstanding.



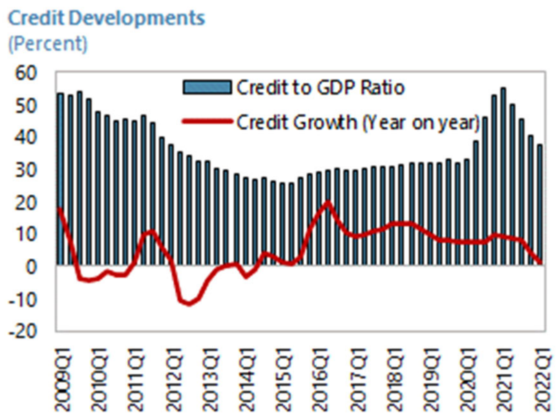
Commercial banks' NFAs increased as their foreign positions rise.



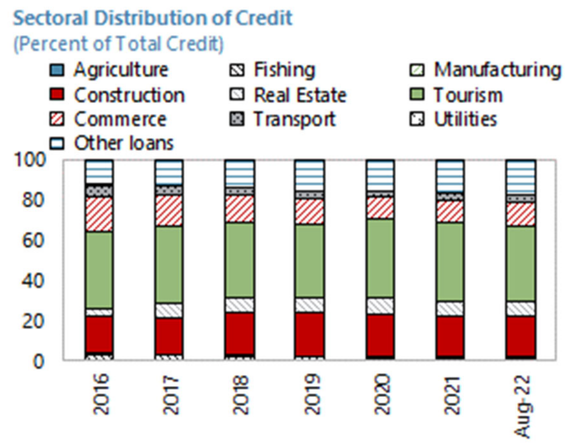
Sources: Maldives Monetary Authority; and IMF Staff Calculations.

Figure 5. Maldives: Financial Sector

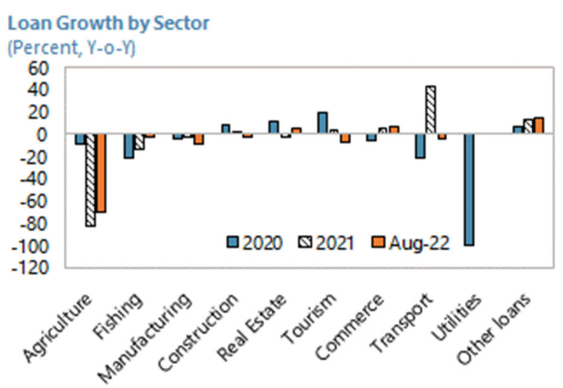
Banking sector private credit continues to fall…



…with uneven distributions of credit across sectors.

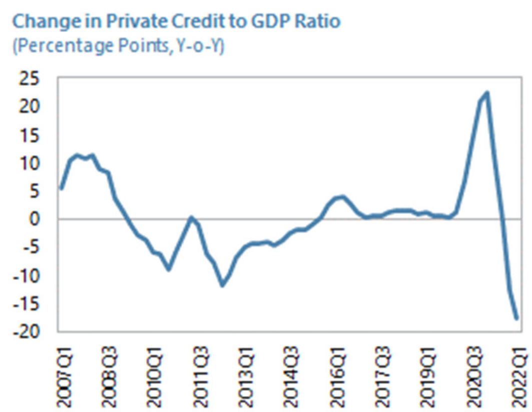


Loan growth is driven by tourism-related sectors.

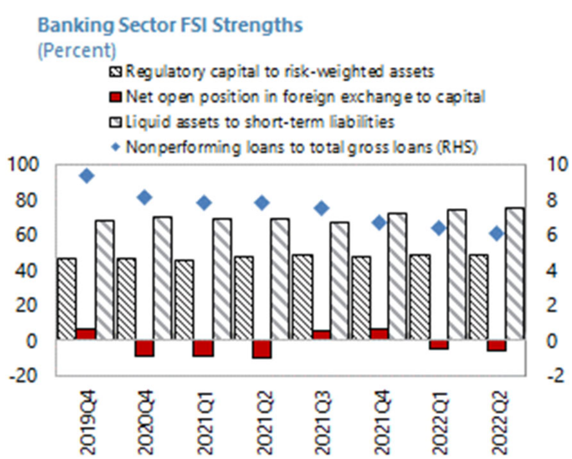


Notes: Loan growth in utilities was not calculated due to lack of data.

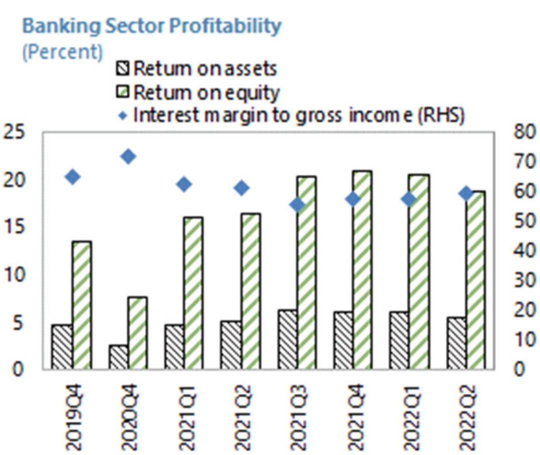
Private credit to GDP ratio has still to recover.



The banking sector's capital buffers remain strong…



…and profitability is recovering.



Sources: Maldives Monetary Authority; IMF Financial Soundness Indicators; and IMF Staff Calculations.

Table 1. Maldives: Selected Economic and Financial Indicators, 2018–27

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prel.	Proj.					
Output and prices			(Annual percentage change)							
Real GDP	8.1	6.9	-33.5	37.0	10.5	6.6	5.7	6.5	5.9	5.5
Inflation (end-of-period) 1/	0.5	1.7	-2.0	0.2	7.0	3.2	2.0	2.0	2.0	2.0
Inflation (period average) 1/	1.4	1.3	-1.6	0.2	3.9	4.9	2.4	2.0	2.0	2.0
GDP deflator	3.1	-1.1	0.4	1.7	3.9	4.9	2.4	2.0	2.0	2.0
Central government finances			(In percent of GDP)							
Revenue and grants	27.2	26.4	26.4	26.6	28.9	29.6	29.2	28.8	28.7	28.7
Expenditure and net lending	32.5	33.0	49.9	40.9	43.1	39.5	39.0	34.7	33.5	33.0
Overall balance	-5.3	-6.6	-23.5	-14.3	-14.3	-9.9	-9.8	-5.9	-4.8	-4.3
Overall balance excl. grants	-6.3	-7.9	-25.2	-15.6	-15.4	-11.4	-10.6	-6.6	-5.4	-5.0
Financing	5.3	6.6	23.5	14.3	14.3	9.9	9.8	5.9	4.8	4.3
Foreign	7.0	1.1	4.4	6.5	2.8	2.2	1.9	0.5	1.5	-0.2
Domestic 2/	-1.7	5.5	19.2	7.8	11.4	7.7	7.9	5.4	3.3	4.5
of which: Unsecured financing 3/	...	...	...	...	...	1.7	...	...	...	...
Primary balance	-3.5	-4.8	-20.7	-11.7	-11.0	-6.2	-6.1	-2.3	-1.3	-1.0
Public and publicly guaranteed debt	72.0	78.8	154.4	124.3	122.6	117.5	117.7	112.9	107.7	103.2
Monetary accounts			(Annual percentage change)							
Broad money	3.4	9.5	14.2	26.2	14.7	9.8	8.3	8.6	8.1	7.7
Domestic credit	7.6	3.4	34.4	8.8	20.8	9.9	12.2	11.9	11.1	10.8
Balance of payments			(In percent of GDP, unless otherwise indicated)							
Current account	-28.4	-26.6	-35.5	-8.8	-16.5	-15.2	-13.8	-13.6	-9.7	-9.3
Of which:										
Exports	6.4	6.4	6.9	5.5	5.6	5.3	5.2	5.1	5.0	5.0
Imports	-52.2	-49.2	-45.7	-46.0	-51.2	-50.0	-49.2	-48.3	-45.7	-45.3
Tourism receipts (in nonfactor services, net)	57.2	56.4	37.4	66.7	65.0	62.2	62.2	62.2	62.2	62.2
Income (net)	-9.3	-10.0	-8.2	-9.3	-8.2	-8.6	-8.3	-8.0	-7.6	-7.4
Current transfers	-9.3	-10.4	-9.6	-8.1	-8.9	-7.8	-7.3	-7.2	-7.1	-6.9
Capital and financial account (including e&o)	30.7	27.4	41.7	5.3	15.1	13.5	14.2	13.4	8.8	11.4
Of which:										
General government, net	3.0	1.9	4.0	4.0	4.1	0.5	1.9	-0.5	0.6	-0.9
Banks and other sectors, net	17.7	3.5	8.2	-5.0	-1.2	1.0	0.3	0.3	0.3	0.3
Overall balance	2.4	0.7	6.2	-3.4	-1.4	-1.7	0.4	-0.2	-0.9	2.1
Gross international reserves (in millions of US$; e.o.p.)	712	754	985	806	695	582	611	591	510	697
In months of GNFS imports	2.1	3.7	3.4	2.2	1.7	1.3	1.3	1.2	1.0	1.3
Exchange Rate (rufyiaa/US$, e.o.p.)	15.4	15.4	15.4							
Memorandum items:										
GDP (in millions of rufiyaa)	81,586	86,259	57,569	80,192	92,094	103,002	111,526	121,113	130,866	140,884
GDP (in millions of U.S. dollars)	5,294	5,598	3,736	5,204	5,976	6,684	7,237	7,859	8,492	9,142
Tourism bednights (000')	9,477	10,689	3,985	10,073	11,380	11,964	12,994	14,456	15,772	16,997
Tourist arrivals (000')	1,484	1,703	556	1,322	1,626	1,709	1,856	2,126	2,319	2,499
Tourism bednights (% change)	10.2	12.8	-62.7	152.8	13.0	5.1	8.6	11.3	9.1	7.8
Tourist arrivals (% change)	7.1	14.7	-67.4	137.8	23.0	5.1	8.6	14.5	9.1	7.8
Dollarization ratio (FC deposits in percent of broad money)	48.8	52.9	45.8	...	...	...	...	...	...	...

Sources: Maldivian authorities and IMF staff projections.

1/ CPI-Male definition.

2/ Domestic financing includes MMA advances, SDF contribution and India's USD 250 million bond from the State Bank of India branch in Male.

3/ Unsecured financing includes possible new sources of domestic financing or negotiated official bilateral financing as higher external financing costs are limiting options to tap international capital markets.

Table 2. Maldives: Balance of Payments, 2018–27
(In millions of USD, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prel.	Proj.					
Current account	-1,503	-1,490	-1,327	-457	-986	-1,014	-998	-1,071	-822	-849
Balance of goods and nonfactor services	-518	-348	-662	449	33	81	134	123	421	456
Trade balance	-2,425	-2,392	-1,451	-2,107	-2,730	-2,991	-3,185	-3,397	-3,453	-3,688
Exports (f.o.b.)	339	361	258	285	333	352	373	399	426	457
Domestic exports	229	217	163	151	172	179	189	202	215	232
Re-exports	110	144	95	134	161	172	184	197	211	226
Imports (f.o.b.)	-2,764	-2,753	-1,708	-2,392	-3,063	-3,343	-3,559	-3,796	-3,879	-4,146
Tourism-related	-396	-421	-199	-453	-514	-549	-595	-646	-698	-751
Other	-2,368	-2,332	-1,509	-1,939	-2,549	-2,793	-2,964	-3,150	-3,180	-3,394
Of which: Construction	-451	-406	-214	-252	-418	-568	-658	-726	-789	-886
Nonfactor services, net	1,907	2,044	789	2,556	2,763	3,072	3,319	3,520	3,874	4,145
Of which: Travel receipts	3,028	3,157	1,398	3,473	3,887	4,159	4,503	4,891	5,284	5,689
Income, net	-492	-560	-306	-483	-489	-574	-602	-630	-645	-676
Current transfers, net	-493	-582	-360	-423	-530	-522	-530	-564	-599	-629
Receipts	72	92	79	109	67	100	56	57	55	57
Payments	-564	-674	-439	-532	-597	-622	-586	-621	-654	-686
Capital and financial account	1,745	1,919	1,128	487	902	900	1,027	1,054	747	1,042
Financial account	1,745	1,919	1,128	487	902	900	1,027	1,054	747	1,042
Of which: 1/										
Foreign direct investment, net	576	956	441	444	717	802	868	943	1,019	1,097
Portfolio investment, net	103	772	69	307	15	0	0	125	-350	0
Other investment, net	1,066	191	619	-263	169	98	159	-14	78	-55
Monetary authorities 2/	-29	-126	163	-208	0	0	0	0	0	0
General government	159	106	148	207	243	35	141	-35	53	-84
Of which: Disbursements of loans	231	167	202	421	413	291	312	238	237	171
Amortization	-72	-61	-53	-214	-170	-256	-171	-273	-183	-255
Banks	104	-105	254	-310	-110	-93	-25	-26	-26	-27
Other sectors 3/	834	298	54	49	36	157	43	47	51	55
Errors and omissions	-118	-388	431	-209	0	0	0	0	0	0
Overall balance	125	41	231	-179	-84	-114	29	-17	-75	193
Gross international reserves (increase: -)	-125	-41	-231	179	110	114	-29	20	81	-187
SDR allocation	0	0	0	29	0	0	0	0	0	0
Use of Fund credit, net	-1	-1	28.7	0	0	0	0	-3	-6	-6
Purchases	0	0	28.9	0	0	0	0	0	0	0
Repurchases	-1	-1	0	0	0	0	0	-3	-6	-6
Memorandum items:										
Gross international reserves (stock; e.o.p.)	712	754	985	806	695	582	611	591	510	697
In months of GNFS imports	2.1	3.7	3.4	2.2	1.7	1.3	1.3	1.2	1.0	1.3
Current account (in percent of GDP)	-28.4	-26.6	-35.5	-8.8	-16.5	-15.2	-13.8	-13.6	-9.7	-9.3
GNFS balance (in percent of GDP)	-9.8	-6.2	-17.7	8.6	0.6	1.2	1.6	1.6	5.0	5.0
Exports (volume, percent change)	4.8	10.6	-22.9	0.7	-0.6	8.8	10.1	11.9	7.6	8.5
Imports (volume, percent change)	18.3	-0.2	-34.1	14.3	12.5	11.5	6.6	7.0	2.2	6.8
Tourism: bednights (percent change)	10.2	12.8	-62.7	152.8	13.0	5.1	8.6	11.3	9.1	7.8
Tourism: travel receipts (percent change)	10.4	4.3	-55.7	148.5	11.9	7.0	8.3	8.6	8.1	7.7
External debt (in percent of GDP) 4/	64.1	70.8	129.1	100.8	91.9	83.5	79.7	75.1	66.6	61.5
of which: External PPG	36.0	40.3	74.8	58.5	55.3	49.9	48.1	45.4	38.4	34.7
Short-term	1.4	1.2	1.6	1.3	1.1	1.0	0.9	0.9	0.8	0.8
Debt service (in percent of domestic GNFS exports)	7.5	12.9	37.4	17.7	15.4	15.9	13.2	14.2	21.6	12.0
Exchange rate (rufiyaa per U.S. dollar; average)	15.41	15.41	15.41	...	...	...	...	...	...	...
GDP (in millions of U.S. dollars)	5,294	5,598	3,736	5,204	5,976	6,684	7,237	7,859	8,492	9,142.4

Sources: Maldivian authorities; and IMF staff projections.

1/ There are no capital transfers.

2/ MMA liabilities include swaps with the RBI.

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

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

Table 3. Maldives: Monetary Accounts, 2018–27

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prel.	Proj.					
	(In millions of rufiyaa, e.o.p.)									
Net foreign assets	9,819	13,042	6,618	14,163	14,611	17,466	18,115	17,985	16,915	19,978
Maldives Monetary Authority, net	9,065	11,010	8,497	11,265	10,519	8,928	9,406	9,102	7,855	10,737
Assets	10,983	11,598	15,187	12,410	10,715	8,962	9,412	9,103	7,855	10,737
Liabilities	-1,918	-588	-6,690	-1,145	-196	-34	-6	-1	0	0
Commercial banks, net	754	2,032	-1,879	2,898	4,091	8,538	8,708	8,882	9,060	9,241
Net domestic assets	23,269	23,200	34,767	38,062	45,266	48,273	53,065	59,313	66,608	69,938
Domestic credit	39,340	40,668	54,676	59,474	71,868	78,998	88,652	99,170	110,209	122,109
Public sector	15,585	15,076	26,882	30,732	39,933	44,289	51,119	58,461	66,268	74,678
Central government (net)	13,093	13,385	24,818	27,780	36,520	40,486	47,046	54,181	61,903	70,225
Public enterprises	2,492	1,691	2,064	2,953	3,412	3,803	4,073	4,280	4,365	4,452
Private sector	23,084	24,790	27,168	28,162	31,356	34,129	36,953	40,130	43,362	46,681
Other items (net)	-16,071	-17,469	-19,909	-21,413	-26,603	-30,725	-35,588	-39,857	-43,601	-52,170
Broad money	33,088	36,241	41,385	52,225	59,877	65,739	71,179	77,298	83,523	89,916
Narrow money	14,579	14,557	19,003	22,346	25,620	28,129	30,457	33,075	35,738	38,474
Currency	3,057	2,993	3,395	3,269	3,269	3,269	3,269	3,269	3,269	3,269
Demand deposits	11,522	11,564	15,608	19,078	22,352	24,860	27,188	29,806	32,470	35,205
Quasi-money	18,509	21,685	22,382	29,879	34,256	37,610	40,723	44,223	47,785	51,442
Broad money	3.4	9.5	14.2	26.2	14.7	9.8	8.3	8.6	8.1	7.7
Narrow money	0.8	-0.2	30.5	17.6	14.7	9.8	8.3	8.6	8.1	7.7
Domestic credit, net	7.6	3.4	34.4	8.8	20.8	9.9	12.2	11.9	11.1	10.8
Central government	10.2	2.2	85.4	11.9	31.5	10.9	16.2	15.2	14.3	13.4
Public enterprises	-26.8	-32.1	22.0	43.1	15.6	11.5	7.1	5.1	2.0	2.0
Private sector	11.4	7.4	9.6	3.7	11.3	8.8	8.3	8.6	8.1	7.7
	(In percent of GDP)									
Broad money	40.6	42.0	71.9	65.1	65.0	63.8	63.8	63.8	63.8	63.8
Narrow money	17.9	16.9	33.0	27.9	27.8	27.3	27.3	27.3	27.3	27.3
Domestic credit, net	48.2	47.1	95.0	74.2	78.0	76.7	79.5	81.9	84.2	86.7
Central government	16.0	15.5	43.1	34.6	39.7	39.3	42.2	44.7	47.3	49.8
Public enterprises	3.1	2.0	3.6	3.7	3.7	3.7	3.7	3.5	3.3	3.2
Private sector	28.3	28.7	47.2	35.1	34.0	33.1	33.1	33.1	33.1	33.1
	(In millions of U.S. dollars)									
Gross international reserves (stock; e.o.p.) 1/	712	754	985	806	695	582	611	591	510	697
Commercial banks NFA	49	132	-122	188	266	554	565	576	588	600
Commercial banks Balance Sheet FX Gap 2/	567	448	198	157	168	174	177	181	184	188
Memorandum items:										
Velocity	2.5	2.4	1.4	1.5	1.5	1.6	1.6	1.6	1.6	1.6
Money multiplier	2.9	3.3	3.4	4.2	3.4	3.4	3.4	3.4	3.4	3.4
Reserve money (in millions of rufiyaa, e.o.p.)	11,531	11,106	12,249	12,429	17,611	19,335	20,935	22,735	24,566	26,446

Sources: Maldivian authorities; and IMF staff projections.

1/ Gross international reserves is equivalent to gross foreign assets of MMA.

2/ Commercial Bank Balance Sheet FX Gap is the difference between total FX denominated assets and total FX denominated liabilities on commercial banks' balance sheets.

Table 4. Maldives: Summary of Government Operations and Stock Positions, FY2018–27

(In millions of Rufiyaa)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prelim.	Proj.					
Total revenue and grants	22223	23232	15222	21354	26596	30533	32582	34840	37545	40383
Revenue (excluding privatization receipts)	21403	22077	14264	20322	25571	28992	31713	33967	36695	39508
Tax revenue	15834	16531	10959	14682	19215	23832	25649	27940	30170	32483
Import duties	3149	3412	2264	2843	3472	3883	4079	4475	4836	5206
Airport service charge	645	731	283	473	829	872	947	1084	1183	1275
Business profit tax (BPT)	2710	2899	2618	1847	2879	3220	3487	3787	4092	4405
Personal income tax			83	217	310	346	375	407	440	474
Remittance Tax	706	103	9	0	0	0	0	0	0	0
Goods and services tax (GST)	7689	7748	4307	7733	9744	13619	14746	16014	17303	18628
Of which: General GST	2906	2845	2087	2486	3046	4257	4609	5005	5408	5822
Tourism GST	4783	4903	2220	5248	6697	9362	10137	11008	11895	12805
Tourism tax ($6 green tax)	811	851	352	802	974	1024	1112	1237	1350	1455
Other	124	787	1044	766	1007	867	902	935	966	1040
Nontax revenue	5569	5546	3305	5640	6356	5159	6064	6027	6525	7025
Grants	820	1155	958	1032	1025	1542	870	873	850	876
Expenditure and net lending	26522	28995	28754	32806	39731	40695	43520	41989	43806	46507
Current expenditure	18268	21372	20307	23983	27556	31573	33303	34099	36444	39039
Primary current expenditure	16828	19831	18704	21879	24506	27827	29163	29721	31884	34325
Of which: Salaries and allowances	7677	8294	8206	8681	9940	10953	12202	13030	13849	14909
Administrative Services	1793	1931	1620	2276	2430	2456	2444	2444	2641	2843
Social welfare contributions	2417	3937	2532	2910	2842	2917	2854	2678	2894	3116
Repairs and maintenance	220	408	215	310	352	348	351	381	412	443
Subsidies and transfers	1687	2260	3298	4227	5562	6419	6449	6165	6662	7172
Interest	1440	1541	1604	2104	3049	3746	4139	4378	4560	4714
Other	3034	3001	2832	3474	3381	4734	4864	5022	5427	5842
Capital expenditure	8254	7623	8446	8823	12175	9122	10218	7889	7362	7468
Overall balance	-4299	-5763	-13532	-11453	-13135	-10162	-10938	-7148	-6261	-6123
Overall balance, excluding grants	-5119	-6918	-14490	-12484	-14160	-11703	-11807	-8021	-7111	-6999
Financing	4300	5763	13532	11453	13135	10162	10938	7148	6261	6123
External	5713	936	2505	5182	2620	2243	2159	604	1987	-225
Domestic	-1413	4827	11027	6271	10514	6180	8779	6544	4275	6348
of which: SDF contribution 1/	1315	1385	-394	-485	0	0	0	0	-4951	0
Unsecured financing	0				0	1739	0	0	0	0
Memorandum items:										
Current balance	3135	705	-6044	-3662	-1985	-2582	-1590	-132	251	469
Primary balance	-2859	-4222	-11928	-9348	-10085	-6416	-6799	-2770	-1701	-1409
Current primary balance	4575	2246	-4440	-1557	1064	1164	2549	4246	4811	5183

Sources: Maldivian authorities; and IMF staff projections.

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

Table 5. Maldives: Summary of Government Operations and Stock Positions, FY2018–27
(In percent of GDP, unless otherwise specified)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Prel.	Proj.					
Total revenue and grants	27.2	26.4	26.4	26.6	28.9	29.6	29.2	28.8	28.7	28.7
Revenue (excluding privatization receipts)	26.2	25.1	24.8	25.3	27.8	28.1	28.4	28.0	28.0	28.0
Tax revenue	19.4	18.8	19.0	18.3	20.9	23.1	23.0	23.1	23.1	23.1
Import duties	3.9	3.9	3.9	3.5	3.8	3.8	3.7	3.7	3.7	3.7
Airport service charge	0.8	0.8	0.5	0.6	0.9	0.8	0.8	0.9	0.9	0.9
Business profit tax (BPT)	3.3	3.3	4.5	2.3	3.1	3.1	3.1	3.1	3.1	3.1
Personal income tax			0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Remittance Tax	0.9	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services tax (GST)	9.4	8.8	7.5	9.6	10.6	13.2	13.2	13.2	13.2	13.2
Of which: General GST	3.6	3.2	3.6	3.1	3.3	4.1	4.1	4.1	4.1	4.1
Tourism GST	5.9	5.6	3.9	6.5	7.3	9.1	9.1	9.1	9.1	9.1
Tourism tax ($6 green tax)	1.0	1.0	0.6	1.0	1.1	1.0	1.0	1.0	1.0	1.0
Other	0.2	0.9	1.8	1.0	1.1	0.8	0.8	0.8	0.7	0.7
Nontax revenue	6.8	6.3	5.7	7.0	6.9	5.0	5.4	5.0	5.0	5.0
Grants	1.0	1.3	1.7	1.3	1.1	1.5	0.8	0.7	0.6	0.6
Expenditure and net lending	32.5	33.0	49.9	40.9	43.1	39.5	39.0	34.7	33.5	33.0
Current expenditure	22.4	24.3	35.3	29.9	29.9	30.7	29.9	28.2	27.8	27.7
Of which: Salaries and allowances	9.4	9.4	14.3	10.8	10.8	10.6	10.9	10.8	10.6	10.6
Administrative Services	2.2	2.2	2.8	2.8	2.6	2.4	2.2	2.0	2.0	2.0
Social welfare contributions	3.0	4.5	4.4	3.6	3.1	2.8	2.6	2.2	2.2	2.2
Repairs and maintenance	0.3	0.5	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Subsidies and transfers	2.1	2.6	5.7	5.3	6.0	6.2	5.8	5.1	5.1	5.1
Interest	1.8	1.8	2.8	2.6	3.3	3.6	3.7	3.6	3.5	3.3
Other	3.7	3.4	4.9	4.3	3.7	4.6	4.4	4.1	4.1	4.1
Capital expenditure	10.1	8.7	14.7	11.0	13.2	8.9	9.2	6.5	5.6	5.3
Overall balance	-5.3	-6.6	-23.5	-14.3	-14.3	-9.9	-9.8	-5.9	-4.8	-4.3
Overall balance, excluding grants	-6.3	-7.9	-25.2	-15.6	-15.4	-11.4	-10.6	-6.6	-5.4	-5.0
Financing	5.3	6.6	23.5	14.3	14.3	9.9	9.8	5.9	4.8	4.3
External	7.0	1.1	4.4	6.5	2.8	2.2	1.9	0.5	1.5	-0.2
Domestic	-1.7	5.5	19.2	7.8	11.4	6.0	7.9	5.4	3.3	4.5
of which: SDF contribution 1/	1.6	1.6	-0.7	-0.6	0.0	0.0	0.0	0.0	-3.8	0.0
Unsecured financing	0.0	0.0	0.0	0.0	0.0	1.7	0.0	0.0	0.0	0.0
Memorandum items:										
Current balance	3.8	0.8	-10.5	-4.6	-2.2	-2.5	-1.4	-0.1	0.2	0.3
Primary balance	-3.5	-4.8	-20.7	-11.7	-11.0	-6.2	-6.1	-2.3	-1.3	-1.0
Current primary balance	5.6	2.6	-7.7	-1.9	1.2	1.1	2.3	3.5	3.7	3.7
Public and publicly guaranteed debt	72.0	78.8	154.4	124.3	122.6	117.5	117.7	112.9	107.7	103.2
Domestic	36.0	38.5	79.5	65.7	67.3	67.5	69.7	67.5	69.3	68.5
External (excl. currency swaps by MMA)	36.0	40.3	74.8	58.5	55.3	49.9	48.1	45.4	38.4	34.7
GDP (in millions of rufiyaa)	81,586	87,837	57,569	80,192	92,094	103,002	111,526	121,113	130,866	140,884

Sources: Maldivian authorities; and IMF staff projections.

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

Table 6. Maldives: Financial Soundness Indicators—Local Banking Sector, 2019 Q1–2022Q2
(In percent, unless otherwise indicated)

	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	2021Q1	2021Q2	2021Q3	2021Q4	2022Q1	2022Q2
Core FSIs												
Regulatory capital to risk-weighted assets	47.26	46.40	46.51	47.93	48.19	46.27	45.76	47.17	48.75	47.26	48.83	48.28
Tier 1 capital to risk-weighted assets	40.84	38.96	43.57	44.07	42.94	40.97	42.05	41.47	39.86	36.21	44.69	42.22
Nonperforming loans net of provisions to capital	4.17	2.32	1.68	2.22	1.39	0.08	-0.32	0.13	-0.03	0.43	0.13	-0.71
Common Equity Tier 1 capital to risk-weighted assets	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Capital to assets (leverage ratio)	22.69	20.81	22.65	22.66	21.46	19.03	19.07	18.51	17.73	15.66	18.73	17.88
Nonperforming loans to total gross loans	9.58	9.35	9.19	9.63	8.92	8.16	7.84	7.85	7.46	6.69	6.38	6.05
Loan concentration by economic activity	87.80	87.07	86.84	86.84	86.79	87.79	88.60	89.23	89.52	88.90	88.07	87.71
Provisions to nonperforming loans	78.21	87.60	90.93	88.31	92.25	99.51	101.97	99.16	100.21	96.60	98.87	106.46
Return on assets	5.06	4.59	4.42	3.09	3.44	2.50	4.72	4.93	6.12	6.05	5.90	5.38
Return on equity	14.72	13.35	13.00	8.86	9.75	7.50	15.86	16.33	20.18	20.91	20.39	18.63
Interest margin to gross income	64.12	65.03	66.56	71.15	72.57	71.65	62.14	61.22	55.69	57.14	57.40	59.30
Noninterest expenses to gross income	29.81	31.84	30.33	29.56	28.70	31.76	28.55	27.92	24.91	27.14	31.53	29.24
Liquid assets to total assets	40.63	42.58	43.20	44.59	39.07	42.56	43.43	42.54	42.35	46.30	48.16	48.88
Liquid assets to short-term liabilities	66.67	68.20	66.96	69.94	67.02	69.73	69.40	68.66	67.37	71.80	73.85	74.60
Net open position in foreign exchange to capital 1/	8.44	6.42	9.59	9.13	5.21	-9.25	-8.65	-10.08	5.58	6.20	-5.23	-5.69
Additional FSIs												
Large exposures to capital	60.89	60.71	45.59	53.94	58.45	70.17	60.59	70.68	72.67	68.60	44.36	47.18
Gross asset position in financial derivatives to capital	0.00	0.00	0.00	0.00	0.00	2.35	1.33	1.27	1.20	1.15	1.12	0.98
Gross liability position in financial derivatives to capital	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Trading income to total income	4.28	4.08	3.95	3.67	3.76	3.59	3.55	3.20	2.92	3.10	3.88	3.74
Personnel expenses to noninterest expenses	34.59	34.93	37.45	39.19	40.03	37.22	32.55	34.71	34.48	34.51	30.58	31.29
Customer deposits to total (noninterbank) loans	122.20	131.12	134.28	134.21	124.62	137.24	145.37	145.88	143.72	164.69	177.80	180.92
FX loans to total loans	50.06	48.13	47.74	48.45	48.28	47.61	47.63	47.56	47.91	47.19	45.46	44.60
FX liabilities to total liabilities	55.07	56.26	55.33	50.59	52.45	54.98	55.18	52.63	51.96	54.16	55.26	55.03
Credit growth to private sector	7.44	7.48	7.34	6.46	7.46	8.86	8.62	9.57	8.19	4.94	2.23	1.60
Residential real estate loans to total gross loans	5.37	5.39	5.24	5.31	5.30	5.37	5.43	5.33	5.21	5.12	5.24	5.24
Commercial real estate loans to total gross loans	0.5	0.6	0.6	0.6	0.5	0.5	0.3	0.2	0.2	0.3	0.3	0.4

Source: IMF Financial Soundness Indicators.

1/ The net open position in foreign currency measures the foreign currency mismatch for the deposit taking institutions to identify exposure to exchange rate risk, which takes into account both on- and off-balance-sheet positions.

Table 7. Integrating Fund Surveillance and Capacity Development		
Sector	**Surveillance Recommendations**	**Capacity Development Recent Actions/Plans**
Monetary policy	Implementing the FX reform strategy, including to (i) enhance the use of Rufiyaa; (ii) promote alternative financial instruments that are denominated in Rufiyaa and satiate risk appetites and liquidity preferences of large investors; and (iii) calibrate policies that create a macro-fundamental-driven interest rate wedge in favor of local currency is important.	SARTTAC provided several TA missions to the MMA to provide guidance on wide range of areas including on the MMA Strategic Plan, central bank governance (HQ-led), functioning two-way FX markets, de-dollarization, currency baskets and active domestic liquidity management. The latest TA in end-2021 focused on introducing the interest rate corridor for an active liquidity management to support the peg.
Tax policy and administration	A fiscal consolidation that relies both on expenditure rationalization and domestic revenue mobilization is key.	In August 2022, FAD provided a TA on medium-term revenue strategy that provides options to raise up to 9.4 percent of GDP in revenue by 2028. In 2022, an FAD TA mission reviewed the GST and additional support was provided by FAD and SARTTAC to improve tax administration, including the management of international tax risks, estimate of GST gap, and completion of a Tax Administration Diagnostic Assessment Tool.
Expenditure policy	Rationalizing subsidies, combined with targeted assistance to the most vulnerable, and a reform of SOEs would support the fiscal consolidation effort.	In October 2022, the Fund provided TA on reviewing the fuel and electricity subsidies regimes. Previous TAs have supported SOEs oversight and fiscal risks management.
Public financial management	Accelerating reforms in public financial and investment management would help enhance the credibility of fiscal policy. Priorities include (i) developing a more strategic and focused Public Sector Investment Program to strengthen the efficiency of public investment and (ii) preparing a costed medium-term national development strategy that prioritizes growth-enhancing investment within a realistic resource envelope.	In 2020, the Fund has provided an evaluation of fiscal transparency following the Fiscal Transparency Code of the IMF, and TA to reform the current Fiscal Responsibility Act to be a principle-based approach with strong accountability requirements. To strengthen the public investment management, the Fund will conduct early 2023 a TA on PIMA follow-up and Climate PIMA. The Fund will provide a TA on developing a law for the Sovereign Development Fund.
Debt management	Improving debt management capacity will help better assess and address debt-related risks, including by enhancing the medium-term debt strategy and annual borrowing report, expanding the institutional coverage of debt reports, and developing capacity to monitor SOE debt.	FAD, MCM, and LEG jointly provided recommendations in 2021 for developing a new debt management law aiming to clarify the mandate, authority, and responsibilities of key actors and the interaction of the draft law with other key pieces of legislation such as the new fiscal responsibility law.
Macro Forecasting	Enhance macroeconomic forecasting and policy analysis capacity.	ICD is working on a 3-year TA project to build MMA's capacity for consistent baseline forecasts and scenario analyses to further support policy discussions.

Appendix I. External Sector Assessment

Overall Assessment: *The external position of Maldives in 2021 was broadly in line with the level implied by fundamentals and desirable policies, but the parallel market rate premium remained elevated. The current account (CA) deficit temporarily narrowed to 8.8 percent of GDP in 2021, in part due to a stronger than expected recovery in tourism and tourism receipts. These and other transitory effects are expected to stabilize going forward, and together with the hike in global commodity prices and tightening global financial conditions, they are projected to cause a widening of the current account deficit. Dollar shortages have persisted with significant spreads (around 10 percent down from 23 percent in early 2021) in the parallel foreign exchange market and likely to persist until tourism recovers to pre-pandemic levels, and gross international reserves declined.*

Potential Policy Responses: *Growth friendly fiscal consolidation, including through tax and subsidy reforms, as well as moderation of current and non-priority capital expenditure, will help to safeguard FX reserves and build resilience to external shocks.*

Foreign Assets and Liabilities: Position and Trajectory

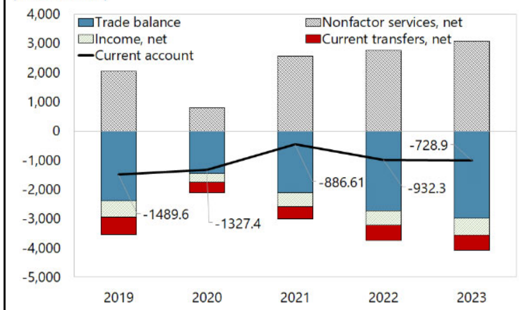
Background. The public debt is deemed unsustainable since the 2021 Article IV. Alongside the economic recovery and payments of guaranteed debt in 2021, the public and publicly guaranteed (PPG) debt-to-GDP ratio declined to around 124 percent from the pandemic peak of 154 percent in GDP in 2020. However, PPG debt is expected to remain high over the medium-term under current policies, mostly reflecting elevated fiscal deficits. External gross financing needs have increased significantly relative to the 2021 Article IV and authorities issued in March 2021 a global Sukuk bond in the amount of US$200 million at 10.5 percent, maturing in 5 years in 2026, that helped to repurchase 77 percent of the US$D250 million maiden Eurobond, that was trading cost at 26 percent yield, and was expected to mature in April 2026. Subsequently, the Maldives issued another US$100 million sukuk in April 2021 (reopened on April 27 under the same conditions as the March 2021 subscription) and US$200 million in September 2021 to cover budgetary expenses, which are now trading at about 20 percent yield. To repay the Eurobonds, the authorities created a sovereign development fund (SDF) to mitigate the rollover risk and has accumulated funds in Rufiyaa equivalent in the amount of above US$270 million as of September 1st, 2022.

Assessment. Maldives is at a high-risk of debt distress for overall and external PPG debt. Without significant fiscal adjustment, public debt is on an unsustainable path in the baseline. The growing reliance on shorter-term commercial debt—e.g., the global sukuks and the US$100 million private placement at 7 percent interest rate in mid-2022 over a three year-maturity period only— is making the debt profile more vulnerable to rollover risk. The authorities are considering ways to restructure the SDF to act as a buffer and Fund TA has been requested.

Current Account

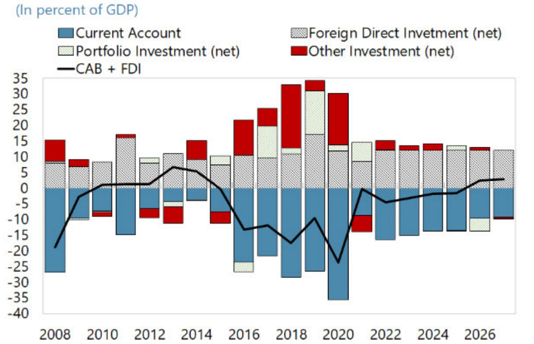
Background. The CA dynamics were primarily driven by the trade balance and nonfactor services. While the trade balance deteriorated on account of significant increases in the imports of petroleum products, the exceptional turnaround in tourism and travel receipts more than offset it. In 2021, total tourist arrivals increased by 138 percent in annual terms (-67 percent in 2020) while total bednights of the industry observed an increase of 153 percent (-63 percent in 2020). However, both tourist arrivals and bednights remained below pre-pandemic levels (2019), by 22 percent and 7 percent in 2021, respectively. During this period, the average stay is reported to have increased to 8.8 days, from 7.2 days in the 2020. The largest number of tourist arrivals were recorded from India, followed by Russia, the United Kingdom, Germany, and Italy.

Maldives: Current Account Balance
(In USD million)



Sources: Maldives Monetary Authority; and IMF Staff estimates.

Maldives: Balance of Payments
(In percent of GDP)



Sources: MMA; and IMF Staff estimates.

Assessment. The revised EBA-lite CA model estimates a CA gap of -0.2 percent of GDP in 2021, with a policy gap of -1.1 percent of GDP, driven mainly by a negative policy gap stemming from fiscal policy (i.e., higher deficit vis-à-vis rest of the world) and adding pressure to the exchange rate. The small CA gap suggests that the external position of Maldives in 2021 was broadly in line with the level implied by fundamentals and desirable policies.

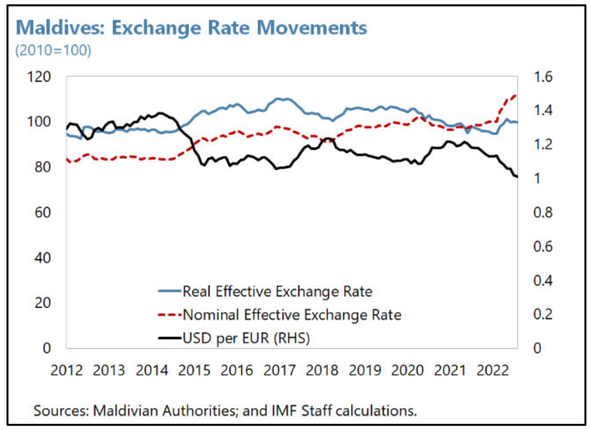
Maldives: Model Estimates for 2021 (in percent of GDP)
(in percent of GDP)

	CA model 1/	REER model 1/
CA-Actual	**-8.8**	
Cyclical contributions (from model) (-)	1.2	
COVID-19 adjustor (-) 2/	-0.2	
Additional temporary/statistical factors (-)	0	
Natural disasters and conflicts (-)	-0.2	
Adjusted CA	**-9.6**	
CA Norm (from model) 3/	**-9.4**	
Adjustments to the norm (-)	0	
Adjusted CA Norm	**-9.4**	
CA Gap	**-0.2**	**6.5**
o/w Relative policy gap	-1.1	
Elasticity	-0.5	
REER Gap (in percent)	**0.4**	**-13**

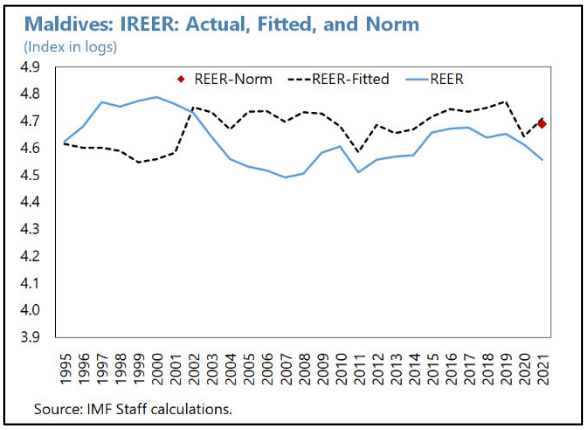
1/ Based on the EBA-lite 3.0 methodology
2/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism (.16 percent of GDP) and remittances (0 percent of GDP).
3/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. The REER has gradually appreciated since 2021, reflecting some ease in dollar shortages following strong tourist arrivals, while staying below its long-term average.



Assessment. The REER gap varies between 0.4 and -13 percent across the EBA-lite CA and REER models. The policy gap from the REER model suggested that the real interest rate (as a measure of monetary policy) was tighter than the rest of the world, with the caveat that the interest rate in the Maldives is less of an anchor and more of a signal as monetary policy transmission remains weak and the stance remained accommodative due to the MMA's provision of large advances to the government. The authorities should phase out the outstanding advances to tighten the monetary stance and limit pressures on prices and the exchange rate.



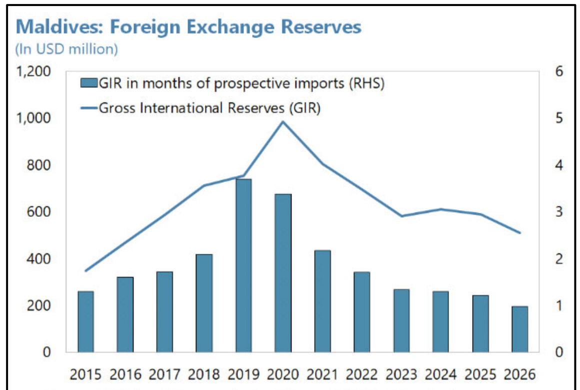
Capital and Financial Accounts: Flows and Policy Measures

Background. The Maldives has a relatively open capital account. FX availability was prioritized by MMA for SOEs' repayment of loans and import of essentials.

Assessment. The authorities should finalize and gradually implement their FX reform strategy including to (i) enhance the use of Rufiyaa by implementing both legal and institutional measures such as granting legal tender status only to Rufiyaa (with a few exemptions), including requiring tax payments to be made only in Rufiyaa; (ii) promote alternative financial instruments that are denominated in Rufiyaa and satiate risk appetites and liquidity preferences of large investors (e.g., SOEs), helping monetary policy to better influence structural liquidity in local currency; and (iii) calibrate policies that create a macro-fundamental-driven interest rate wedge in favor of local currency and actively absorb Rufiyaa liquidity through an effective monetary operational framework to support the peg.[1]

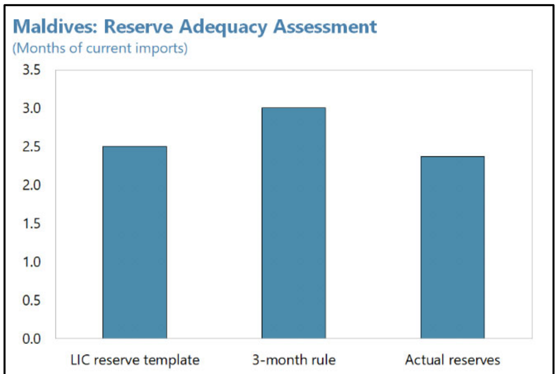
FX Intervention and Reserves Level

Background. Gross international reserves (official (reserve assets) declined to US$806 million at the end of December 2021, from US$943.8 million at the end of November 2021, and US$984.9 million recorded at the end of December 2020. The 20 percent decline when compared to December 2020, reflected in part the repayment of RBI swap during in December 2021. It also, reflected the 77 percent pay-off of the US$250 million Eurobond with issuance of US$500 million global sukuks. Reserves fell to US$658 million in August 2022.



Sources: Maldives Monetary Authorities; and IMF Staff projections.

Assessment. The reserve adequacy tool for credit constrained economies is applied to the Maldives, with fixed exchange regime. Using the marginal cost of capital as the cost of holding reserves, estimated at 6.2 percent, the benchmark reserves should be closer to 3 months of prospective imports, while Maldives had 2.4 months. Gross reserve coverage around 3 months of imports is recommended. Looking forward, reserve coverage is expected to fall below 2 months of imports, strengthening the case for a growth-friendly fiscal consolidation, including a moderation of non-priority capital expenditure. The authorities will consider a new FX swap agreement under the existing SAARC framework 2019-2022 which has been extended till 30 June 2023, should the need arise.



Source: IMF Staff calculations.

[1] See "Maldives De-dollarization Strategy in Support of Strengthening the FX Market," Technical Assistance Report, SARTTAC, 2019.

Appendix II. Past Article IV Recommendations

Sector	Staff Recommendations	Related Policy Action
Debt and Fiscal Policy	A multipronged adjustment strategy is needed to restore sustainability to public finances. Further revenue mobilization is required to expand capital spending, and to mitigate the risks related to high public debt. Staff recommended rationalizing capital spending plans starting in 2021, including the capital spending of SOEs, as well as containing recurrent spending pressures—including from the wage bill.	To improve fiscal sustainability, the authorities have set four anchors in their Medium-Term Fiscal Strategy 2023-25: (1) reduce public debt (excluding guarantees) to less than 100 percent of GDP by 2025, (2) maintain a primary deficit of less than 5 percent of GDP starting in 2023, (3) maintain the public debt to GDP ratio on a downward trend, and (4) contain current spending below government revenues (excluding grants) from 2023. In this context, they are taking steps to increase the domestic and tourist GST rates to mobilize revenue of 2.7 percent of GDP as of 2023 and are considering reducing fuel, electricity, and health subsidies. Nevertheless, capital spending remains elevated, while election-related pressures on the wage bill and subsidies can raise current spending beyond the path envisaged in the Fiscal Strategy.
Governance, structural, and PFM	Fiscal stability will require improvements in the public financial framework, including (i) addressing weaknesses in the public investment management system with the aim of enhancing transparency; (ii) strengthening the institutional framework for SOE fiscal risk oversight; (iii) rationalizing government support to SOEs; (iv) adopting a robust legal framework for public debt management; (v) mitigating fiscal risks related to the pension system; and (vi) improving transparency with respect to COVID-19 spending.	While more effort is needed, on-going reforms are being implemented to improve governance and PFM. A new State Shareholder Management Department was created with the aim of prioritizing support to SOEs, rationalizing their capital spending and actively monitoring their fiscal risks. A draft debt management law is being reviewed within MOF. A guideline for harmonizing the procurement procedures of SOEs has been introduced in 2021. Currently, a review of fuel, electricity, and healthcare subsidies is ongoing with the aim of the reform being implemented in 2023.
Exchange Rate and Monetary Policy	Inflation stability and the sustainability of the exchange rate peg need to be ensured. Maldives Monetary Authority (MMA) advances should not exceed limits and pandemic-related policy support measures should be unwound as planned.	MMA advance was extended to end of 2023 without changes in the limit (MVR 4.4 billion) and the pandemic-related policy support measures were fully unwound. MMA is planning to gradually reduce its advances to the government.
Exchange Rate and Monetary Policy	Staff does not recommend approval of existing exchange rate restrictions and multiple currency practices (MCPs) and advises the MMA to accept the obligations of Article VIII as a measurable goal of its Strategic Plan.	FX market reforms have stalled since the pandemic. MMA recently proposed a roadmap for FX reforms including to strengthen regulations of money changers, encourage the use of Rufiyaa in domestic transactions, and limit transaction types on FX accounts accordingly. MMA is now discussing the roadmap with different stakeholders from both public and private sectors.
Financial Stability and Structural Reform	Prudential regulation and supervision (including addressing data gaps) as well as introducing a comprehensive crisis management framework by operationalizing a bank resolution framework could be further advanced to promote the health of the banking system amid higher asset quality risks.	No material changes in prudential regulation and supervision. Banking sector macroprudential measures and resolution framework will be discussed in the forthcoming FSAP mission.
Climate	Further advances on building resilient climate change infrastructure and investment in renewables are needed.	The authorities have complained about the lack of grants and concessional financing for climate resilient investments.

III. Risk Assessment Matrix/[1]

Risks	Likelihood	Impact of Risk (High, Medium, Low)	Policy Response
Intensifying spillovers from Russia's war in Ukraine. Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility, with Europe, LICs, and commodity-importing EMs among the worst hit.	High	**High:** A slowdown in key tourist source countries as a result of the war in Ukraine would severely undermine the recovery of Maldives' tourism sector and damage business confidence.	Provide targeted and temporary fiscal support to the most vulnerable and hardest-hit workers and businesses, and if necessary, keep financial conditions accommodative to support bank lending.
Commodity price shocks. A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	High	**Medium-High:** Price subsidies have limited pass-through to local prices but are not sustainable. Living standard could be worsening, causing social and economic instability.	Provide targeted and temporary social assistance to the most vulnerable while gradually allowing pass-through of higher global prices.
Systemic social unrest. Rising inflation, declining incomes, and worsening inequality amplify social unrest and political instability, causing capital outflows from EMDEs, slowing economic growth, and giving rise to economically damaging populist policies (e.g., preserving fossil fuel subsidies).	Medium	**Medium-High:** Price subsidies have limited pass-through to local prices but are not sustainable. Living standard could be worsening, causing social and economic instability.	Provide targeted and temporary fiscal support to the most vulnerable and hardest-hit workers and businesses, and if necessary, keep financial conditions accommodative to support bank lending.
De-anchoring of inflation expectations and stagflation. Supply shocks to food and energy prices sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand, currency depreciations in EMDEs, higher borrowing costs, and sovereign defaults. Together, this could lead to the onset of stagflation.	Medium	**High:** Slower growth and damage to business confidence would adversely impact investment and consumption. Global financial tightening threats FX stability and reduces options for external market-based financing while increasing risks given SOEs' balance sheets vulnerabilities (through rising cost of debt service due to significant exposure to SOFR-lined debt).	Extend support measures: (i) asset purchase program to support liquidity in bond markets and compress risk premia and (i) provide liquidity support to banks. To mitigate risks arriving from the bank-sovereign nexus, the authorities should implement fiscal consolidation to reduce financial needs and adjust risk weight on banking sector sovereign debt exposure.

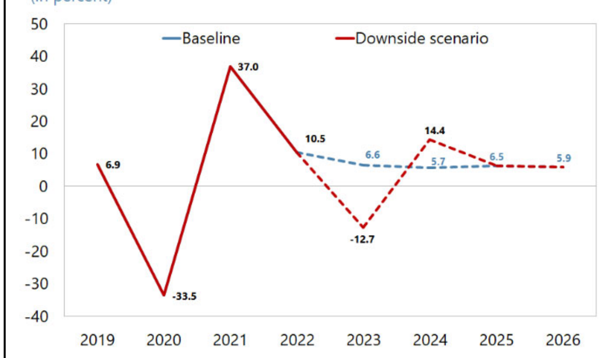
Risks	**Likelihood**	**Impact of Risk** (High, Medium, Low)	**Policy Response**
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, particularly in Europe, spillovers through trade and financial channels, and downward pressures on some commodity prices. In EMDEs, this could also lead to tightening of global financial conditions, spiking risk premia, widening of external imbalances and fiscal pressures, and debt and financial crises.	**Medium**	**High:** A slowdown in key tourist source countries, particularly in Europe, would severely undermine the recovery of Maldives' tourism sector and damage business confidence, adversely impacting investment and private consumption.	Provide targeted and temporary fiscal support to the most vulnerable and hardest-hit workers and businesses, and if necessary, keep financial conditions accommodative to support bank lending.
Local Covid-19 outbreaks. Outbreaks in slow-to-vaccinate countries or emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce. This results in extended supply chain disruptions, slower growth, capital outflows, and debt distress in some EMDEs.	**Medium**	**Medium:** Outbreaks in Maldives and/or key tourist source countries would undermine the recovery of the tourism sector and damage business confidence.	Provide targeted and temporary fiscal support to the most vulnerable and hardest-hit workers and businesses, and if necessary, keep financial conditions accommodative to support bank lending.
Sovereign-bank nexus. Despite strong buffers, risks arising from the banking sector's large exposure to the sovereign, which increased markedly since the pandemic, could pose risk to financial stability.	**Medium**	**Medium:** Banks' capital could therefore erode rapidly in the event of sovereign stress considering that risk weight on banks' sovereign debt exposure is zero while sovereign debt represents more than 25 percent of banks' total assets.	Provide liquidity to banks in the short-term and mitigate risks by reducing financing needs (through a fiscal consolidation) and adjusting risk weight on banking sector sovereign debt exposure.
Natural disasters related to climate change. More frequent natural disasters deal severe damage to infrastructure (especially in smaller vulnerable economies) and amplify supply chain disruptions and inflationary pressures, causing water and food shortages and reducing medium-term growth.	**Medium**	**Medium-High:** Disruption in tourism and other economic activity (fishing, agriculture production), damage to properties, and higher food inflation, with larger impact on low-income households.	Establish contingent financing plans with development partners. Provide targeted assistance to affected groups and sectors. Prioritize public investment in disaster-resistant infrastructure and sustainable growth.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon. G-RAM operational guidance is available from the **SPR Risk Unit website.**

Appendix IV. Downside Scenario

1. **Staff has developed a downside scenario to illustrate the macroeconomic impact of the materialization of major risks to the outlook**. The scenario assumes:

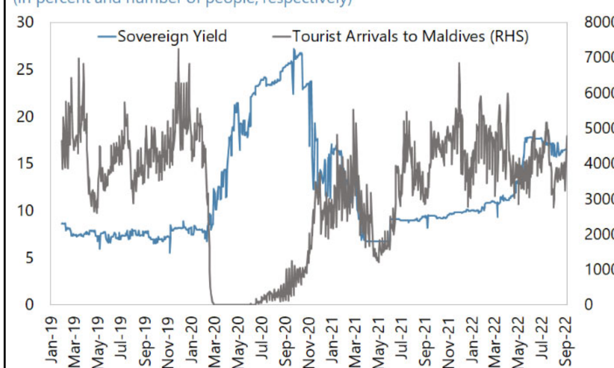
- A sharp global economic slowdown, which would adversely impact key source markets for tourism, particularly in Europe. This is compounded with outbreaks of new lethal and highly contagious COVID-19 variants that would further reduce global tourism activity and severely hit Maldives' economy.[1] As a result, the economy would contract by 12.7 percent in 2023 (or about one and half standard deviation) and partially recover in the following years.



Source: IMF Staff calculations.

- Lower tourism receipts combined with lower economic activity would curtail domestic revenues while targeted transfers to cushion the impact of the economic shock would add to spending pressures.

- Considering the historical negative correlation between sovereign bond yields and tourist arrivals, the sharp drop in tourist arrivals is also expected to raise sovereign bond yields and widen spreads, effectively reducing access to markets by raising costs and further adding to financing pressures.



Sources: Refinitiv Datastream; and Maldivian authorities.

2. **Fiscal and debt vulnerabilities will further worsen under the downside scenario**. The fiscal deficit would widen to around 19 percent of GDP in 2023 and remain elevated through 2025, opening up a larger and more acute financing gap than envisaged under the baseline. The scarcity of tourism-linked dollar inflows, would further strain the thin reserve buffers, putting the sustainability of the peg at a high risk.[2] This could manifest through a spike in the parallel market premium as at the height of the pandemic, but also higher inflation exacerbated by elevated global commodity prices. The public debt-to-GDP ratio would spike

[1] The downside scenario assumes that the Maldives will experience a severe loss in tourist arrivals. The total loss in tourist arrivals is aggregated as a weighted average of losses across all source countries by their market share. The downside scenario also assumes that tourist arrivals in 2024 will recover partially, as experienced in 2021, and takes the value that equals to the average of arrivals between 2019 and 2023.

[2] A depreciation of the official exchange rate would trigger numerous balance sheet mismatches in the dollarized Maldivian economy.

to 150 percent of GDP in 2023 and remain high at around 141 percent of GDP by 2025. Public debt, which is on an unsustainable path in the baseline scenario, would worsen and the Maldives would continue to have a high risk of external debt distress and a high overall risk of debt distress. Exacerbated dollar shortages would jeopardize servicing outstanding external debt obligations.

3. **The downside scenario underscores the importance to swiftly implement critical reforms to reduce fiscal and debt vulnerabilities and preserve sustainable growth going forward**. Critical reforms include implementing a gradual fiscal consolidation that relies on both expenditure rationalization, in particular scaling back non-priority spending, and domestic revenue mobilization to materially reduce the debt-to-GDP ratio and keep it on a firm downward trajectory. Reducing subsidies and reforming SOEs would also support the reform-based consolidation effort. Other key reforms include limiting fiscal dominance and reforming the FX markets to support the sustainability of the peg.

4. **The authorities should have a contingency plan ready to urgently address acute fiscal and balance of payments needs under the downside scenario**. They should consider a wide range of options that would help address short-term liquidity needs and support long-term sustainability, such as a reactivation of bilateral swap lines; opportunities for market financing at longer maturities to rollover existing debt service-obligations; concessional financing from multilateral institutions and development partners; short-term growth friendly fiscal consolidation measures, including spending rationalization, to reduce financing pressures and dollar liquidity needs for both the central government and SOEs; actions on the exchange rate to contain the spread with the parallel market rate; and identification of dollar mismatches in banks' and SOEs' and corrective measures to strengthen their balance sheets.

Table 1. Maldives: Downside Scenario

	2019	2020	2021	2022		2023		2024		2025	
		Prel.	Prel.	Base.	Down.	Base.	Down.	Base.	Down.	Base.	Down.
Real GDP growth (percent)	6.9	-33.5	37.0	10.5	10.5	6.6	-12.7	6.7	14.4	6.5	6.5
Primary fiscal balance (percent of GDP)	-4.9	-20.7	-11.7	-11.0	-11.0	-6.2	-14.3	-6.1	-11.2	-2.3	-6.5
Overall fiscal balance (percent of GDP)	-6.7	-23.5	-14.3	-14.3	-14.3	-9.9	-18.8	-9.8	-15.4	-5.9	-10.9
Current account balance (percent of GDP)	-26.6	-35.5	-8.8	-16.5	-16.5	-15.2	-22.4	-13.9	-18.0	-13.7	-17.8
Public and publicly guaranteed debt (percent of	78.8	154.4	124.3	122.6	122.6	117.5	150.3	117.9	143.3	113.1	141.4

Source: Maldivian authorities; and IMF staff projections.

Appendix V. Digitalization and Public Finances[1]

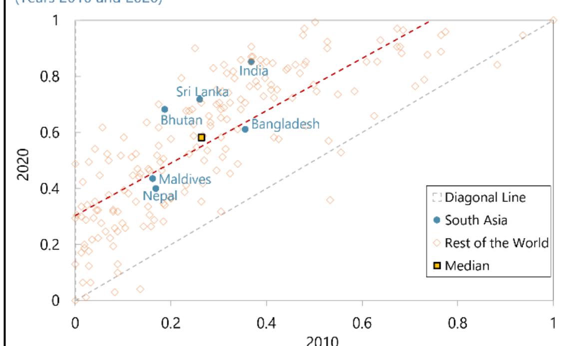
Digital technologies offer powerful tools that public administrations can leverage to modernize and improve their operational efficiency. The Maldives and other South Asian economies have progressively adopted GovTech solutions over the past decade. This chapter discusses their digitization advancements and presents empirical evidence in support of GovTech efforts to improve tax revenue performance, as well as health and education outcomes.

Introduction

1. **Can the Maldives increase government efficiency by stepping up its digitalization efforts?** Public services are increasingly turning digital across South Asia, albeit at a different pace for each country. Digitalization can enable governments to improve the efficiency of expenditure and tax policies by facilitating the collection and processing of more reliable, timely, and accurate information on relevant stakeholders. Moreover, the digitalization of public finances can help enhance access to services and entitlements, reduce errors and frauds, strengthen procurement procedures, and improve tax compliance by simplifying the tax-filing process. By gradually digitalizing its government operations, the Maldives is incrementally reducing its digital divide to the public administrations of more advanced economies, yet not as fast as other countries in the region and the world.

Government Online Services Index

(Years 2010 and 2020)



Sources: UN e-Government Survey; Staff Estimates.

2. **The important policy question that arises is whether e-governments are better at mobilizing revenue or spending their resources more efficiently.** This question is explored empirically in this chapter using a broad sample of 180 countries at different stages of GovTech development during the period 2008–2019. We focus on three public administration performance areas that digitalization has significant potential to improve: (i) government revenue productivity; (ii) health outcomes; and (iii) educational outcomes. The overall progress in e-government is proxied by the United Nation's Online Service Index that assesses the scope and quality of public-sector online services, including online services for tax submission and registration of businesses.[2] We find that building on their recent progress, the Maldives and other South Asian countries stand to benefit from further GovTech advancements in terms of public finance efficiency in revenue collection and health and education spending efficiency.

[1] Prepared by Emmanouil Kitsios (APD). The section on education and health spending efficiency is based on joint work with Sanghamitra Warrier Mukherjee (IMF summer intern).

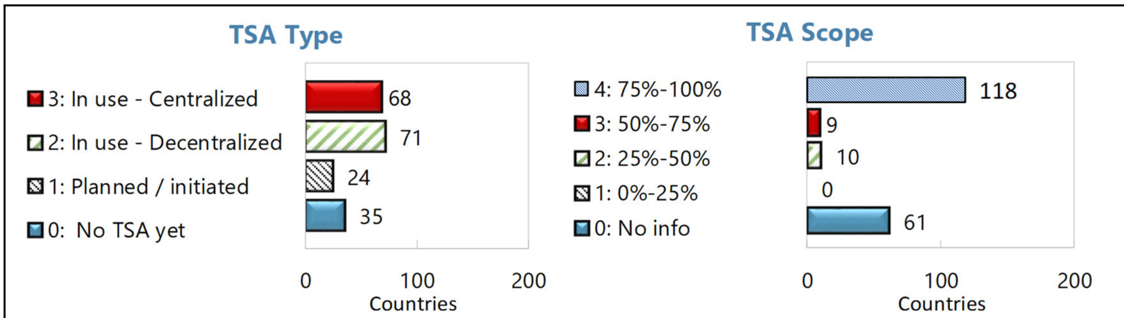
[2] The index is based on data collected from an independent Online Service Questionnaire conducted by the United Nations Department of Economic and Social Affairs.

State of GovTech in the Maldives

3. **Despite the impressive progress made, there is scope to scale up the use of digital technologies in revenue administration, payroll systems, and procurement.** Each bullet in this section discusses a set of GovTech indicators for the Maldives and other regional peers as of end-2020, with the accompanying text tables reflecting the values and implementation year of the corresponding GovTech option. Higher values in the tables indicate more digitally advanced public financial management systems. The horizontal bar charts accompanying the tables document the labels of the indicator values reported in the columns of the tables, along with the number of countries in the world implementing a GovTech solution with similar characteristics.

- **Treasury Single Account (TSA):** The Maldives, along with most South Asian countries, has centralized TSA systems that record at least 75 percent of their government's revenue and expenditure transactions.[3] Most countries worldwide do not have fully centralized TSA systems, though most countries have TSA systems that cover more than 75 percent of transactions.

Treasury Single Account (TSA)			
Country	Year	Type	Scope
Bangladesh	2008	2	2
Bhutan	2008	2	4
India	1963	3	4
Maldives	2009	3	4
Nepal	2013	3	4
Sri Lanka	2007	2	4



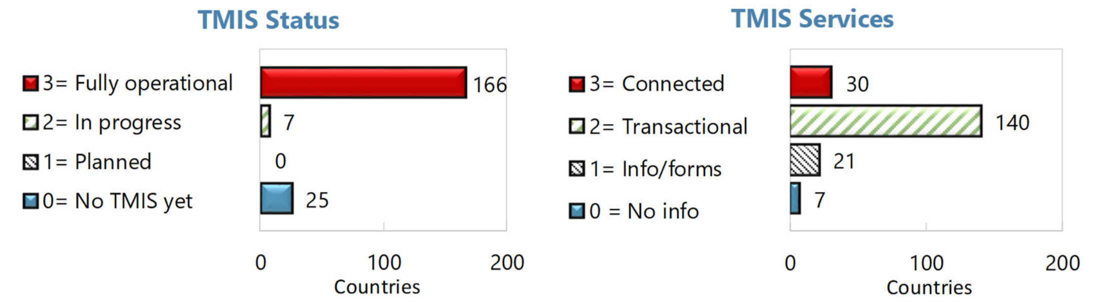
Source: WB, Digital Government/GovTech Systems and Services (DGSS) Dataset

- **Tax Management Information System (TMIS):** Contrary to most countries in the region—and worldwide—the Maldives does not benefit from fully operational TMISs. Digitalizing the business process of the revenue administration can help minimize the tax compliance costs and enable the faster processing of returns and payment data, as well improve the communication between taxpayers and the tax authority. Implementation of a fully operational and connected TMIS is in progress in the Maldives. Fully integrating TMIS with existing information systems at other government agencies

Tax Administration (TMIS)			
Country	Year	Status	Services
Bangladesh	2018	2	2
Bhutan	2015	3	2
India	1981	3	2
Maldives	-	2	2
Nepal	2010	3	2
Sri Lanka	2014	3	3

[3] TSA operational scope in the text table refers to the revenue and expenditure shares captured by the TSA.

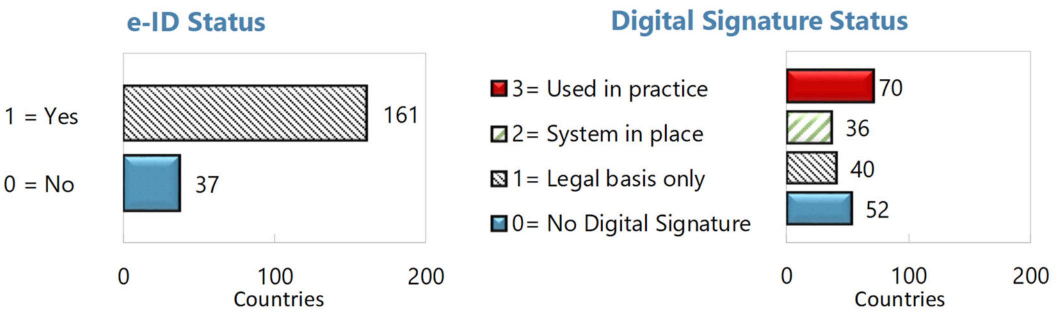
can help analyze taxpayer information more comprehensively and strengthen the capacity of the revenue authority to assess tax liabilities and monitor compliance.



Source: WB, Digital Government/GovTech Systems and Services (DGSS) Dataset

- **e-ID and e-Signature:** All countries in South Asia benefit from digitized identification (ID) systems. However, the Maldives is among the 52 countries that do not have such digital signature systems and lack the regulation or infrastructure to support them.

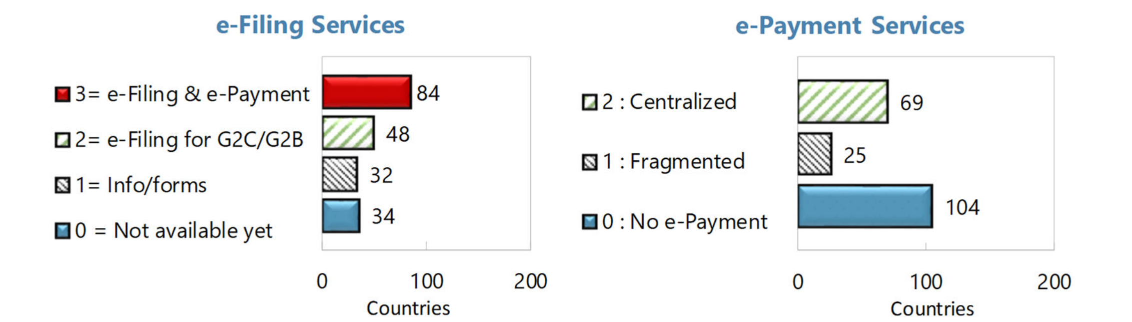
	e-ID	Digital Signature	
Country	Status	Year	Status
Bangladesh	1	2009	2
Bhutan	1	2006	1
India	1	2008	3
Maldives	1	-	0
Nepal	1	2012	2
Sri Lanka	1	2013	2



Source: WB, Digital Government/GovTech Systems and Services (DGSS) Dataset

- **e-Filing and e-Payment:** The Maldives provides online e-filing services for government to citizens (G2C) or government to businesses (G2B) via its e-tax systems but does not offer government e-payment solutions.

	e-Filing		e-Payment	
Country	Year	Services	Year	Services
Bangladesh	-	1	2012	1
Bhutan	2009	2	-	0
India	2005	3	2011	1
Maldives	2013	2	-	0
Nepal	2013	2	-	0
Sri Lanka	-	1	2012	2

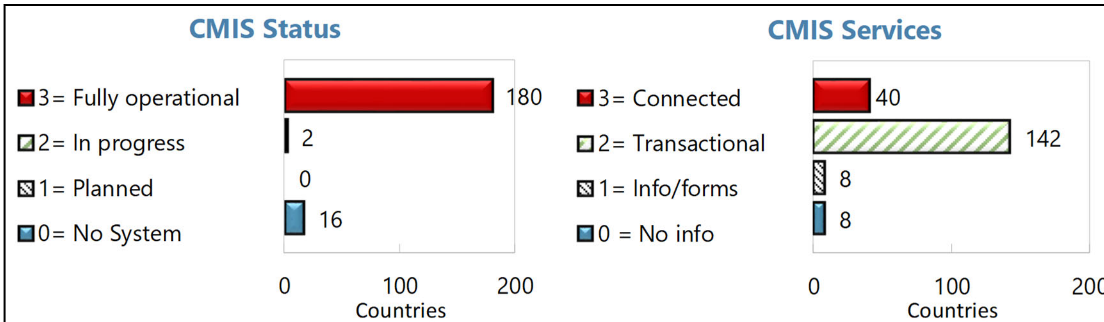


Source: WB, Digital Government/GovTech Systems and Services (DGSS) Dataset

- **Customs Administration Management Information System (CMIS):** All South Asian countries, including the Maldives, benefit from a fully operational online customs systems that offer transactional capabilities but are not operating yet as single windows. Fully operational single-window systems allow traders to submit all import, export, and transit information required by customs and other agencies via a single electronic gateway instead of paper-based processing systems. Most countries in the world operate the CMIS, while 40 countries benefit from more advanced systems.

Customs Administration (CMIS)

Country	Year	Status	Services
Bangladesh	1994	3	2
Bhutan	2015	3	2
India	1997	3	2
Maldives	1994	3	2
Nepal	1998	3	2
Sri Lanka	1994	3	2

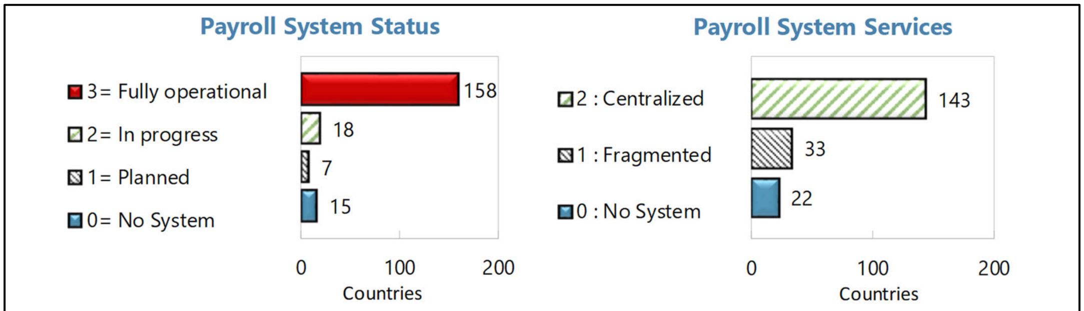


Source: WB, Digital Government/GovTech Systems and Services (DGSS) Dataset

- **Payroll System:** The Maldives, has a fully operational payroll system and is implementing a centralized payroll platform that is shared across line ministries. The SAP wage bill system though could be further improved to include the main allowances (overtime and holiday allowances) of atoll-based public employees. Most countries operate fully centralized payroll systems.

Payroll System

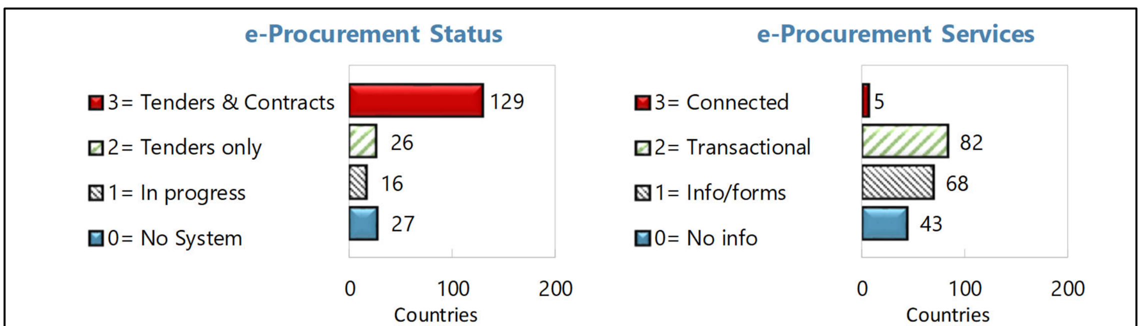
Country	Year	Status	Services
Bangladesh	2016	3	1
Bhutan	2014	3	2
India	-	3	1
Maldives	2010	3	2
Nepal	2004	3	2
Sri Lanka	2012	3	2



Source: WB, Digital Government/GovTech Systems and Services (DGSS) Dataset

- **e-Procurement System:** The electronic procurement system of the Maldives facilitates the publication of tenders but does not offer the functionalities allowing the publication of contract information or including bidding documents and contract awards. Also, Maldives' e-procurement system only includes procurement related information and forms, without any transactional or connected services provided, as in many other countries worldwide.

e-Procurement			
Country	Year	Status	Services
Bangladesh	2011	3	2
Bhutan	2017	2	3
India	2007	3	2
Maldives	2011	2	1
Nepal	2014	3	2
Sri Lanka	-	1	0



Source: WB, Digital Government/GovTech Systems and Services (DGSS) Dataset

Digitalization and Revenue Collection Efficiency

4. **Can digitalization help countries in the region improve their revenue efficiency?** To explore this question, we estimate the effect of the government digitalization proxy ($GovTech$) on annual efficiency measures of value-added tax (VAT), personal income tax (PIT), and corporate income tax (CIT).[4] These tax efficiency measures are the dependent variables of interest ($Tax_{i,t}$).[5] To address

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[4] See Kitsios, Jalles, and Verdier (2022) for a study examining the effect of government digitalization on reducing cross-border fraud and increasing trade-related revenue.

[5] VAT productivity is measured as the ratio of VAT revenue to the product of GDP and the standard VAT rate. VAT C-efficiency is measured as the ratio of actual VAT revenues to the product of the standard rate and final consumption expenditure. Similarly, CIT productivity = (CIT revenue as percent of GDP)/(CIT rate) and PIT productivity = (PIT revenue in percent of GDP)/(highest PIT rate).

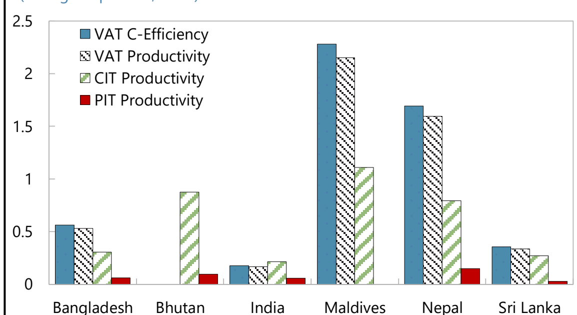
omitted variable bias, we include in our specification country characteristics that are also likely to affect revenue productivity besides government digitalization (Equation 1).

$$Tax_{i,t} = \beta \cdot GovTech_{i,t-1} + \boldsymbol{\theta} \cdot \mathbf{X}_{\boldsymbol{i,t-1}} + \alpha_i + \gamma_t + u_{i,t} \qquad (1)$$

The vector $\mathbf{X}_{\boldsymbol{i,t-1}}$ of lagged values of covariates includes (i) GDP per capita to proxy for the level of development; (ii) real GDP growth to account for the business cycle effects on revenue performance; (iii) agriculture's share of GDP as a proxy for informality; (iv) the United Nation's (UN's) telecommunication index to control for the broader digital technological infrastructure available in the country; (v) the country's non-oil imports and exports shares of GDP as a proxy for trade dependence; (vi) the oil trade balance share of GDP to account for oil trade's impact on revenue collection efforts; (vii) demographic characteristics impacting the workforce structure, such as population growth and the age dependency ratio; (viii) UN's human capital index to proxy for digital literacy; and (ix) an indicator on government effectiveness to account for more effective governments being more likely to adopt GovTech solutions.[6] Country-fixed effects (α_i) are used to capture any time-invariant country-level heterogeneity and year-fixed effects (γ_t) are included to account for cross-country shocks and general trends in revenue performance measures over time.

5. The estimates suggest that there is a positive association between the GovTech index and revenue efficiency measures. Bridging the government digitalization divide would result in higher revenue collection efficiency. The results suggest that if South Asian countries reached the GovTech frontier (that is, government online services index equaled one), then revenue efficiency would improve (see Table 1).[7] For example, VAT productivity and VAT C-efficiency measures would increase by about 2.2 and 2.3 percentage points, respectively, for the Maldives. Similarly, CIT productivity would increase by 1.1 percentage points, while the overall impact on revenue is estimated at about 2.5 percent of GDP. This is higher compared to other countries in South Asia, as the relative distance of the Maldives to the GovTech frontier is higher than other regional peers.

GovTech Frontier Impact on Revenue Efficiency
(Change in percent; 2019)



Sources: IMF Government Finance Statistics; IMF FAD Tax Rates Database; IMF World Economic Outlook; OECD Global Revenue Statistics Database; USAID Collecting Taxes Database; WB World Development Indicators; IMF staff estimates.

Digitalization and Health Spending Efficiency

6. Can digitalization improve the efficiency of health spending execution? Digital payments and e-procurement have the potential to improve the health budget execution process and simplify the provision and management of public health resources. This section uses a stochastic frontier

[6] Similar determinants of revenue efficiency are used by Fenochieto and Pessino (2013) and Cevik and others (2019).

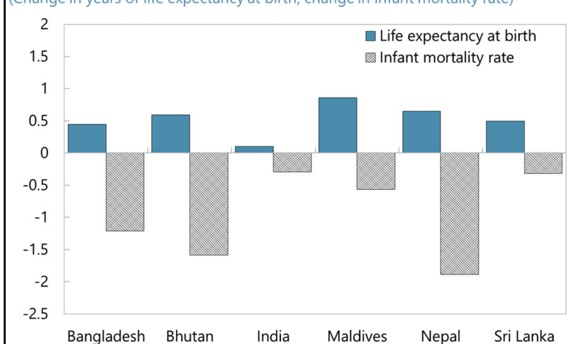
[7] VAT/PIT efficiency gains are not shown for Bhutan and the Maldives, as due to lack of relevant taxes prior to 2020.

analysis whereby the health system outcomes of average life expectancy at birth and infant mortality rates ($Health_{i,t}$) are regressed on inputs $\mathbf{X}_{i,t-1}$, such as the level of resources made available and the level of development (Equation 2).[8] The compound error term $\varepsilon_{i,t}$ comprises a normally distributed error term $u_{i,t}$, and a disturbance $v_{i,t}$ representing the distance of each country's error term to the frontier (Equation 3).[9] The latter is assumed to follow a truncated normal distribution multiplied by a function of time, t, where T_i is the last period observed in the i-th country, η is a decay parameter (Equation 4).[10] The estimated time-varying country-specific technical efficiency is obtained via $TE_{i,t} = \exp\{(-v_{i,t})|\varepsilon_{i,t}\}$, and is regressed on potential determinants of health spending efficiency (GovTech index, telecommunication proxy ($TCom_{i,t}$), and pre-determined variables $\boldsymbol{Z}_{i,t-1}$, such as GDP per capita, the ratio of births attended by skilled health staff, the urban population share, income Gini index, and the universal health coverage index. Country-fixed effects are included to capture the possibility of time-invariant heterogeneity in efficiency (Greene 2004).

$$Health_{i,t} = \alpha_i + \mathbf{X}_{i,t-1} \cdot \boldsymbol{\theta} + \varepsilon_{i,t} \quad (2)$$
$$\varepsilon_{i,t} = u_{i,t} - v_{i,t} \quad (3)$$
$$v_{i,t} = \exp\{-\eta(t - T_i)\} \cdot v_i \quad (4)$$
$$TE_{i,t} = \alpha_i + \beta \cdot GovTech_{i,t} + \gamma \cdot TCom_{i,t} + \boldsymbol{\theta} \cdot \boldsymbol{Z}_{i,t-1} + u_{i,t} \quad (5)$$

7. **The results suggest that both government digitalization as well as telecommunication infrastructure quality are positively correlated with the estimated efficiency in health spending.** The chart illustrates estimated gains in health outcomes from bridging the gap to the GovTech frontier (see Table 2). The Maldives would obtain the highest increase in life expectancy in the region by about 0.9 years, while the country would also reduce the infant mortality rate by 0.6 percentage points. Higher GDP per capita and higher health spending are associated with better health outcomes (frontier equation). Health systems tend to be more efficient in countries that are more developed or have a greater share of their population living in urban areas (efficiency equation). Also, health spending efficiency is higher for countries that deploy more skilled health staff to attend births or cover a greater share of essentials.

GovTech Frontier Impact on Health Outcomes
(Change in years of life expectancy at birth; change in infant mortality rate)



Sources: World Bank, World Development Indicators; IMF Staff Estimates

Digitalization and Education Spending Efficiency

8. **Are e-governments better at providing access to education?** Digital approaches to remote learning during the pandemic underscored the need to promote e-education. In this section, we

[8] Grigoli and Kapsoli (2018) discuss the advantages of stochastic frontiers in estimating health spending efficiency.

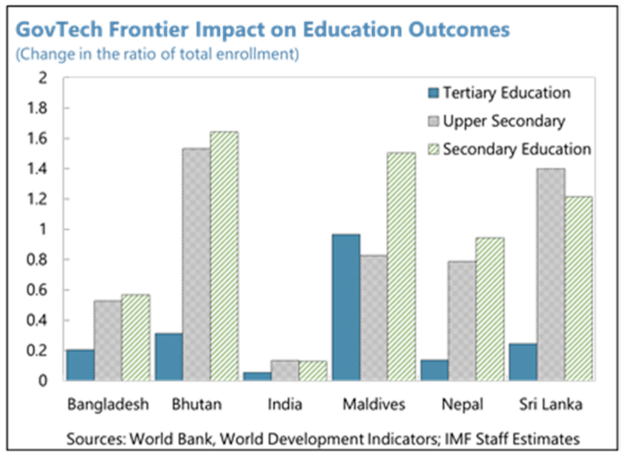
[9] The stochastic frontier analysis estimates a frontier of best-performing countries that obtain higher outcomes for a given level of inputs. The method then yields efficiency scores for each country by comparing its outcome and inputs to the reference set of the best-performing countries.

[10] See Battese and Coelli (1992) for further details on the estimation procedure used.

examine whether e-governments tend to be more efficient in administering education spending to achieve better education outcomes. The stochastic frontier analysis described in the previous section is used with education spending per capita and GDP per capita as the main inputs to generate education outcomes, such as school enrollment in secondary, upper secondary, and tertiary education (Equation 6). The estimation is carried out following a similar structure to Equations (3)–(5). The technical efficiency estimates obtained from Equation (6) are regressed upon determinants of education spending efficiency that include the GovTech index, the telecommunication infrastructure index, the level of development, the share of the population with access to basic sanitation, the urban population share, and the income Gini index.[11]

$$Education_{i,t} = \alpha_i + \mathbf{X}_{\boldsymbol{i,t-1}} \cdot \boldsymbol{\theta} + \varepsilon_{i,t} \qquad (6)$$

9. The results show that countries with stronger e-governments tend to have higher efficiency of education spending. The chart illustrates estimated gains in education outcomes from bridging the gap to the GovTech frontier (see Table 3). Gains in the Maldives would be among the highest in the region as the country gross enrollment ratio in tertiary, upper secondary and secondary education would increase by 1, 0.8 and 1.5 percentage points, respectively. The estimates also suggest that countries with better access to basic sanitation services and more advanced telecommunication infrastructure tend to have better education spending efficiency.



Conclusion

10. Scaling up the use of GovTech solutions by the Maldives offers significant potential in transforming service delivery and mobilizing resources. Countries with more digitalized government services tend to have higher efficiency in generating fiscal revenue and achieving higher outcomes from their health and education spending. The COVID-19 pandemic has accelerated the e-government transition that was already underway in the Maldives and the South Asia region more broadly. However, to reap the full dividends of the GovTech revolution, it is important that institutional frameworks are in place to safeguard against risks related to cybersecurity, digital exclusion, fraud, and privacy infringement.

[11] See Grigoli (2014), Herrera and Pang (2005), Herrera and Abdoulaye (2018), and Wagstaff and Wang (2011) for including similar determinants of education spending efficiency.

Table 1. Maldives: Tax Revenue Efficiency

	(1) VAT C-Eff.	(2) VAT C-Eff.	(3) VAT Prod.	(4) VAT Prod.	(5) PIT Prod.	(6) PIT Prod.	(7) CIT Prod.	(8) CIT Prod.
GovTech Index	0.426**	0.401*	0.397**	0.380*	0.453**	0.427*	0.242*	0.233*
	(0.186)	(0.192)	(0.185)	(0.187)	(0.210)	(0.209)	(0.126)	(0.127)
GDP per capita	0.700***	0.611***	0.569***	0.470***	0.932***	0.806***	-0.078	-0.114
	(0.149)	(0.149)	(0.152)	(0.156)	(0.212)	(0.206)	(0.060)	(0.067)
GDP Growth	0.010***	0.010***	0.005*	0.005*	0.019***	0.020***	-0.002	-0.002
	(0.003)	(0.003)	(0.003)	(0.002)	(0.004)	(0.004)	(0.004)	(0.004)
Telecommunications Index	0.447	0.373	0.545*	0.479	0.707	0.635	-0.156	-0.183
	(0.298)	(0.299)	(0.298)	(0.303)	(0.415)	(0.398)	(0.166)	(0.159)
Agriculture Value Added (%GDP)	0.027	0.020	0.108	0.099	0.022	0.014	-0.108**	-0.110**
	(0.075)	(0.079)	(0.078)	(0.083)	(0.074)	(0.074)	(0.043)	(0.044)
Non-Oil Imports (%GDP)	-0.000	-0.001	0.003	0.003	0.009**	0.009**	0.008***	0.008***
	(0.002)	(0.002)	(0.003)	(0.003)	(0.004)	(0.004)	(0.002)	(0.002)
Non-Oil Exports (%GDP)	-0.007**	-0.007**	-0.012***	-0.012***	-0.016***	-0.016***	0.002	0.002
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)	(0.002)	(0.002)
Oil Trade Balance (%GDP)	-0.016**	-0.015**	-0.023***	-0.022***	-0.014**	-0.013**	-0.005*	-0.004
	(0.006)	(0.006)	(0.006)	(0.005)	(0.005)	(0.005)	(0.003)	(0.003)
Population Growth	0.024	0.022	0.012	0.010	-0.021	-0.021	-0.017	-0.019
	(0.027)	(0.028)	(0.027)	(0.028)	(0.023)	(0.023)	(0.016)	(0.017)
Age Dependency Ratio	-0.005*	-0.005	-0.007**	-0.006**	-0.012***	-0.012***	-0.018***	-0.019***
	(0.002)	(0.003)	(0.002)	(0.003)	(0.002)	(0.002)	(0.003)	(0.004)
Human Capital Index		-0.003		-0.256		0.030		0.053
		(0.348)		(0.343)		(0.242)		(0.186)
Government Effectiveness		0.168**		0.176**		0.221**		0.068
		(0.072)		(0.066)		(0.093)		(0.097)
Observations	1714	1714	1749	1749	1813	1813	1904	1904
Countries	130	130	134	134	134	145	145	141
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Adj. R-squared	0.04	0.04	0.04	0.04	0.06	0.06	0.03	0.03

Sources: IMF Government Finance Statistics; IMF FAD Tax Rates Database; IMF World Economic Outlook; OECD Global Revenue Statistics Database; UN e-Government Survey; USAID Collecting Taxes Database; WB World Development Indicators; IMF staff estimates.

Notes: VAT C-efficiency is measured as the ratio of actual VAT revenues to the product of the standard rate and final consumption expenditure. VAT productivity is measured as the ratio of VAT revenue to the product of GDP and the standard VAT rate. Similarly, PIT productivity = (PIT revenue in percent of GDP)/(highest PIT rate) andCIT productivity = (CIT revenue as percent of GDP)/(CIT rate). Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1. The dependent variables and the independent variables of GDP per capita and agriculture value added are specified in logs.

Table 2. Maldives: Stochastic Frontier Analysis: Health Spending Efficiency

Frontier Equation								
	Life Expectancy				Infant Mortality			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Health Spending per capita	0.006***	0.006***	0.006***	0.006***				
	(0.002)	(0.002)	(0.002)	(0.002)				
GDP per capita	0.028***	0.028***	0.028***	0.028***				
	(0.002)	(0.002)	(0.002)	(0.002)				
Health Spending per capita					-0.045***	-0.045***	-0.045***	-0.045***
					(0.012)	(0.012)	(0.012)	(0.012)
GDP per capita					-0.200***	-0.200***	-0.200***	-0.200***
					(0.022)	(0.022)	(0.022)	(0.022)
Observations	1891	1891	1891	1891	1967	1967	1967	1967
Efficiency Equation								
GovTech Index	0.023***	0.018***	0.006	0.008**	-0.000***	-0.000***	-0.000***	-0.000***
	(0.006)	(0.006)	(0.004)	(0.004)	(0.000)	(0.000)	(0.000)	(0.000)
Telecommunications Index	0.074***	0.063***	0.041***	-0.004	-0.001***	-0.001***	-0.000***	-0.000
	(0.008)	(0.009)	(0.006)	(0.006)	(0.000)	(0.000)	(0.000)	(0.000)
GDP per capita		0.025**	0.012**	0.026***		-0.000**	-0.000**	-0.000
		(0.011)	(0.006)	(0.008)		(0.000)	(0.000)	(0.000)
Skilled Health Staff			0.000***	0.000***			-0.000***	-0.000***
			(0.000)	(0.000)			(0.000)	(0.000)
Urban Population Rate			0.108***	0.048			-0.000***	-0.000**
			(0.036)	(0.054)			(0.000)	(0.000)
UHC Index				0.000*				-0.000**
				(0.000)				(0.000)
Gini Index				0.000				-0.000
				(0.000)				(0.000)
Observations	1886	1886	1005	85	1963	1963	1038	85
Countries	173	173	164	51	180	180	168	51
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Adj. R-squared	0.43	0.45	0.67	0.74	0.43	0.46	0.72	0.79

Sources: IMF World Economic Outlook; WB World Development Indicators; IMF staff estimates.
Notes: Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1. The dependent variables, and the independent variables health spending per capita, GDP per capita and urban population rate are expressed in logs.

Table 3. Maldives: Stochastic Frontier Analysis: Education Spending Efficiency

Frontier Equation

	Secondary			Upper Secondary			Tertiary		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Education Spending per capita	0.033	0.033	0.033						
	(0.021)	(0.021)	(0.021)						
GDP per capita	0.191***	0.191***	0.191***						
	(0.025)	(0.025)	(0.025)						
Education Spending per capita				0.021	0.021	0.021			
				(0.037)	(0.037)	(0.037)			
GDP per capita				0.346***	0.346***	0.346***			
				(0.042)	(0.042)	(0.042)			
Education Spending per capita							0.152***	0.152***	0.152***
							(0.044)	(0.044)	(0.044)
GDP per capita							0.399***	0.399***	0.399***
							(0.055)	(0.055)	(0.055)
Observations	531	531	531	535	535	535	518	518	518

Efficiency Equation

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
GovTech Index	0.036***	0.024**	0.011*	0.042***	0.027**	0.017**	0.040***	0.020*	0.006
	(0.006)	(0.010)	(0.005)	(0.006)	(0.011)	(0.006)	(0.008)	(0.011)	(0.008)
Telecommunications Index	0.057***	0.028	-0.035	0.088***	0.052**	-0.012	0.105***	0.056**	0.040**
	(0.020)	(0.020)	(0.024)	(0.022)	(0.020)	(0.025)	(0.020)	(0.021)	(0.018)
GDP per capita		0.067**	0.075***		0.083**	0.079**		0.092***	0.093***
		(0.028)	(0.018)		(0.032)	(0.029)		(0.022)	(0.020)
Urban Population Rate			0.060			0.159			0.005
			(0.129)			(0.125)			(0.074)
Gini Index			-0.001			-0.001			0.001
			(0.001)			(0.001)			(0.001)
Basic Sanitation			0.082***			0.079***			0.057**
			(0.022)			(0.026)			(0.024)
Observations	152	152	53	152	152	53	114	114	39
Countries	28	28	20	28	28	20	21	21	14
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Adj. R-squared	0.50	0.59	0.84	0.57	0.66	0.89	0.70	0.81	0.93

Sources: IMF World Economic Outlook; WB World Development Indicators; IMF staff estimates.
Notes: Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1. The dependent variables, and the independent variables education spending per capita, GDP per capita and urban population rate are expressed in logs.

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Appendix VI. Energy Subsidy Reform[1]

Maldives' unique geographical configuration and heavy reliance on imported fuel for electricity generation makes electricity expensive to generate and distribute. Electricity subsidies (including the fuel input subsidy) are estimated at 1 percent of GDP for 2021 but are expected to increase significantly in 2022[2]. Reflecting higher commodities and limited pass-through to domestic prices, the fuel input subsidy alone (referred to as fuel subsidy) is projected to increase to about 2½ to 3 percent of GDP compared to a budgeted amount of 0.4 percent of GDP. In addition to the fuel input subsidy, the government compensates utility companies for their revenue losses under fixed tariffs for [some] consumers based on a revenue loss formula that uses 2009 tariffs as reference (referred to as electricity subsidy), which could amount to 1.1 percent of GDP in 2022. High dependency on subsidized fuel for electricity generation weigh on the budget and adds to fiscal vulnerabilities. Moreover, the current system is complex and non-transparent with different compensation mechanisms by the government, numerous different rates applied to different customers and areas and additional discounts.

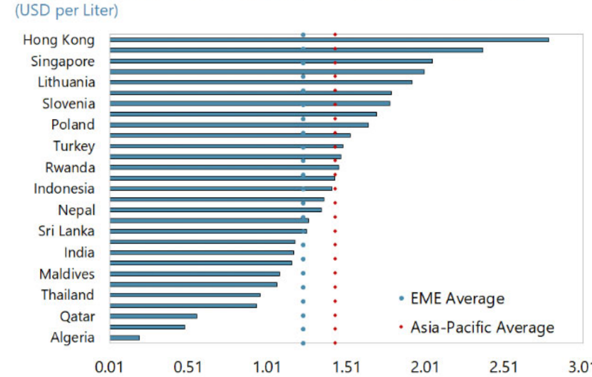
Introduction

1. Energy subsidy reform is crucial for the provision of sustainable energy and can help in creating a strong social safety net. Pricing reforms will provide correct price signals which are important for consumption, production and investment decisions. Artificially low rates can encourage overconsumption, which may threaten service reliability. Utilities faced with below cost recovery rates have little incentive and financial means to improve productive efficiency, such as investing in grid upgrades or in renewable energy. Moving from inefficient and inequitable price subsidies to targeted cash transfers can improve equity. Equity can also be improved by reallocation of (a portion of the) fiscal savings to better targeted programs in health and education. Given the lack of a comprehensive social assistance program, a well-designed cash transfer program for energy subsidy reform could have the potential to turn into a broader social assistance program for the Maldives.

Fuel Sector

2. Taxation of fuel products in the Maldives tends to be low leading to lower retail prices compared to peers. Fuel products are only taxed with customs duties and should be reviewed with a view to reflect revenue, environmental and efficiency issues. STO is the largest player in the retail market. While there are no recorded retail price subsidies in the budget, pass-through of import to domestic retail prices was at times incomplete, such as

Figure 1. Maldives: Retail Price of Diesel, July 2022
(USD per Liter)



Sources: Maldivian authorities; GlobalPetrolPrices.com; and IMF staff calculations.

[1] Prepared by Emine Hanedar, Nicolo Bird, Majdeline El Rayess, Fabiana Machado and Alberto Tumino.

[2] Subsidies are estimated based on the "Price Gap Methodology" using the difference between the average cost recovery rate and average tariff (Clements et al, 2013).

during the pandemic and first half of 2022. This is indicative of price smoothing by STO which can push other players (temporarily) out the market. A level playing field is required to ensure competition on an equal footing including by limiting preferential lending to avoid price changes on discretionary grounds. On the other hand, the price of diesel sold for domestic electricity consumption is controlled by the government. The difference between the cost-recovery price for STO and the controlled price is compensated by the government through a direct subsidy to STO and is recorded as the "fuel subsidy" in the budget. However, in practice this is part of the electricity subsidy. The fuel input subsidy is estimated at 0.6 percent of GDP in 2021 and rose sharply to 1.3 percent of GDP in the first half of 2022. The pricing formula used to derive the cost recovery price of diesel for domestic electricity consumption is not fully transparent and has several shortcomings such as including a charge to cover the cost of delivering subsidized staple foods which is unrelated to electricity provision.

Electricity Sector

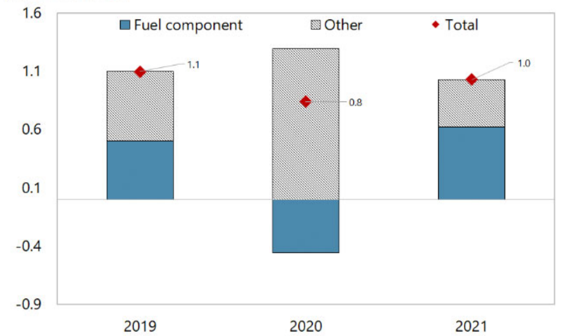
3. The regulated electricity sector is dominated by two SOEs with a different cost structure but mandated to charge the same tariffs. STELCO serves the greater Male' region plus 35 islands and FENAKA serves 156 islands.[3] About 95 percent of total electricity generated uses imported diesel. The Maldives are one of the most geographically dispersed countries, posing unique challenges to electricity generation. FENAKA tends to incur higher operation and maintenance costs, due to the dispersion of its service areas and reliance on less efficient generators but has potential for renewable energy. STELCO is able to reap some gains of scale from its operations in the greater Male' region but is more limited in renewable generation options, given land limitations in these densely populated areas. The last full tariff revision, taking cost of service provision into account, happened in 2009. As of 2019, domestic tariffs were harmonized between the islands and Male region using as baseline the tariffs approved for the Male region in 2009, which had the lowest rates. Residential consumers are billed based on a different increasing block tariff (IBT) structure up to seven blocks. In addition, residential users are awarded a fuel discount on their bills in the amount of 12 cent per kWh consumed.

4. Electricity subsidies including the fuel input subsidy are estimated at 1 percent of GDP in 2021 but expected to raise significantly in 2022. The fuel input subsidy alone is projected to increase to 2½ percent of GDP compared to a budgeted amount of 0.4 percent of GDP (Figure 2) High dependency on subsidized fuel for electricity generation weigh significantly on limited fiscal resources, adding to fiscal vulnerabilities. Given the same tariff rates applied under the harmonization but a higher cost for FENEKA, subsidies are higher for FENAKA than for STELCO. Moreover, these average subsidies hide differences across different groups of users. Currently, government and business users slightly cross-subsidize residential consumers. In order to reach cost recovery levels, tariff rates applied to residential consumers would need to almost double. The governments compensation of utility companies is not based on current actual cost recovery rates but involves a complex two-tier compensation mechanism. In addition to the fuel input subsidy, there is an electricity subsidy which is based on a "revenue loss formula". Under this arrangement,

[3] Resorts generate their own electricity using unsubsidized fuel.

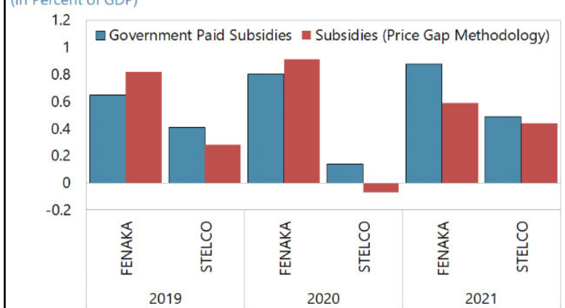
utilities receive from the budget, the difference between their revenue from residential and business users under the 2009 (higher) tariff rates and their revenue for these same users under the current harmonized (lower) tariff rates. Total government compensation to utilities, recorded and referred to as “fuel” and “electricity subsidy” in the budget, reached an estimated 1.4 percent of the GDP in 2021 and could potentially reach 4.1 percent of GDP in 2022. This figure is higher than total subsidies from comparing current tariff rates to current cost recovery rates (Figure 3). Depending on the year and underlying developments in cost and the revenue loss formula, in some years FENEKA is receiving a higher compensation than the subsidy based on their current cost and in some years STELCO. The government’s revenue loss compensation formula is complex, not proportional to either consumption or costs of provision, making it difficult to predict.

Figure 2. Maldives: Total Subsidies
(In Percent of GDP)



Sources: Maldivian authorities; and IMF staff calculations.

Figure 3. Maldives: Subsidies versus Government Paid Subsidies
(In Percent of GDP)



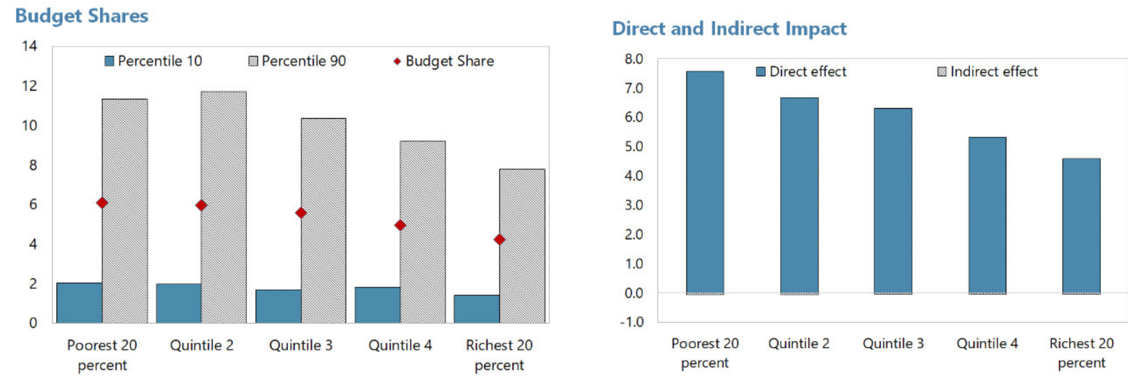
Sources: Maldivian authorities; and IMF staff calculations.

Distributional Impact

5. While the poor will be impacted more as a share of their income from increasing tariffs, subsidies accrue more to the rich. Households spend on average 5 percent of their income on electricity. The share of income spent on electricity declines with income but varies substantially within each quintile. For the poorest 20 percent these shares vary between about 2 and 11 percent, and for the richest 20 percent this share varies between about 1 and 8 percent (Figure 4, Panel A). The current block tariff system does not effectively target poorer households as quantities consumed within a household connection are not a good indicator for poverty. Almost no households consumes less than the limit of the first block, while more than 40 percent of households consume kwh in the highest block. The highest tariff block is also the prevalent block across all quintile groups (Figure 5). The average price paid by households per kWh consumed is broadly similar across the income distribution. Bringing electricity prices to cost recovery levels, would affect households from the poorest quintile the most, with effects becoming smaller as income increase (Figure 4, Panel B)[4]. However, as richer households spend more on the electricity bill in absolute terms, a higher share of total subsidies accrues to those groups, making electricity subsidies regressive.

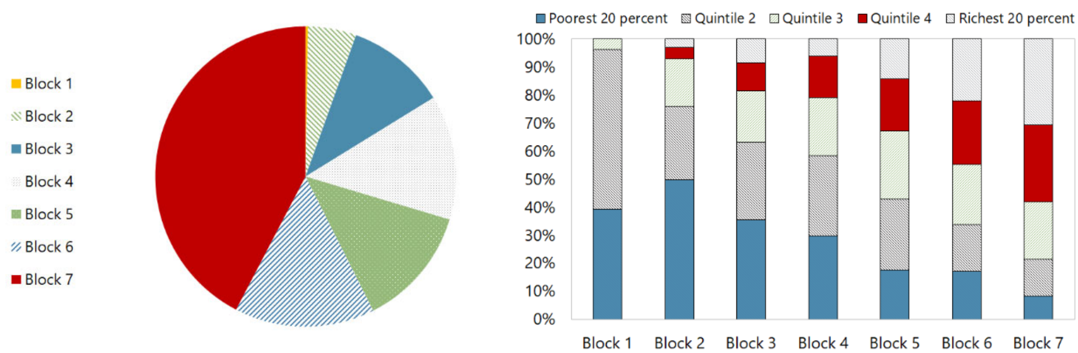
[4] The direct and indirect impact are estimated as in Coady and Newhouse (2006). The indirect impact of an increase in electricity tariffs on the price of other goods and services is slightly positive as business rates are slightly above cost recovery rate requiring a minor decrease in business rates.

Figure 4. Maldives: Distributional Impact of Energy Subsidies
(Percent of Income)



Sources: HIES 2019 data, Input Output table 2017; and IMF staff calculations.

Figure 5. Maldives: Distributional Impact of Block Tariff
(Percent of Total and Total by Quintile, respectively)



Sources: HIES 2019 data; and IMF staff calculations.

Strategy for Energy Subsidy Reform

6. **Designing energy subsidy reform involves considerations on fiscal savings, distributional impact, and institutional capacity to target the desired groups effectively.** Fiscal and distributional implications should be assessed carefully and mitigating measures with sufficient coverage and generosity should be implemented. In all cases, the existence of an efficient targeting mechanism helps to reduce the cost of reaching the desired groups. International experience has shown that, in addition to overcoming political economy considerations, a reform strategy should be based on six key ingredients (Clements et. others, 2013):

- ***A comprehensive reform plan.*** The plan should be embedded in a broader reform agenda. Given the complexity and interconnections of the current system, fuel and electricity sector reforms as well as the reforms of the three SOEs need to be analyzed jointly.

- ***An effective communications strategy.*** Successful communication strategies require a dedicated full-time unit implementing the communication strategy. A two-way dialogue between the government and key stakeholders is crucial and sufficient time should be allowed to implement the communication strategy.

- ***Appropriately phased price increases.*** A decision on a timeline should be carefully calibrated based on the gap between average cost and average tariffs, the available fiscal space and the ability to implement mitigating measures (Amaglobeli et others, 2022). Gradual price increases are preferred.

- ***Targeted mitigating measures.*** A targeted cash transfer independent from the quantities consumed is preferred as this does not distort relative prices but implementation will depend on institutional capacity.

- ***Depoliticized price setting.*** Tariff setting should be depoliticized to increase transparency and predictability. A key measure is to choose a regulatory regime that sets clear rules for setting prices, including how to determine tariff rates and how often to revise

- ***SOE reform.*** To better manage fiscal risks and reduce the government's exposure, strengthening the oversight of SOEs becomes imperative. In addition to pricing reforms, broader sectoral reform will help in reducing costs especially for FENEKA.

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Appendix VII. Bank – Sovereign Nexus[1]

As the public debt ratio is rising, Maldives' domestic financial institutions—domestic banks and MMA—have both significantly increased their sovereign debt purchase since the pandemic. Domestic banks' sovereign exposure crowds out private lending and may intensify spillovers risks if sovereign distress materializes. MMA's fiscal financing has exacerbated excess liquidity, posing risks to exchange rate stability. Containing commercial banks' sovereign exposure and phasing out central bank fiscal financing are imperative.

Introduction

1. **The COVID-19 crisis has severely impacted the Maldivian economy**. To mitigate the economic loss, the authorities responded with unprecedented fiscal support measures. The economic contraction and fiscal measures to cushion its impact have fueled the public debt-to-GDP ratio, which jumped from about 80 percent to 154 percent of GDP in 2020. The domestic banking sector and the Maldives Monetary Authority (MMA) stood out as two important players in financing the public debt. Their total exposure represented around 23 percent of total outstanding sovereign debt.[2] While fiscal financing through domestic sources supported necessary fiscal measures to support economic recovery and the most vulnerable, it entails risks and could have unintended consequences, particularly if the domestic financial institutions (banking sector and MMA) excessively increase their exposure to sovereign debt. The sovereign-financial nexus, in the context of the Maldives, encompasses commercial banks' direct sovereign debt holding that crowds out private credit and increases sovereign risk spillovers. It also includes MMA's advances to the central government, which creates excess liquidity in the financial system and could exacerbate exchange rate pressures.

Nexus between the Maldives' Central Government and the Domestic Banking Sector

2. **The banking sector's holding of sovereign debt in the Maldives has drastically increased since the onset of the pandemic**, leading peer countries in the region and the average of EMDEs (Figure 1, panel 1). Several factors have contributed to the banking sector's increased sovereign exposure. These moral suasions arising from financial repression, preferrable regulatory risk weight treatment on sovereign debt, liquidity management, expected returns, and safe collateral shortage (Dell'Ariccia et al., 2018).

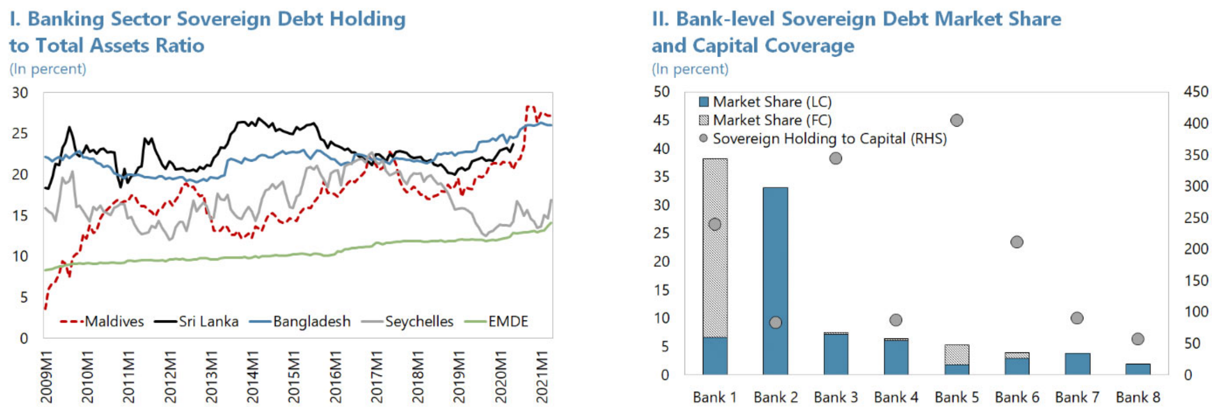
3. **In the Maldives, government moral suasions seem to have driven the surge in the banking sector's purchase of sovereign debt since early 2020**. As Figure 1 panel 2 shows, Bank of Maldives (BML) and State Bank of India (SBI), the largest domestic state-owned bank and the largest foreign state-owned bank in the Maldives, held more than 70 percent of outstanding Maldivian sovereign debt controlled by the banking sector by end-2020, supporting the view that state interventions (domestic or external) may have pushed up banks' sovereign exposures. Particularly,

[1] Prepared by Yizhi Xu (APD).

[2] According to the 2021 Maldives Article IV Consultation Staff Report, MMA's and commercial banks' claims on the central government are respectively 21 percent and 42 percent of total claims on the central government at end-2020.

BML's sovereign holding are exclusively concentrated in local currency sovereign bonds while SBI purchased a large share of foreign currency sovereign bonds, suggesting stronger moral suasion on domestic state-owned banks to finance local currency denominated debt.[3]

Figure 1. Maldives: Banking Sector Sovereign Debt Exposure



Sources: Maldives Monetary Authority; IMF Monetary and Financial Statistics; IMF staff calculations.

Note: In panel 2, market share is defined as local currency (LC) or foreign currency (FC) domestic sovereign debt holding to total banking sector sovereign debt holding ratio. Sovereign holding to capital ratio is defined as banks' total domestic sovereign debt holding to total capital ratio.

4. There are several implications of the increased banking sector sovereign debt holding. First, increased sovereign debt exposure crowds out banks' capacity to extend private credit. As Figure 2 panel 1 shows, the rise in sovereign debt as a share of banking sector total assets is accompanied by a decreasing share of private lending, which has fallen from nearly 50 percent of total banking sector assets before the pandemic to around 32 percent as of early 2022. The crowding-out effect is investigated more formally through a local projection analysis (Figure 2 panel 2). The results illustrate that a one percentage point increase in sovereign bonds holding on banks' balance sheets, reduces the banking sector's share of private sector credit provision by 0.8 percentage points 2 years after the shock, suggesting a close to one-for-one crowding-out impact.[4]

5. A higher sovereign debt exposure of the banking sector also poses downside risks to financial stability. As highlighted in many early academic research using the Eurozone crisis as an example, an increase in the sovereign default risk can lead to significant equity losses for banks with high sovereign exposure. Figure 1 panel 2 shows almost all Maldivian banks' sovereign debt holdings

[3] As part of the India government's support to the Maldives in 2020, SBI (Male) purchased $250 million foreign currency denominated Maldives government bonds without conditions. The purchase was done through SBI (Male) and is not reflected in Maldives' external borrowings.

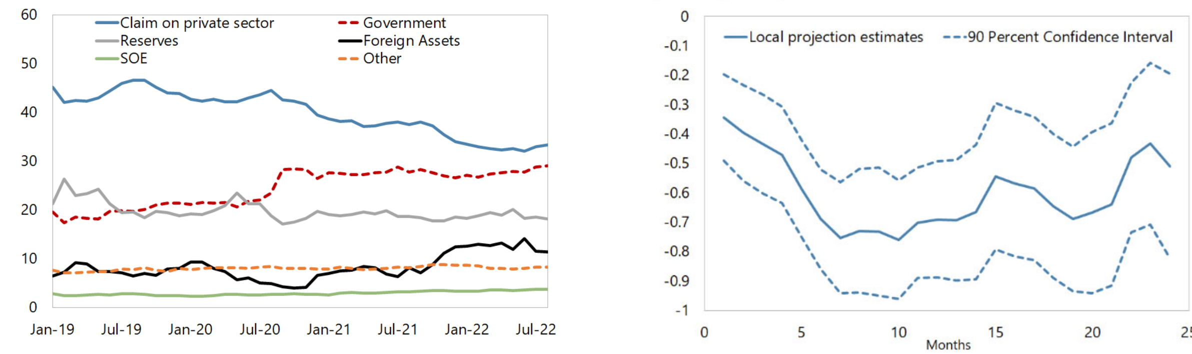
[4] The empirical analysis controls for banking sector soundness indicators (e.g., capital adequacy, NPL, profitability), fiscal and monetary indicators (public debt ratio and MMA reserve coverage for instance defined as the ratio of MMA net FX assets to commercial bank total reserve and deposit at MMA), and macroeconomic variables (e.g., year-on-year real GDP growth and inflation rate).

are around or higher than 100 percent of total capital, which implies that the impact on the banking sector stability can be large if a sovereign distress materializes.[5]

Figure 2. Maldives: Crowding Out Effect of Banking Sector Sovereign Debt Holding

I. Commercial Bank Asset Composition (Percent of Total Bank Asset Size)

II. Local Projection Implied Crowding-out Effect (Percentage Points)



Sources: Maldives Monetary Authority; IMF staff calculations.

Note: In panel 2, the impulse response is estimated with the following local projection specification: $\Delta Private\_Loan\_Share_{t+h} = \beta_h \Delta Sovereign\_Share_t + \Gamma_h X_t + \varepsilon_t$ where $h \in \{1,2,3,\ldots\}$, $Private\_Loan\_Share_{t+h}$ is h-month ahead monthly cumulative change in banking sector private loan share, $\Delta Sovereign\_Share_t$ is monthly year-on-year change in banking sector sovereign debt share, X_t is a vector of banking sector financial soundness indicators (e.g., Tier 1 capital ratio, non-performing loan ratio, ROA, liquidity ratio, change in commercial bank NFA ratio, etc.), macro indicators (e.g., monthly year-over-year real GDP growth, inflation, sovereign debt ratio, MMA reserve coverage ratio, etc.), and lagged banking sector sovereign debt share.

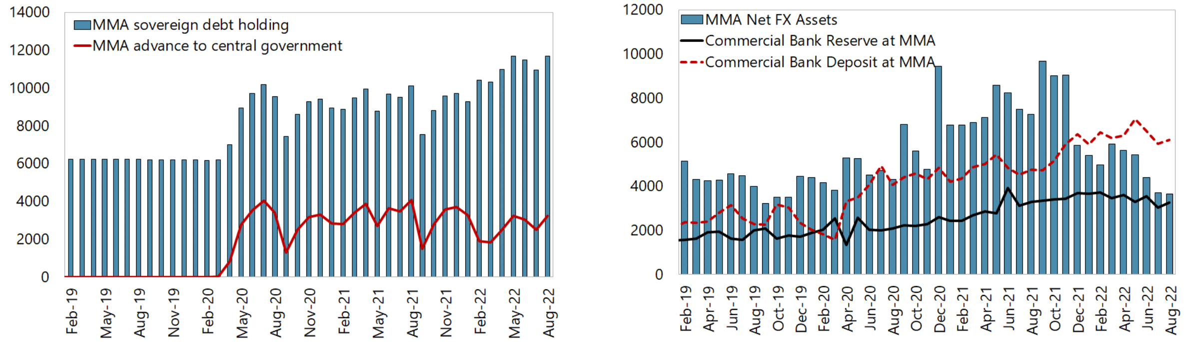
Nexus between Central Government and the Maldives Monetary Authority

6. **Since the COVID-19 pandemic onset, the MMA has started providing credit** (MMA advances) **to the central government**. For most of the time since early 2020, MMA advances to government have driven the fluctuations in MMA's total claims on the Maldivian government (Figure 3, panel 1). MMA advances are the main source of the excess banking sector liquidity, as credit to the government is granted through the public account overdraft facility. Thus, the MMA experienced a sizeable increase in the inflow of commercial banks deposits since early 2020, which is not captured by MMA reserve requirements. The total amount of commercial banks' deposits at MMA surpassed MMA's total net FX assets (Figure 3, panel 2) since late 2021. The inadequacy of active liquidity management tools has resulted in increased pressures on the peg, forcing MMA to ration provision of FX to the private sector.

[5] The forthcoming FSAP mission to Maldives will conduct a more comprehensive stress-test analysis that take into account of the sovereign-bank transmission channel.

Figure 3. Maldives: MMA Advances and Excess Liquidity in Financial System

I. MMA Sovereign Debt Holding (In millions of MVR) | **II. MMA Net FX Assetsand Excess Liquidity** (In millions of MVR)



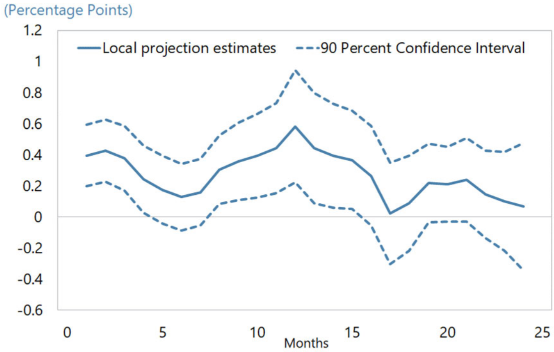
Sources: Maldives Monetary Authority; IMF staff calculations.

7. The empirical analysis confirms that the increased MMA advances to the central government were followed by a significant increase in excess liquidity in the financial system. As Figure 4 panel 1 shows, a one-percentage-point increase in the ratio of MMA advances to government over MMA total asset, increases the ratio of commercial banks' total deposit and reserves at MMA over MMA total assets by as much as 0.5 percentage point, although the relation became insignificant around one year afterwards. In a similar exercise, if the financial system excess liquidity ratio is defined narrowly as only commercial banks' total deposit at MMA over MMA total assets, the impulse response to a one-percentage-point increase in the ratio of MMA advances over MMA total asset is significant until 12 months after the shock. As the pressure on local currency due to MMA excess liquidity and failure in liquidity management continues, MMA advances to central government could also contribute to increased pressures in the FX market. Data permitting the same empirical specification could be used to test the impulse response of FX spreads in the parallel market to shocks in MMA advances, which may confirm that failure to manage central bank excess liquidity could threaten exchange rate stability.

Figure 4. Maldives: Local Projection Impulse Response of Excess Liquidity to MMA Advance Shock

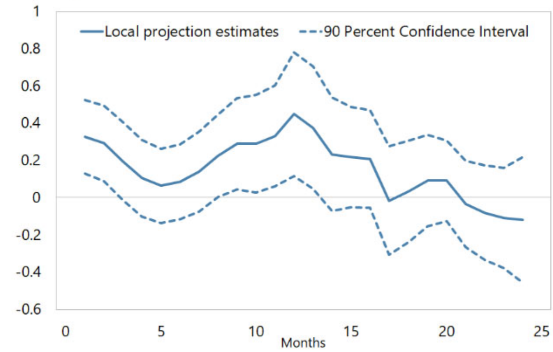
I. Response of Commercial Bank Total Reserve and Deposit at MMA

(Percentage Points)



II. Response of Commercial Bank Total Deposit at MMA

(Percentage Points)



Sources: Maldives Monetary Authority; IMF staff calculations.

Note: The charts present the impulse response of central bank excess liquidity to the change in MMA advance ratio. The following specification is estimated: $\Delta Excess\_Liquidity\_Ratio_{t+h} = \beta_h \Delta MMA\_Advance\_Ratio_t + \Gamma_h X_t + \varepsilon_t$ where $\Delta Excess\_Liquidity\_Ratio_{t+h}$ is h-month ahead monthly cumulative change in central bank excess liquidity (i.e., commercial bank deposit in MMA standing deposit facility and commercial bank reserve at MMA in panel 1 and commercial bank deposit in MMA standing deposit facility for panel 2) as a ratio of MMA total assets, $\Delta MMA\_Advance\_Ratio_t$ is monthly year-on-year change in MMA advance to government as a ratio of MMA total assets, and X_t is a vector of controls including same variables as those in Section 2 together with MMA net FX assets.

Appendix VIII. Accessing Climate Financing to Address Climate Change in Maldives[1]

This appendix presents an overview of the efforts that the Maldivian authorities are undertaking to access climate finance (CF) as well as the obstacles they are facing. While the challenges faced by the Maldivian authorities are common among small states and islands in particular, the appendix highlights the experience of the Pacific Island Countries (PICs) in accessing climate financing, lessons learnt for the way forward, and presents an overview of the IMF's support to combat climate change.

Climate Financing in the Maldives

1. **The Maldives is extremely vulnerable to climate change**. 80 per cent of the land area are less than one meter above mean sea level. According to the authorities[2] over 90 percent of the islands report flooding annually and 97 percent are reporting shoreline erosion while 64 percent are experiencing severe erosion. With such vulnerability and exposure to climate change, negative consequences could be expected on the Maldivian economy and society. Given the dependence of the Maldives' economy on natural ecosystems and tourism, climate change is an existential threat that needs to be addressed.

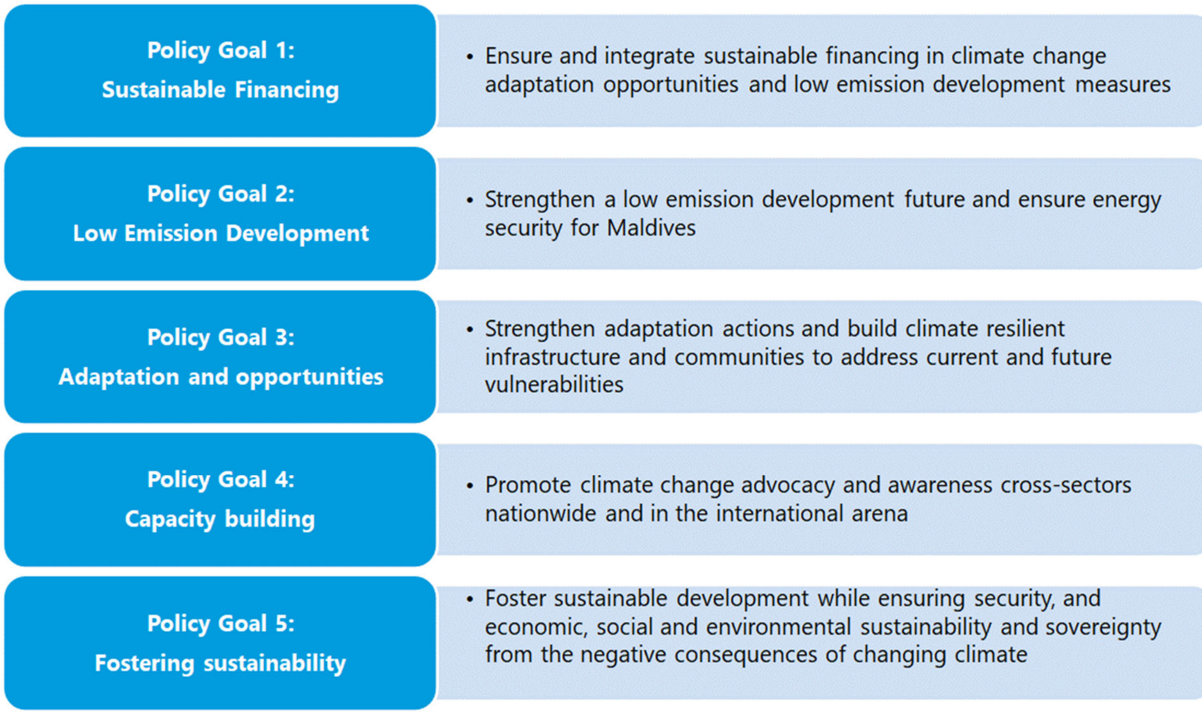
2. **Maldives has been taking steps to enhance climate policies to meet its renewed climate mitigation objectives and adaptation needs**. Various national mitigation and adaptation strategic plans, and policies are enacted[3], of which the he Nationally Determined Contribution (NDC) of Maldives 2020 that lays out plans to reduce CO2 emissions by 26 percent by 2030 and strive to achieve net zero emissions by 2030 if there is adequate international support and assistance, (ii) the Maldives Climate Change Policy Framework (MCCPF, 2015) that sets the policy goals and objectives (Figure 1), and (iii) the Climate Emergency Act of 2021 sets out the conditional plans to achieve net-zero emission and large adaptation needs mainly in renewable energy and resilient infrastructure. However, implementation is still lacking as the Maldives has not enacted any regulations to directly address climate change or develop concrete financing plans.

[1] Prepared by Majdeline El Rayess (FAD).

[2] Aminath Shauna, Environment Minister, IMF Finance and Development Magazine, September 2021

[3] (i) Climate Emergency Act (2021), (ii) NDC (2020), (iii)Strategic Action Plan 2019-2023(2019), (iv) Maldives Climate Change Policy Framework (2015), (v) Disaster Management Act (2007), and (vi) National Adaptation Program of Action (2006).

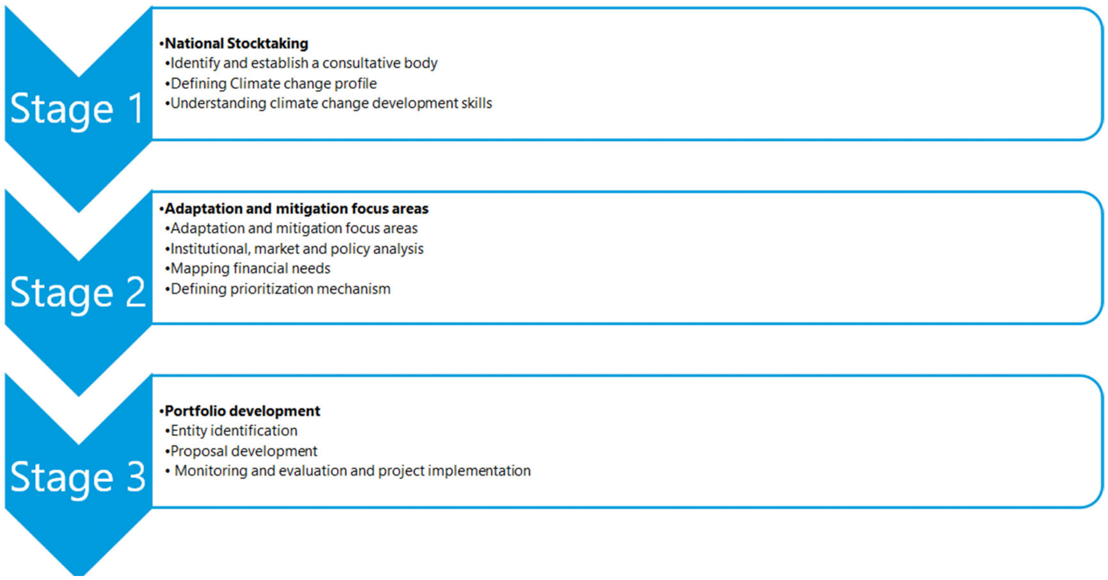
Figure 1. Maldives: Policy Goals under the MCCPF



Source: Ministry of Environment, National Strategic Framework to Mobilize International Climate Finance to Address Climate Change in the Maldives 2020–2024.

3. **Climate financing needs are large in the Maldives**. The cost of adaptation and mitigation needs are estimated at USD 8.8 billion and USD 1 billion respectively. While the government has adopted some innovative sources of funding such as the Green Tax paid by tourists and Baa Atoll Conservation Fund to address various aspects of climate change, domestic resources are not enough to cover needs and addressing climate change necessitates support from development partners and the international community. The MCCPF assessed the needs from the Green Climate Fund (GCF) to address climate change in the Maldives for 2020-2024 at USD500 million and developed a pipeline of projects according to the GCF guidance (Figure 2).

Figure 2. Maldives: Policy Goals under the MCCPF



Source: Ministry of environment, National Strategic Framework to Mobilize International Climate Finance to Address Climate Change in the Maldives 2020-2024

4. **Despite efforts, access to climate funding remains weak in the Maldives.** Accessing multilateral climate financing mainly through the GCF continue to be highly challenging for the Maldives. According to the authorities, access procedures to multilateral climate funds are highly cumbersome and costly, particularly the requirements related to certain level of scientific data to prove that proposed projects are climate relevant. The hurdles faced by the Maldives are similar to those of many small islands with limited capacities. The following section presents the experience of the Pacific Islands in accessing CF. Hurdles to access climate financing can be summarized in lack of capacity to satisfy preconditions required by the climate funds, and cumbersome and complex processes to acquire accreditation and approval of projects.

Experience of PICs in Accessing Climate Financing [4]

5. **PICs face a large climate financing gap to address climate challenges.** Fouad et al. (2021) estimated the average additional annual spending needs at 6.5 to 9 percent of GDP to address climate challenges and limit economic losses. While donors and entities (under varying modalities) are providing climate finance to the PICs, needs are still well beyond available fund and disbursements are often delayed for several years for various reasons.

Access Modalities for Multilateral Climate Finance Vary. These include:

- *Direct Application for Project Funding*: Project proponents apply directly to the fund or facility, which evaluates the proponent or sponsor's capacity to act as an executing entity to implement

[4] This summary is based on the findings of the Departmental Paper, Fouad et al., 2021, Unlocking Access to Climate Finance for Pacific Islands Countries, DP /2021/020.

the project. Multilateral CFs like the GCF typically do not allow direct applications without first completing an accreditation process, but bilateral funds often do.

- *Access through Accredited Entities (AEs)*: AEs are entities or intermediaries that are pre-qualified to access, manage and carry out activities such as developing funding proposals and managing projects/programs. An accreditation process is required to access funding.
- *Direct Access*: Direct access is a process through which regional, national, or subnational entities become accredited to receive finance directly from the fund without going through an international intermediary. The facilitation and fiduciary functions normally played by an international entity are taken on by the accredited direct access entity.
- *International Access*: Access is granted to institutions like United Nations agencies, multilateral development banks (MDBs), international financial institutions, NGOs, and regional institutions that are either designated or accredited as official access channels to a fund or facility. These accredited entities (that are sometimes implementing entities) have been verified as having the expertise to handle various climate change projects and financing instruments.

6. **PICs have had mixed results in accessing CFs namely the GCF**. Almost all PICs are targeting to obtain direct access to the GCF since it is the single largest source of climate finance for the PICs by seeking national entity accreditation. However, they are facing many challenges. Only two PICs, Fiji and the Cook Islands, have managed to secure direct access to the GCF through national accredited entities.[5] Even with approved national accredited entities, accessing the GCF financing has been time consuming and as no funding has been disbursed of July 2022 (Table 1). Access to GCF through international and regional accredited entities has proven to be more successful in the region with 15 projects totaling USD 430 million has been approved by the GCF.

Table 1. Maldives: GCF Direct Access Entities in the Pacific as end of July 2022

Track Record – Direct access	Accreditation Phase			
	Outcomes			
Direct Access – National Accredited Entity	Accreditation Complete (Date)	Time since accreditation (Year)	Projects Approved (#)	Funding disbursed as of end July 2022?
Fiji- Fiji Development Bank	Oct - 2017	3.7	1	No
Cook Islands – Ministry of Finance	Oct - 2018	2.6	0	No

Source: GCF website, and IMF staff.

[5] the Fiji Development Bank in 2017 for projects up to $10 million and the Cook Islands Ministry of Finance and Economic Management in 2018 for projects up to $50 million.

7. Challenges and successes of PICs accessing funding from CF are various throughout the lifecycle of a project. While direct access accreditation remains the objective of many PICs, it is a lengthy process that takes a minimum 2-5 years and should be able to satisfy a range of PFM-related requirements covering seven broad areas of PFM practices and institutions.[6] Table 2 provides a summary of the challenges and successes that PICs phased during two phases of the climate finance lifecycle - accreditation and project approval and implementation. This summary could inform other small countries and islands of the best path to take to achieve successful access to CF.

Table 2. Maldives: Summary of Challenges and Successes Experienced by PICs During Climate Finance Lifecycle

Climate Finance Lifecycle	Challenges	Successes
Accreditation Phase		
GCF Direct Access Accreditation	• Complexity of requirements • Lengthy process, re-accreditation needed every 5 years • Requires significant resources where capacity is already thin	• Reciprocal recognition between global CFs allowing for "fast tracking" (although still lengthy process) • Readiness funding usefully deployed • Gap assessment helpful
GCF Access vis Regional Accredited Entity	• Demand for support is too high; not all request can be supported • Can on support small-to-medium size projects	• Offer crucial support for GCF readiness grants • RE-accreditation done by regional entity
GCF Access vis International Accredited Entity	• Demand for support is too high; not all request can be supported • Misalignment of priorities can constrain support • Management fees	• Large amounts of funding can be available even for low capacity countries • Implementation can begin earlier than with direct access • Re-accreditation done by international entity
Project Approval and Implementation		
	• Insufficient human resources and technical skills to develop projects • Disbursements delays • Harder to get funding for adaptation projects • Onerous procurement procedures	• Steps toward better monitoring of climate budget tagging • Introduction of climate units to coordinate finance activities

Lessons Learnt and Way Forward

8. For PICs, adapting to climate change is an urgent need; However past experiences have showed that national direct-access modalities do not offer a rapid or sizable path to climate finance. Without further efforts, especially with the pace of development of PFM capacity and no change in climate finance requirements, direct-access accreditation will remain out of reach for many PICs for some years. Since this process is timely and heavy on resources, it is increasingly clear that a mix of modalities is needed.

[6] The basic PFM-related standards required for access to the GCF cover the following areas: (i) corporate governance, (ii) financial reporting, (iii) budget credibility, (iv) internal and external audit, (v) internal control, (vi) procurement, and (vii) transparency and accountability.

9. For Maldives, moving forward, various measures could be taken to enhance access to financing related to climate change. While direct accreditation remains the main objective of the authorities to ensure financing for climate change projects, the experience has proven that the accreditation process tends to be a lengthy and cumbersome and not necessarily yielding the expected outcomes. The Maldives should explore a variety of access modalities that could be strategically utilized and should consider the actual costs and perceived benefits for each path. Where access to financing is demanding on PFM related requirements, the authorities are encouraged to continue their PFM reforms to adapt current public finance management (PFM) practices and make them environment and climate sensitive.

IMF's Support to Address Challenges of Climate Change

10. The IMF is helping its members address challenges related to climate change through financing solutions, capacity development and analytical work including data.

Financing Solutions - Resilience and Sustainability Facility (RSF)

11. The Resilience and Sustainability Facility (RSF) complements the existing IMF lending toolkit by helping low-income and vulnerable middle-income countries address longer-term challenges, including those related to climate change and pandemic preparedness.[7] Three quarters of the IMF's membership – are eligible for RSF financing including small states. Eligible countries requesting access to the RSF need (i) high quality policy reforms, (ii) a concurrent IMF-supported program, and (iii) sustainable debt and adequate capacity to repay.

Capacity Development

12. The Fund is helping its member by extending its capacity development support, which now includes climate macroeconomic assessment programs (CMAP), climate-focused public investment management assessments (C -PIMA)[8] and green public financial management.[9] Each of these tools can play an important role across the climate finance lifecycle to build PFM capacity in particular areas and identify where gaps exist.

Analytical Work and Data

13. The IMF publishes research and analysis related to the impact of climate change on macroeconomic and financial stability, including on mitigation, adaptation, and transition.[10] Moreover, the Climate Change Indicators Dashboard[11] is an international initiative to address the growing need for climate-related data used in macroeconomic and financial stability analysis. Led by

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[7] https://www.imf.org/en/About/Factsheets/Sheets/2022/resilience-and-sustainability-facility-rsf

[8] https://www.imf.org/-/media/Files/Publications/PP/2021/English/PPEA2021076.ashx

[9] https://www.imf.org/-/media/Files/Publications/Staff-Climate-Notes/2021/English/CLNEA2021002.ashx

[10] The IMF Staff Climate Note Series

[11] Climate Change Indicators Dashboard (imf.org)

the IMF's Statistics Department (STA) and designed in cooperation with other IMF departments and international organizations, the Dashboard aims to become a comprehensive aggregator for statistical indicators on climate change, greenhouse gas emissions from economic activity, trade in environmental goods, green finance, government policies, and physical and transition risks.

INTERNATIONAL MONETARY FUND

MALDIVES

November 4, 2022

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of September 2022)

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

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

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	28.01	100.00
Holdings	1.83	6.55

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
RCF Loans	21.2	100

Latest Financial Arrangements:

Type	**Arrangement Date**	**Expiration Date**	**Amount Approved (SDR million)**	**Amount Drawn (SDR Million)**
RCF	04/22/2020		21.20	21.20
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				
	2022	**2023**	**2024**	**2025**	**2026**
Principal				2.12	4.24
Charges/Interest	0.12	0.53	0.53	0.53	0.53
Total	**0.12**	**0.53**	**0.53**	**2.65**	**4.77**

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

Exchange Arrangements

Since April 2011, the Rufiyaa has floated in a band of 20 percent on either side of Rf 12.85 per dollar. In practice, however, the Rufiyaa has been virtually fixed at the band's weaker end of Rf 15.42 per dollar. The de jure exchange rate arrangement is a pegged exchange rate within horizontal bands and the de facto exchange rate arrangement is classified as a stabilized exchange rate arrangement. Maldives continues to avail itself of the transitional provisions of Article XIV but no longer maintains any measures under this provision, and has not yet accepted the obligations of Article VIII, Sections

2, 3, and 4. It maintains an exchange restriction subject to IMF approval under Article VIII, Section 2(a) of the IMF's Articles of Agreement arising from a shortage of foreign exchange (FX) at the official rate which leads to the Maldives Monetary Authority (MMA) rationing its supply of FX to commercial banks. This results in a channeling of FX transactions for current international transactions to the parallel market where transactions take place at an exchange rate that deviates by more than 2 percent from the prevailing market exchange rate. The greater than 2 percent spread gives rise to multiple currency practice subject to IMF approval under Article VIII, Section 3, and also to an exchange restriction, given the additional cost involved for obtaining foreign exchange. Since April 2020, the MMA has continued to increase the amount of US dollar sales to commercial banks. The official exchange rate used by the MMA for government transactions is calculated based on the mid-point of the weighted average of the buying and selling rates of FX transactions conducted by commercial banks one day earlier. The lack of a mechanism to prevent the spread between this official exchange rate used by the MMA for government transactions and the prevailing market exchange rate from deviating by more than 2 percent gives rise to a multiple currency practice subject to IMF approval under Article VIII, Section 3.

Last Article IV Consultation

The 2021 Article IV consultation was concluded by the Executive Board on September 10, 2021.

Technical Assistance

FAD: FAD's main areas of engagement in recent years have been on tax policy and tax administration, subsidy reforms, public investment and financial management, and debt management. Public Investment Management Assessment (PIMA) was conducted by FAD in December 2016, with the purpose to identify, and propose improvements in, PFM practices that are associated with efficient public investment. October 2017 Tax Administration TA mission reviewed progress with the strategic priorities in the Maldives Inland Revenue Authority (MIRA) 2015–19 Strategic Plan. The January 2018 Budget Formulation TA mission focused on budget preparation and public investment management. A follow-up mission on Strengthening Public Investment Management took place in June 2018. In July 2018, a TA mission focused on developing a risk management framework for MIRA. A Tax Policy TA took place in February 2019, to assess the overall design of taxation in the Maldives and identify reform options to support revenue, efficiency, and equity. Also, in February 2019, concurrent tax administration missions took place to advise MIRA on the development of the 2020-24 Strategic Plan and risk framework, as well as improve the skills of staff. In February 2020, a mission took place to strengthen the management of fiscal risks of SOEs and a tax policy reform assessing the recent progress and proposing further improvements. Also, in November 2020, two missions took place on reviewing the current Fiscal Responsibility Act and a Fiscal Transparency Evaluation following the Fiscal Transparency Code of the IMF. In 2021, FAD with MCM conducted a joint desk review of the debt management law and a Tax Administration Assessment Tool (TADA) mission was conducted. In 2022, three missions took place, on Medium-term Revenue Strategy (MTRS), GST Gap Analysis, and Fuel and Electricity Subsidy Reforms.

LEG: In October 2003, LEG provided TA on the revision of the Maldives Monetary Authority (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 help with the MMA Act (jointly with MCM). A follow-up mission in February 2011 focused on payments law. LEG conducted an AML/CFT assessment in October 2010 and conducted a desk-based review of the draft AML/CFT law in May 2012. In 2014 and 2015, LEG provided advice on the Special Economic Zones Law, offshore banking legislation and deposit insurance.

MCM: In 2006, two missions provided TA on monetary operations, financial market development, and banking issues. In 2007, TA on debt management, monetary policy and financial supervision was delivered. In 2008, three missions consulted on monetary operations and liquidity management, monetary policy, and financial supervision issues. In November 2008 and March/May/August 2009, TA was provided on research capacity building, banking supervision, and monetary policy and reviewing of the MMA Act with recommendations. Furthermore, two missions also provided advice on monetary operations, liquidity management, and the development of a crisis management framework. In December 2010, MCM conducted a TA mission on crisis preparedness and management, bank restructuring, and monetary operations. In May and September 2011, TA on the development of debt markets and on-site banking supervision was provided and in February 2012, on assessing the FX operations framework. In the first half of 2014, MCM continued its TA delivery on banking supervision along with a joint MCM-APD mission on developing FX market. The Department also provided advice on deposit insurance schemes during 2014. Banking supervision (March) and FX reserve management (September) continued to be areas of priority to the authorities in 2015 with MCM TA responding with follow-up missions. In March 2016, further TA on FX and monetary policy operations was also provided. A follow-up mission on banking supervision with a focus on operational risk took place in May 2016. During 2017, two HQ missions covering accounting and auditing framework for MMA, and two SARTTAC missions establishing the work plan for monetary operations and banking supervision took place. Four TA missions took place during 2017-18 as part of the multi-year TA program to enhance the supervisory capacity of the Insurance Division of the MMA. In December 2018, a multitopic TA took place to formulate a TA roadmap to support MMA's reforms, including central bank governance, monetary and FX operations and financial sector supervision and regulation, with a follow up mission in 2019 and desk-review of various of policy notes in 2021 on Use of MVR in all monetary transactions; Repatriation and surrender of export earnings; Licensing money changers. In January 2019, a TA mission assisted the authorities in the application of International Financial Reporting Standard 9 – Financial Instruments and reviewing progress in the strengthening of their Internal Audit and Enterprise Risk Management practices. In February 2019, an external expert visited Maldives to advise the MMA governor on strengthening the MMA governance and internal organization. Since the pandemic, SARTTAC conducted two TA missions in coordination with MCM. During December 2021 to January 2022, a TA mission on operationalizing an interest rate corridor provided a set of recommendations on the introduction and implementation of an interest rate corridor as a way to support an active liquidity management policy and a policy tool to support the development of the money market and the use of domestic currency. The TA mission on strengthening MMA's banking supervision capacity concluded with an in-person mission in June 2022. The mission assessed MMA's implementation of corporate governance regulations and risk management guidelines and provided further recommendations to ensure full implementation in practice.

***STA*:** An April 2018 external sector statistics SARTTAC mission assessed data reliability and assisted in improving specific BOP components, advised on further developments in source data and statistical techniques to address existing data gaps. An August 2018 SARTTAC mission has provided GFS and public sector debt statistics (PSDS) training - the onset of a broader SARTTAC training and technical assistance effort to enable the Maldives to improve and strengthen its fiscal reporting. In January 2019, a SARTTAC mission on GFS and PSDS focused on strengthening compilation and dissemination of the statistics in line with internationally accepted statistical standards. A subsequent SARTTAC PSDS training mission, held in August 2019, provided training to compilers on the concepts, methods, and practices related to PSDS compilation and dissemination. In February 2019, SARTTAC missions assisted with the updating of the consumer price index and developing experimental annual GDP estimates by expenditure at current prices for 2017. In January 2020 and January 2021, SARTTAC GFS and PSDS missions focused on enhancing compilation and dissemination practices, including aligning GFS and PSDS reports to the *GFSM 2014* framework, moving forward to producing quarterly GFS reports, and broadening the institutional coverage of the fiscal statistics. During 2020 and the first half of 2021, several SARTTAC missions focused on national accounts statistics including improving the expenditure approach for annual GDP and quarterly national accounts. In June 2022, SARTTAC provided a technical assistance mission to assist the Maldives Bureau of Statistics with developing the producer price index (PPI) and updating the consumer price index (CPI).

ICD: An in-person TA mission was conducted in August 2022 to help MMA to customize and implement an Excel-based microframework in line with the "Comprehensive Adaptive Expectations Model" (CAEM). The mission focused on two areas: i) customize the template to the Maldivian economy; ii) formulate a baseline forecast and run policy scenarios.

Safeguards Assessment

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

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

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

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

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

STATISTICAL ISSUES

(As of October 27, 2022)

I. Assessment of Data Adequacy for Surveillance
General: Macroeconomic statistics have improved in recent years, with technical assistance from STA and the Asian Development Bank (ADB). While data are broadly adequate for surveillance there are nonetheless data gaps remaining affecting the balance of payments, government finance, and national accounts statistics.
Real sector: Maldives compiles quarterly and annual national accounts (base year 2014) using supply and use tables (SUTs 2014). IMF's STA and SARTTAC assisted in modernizing and improving the EXCEL-based GDP compilation system which further improved the consistency between GDP-Production and Quarterly GDP estimates. GDP by expenditure and quarterly GDP series were also improved and disseminated on Maldives official website. STA and SARTTAC are organizing a mission for end-2022 to support the authorities' work program to develop SUTs for 2019 and to subsequently rebase GDP to 2019. The Consumer Price Index (CPI) currently uses weights from the 2016 Household Income and Expenditure Survey. A TA mission in April 2022 developed preliminary weights using the 2019 Household Income and Expenditure Survey. A CPI series with updated weights, and with coverage expanded to include owner occupied housing, is expected to be disseminated later in 2022. The Producer Price Index (PPI) was not produced between 2017 and 2019, but SARTTAC supported the re-introduction of a monthly PPI (disseminated quarterly) in 2020. To date, data for communications and education have been released covering the period from January 2019 to March 2022. It is planned to disseminate new price indices for utilities, resorts, and construction.
Fiscal sector: With support from SARTTAC, the authorities are currently disseminating GFS data based on the *Government Finance Statistics Manual 2014* for the budgetary central government. Furthermore, the authorities have ongoing reforms to update the chart of accounts and update the accounting basis to follow international standards allowing for the production of balance sheet data. Data on local government is limited; however, with decentralization being implemented, plans are underway to provide a portal with detailed data on the finances of local government. On SOEs, a quarterly report is produced with data on individual SOEs; however, GFS data for a consolidated public corporations subsector is not currently being produced. Nevertheless, plans are underway with support from SARTTAC to produce such data.
Financial sector: APD receives an electronic report on monetary statistics every two weeks, covering the balance sheets of the MMA and the commercial banks. The MMA uses the standardized report forms (SRFs) to report monthly data for the central bank, other depository corporations and other financial corporations to the Fund on a regular basis. An integrated monetary database that meets the needs of the MMA, STA, and APD is operational. There are

inconsistencies between monetary and fiscal data regarding the financing of the fiscal deficit due to issues of timing and coverage. Maldives also reports data on some key series of the Financial Access Survey, including mobile money and gender-disaggregated series, and the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the United Nations to monitor Target 8.10 of the Sustainable Development Goals. MMA reports all 14 core Financial Soundness Indicators (FSIs) and eight additional FSIs for deposit takers as well as two additional FSIs on real estate markets on a quarterly basis for publication on the IMF's FSI website. MMA could improve its coverage of the additional FSIs to include other sectors, notably, other financial corporations, nonfinancial corporations, and households.	
External sector: The MMA compiles balance of payments data on an annual basis only. MMA has started a project to enhance the international transaction reporting system (ITRS). They also have taken some actions to improve the coordination among data producers and the data collection processes. MMA does not compile International Investment Position (IIP), Coordinated Direct Investment Survey (CDIS), Coordinated Portfolio Investment Survey (CPIS) data, and there are difficulties in pulling together all the existing information that would allow for a consistent compilation of the financial transactions for the preparation of these data. Quarterly data on external debt and debt service are available for the government and the MMA, and to some extent for the banking sector and state enterprises, but no data are reported to the World Bank Quarterly External Debt Statistics (QEDS) database. The main source for EDS is the Commonwealth Secretariat Debt Recording Management System (DRMS). This system has inbuilt EDS templates for reporting these data to the World Bank and for assisting the MMA in improving balance of payments data and, in the future, for the preparation of the IIP. Official reserves assets are reported every two weeks with a (variable) one-week lag. Predetermined foreign currency outflows (mainly debt service payments) are known and reported to APD at the time of annual Article IV consultation missions, while other movements of foreign currency assets are not identified.	
II. Data Standards and Quality	
Maldives has participated in the IMF's General Data Dissemination System (GDDS) since October 14, 2011, with its metadata posted on the Data Standards Bulletin Board. On June 18, 2019, with IMF support, Maldives implemented the recommendations of the Enhanced General Data Dissemination System (e-GDDS) by publishing essential macroeconomic statistics through a National Summary Data page (NSDP).	No data ROSC available.

Maldives: Table of Common Indicators Required for Surveillance
(As of September 30, 2022)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	September 2022	October 2022	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	August 2022	September 2022	M	M	M
Reserve/Base Money	August 2022	September 2022	M	M	M
Broad Money	August 2022	September 2022	M	M	M
Central Bank Balance Sheet	August 2022	September 2022	M	M	M
Consolidated Balance Sheet of the Banking System	August 2022	September 2022	M	M	M
Interest Rates[2]	September 2022	October 2022	M	M	M
Consumer Price Index	July 2022	September 2022	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	N.A.	N.A.	N.A.	N.A.	N.A.
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2021	September 2022	A	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2021	September 2022	A	A	A
External Current Account Balance	2021	September 2022	A	A	A
Exports and Imports of Goods and Services	2021	September 2022	A	A	A
GDP/GNP	2021A, 2022 Q2	August 2021, September 2022	A, Q	A, Q	A, Q
Gross External Debt	2021 A	September 2022	A	A	A
International Investment Position		N.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. Interest rates on bank deposits are not provided.
[3]Foreign, domestic bank, and domestic nonbank financing.
[4]The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5]Including currency and maturity composition.
[6]Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND

MALDIVES

November 4, 2022

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

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

Maldives: Joint Bank Fund Debt Sustainability Analysis	
Risk of external debt distress	High
Overall risk of debt distress	High
Granularity in the risk rating	Not sustainable under baseline
Application of judgement	No

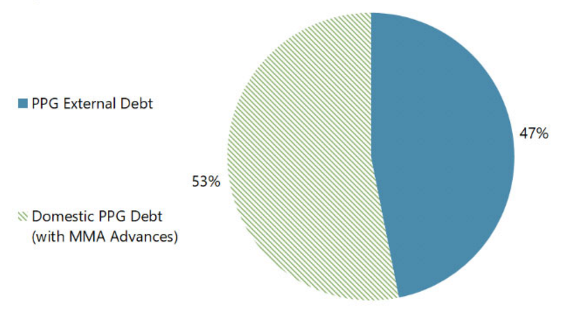
The Maldives remains at a high risk of external and overall debt distress. Since the September 2021 Debt Sustainability Analysis (DSA), some debt indicators, such as debt-to-GDP ratio, have improved in the near term, reflecting the robust recovery in tourism and growth in 2021. Nevertheless, external gross financing needs have increased significantly relative to the 2021 DSA due to (i) persistently higher commodity prices, (ii) a more expansionary fiscal stance reflecting higher subsidies, as well as other current and capital project related spending, and (iii) repayments and rollovers of non-concessional debt, mainly global sukuks. External refinancing pressures are expected to peak in 2026. The authorities have been current on debt service obligations to both domestic and external creditors. Increasingly higher amortizations and large interest payments would trigger protracted breaches in several debt indicators by 2026 making the assessment of debt not sustainable under the baseline projections, similar to the 2021 DSA. The key external debt stock indicator, the present value (PV) of external debt-to-GDP, will converge to the 30 percent threshold by the medium-term. Addressing debt vulnerabilities requires sustained fiscal consolidation, conservative debt management, and continued strong growth. Staff noted the authorities' adoption of fiscal anchors in

their 2023–2025 medium-term fiscal strategy to support fiscal sustainability. In addition to the planned increase of Goods and Services Tax (GST), which is included in the baseline projections, a decisive and sustained additional fiscal adjustment of around 3 percent of GDP would help lower the PV of public debt below 70 (50) percent of GDP by 2032 (2042) and put debt on a sustained downward path. The debt dynamics will remain vulnerable to adverse shocks in growth, interest rates (due to Secured Overnight Financing Rate (SOFR)-linked debt), and the fiscal position in the near term. A possible upside is the resumption of tourist arrivals from China.

BACKGROUND AND DEVELOPMENTS ON DEBT

1. **Total public and publicly guaranteed (PPG) debt-to-GDP ratio declined to about 124 percent of GDP in 2021 from 154 percent in 2020 and 137 percent of GDP projected for 2021 in Article IV 2021, reflecting the unexpected rebound in tourism and growth supported by a strong vaccination program and pandemic related policies.** However, the ratio remained elevated compared to 78.8 percent in 2019, reflecting the double-digit fiscal deficit in response to spending pressures and end-year global commodity price hikes. Nominal PPG debt stock increased to US$6469 million in 2021 from US$5768 million in 2020 driven by a large annual increase in central government budgetary debt, to about US$5527 (an increase of about 14 percent) even as guaranteed debt increased at a slower pace to about US$941 million. Overall, both external and domestic debt increased during 2021 with the domestic debt slightly above half the mix (53 percent of total).[1]

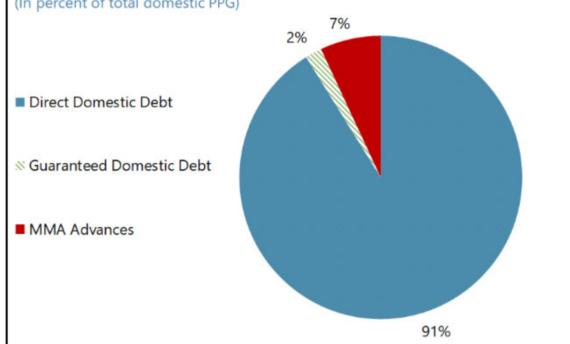
Maldives: PPG Debt, 2021
(In percent of total)



Source: Maldives Ministry of Finance.

2. **Domestic PPG debt stood at US$3452.1 million (MVR 53164 million) or 66.3 of GDP at end 2021 up from US$2973.6 million in 2020 in nominal terms.** Unlike guarantees on external debt, which have been declining steadily since end-2020 due to payments by state-owned enterprises like HDC and STELCO, guarantees on domestic debt has remained stable over time. To bridge the financing of the government during the COVID-19 crisis, in end-April 2020 the parliament of the Maldives approved the temporary suspension of elements of Fiscal Responsibility Act (FRA) to allow for a one-year expansion of the cap of MMA advances to the government to MVR 4.4 billion (US$286 million). Domestic PPG debt also includes US$239.5 million (MVR 3.689 billion) in advances, from the Maldives Monetary Authority (MMA) to the central government

Maldives: Domestic PPG Debt, 2021
(In percent of total domestic PPG)

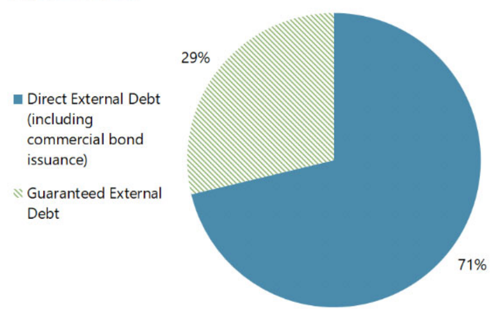


Sources: Maldives Ministry of Finance; and Maldives Monetary Authority.

[1] The Maldives used the swap arrangements with the Reserve Bank of India (RBI) in the amount of US$400 million in 2020. This was paid back in full in two tranches, an early payment of US$150 in January 2021 and remaining US$250 at end end-December 2021. The swap arrangement with the RBI was for the purpose of reserve management and there is no indication of it is being used for fiscal purposes. Thus, the swap with RBI was excluded from public debt.

(4.6 percent of GDP).[2] In end-December 2021 the authorities engaged in securitization of the outstanding MMA advances, in the amount of MVR 2.5 billion (US$162 million, around 4.5 percent of domestic PPG debt) converting the advances into a 40-year bond at a 2.4 percent annual interest. Commercial banks had the largest claim on central government, around US$1439.7 million (42 percent of domestic PPG debt), followed by other financial corporations, US$1068 million (30.9 percent of domestic PPG debt). A US$250 million bond, purchased in 2020 by the State Bank of India (SBI) Male branch as budget support to buffer the impact of COVID, remains outstanding. This bond is expected to be paid back in 10 years as a bullet payment with bi-annual interest payment in dollars at an interest rate of 3.5 percent.[3]

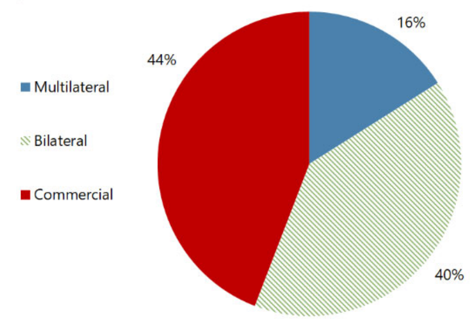
Maldives: External PPG Debt, 2021
(In percent of total)



Source: Maldives Ministry of Finance

3. **External PPG debt stood at US$3046 million in 2021, around 58.5 percent of GDP up from US$2796 million in 2020 in nominal terms.** External PPG debt is predominantly owed to commercial (44 percent) and bilateral (40 percent) creditors. End-2021 data suggests that direct budgetary debt, constituted 71 percent of PPG external debt, with the remaining 29 percent extended to State-Owned Enterprises (SOEs) with sovereign guarantees. Around 67 percent of guaranteed external loans are for housing development projects carried out by the SOEs, the Housing Development Corporation (HDC) and the Fahi Dhiriulhun Corporation (FDC). Guaranteed external debt is owed mainly to commercial creditors (around 9 percent of total) with the rest (3 percent) to bilateral creditors and a small amount (1 percent) to a multilateral creditor. China is the largest external creditor (20 percent of total public debt or 42 percent of total

Maldives: External PPG Debt by Creditor Type, 2021
(In percent of total)



Source: Maldives Ministry of Finance.

	USD million	% of total public debt	% of PPG external debt
Direct External debt	**2,170**	**33**	**71**
Multilateral	454	7	15
Bilateral	959	15	31
o/w China	543	8	18
Commercial	758	12	25
Guaranteed External debt	**875**	**13**	**29**
Multilateral	36	1	1
Bilateral	253	4	8
o/w China	188	3	6
Commercial	587	9	19
o/w China	542	8	18

[2] The advances were initiated in March 2020 and had an outstanding balance of US$214 million in end-2020. The Ministry of Finance was granted a one-year extension to the increase in the cap on government advances to help bridge financing needs in 2021. A further extension of the increase in cap in the amount of MVR 4.4 billion was granted until April 2022 and now extended until December 2023 at 1.5 percent per annum, over and above the securitized amount of MVR 2.5 billion.

[3] The SBI loan is included in commercial bank claims on the central government.

external PPG debt), with the Chinese Exim Bank holding 11 percent of the total.

4. The debt sustainability analysis includes PPG external and domestic debt. Public debt comprises the debt of the central government, including guarantees to SOEs. The stock of externally guaranteed SOE debt stood at around US$875 million (around 17 percent of GDP) with large exposures to the housing development corporation and mainly from Chinese creditors (see ¶ 3). External debt is defined by residency criteria. The calibration of the contingent liability shock is based on the default values for the SOE debt (2 percent of GDP) and financial market component (5 percent of GDP) since they are sufficient to represent fiscal risks.[4]

Debt Coverage

	Subsectors of the public sector	Check box
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

1	The country's coverage of public debt	The central government, central bank, government-guaranteed debt	
		Default	Used for the analysis
2	Other elements of the general government not captured in 1.	0 percent of GDP	0
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2
4	PPP	35 percent of PPP stock	0.00
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5
	Total (2+3+4+5) (in percent of GDP)		7.0

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

5. During 2020, the Maldivian government received exceptional concessional external financing amounting to around US$ 269.8 million in loans and grants from international financial institutions (IFIs) and US$ 11.35 million from bilateral creditors, including US$28.9 million from the IMF's Rapid Credit Facility (RCF) approved on April 22, 2020, and US$59.7 million in grants. Around 81 percent of grants were provided by the Asian Development Bank (US$ 25.0 million), the World Bank (US$15.6 million), and Japan (US$7.5 million), (see complete list of creditors providing pandemic related assistance, here). No further concessional loans have been contracted since the pandemic 2020, except for some grant financing provided from IDA and, potentially, others. The Maldives continues to borrow under non-concessional terms from the capital markets. Although Maldives is categorized as an IDA-only country at high risk of external debt distress, effective FY23, it faces a hardening of financing terms as a remedial measure for not complying with the agreed zero non-concessional borrowing ceiling under IDA's Sustainable Development Finance Policy (SDFP) for the second year in a row. As a result, effective July 1,

[4] As most of SOEs' debt are guaranteed, the default calibrated shock of 2 percent of GDP is reasonable to cover the risk from non-guaranteed SOE debt.

2022, Maldives' financing terms will be 50 percent grants and 50 percent 40-year credits on Small Economy terms with a 10-year grace period, instead of the 100 percent grants applied in FY22.[5]

- The Maldives issued two sovereign Eurobonds with a total face value of US$350 million.

    i. The first, issued to Abu Dhabi in 2018, was expected to fall due in 2023 (US$100 million) and now extended to 2026.

    ii. Another US$250 million maiden Eurobond (also known as Sunny side bond) issued to the international market, which was partly repurchased in March 2021, with the remainder repaid on maturity in June 2022.

- In March 2021, the government was able to issue a global Sukuk bond, due to mature in 2026, in the amount of US$200 million at 10.5 percent, that helped repurchase 77 percent of the US$250 million maiden Eurobond that was expected to mature in 2023, and was trading at 26 percent yield. At the time, and in the absence of access to concessional financing, this helped to save the yield differential.

- Subsequently, the Maldives issued another US$100 million sukuk in April 2021 under the same conditions as the March 2021 subscription and,

- Another US$200 million in September 2021 to cover budgetary expenses, trading at about 20 percent yield.

- In May 2022 the government also secured a US$100 million loan through private placement expected to mature in 2025 and at a 7 percent annual interest rate.

6. **The Maldives applied for the G20 Debt Service Suspension Initiative (DSSI) and received relief from most bilateral official creditors totaling around US$19 million in 2020.** They also applied for both extensions to the DSSI from creditors that provided suspension on the original request. Most bilateral creditors granted a third extension of the debt outstanding under the DSSI, which freed up about

[5]Maldives did not satisfactorily implement two of the FY22 PPAs including a zero non-concessional borrowing (NCB) ceiling PPA for the second time for which Maldives faced a discount of IDA resource (or lost set-aside applied to FY22 allocation). As an IDA-eligible country at high risk of external debt distress, Maldives is subject to a zero ceiling on external non-concessional borrowing under IDA's Sustainable Development Finance Policy (SDFP). If Maldives does not satisfactorily implement its missed FY22 PPA(s) in FY23, it will lose the set-aside currently applied to the FY23 allocation, and if it fails to implement the new FY23 PPA(s), then another set-aside will also be applied to the FY24 allocation. Repeated non-performance (especially of non-concessional borrowing ceilings) could also trigger an extension of the hardening of IDA financing terms.

US$66.7 million in 2021 through postponement of debt servicing.[6]

MACROECONOMIC AND FINANCING ASSUMPTIONS

7. The macroeconomic assumptions underlying this debt sustainability analysis (DSA) are as follows:

- **Growth.** Real GDP partly recovered in 2021, due to favorable base effects as tourist arrivals resumed, with 1.32 million arrivals (lower than 2019 arrivals of 1.7 million but exceeding the Article IV 2021 projections of 1 million arrival), on the back of a highly vaccinated population and opening of borders. Tourist arrivals have steadily risen and are approaching pre-pandemic levels. The continued strong expected recovery in the tourism sector (with about 1.63 million arrivals expected compared to 1.43 million projected during 2021 Article IV and slightly higher average bed nights) and associated spillovers to other sectors are expected to yield a robust real GDP growth of 10.5 percent in 2022. With the opening of the runway, the arrivals and bed-nights are expected to strengthen in 2023, and remain strong thereafter. Medium-term growth projections are also supported by the expansion of airport passenger (terminal) capacity to meet higher demand from airlines, particularly for the Velana International Airport in Male. The expansion of the Hannimandoo International Airport in the North could provide further boost to tourist reception capacity. The positive impact of increased airport and accommodation capacities on tourist flows and growth is expected to more than offset the negative impulse from the fiscal consolidation in the baseline, considering low fiscal multipliers in small states[7]. Complementary structural reforms, including plans for financial market deepening and to enhance skills in the tourism and hospitality sector are expected to improve labor productivity. Growth is expected to remain strong in 2023, but moderate, in line with the global economic slowdown.

- Headline **inflation** is projected to be higher than the Article IV 2021 projections, reaching 3.9 percent in 2022, reflecting the persistence of higher costs of energy, food, transportation, and healthcare observed through July 2022, spending pressures for the 2023 elections, and the end of discounts for telecommunication services. Inflation is projected to increase to about 4.9 percent in 2023, mostly reflecting the impact of the GST and TGST increases and is expected to stabilize in the medium term.

[6] The DSSI is a G20 initiative to help IDA-eligible countries cover the health costs of COVID-19. The original DSSI consisted of a suspension of interest and principal repayments due between May 1 and Dec. 31, 2020 from official bilateral creditors on direct debt. Private creditors were encouraged to participate. Two extensions of the DSSI were applied to suspend interest and principal payments falling due in 2021. The payment of suspended amounts will be NPV neutral. The suspended amounts from the original DSSI are to be repaid in three years with one-year grace. The amounts from the extension are to be repaid over 5 years with one-year grace.

[7] See Alichi et al. ,2019, https://www.imf.org/en/Publications/WP/Issues/2019/03/26/Fiscal-Policy-Multipliers-in-Small-States-46679. Complementary structural reforms would also support growth.

- **Risks to the outlook** are tilted to the downside, arising mainly from an economic slowdown in key source countries for tourists, threats of new more contagious COVID-19 variants, and tightening global financial conditions. A protracted war in Ukraine could add to inflationary pressures through higher food and energy prices and disruptions to supply chains. Slow implementation of macro critical structural reforms to boost productivity, revenue and exports, or a large currency depreciation with rising debt servicing costs without matching increases in domestic revenues could be a drag on growth. Diverting resources from growth friendly investment spending are other plausible risks. A resumption of tourist arrivals from China is an upside risk to growth.

- **Fiscal policy**. The primary fiscal deficit is projected to improve over the medium term. Still, high deficits are expected to persist in the medium-term, contributing to elevated public debt. Fiscal vulnerabilities remain high, despite a robust recovery in revenue. The fiscal (primary) deficit is expected to remain in double digits and peak in 2022, despite revenue performing strongly by end-September and projected to exceed the 2019 pre-pandemic level (higher than projected in the 2021 Article IV). The authorities anticipate expenditures to be higher than budgeted in 2022, as emerging spending pressures arise from increased subsidies, increased interest costs, sustained high infrastructure spending and reforms of the wage bill. To reduce budget financing risks in 2023, the authorities intend to mobilize revenue of around 2.7 percent of GDP by increasing the domestic and tourist GST rates from 6 to 8 percent and from 12 to 16 percent, respectively.[8] The increase in GST rates, which is included in the baseline, is one of the SDFP PPAs for FY23 and could provide an added incentive to implement this key tax policy reform measure. To support fiscal sustainability, the authorities also developed their medium-term fiscal strategy along four anchors: (i) reducing public debt excluding guarantees to less than 100 percent of GDP by 2025, (ii) reducing the primary budget deficit to less than 5 percent of GDP by 2023, (iii) maintaining public debt as a share of GDP on a downward trend, and (iv) reducing recurrent expenditure to levels that do not exceed government revenue by 2023.

- **There are a number of upside risks to the fiscal outlook including the implementation of a** subsidy reform for which the authorities have received Fund's technical assistance, and a reform of the pricing of medical consumables under the Aasandha health insurance scheme. These reforms would help generate fiscal efficiencies and savings. On the downside, the key risks include delays in implementation of revenue measures, materialization of additional spending pressures to shield against higher commodity prices and public investment cost overruns. Also, fiscal risks could arise from materialization of contingent liabilities and capital contributions to SOEs, mainly to repay their debt contracted with sovereign guarantees, and poor targeting of social assistance, including in social housing programs. For instance, social housing is not well-targeted based on income eligibility criteria and lease tariff is set at below market price. The

[8] The GST remains regressive as the effective tax rate is much lower for the better-off segments of the population, and there is considerable scope to identify further reforms that would, simultaneously or in combination, increase revenue mobilization while more effectively protecting the poor and vulnerable. A comprehensive welfare assessment of the tax and transfer system is being initiated this FY, which should provide the evidentiary basis for such reforms.

delinquency rate for social housing is also elevated at about 37 percent. Government's ambitious public infrastructure investment agenda, executed mainly by SOEs, has been a key driver of debt vulnerabilities.

- **Non-interest current account (CA) dynamics.** The external sector recovery has been set back by the impact of the war in Ukraine and reserves have come under pressure. The external financing pressures emanated originally from the authorities' expansionary, post-pandemic fiscal stance with an acceleration of capital spending. The non-interest current account deficit (CAD) improved temporarily (-6.8 percent of GDP), driven by higher tourism receipts in 2021. The non-interest current account deficit is projected to stay elevated at 8-12 percent of GDP over the medium term (above the 2021 Article IV projections), reflecting high import costs of fuel, food, and construction materials.

- **Financing assumptions.** Spending pressures arising mainly from subsidy payments and capital outlays, and an expected payment (US$250 million) in 2022 of a Eurobond, forced the authorities to access the global sukuk market, in the absence of access to sufficient concessional financing. The authorities raised US$500 million at a high cost (10.5 yield) maturing in 2026. The SDR allocation equivalent to US$29 million were added to reserves in 2021 and later in 2022 used for budget support.[9] External and total gross financing needs have been large and significantly above 2021 Article IV projections in the medium term, as authorities continue to take recourse to non-concessional and shorter-term financing. Going forward, the authorities do not plan for significant issuances from the international market prior to 2025. Most financing needs are ambitiously expected to be funded domestically in the medium term. As MMA's advances to the government are reaching their limits and additional domestic bank financing are expected to be constrained, a budget financing gap (unidentified financing) of around 1.7 percent of GDP could open in 2023. The debt sustainability framework assumes the unidentified financing as residual domestic financing.[10] The authorities recently contracted a US$100 million loan, with a three-year maturity in 2025 and a 7 percent interest rate. This together with the maturing US$500 million sukuk bonds and another US$100 million bond (Abu Dhabi) in 2026, will require refinancing starting in 2025. The Sukuk issuance program has been established for three-years with total value of US$1 billion. Moving ahead, the authorities plan to issue additional tranches as and when required together with the advice of the Islamic Corporation for

[9] The new SDR allocation was transferred in 2022 to the Ministry of Finance together with the associated liability and therefore recorded as external debt.

[10] The debt sustainability analysis does not include any financing gap at it assumes that unidentified financing is covered through domestic sources. Should domestic financing in this amount not materialize, the authorities will have to rationalize spending or increase revenue, to avoid the risk of accumulating domestic arrears or further monetization of the deficit. Both pending bills accumulation and central bank financing would likely raise Maldives' sovereign debt premium in an environment of tighter global financial conditions.

the Development of the Private Sector (ICD) and when market conditions become favorable.[11] The framework assumes refinancing in two parts:

i. A sukuk issuance of US$125 million in 2025 and maturing in 2030, followed by

ii. Another sukuk issuance of US$250 million in 2026 and maturing in 2031.

- Authorities would like to access concessional financing to mitigate roll-over of risk, particularly from the global sukuks. A large share of domestic financing in the Maldives was short term (maturity of less than one year). Interest rates on short-term debt have ranged between 3.7 and 4.5 percent since December 2016. Over the medium term, we assume that around 65 percent of domestic financing is short term with an interest rate of 4 percent and that the share of long-term debt gradually increases over time.

Macroeconomic Assumptions

	2021	2022	2023	2024	2025	2026	2027	27-40
		proj.						
Real GDP growth (in percent change)								
Current	37.0	10.5	6.6	5.7	6.5	5.9	5.5	4.9
Previous	18.9	13.2	12.1	6.1	5.4	5.4	5.4	4.6
Inflation								
Current	0.2	3.9	4.9	2.4	2.0	2.0	2.0	2.0
Previous	1.4	2.3	1.9	1.8	2.0	2.0	1.8	2.0
Primary fiscal deficit (in percent of GDP)								
Current	11.7	11.0	6.2	6.1	2.3	1.3	1.0	0.5
Previous	14.2	9.0	5.7	3.9	3.3	4.0	0.4	0.5
Non-interest current account deficit (in percent of GDP)								
Current	6.8	15.4	13.3	12.0	12.1	8.5	8.2	6.6
Previous	13.7	11.9	7.1	7.2	6.9	6.6	5.0	4.6
Grants (in percent of GDP)								
Current	1.3	1.1	1.5	0.8	0.7	0.6	0.6	0.3
Previous	2.1	2.7	2.3	1.4	0.9	0.8	0.7	0.3
Capital Expenditures (in percent of GDP)								
Current	11.0	13.2	8.9	9.2	6.5	5.6	5.3	4.4
Previous	15.6	13.9	12.4	11.3	10.2	10.8	7.0	7.0
Public Debt (in percent of GDP)								
Current	124.3	122.6	117.5	117.7	112.9	107.7	103.2	81.0
Previous	137.2	133.3	128.2	128.4	126.8	122.9	118.6	100.3

8. **Debt dynamics in the Maldives will be mostly driven by growth in the medium-term, but also by primary fiscal deficits, and nominal interest rates (Figure 5).** In the past, the current account deficit and the primary fiscal deficit have been the main contributors to the accumulation of external and domestic debt, respectively. Large residuals, which mostly reflect stock-flow adjustment, has also contributed to public debt accumulation. Over the next five years, growth will be the dominating driver, countering the expansion of nominal external interest cost. Domestic debt dynamics over the next five years are balanced by growth and by the primary fiscal deficit, leading to a moderate decline in projected

[11] The first tranche of USD 200 million was issued on 08th April 2021, with a tap on the same series on 30th April, of USD 100 million, and another US$200 million later in September 2021, leaving another US$500 million to access, of which a total of US$375 million is assumed to be used in the baseline for rollover.

debt-to-GDP ratios. As with the last DSA, gross financing needs continue to breach their indicative benchmark, reflecting higher borrowing needs arising from both exogenous shocks and domestic spending push.

9. The realism tool for the baseline projections picks up the substantial size of the authorities' capital investment plans over the next few years (Figure 6). The improvement in the primary balance-to-GDP ratio between 2021 and 2024 is driven by a return to more moderate levels of capital spending and a recovery in GDP but at a more gradual and realistic pace of adjustment than in the previous DSA, reflecting election related spending pressures until 2023.[12] Given the extraordinary nature behind the swings in growth rates, largely driven by changes in tourism, the multiplier approach is not a suitable way to calculate alternative growth paths. The baseline fiscal adjustment is at the 94th percentile of LIC programs. The Government of Maldives signed lines of credit for more than US$1.2 billion with EXIM Bank India. The largest, for US$800 million and US$400 million, were signed in March 2019 and October 2020, respectively, to finance several infrastructure projects including the development of the Gulhifalhu Port and relocation of Male Commercial Harbour, the Greater Male' Connectivity Project, construction of social housing units, and water and sanitation projects. While the disbursement from these commitments is expected to be slow, the government is inclined to continue with these projects to avoid sudden stops and disruptions while limiting new projects. Critical projects for growth such as the expansion of the airport in Male are expected to continue.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TEST

10. The debt carrying capacity of the Maldives remains weak. The composite indicator (CI) score is 2.40 (less than the 2.69 threshold) using the April 2022 WEO and the 2022 World Bank Country Policy and Institutional Assessment (CPIA). The CI is based on a weighted average of several factors such as the country's real GDP growth, remittances, international reserves, world growth, and the CPIA score. The calculation of the CI is based on 10-year averages of the variables, across five years of historical data and five years of projections, and the corresponding CPIA.

11. Tailored stress tests for natural disasters, contingent liabilities, and market financing are relevant for the Maldives. The Maldives is susceptible to rising sea levels and rising global interest rates are expected to impact around 4 percent of budgetary external debt and a large share of outstanding external guaranteed debt (around US$750 million) that are linked to the SOFR.[13] The tailored stress tests were kept to their default calibrations as these are appropriate for the Maldives. The tailored stress tests are not the most extreme shocks for any of the debt indicators. The most extreme shocks are the shock to

[12] Of note is the large contribution of residuals to changes in total external debt and attributed to movements in private sector, primarily tourism resorts, debt-creating inflows and outflows.

[13] "Nearly 98 percent of the existing debt is based on fixed interest rate instruments," page 10, Debt Bulletin, Issue 8, December 2021, Debt Management Department, Ministry of Finance. Variable rate facilities are a small component of the entire debt portfolio – about 4 percent of the direct debt and 15 percent of PPG debt.

exports for the PPG external debt indicators, and the shock to growth for the public debt indicators and external debt service to revenue indicator.

Country Classification

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintages
Weak	Weak	Weak	Weak
	2.40	2.58	2.53

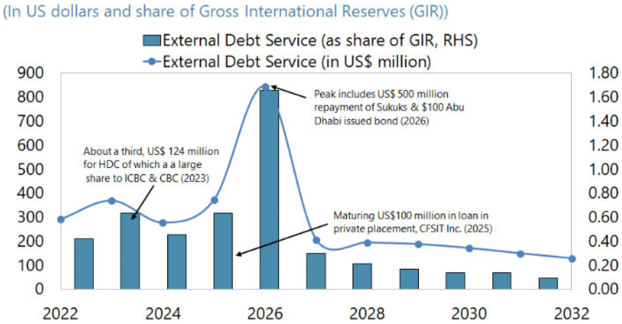
EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

12. Three of the four external debt indicators are above their respective thresholds under the baseline scenario (Figure 3). Maldives remains at a high risk of external debt distress even though growth in 2021 surprised on the upside. As a result, the external debt indicators have improved since the last DSA.[14] The PPG external public debt-to-GDP ratio in the baseline scenario is projected to decrease by around 20 percentage points, from 55 percent of GDP in 2022 to around 35 percent. However, the PV of the PPG external debt-to-GDP ratio will remain above the threshold of 30 percent until 2026 (2030 in the previous DSA), after which it will converge and then fall below the threshold by 2027. Meanwhile, the PV of the debt-to-exports ratio is below its threshold in the baseline scenario as in the last DSA. Both liquidity indicators, the debt service-to-exports ratio and the debt service-to-revenue ratio, breach their thresholds under the baseline scenario due to elevated debt service obligations on existing external PPG debt as in the last DSA.

13. The authorities have been proactive in managing near term external rollover risks and need to address the bunching of payments in the medium term, but external gross financing needs have increased as a share of gross international reserves since Article IV 2021. In 2021 the authorities issued US$500 million in a Sukuk with a five-year maturity and a bullet repayment in 2026. However, the Sukuk was costly with a coupon of around 9.9 percent and a yield of 10.5 percent. Of the US$500 million, US$200 million of the Sukuk issuance was used to repay 77 percent of the maiden US$250 million Eurobond due in June 2022, mitigating rollover risks. The maturity of the privately placed (Abu Dhabi) US$100 million bond was renegotiated in 2019 and extended by three years to 2026. Since the privately placed Abu Dhabi bond and the Sukuk will be due in 2026, this year exhibits a spike in debt service payments. The authorities also need to address the exposure to SOFR. The reprofiling of the debt under the DSSI has also increased debt repayment in the

Maldives: External Vulnerabilities and Debt Service

(In US dollars and share of Gross International Reserves (GIR))



Source: IMF Staff Estimates.

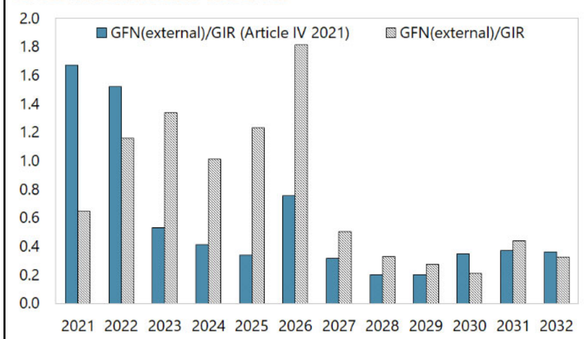
Note: Framework assumes roll over i.) A bond issuance of US$100 million in 2025 and maturing in 2030, ii) followed by another bond issuance of US$225 million in 2026 and maturing in 2031.

[14] Annual IDA disbursements from 2022 until the end of the projection period are assumed on small economy terms.

medium term, though amounts are relatively small.[15] The authorities created a sovereign development fund (SDF) in 2017 to mitigate the rollover risk from Eurobonds with accumulated funds in Rufiyaa equivalent to above US$270 million as of 1st September 2022.[16] The authorities are considering ways to restructure the SDF to act as a buffer and Fund TA has been requested. In the medium-term, rollover risks associated with commercial bonds, higher debt servicing costs, and continued borrowing to finance large fiscal deficits in the baseline lead to protracted breaches in several external debt indicators, making debt not sustainable under the baseline (Figure 3).

14. Overall public debt indicators suggest a high overall risk of debt distress (Figure 4). The total PPG debt-to-GDP ratio declined by around 30 percentage points in 2021 to around 124 percent on the back of higher tourism led-GDP and is expected to decline to around 103 percent of GDP by 2027.[17] Given Maldives' weak debt carrying capacity, the threshold on overall PV of debt-to-GDP is 35 percent. The Maldives breaches this threshold for the entire projection period. The domestic debt market is an important source of financing for the government with domestic debt making up 53 percent of total PPG debt in 2021 (about 62 percent is short-term). It is worth noting in this context that although the Maldives qualifies for PRGT resources and thus uses the LIC DSF, the structure of the economy is closer to an EM given the level of the country's development and GDP-per capita (close to US$8400 and continue to be in the Upper Middle-Income category). The Maldives has been able to access capital markets in recent years and foresees up to a $500 million of further issuance under its global sukuk program (see footnote 11). Nonetheless, the debt-to-GDP ratio of the Maldives is well-above the pre-pandemic ratio of around 80 percent under the baseline. A sustained adjustment of around 3 percent of GDP however, beyond GST, would help to lower the PV of public debt below 70 (50) percent of GDP by 2032 (2042). The IMF and the WB are both providing debt management technical assistance to the authorities. With gross financing needs remaining elevated, the authorities should develop a medium-term debt management plan.[18] The Ministry of Finance is committed to transparency and formulates and publishes its medium-term debt strategy on its website annually. In addition, a public debt bulletin is published biannually and figures on debt outstanding are published quarterly.

Maldives: Gross External Financing Need as a Share of Gross International Reserves



Sources: Maldives Ministry of Finance; and IMF staff estimates.

[15] The authorities applied for the DSSI and both extensions. Relief in 2020 is US$19 million, and for 2021 estimated at US$69 million.

[16] The authorities set up the Sovereign Development Fund (SDF) in 2017 collecting Airport Development Fee and dividends from the state-owned airport operator to repay the external loans related to the expansion of the international airport.

[17] The decline in total PPG debt-to-GDP ratio was projected at 9 percentage points between 2020 to 2021 in the 2021 Article IV.

[18] Performance and policy actions (PPA) under IDA's SDFP are being carried out to strengthen debt transparency and debt management. Maldives is an IDA only country and is borrowing on small economy terms.

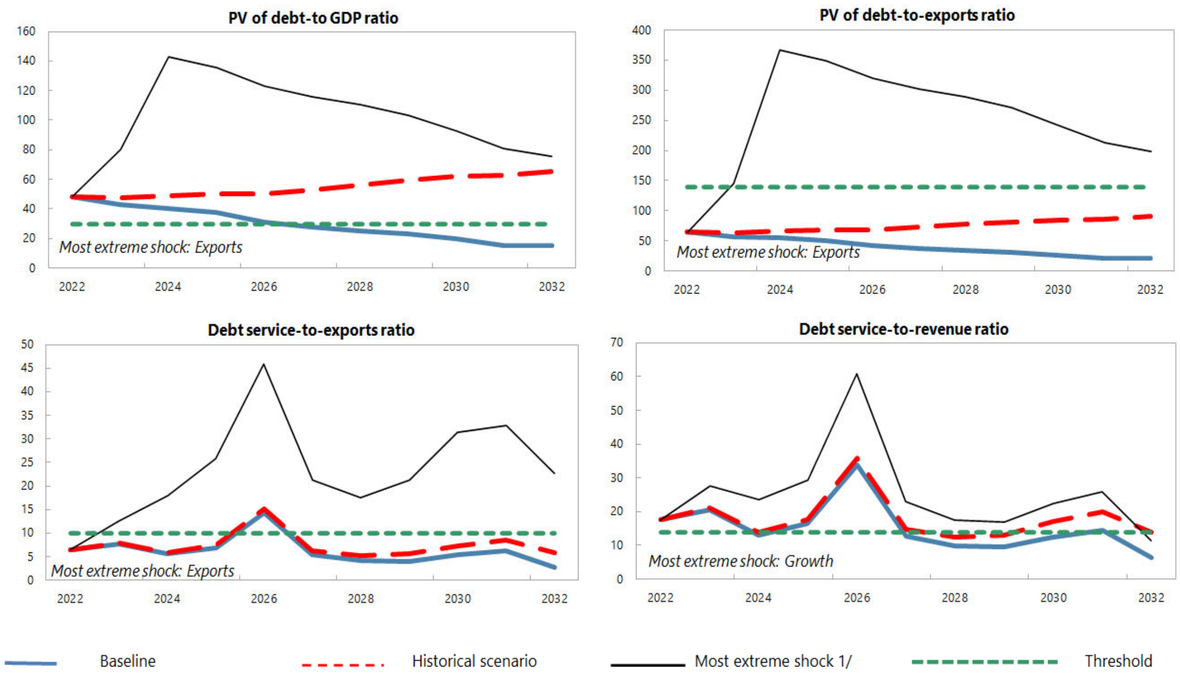
VULNERABILITY ASSESSMENT

15. Maldives has a high risk of external and overall debt distress. Some debt indicators, such as the public debt-to-GDP ratio, have improved in the near term, compared to the previous September 2021 Debt Sustainability Analysis (DSA). This improvement reflects the robust recovery in tourism and growth in 2021. The PV of the PPG external debt-to-GDP ratio will converge to the 30 percent threshold and then fall below the threshold by 2027. Nevertheless, external gross financing needs have increased significantly relative to the 2021 DSA. The external position from 2022 onwards is expected to weaken relative to the 2021 DSA due to higher commodity prices exacerbated by the war in Ukraine and deeper fiscal spending pressures arising from subsidies and authorities expanded medium-term public investment program. Financing the larger fiscal deficit has turned more difficult and expensive, triggering the need to extend the suspension of elements of the FRA to allow the increased cap on MMA advances for two years, beyond what was envisaged in April 2020, until 2023 (a one-year extension was expected during 2021 Article IV). The authorities are, and have been, current on debt service obligations to both domestic and external creditors. While the recent Sukuk issuance partially mitigates rollover risks, high debt servicing costs through the medium-term and continued borrowing, with shorter tenure, to finance large fiscal deficits lead to protracted breaches in several debt indicators over the medium term. As such, debt is assessed to be not sustainable under the baseline projections.

16. Addressing debt vulnerabilities requires balanced and sustained fiscal consolidation and continued strong growth. In addition to the planned increase of GST rates, which is included in the baseline, a sustained adjustment of around 3 percent of GDP, would help lower the PV of public debt below 70 (50) percent of GDP by 2032 (2042) and put debt on a sustained downward path, although liquidity ratios would remain elevated over the medium term (text charts right below). Fiscal consolidation should include rationalizing capital spending, especially in large public investment projects carried out by the central government or SOEs and improving the targeting of social assistance, including in social housing programs. It should also comprise streamlining current expenditures – both subsidies and containing wage increases and further domestic revenue mobilization. Staff noted the authorities' adoption of fiscal anchors in their 2023–2025 medium-term fiscal strategy to support fiscal sustainability. However, more effort is needed, and on-going reforms are being implemented to improve governance and public financial management (PFM). The debt dynamics over the medium-term will remain vulnerable to adverse shocks to growth, interest rates (due to SOFR-linked debt, including a large share of guaranteed external debt and about 4 percent of direct budgetary debt), and the fiscal position. Authorities don't plan to access significant amounts of expensive external financing until 2025 and would like access to concessional financing to mitigate roll-over of risk, particularly from the global sukuks. In this regard there is a need for greater coordination amongst donors supporting the Maldives' development strategy, including through a creditor outreach event. The authorities will consider a new FX swap agreement under the existing South Asian Association for Regional Cooperation (SAARC) framework 2019-2022, which has been extended till 30 June 2023, should the need arise. These factors and a resumption of tourist arrivals from China- which is an upside risk to growth – could be useful in addressing and mitigating in part the debt service cliff in 2026.

Figure 1. Maldives: Indicators of Public and Publicly Guaranteed External Debt under Fiscal Consolidation Scenario, 2022–2032 1/

(In percent, unless otherwise mentioned)



Customization of Default Settings	Size	Interactions
Tailored Stress		
Combined CL	No	
Natural disaster	No	No
Commodity price	n.a.	n.a.
Market financing	No	No

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

Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	2.8%	2.8%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	21	21
Avg. grace period	5	5

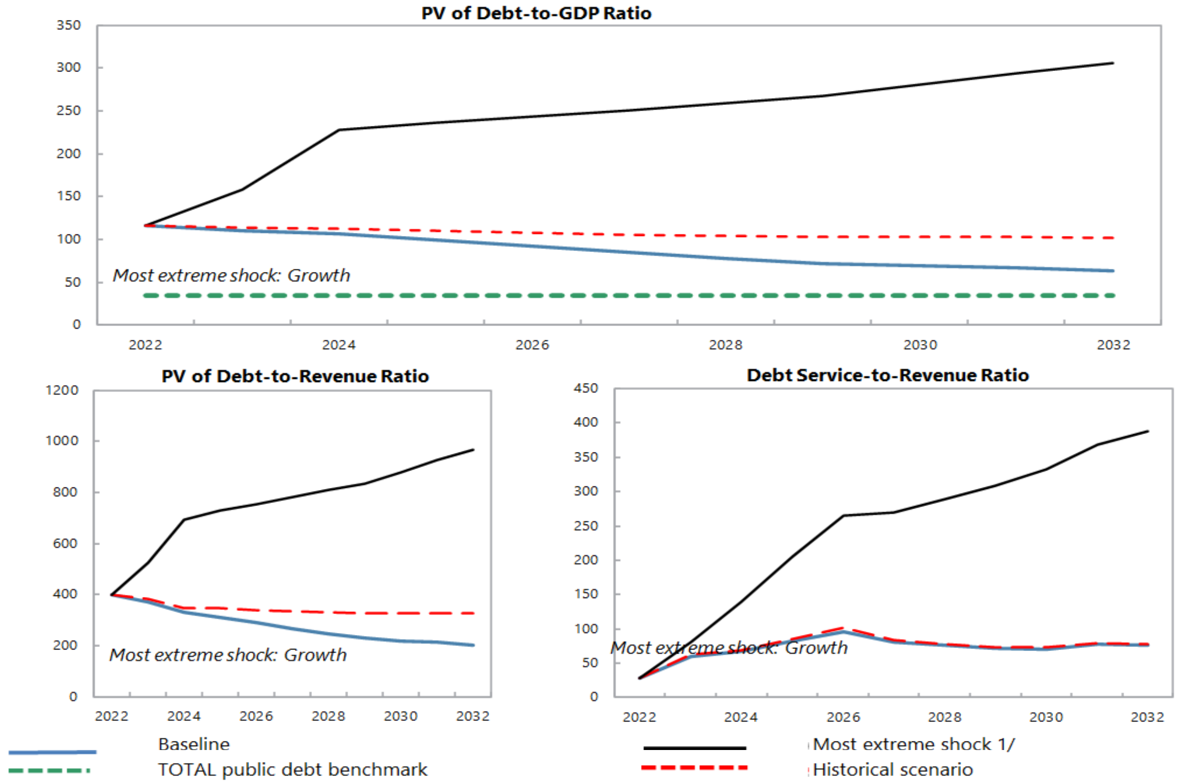
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 2. Maldives: Indicators of Public Debt under Fiscal Consolidation Scenario, 2022–2032

(In percent)



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	14%	14%
Domestic medium and long-term	30%	30%
Domestic short-term	56%	56%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	2.8%	2.8%
Avg. maturity (incl. grace period)	21	21
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	2.5%	2.5%
Avg. maturity (incl. grace period)	3	3
Avg. grace period	1	1
Domestic short-term debt		
Avg. real interest rate	1.5%	1.5%

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

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

AUTHORITIES' VIEWS

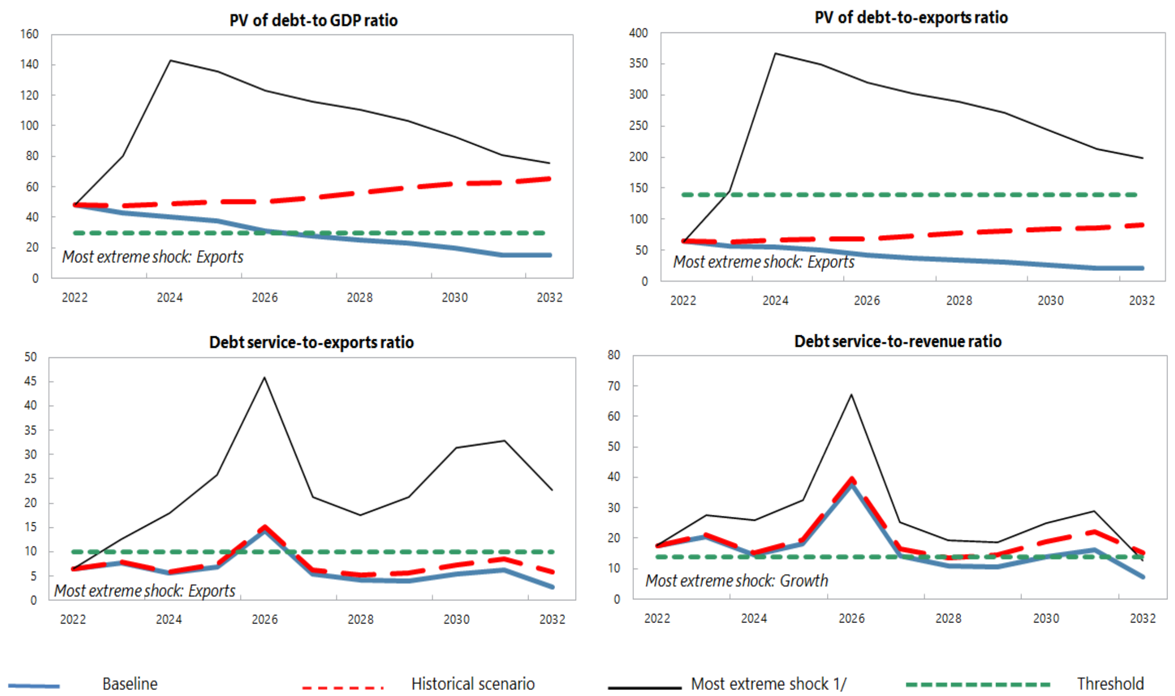
17. The authorities agree that the risk of external debt distress and overall risk of debt distress remains high.

The authorities emphasized that understanding the context of the COVID-19 shock and the subsequent and persistent commodity price shocks is important in assessing debt sustainability. Following the severe shock to GDP that led to a spike of the debt-to-GDP ratio, persistent oil and food price shocks offset the improvement that the post-pandemic tourism rebound could have brought. Given the severity of these exogeneous and global shocks, the authorities suggested that a more nuanced view beyond the LIC DSF model is needed. The authorities highlighted that any assessment on debt sustainability should give credit to the close to concessional nature of the existing debt stock. 86 percent of the direct external debt portfolio has an interest rate below 3 percent, and for external PPG debt this is around 55 percent. While the Maldives remains at a high risk of external debt distress and a high overall risk of debt distress, the US$100 million private placement in 2022 and the 2021 Sukuk issuance—US$500 million— helped the country mitigate rollover risks in the near term by shifting the amortization and interest payments to 2025 and 2026, respectively. The authorities also highlighted that the market yield of the Sukuk bonds responded positively to the announcement of tax hikes in 2023. As the cost of issuing debt on the capital market is expected to be high in this environment of increasing policy rates by central banks of advanced economies, the revised financing strategy does not include significant issuances to the international market prior to 2025, (2023–2025 fiscal strategy). The next significant issuance, amounting to US$200 million, is expected to go forward in 2025 by issuing either a conventional bond or a sukuk, (2023–2025 fiscal strategy). Between now and then, the strategy to obtain foreign financing is to rely primarily on concessional financing from bilateral or multilateral sources. As such, it is planned to raise US$100 million per annum in concessional foreign financing over the next three years, (2023–2025 fiscal strategy).

18. Moving forward, the authorities are committed to a fiscal consolidation path that will bring debt down to a sustainable path as laid out in the 2023–2025 fiscal strategy statement. The authorities will consider a new FX swap agreement under the existing SAARC framework 2019-2022, which has been extended till 30 June 2023, should the need arise. The authorities noted that the Sovereign Development Fund (SDF) established in 2017 to set aside funds for future debt repayment obligations of the Maldives, has reached the equivalent of above US$270 million as of 1st September 2022. However, most of the SDF funds is invested in T-bills denominated in Rufiyaa. With the recent increase in Airport Development Fee rates and the forecasted recovery in the tourist arrivals, the SDF size will continue to grow in the coming years. Currently the government, with technical assistance from the Fund, is working to strengthen the legal status and governance of the SDF. The IMF is also helping with the drafting of the Public Debt law, which is a part of the Government's legislative agenda.

Figure 3. Maldives: Indicators of Public and Publicly Guaranteed External Debt Under Baseline Scenario, 2022–2032 1/

(In percent, unless otherwise mentioned)



Customization of Default Settings	Size	Interactions
Tailored Stress		
Combined CL	No	
Natural disaster	No	No
Commodity price	n.a.	n.a.
Market financing	No	No

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

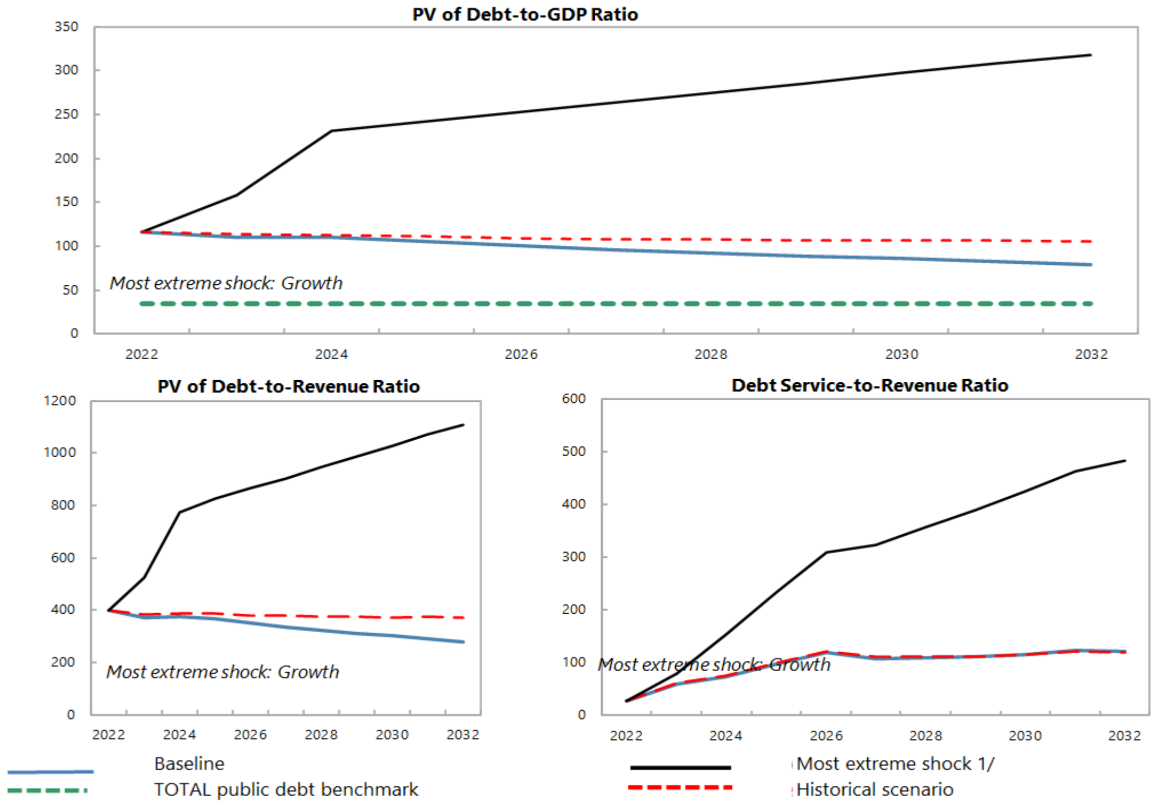
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	2.8%	2.8%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	21	21
Avg. grace period	5	5

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

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 4. Maldives: Indicators of Public Debt Under Baseline Scenario, 2022–2032 1/
(In percent)



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	12%	12%
Domestic medium and long-term	31%	31%
Domestic short-term	57%	57%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	2.8%	2.8%
Avg. maturity (incl. grace period)	21	21
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	2.5%	2.5%
Avg. maturity (incl. grace period)	3	3
Avg. grace period	1	1
Domestic short-term debt		
Avg. real interest rate	1.5%	1.5%

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

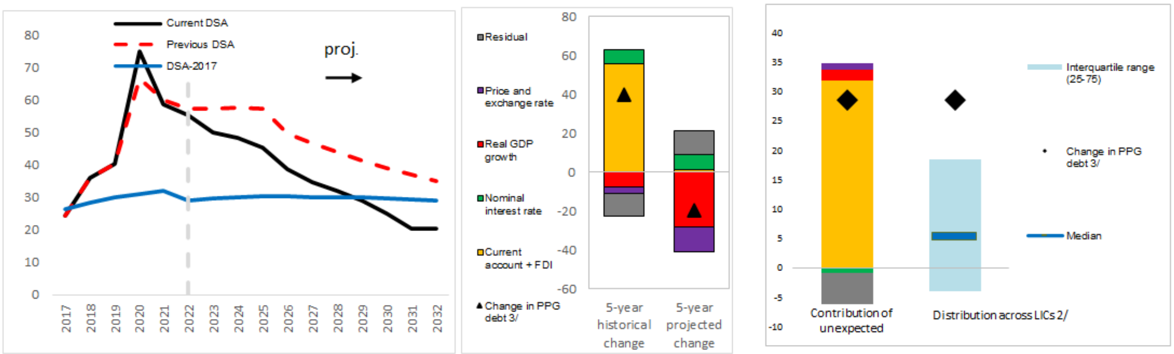
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 5. Maldives: Drivers of Debt Dynamics – Baseline Scenario

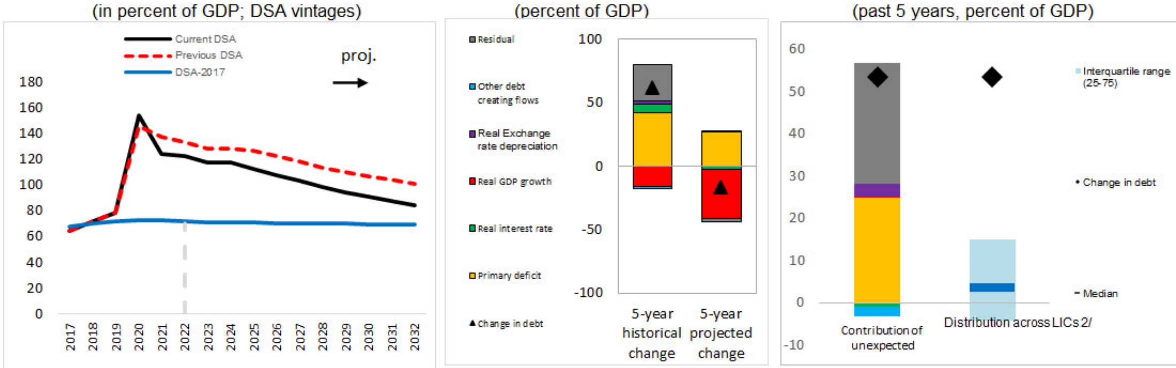
External Debt

Gross Nominal PPG External Debt (in percent of GDP; DSA vintages) | Debt-creating flows (percent of GDP) | Unexpected Changes in Debt 1/ (past 5 years, percent of GDP)



Public Debt

Gross Nominal Public Debt (in percent of GDP; DSA vintages) | Debt-creating flows (percent of GDP) | Unexpected Changes in Debt 1/ (past 5 years, percent of GDP)



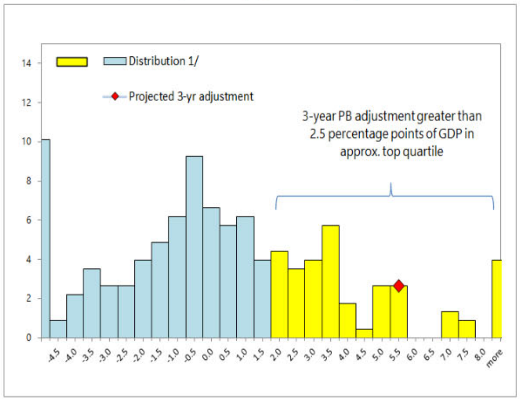
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

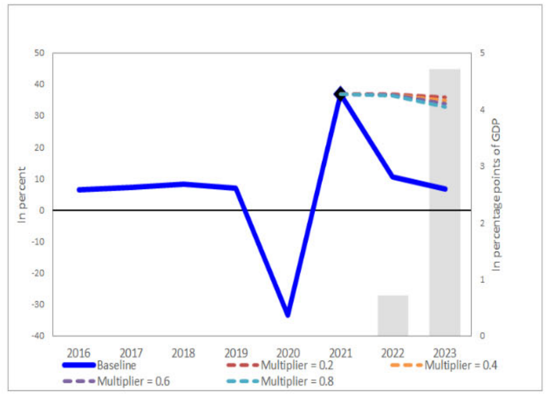
Figure 6. Maldives: Realism Tools- Baseline Scenario

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



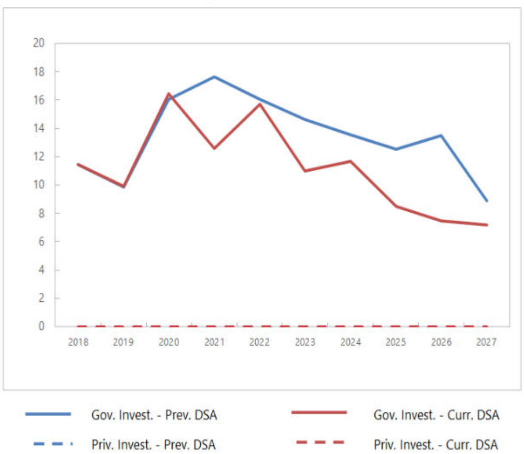
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



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

Public and Private Investment Rates
(percent of GDP)



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

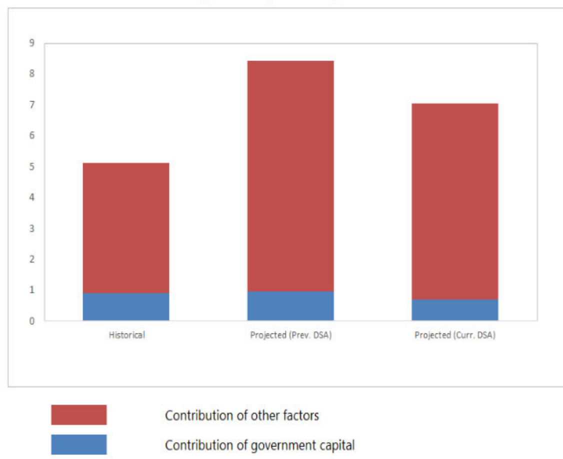
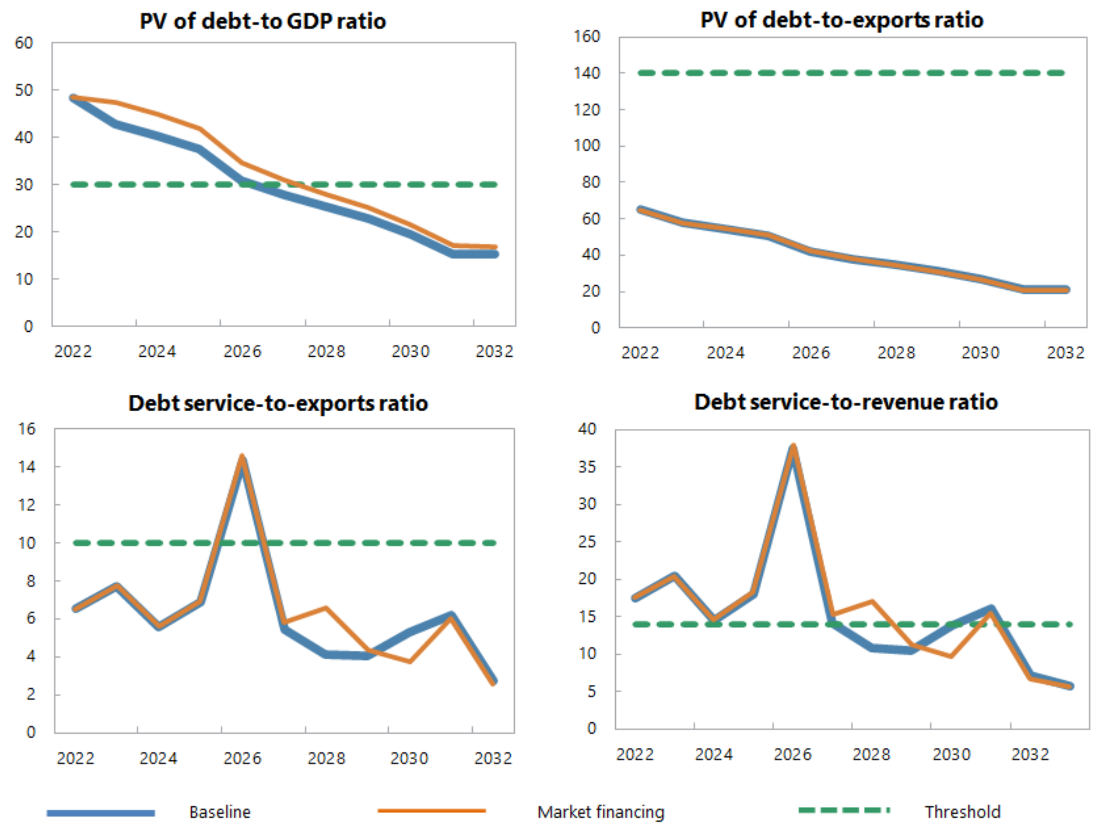


Figure 7. Maldives: Market-Financing Risk Indicators-Baseline Scenario

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	28	n.a.
Breach of benchmark	Yes	n.a.
Potential heightened liquidity needs	Moderate	

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



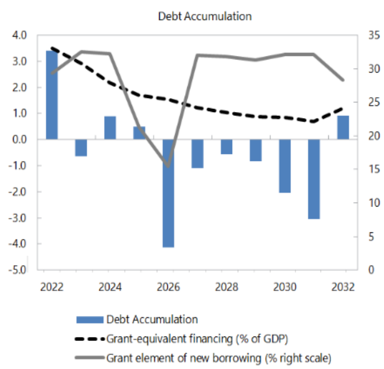
Sources: Country authorities; and staff estimates and projections.

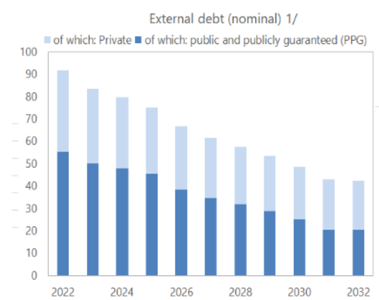
Table 1. Maldives: External Debt Sustainability Framework, Baseline Scenario, 2019–2042 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2032	2042	Historical	Projections
External debt (nominal) 1/	70.8	129.1	100.8	91.9	83.5	79.7	75.1	66.6	61.5	42.3	41.4	54.4	63.9
of which: public and publicly guaranteed (PPG)	40.3	74.8	58.5	55.3	49.9	48.1	45.4	38.4	34.7	20.4	25.2	33.6	36.2
Change in external debt	6.6	58.3	-28.3	-8.9	-8.5	-3.8	-4.6	-8.5	-5.1	-0.8	0.3		
Identified net debt-creating flows	6.0	59.0	-36.1	-4.7	-2.3	-2.6	-3.1	-6.4	-6.1	-3.0	-1.7	3.8	-4.6
Non-interest current account deficit	25.7	32.6	6.8	15.4	13.3	12.0	12.1	8.5	8.2	6.6	5.7	15.8	9.1
Deficit in balance of goods and services	6.2	17.7	-8.6	-0.6	-1.2	-1.8	-1.6	-5.0	-5.0	-7.0	-4.0	-2.1	-4.8
Exports	66.9	47.8	75.9	74.8	74.2	74.0	73.7	73.1	73.1	72.2	70.6		
Imports	73.1	65.5	67.3	74.2	73.0	72.2	72.1	68.2	68.1	65.2	66.6		
Net current transfers (negative = inflow)	10.4	9.6	8.1	8.9	7.8	7.3	7.2	7.1	6.9	7.7	3.9	9.7	7.5
of which: official	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other current account flows (negative = net inflow)	9.1	5.3	7.3	7.1	6.7	6.6	6.5	6.4	6.3	6.0	5.8	8.2	6.4
Net FDI (negative = inflow)	-17.2	-11.8	-8.5	-12.0	-12.0	-12.0	-12.0	-12.0	-12.0	-8.0	-6.0	-10.4	-10.8
Endogenous debt dynamics 2/	-2.6	38.2	-34.4	-8.2	-3.6	-2.6	-3.2	-2.9	-2.3	-1.6	-1.4		
Contribution from nominal interest rate	0.9	2.9	2.0	1.1	1.9	1.8	1.6	1.2	1.1	0.4	0.5		
Contribution from real GDP growth	-4.2	35.5	-34.2	-9.2	-5.5	-4.4	-4.7	-4.1	-3.4	-2.0	-1.9		
Contribution from price and exchange rate changes	0.7	-0.3	-2.2	...	...	...	...	...	...	...	...		
Residual 3/	0.7	-0.7	7.8	-4.1	-6.2	-1.2	-1.4	-2.1	1.1	2.2	2.0	2.5	-0.7
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	52.3	48.5	42.8	40.3	37.6	31.0	27.7	15.3	19.0		
PV of PPG external debt-to-exports ratio	...	...	68.9	64.8	57.6	54.5	51.0	42.3	37.9	21.1	27.0		
PPG debt service-to-exports ratio	5.1	17.7	8.0	6.5	7.7	5.6	6.9	14.4	5.4	2.8	2.5		
PPG debt service-to-revenue ratio	13.4	34.1	24.0	17.6	20.4	14.5	18.1	37.5	14.1	7.1	6.1		
Gross external financing need (Million of U.S. dollars)	919.7	1366.6	521.0	803.5	777.7	616.8	727.2	922.9	350.8	461.6	897.8		
Key macroeconomic assumptions													
Real GDP growth (in percent)	6.9	-33.5	37.0	10.5	6.6	5.7	6.5	5.9	5.5	4.9	4.9	5.2	6.0
GDP deflator in US dollar terms (change in percent)	-1.1	0.4	1.7	3.9	4.9	2.4	2.0	2.0	2.0	2.0	0.6	3.2	2.5
Effective interest rate (percent) 4/	1.5	2.8	2.1	1.2	2.3	2.3	2.1	1.8	1.8	0.9	1.3	1.8	1.7
Growth of exports of G&S (US dollar terms, in percent)	4.4	-52.3	121.1	13.2	11.0	8.0	8.1	7.3	7.7	6.6	6.1	11.4	8.1
Growth of imports of G&S (US dollar terms, in percent)	-0.3	-40.1	43.0	26.7	10.0	7.0	8.5	2.2	7.6	8.7	7.6	6.5	8.4
Grant element of new public sector borrowing (in percent)	...	...	...	29.3	32.5	32.2	21.3	15.4	32.0	28.3	25.5	...	29.0
Government revenues (excluding grants, in percent of GDP)	25.6	24.8	25.3	27.8	28.1	28.4	28.0	28.0	28.0	28.0	28.7	25.4	28.1
Aid flows (in Million of US dollars) 5/	74.9	62.2	67.0	179.9	167.6	128.6	115.7	111.3	100.9	120.9	153.6		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	3.5	2.9	2.2	1.7	1.5	1.2	1.2	0.9	...	1.6
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	37.8	49.8	42.6	31.9	24.0	48.9	35.8	27.9	...	43.6
Nominal GDP (Million of US dollars)	5,598	3,736	5,204	5,976	6,684	7,237	7,859	8,492	9,142	12,853	24,581		
Nominal dollar GDP growth	5.7	-33.3	39.3	14.8	11.8	8.3	8.6	8.1	7.7	7.0	5.5	8.6	8.6
Memorandum items:													
PV of external debt 7/	...	...	94.5	85.1	76.3	71.9	67.3	59.2	54.6	37.1	35.3		
In percent of exports	...	...	124.5	113.8	102.8	97.2	91.4	80.9	74.6	51.4	50.0		
Total external debt service-to-exports ratio	11.8	33.0	15.4	13.4	14.0	11.5	12.5	19.7	10.5	6.9	5.6		
PV of PPG external debt (in Million of US dollars)			2720.7	2898.0	2858.8	2918.6	2954.5	2629.8	2536.7	1960.3	4680.1		
(PVt-PVt-1)/GDPt-1 (in percent)				3.4	-0.7	0.9	0.5	-4.1	-1.1	0.9	1.4		
Non-interest current account deficit that stabilizes debt ratio	19.1	-25.7	35.1	24.3	21.7	15.8	16.6	17.0	13.2	7.4	5.4		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	Yes





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) + Εα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ε=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

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

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

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

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

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

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

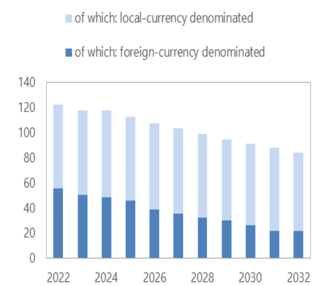
Table 2. Maldives: Public Sector Debt Sustainability Framework, Baseline Scenario, 2019–2042

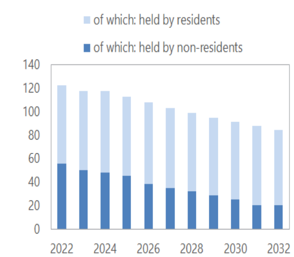
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2032	2042	Historical	Projections
Public sector debt 1/	78.8	154.4	124.3	122.6	117.5	117.7	112.9	107.7	103.2	84.5	66.5	78.0	103.5
of which: external debt	40.3	74.8	58.5	55.3	49.9	48.1	45.4	38.4	34.7	20.4	25.2	33.6	36.2
Change in public sector debt	6.8	75.6	-30.1	-1.7	-5.1	0.3	-4.9	-5.1	-4.5	-3.4	-1.4		
Identified debt-creating flows	3.0	60.4	-27.1	-4.5	-2.7	0.5	-3.8	-4.1	-3.7	-3.1	-1.8	3.5	-3.1
Primary deficit	4.9	20.7	11.7	11.0	6.2	6.1	2.3	1.3	1.0	0.2	-0.4	6.2	2.7
Revenue and grants	26.9	26.4	26.6	28.9	29.6	29.2	28.8	28.7	28.7	28.4	28.8	26.3	28.8
of which: grants	1.3	1.7	1.3	1.1	1.5	0.8	0.7	0.6	0.6	0.4	0.1		
Primary (noninterest) expenditure	31.8	47.2	38.3	39.8	35.9	35.3	31.1	30.0	29.7	28.6	28.4	32.5	31.4
Automatic debt dynamics	-2.2	43.1	-38.8	-15.4	-9.0	-5.6	-6.1	-5.4	-4.7	-3.3	-1.4		
Contribution from interest rate/growth differential	-3.2	42.6	-40.1	-15.4	-9.0	-5.6	-6.1	-5.4	-4.7	-3.3	-1.4		
of which: contribution from average real interest rate	1.4	2.9	1.6	-3.6	-1.3	0.7	1.1	0.9	1.0	0.8	1.8		
of which: contribution from real GDP growth	-4.6	39.7	-41.7	-11.8	-7.6	-6.3	-7.2	-6.3	-5.7	-4.1	-3.2		
Contribution from real exchange rate depreciation	1.0	0.5	1.3	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	0.3	-3.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	0.0
Privatization receipts (negative)	0.3	-3.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	3.8	15.2	-3.0	2.8	-2.4	-0.2	-1.1	-1.0	-0.8	-0.3	0.3	3.6	-0.5
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	118.0	115.8	110.3	110.0	105.1	100.3	96.3	79.3	60.4		
PV of public debt-to-revenue and grants ratio	...	...	443.2	400.9	372.0	376.5	365.4	349.5	335.9	279.6	209.6		
Debt service-to-revenue and grants ratio 3/	26.4	48.7	146.1	28.6	60.5	73.8	97.2	119.2	108.3	121.0	42.2		
Gross financing need 4/	12.3	30.2	50.6	19.2	24.2	27.7	30.3	35.5	32.0	34.5	11.8		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	6.9	-33.5	37.0	10.5	6.6	5.7	6.5	5.9	5.5	4.9	4.9	5.2	6.0
Average nominal interest rate on external debt (in percent)	2.7	4.8	3.7	2.1	3.9	3.8	3.5	2.9	3.1	1.9	2.2	2.8	3.0
Average real interest rate on domestic debt (in percent)	3.3	1.2	3.1	-1.9	-2.4	-0.2	0.5	0.7	0.9	1.3	4.2	0.7	0.3
Real exchange rate depreciation (in percent, + indicates depreciation)	2.9	0.8	2.4	...	...	...	...	...	...	...	...	-1.1	...
Inflation rate (GDP deflator, in percent)	-1.1	0.4	1.7	3.9	4.9	2.4	2.0	2.0	2.0	2.0	0.6	3.2	2.5
Growth of real primary spending (deflated by GDP deflator, in percent)	10.7	-1.5	11.2	15.0	-4.0	4.0	-6.4	2.3	4.4	4.0	2.7	7.5	3.3
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-1.9	-54.9	41.8	12.6	11.3	5.8	7.1	6.4	5.5	3.6	1.1	-5.0	6.3
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**Yes**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt . Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

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

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

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

Table 3. Maldives: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt-Baseline Scenario, 2022–2032

(In percent)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
PV of debt-to GDP ratio											
Baseline	**48**	**43**	**40**	**38**	**31**	28	25	23	20	15	15
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	**48**	**47**	**49**	**50**	**50**	**53**	**56**	**59**	**62**	**63**	**65**
B. Bound Tests											
B1. Real GDP growth	**48**	**58**	**72**	**67**	**56**	**50**	**45**	**41**	**35**	28	27
B2. Primary balance	**48**	**43**	**43**	**40**	**34**	**31**	29	27	23	19	19
B3. Exports	**48**	**80**	**143**	**135**	**123**	**116**	**110**	**104**	**93**	**81**	**75**
B4. Other flows 3/	**48**	**49**	**53**	**50**	**43**	**39**	**37**	**34**	29	24	23
B5. Depreciation	**48**	**53**	**49**	**45**	**37**	**33**	**30**	27	23	18	18
B6. Combination of B1-B5	**48**	**72**	**84**	**79**	**69**	**63**	**59**	**54**	**48**	**40**	**38**
C. Tailored Tests											
C1. Combined contingent liabilities	**48**	**43**	**41**	**39**	**33**	29	27	25	22	18	18
C2. Natural disaster	**48**	**44**	**42**	**40**	**34**	**31**	29	27	24	20	20
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**48**	**48**	**45**	**42**	**35**	**31**	28	25	22	17	17
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	65	58	54	51	42	38	35	32	27	21	21
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	65	64	66	68	68	72	77	81	85	86	90
B. Bound Tests											
B1. Real GDP growth	65	58	54	51	42	38	35	32	27	21	21
B2. Primary balance	65	58	57	55	46	43	40	37	32	27	27
B3. Exports	65	**145**	**366**	**349**	**320**	**301**	**289**	**271**	**242**	**212**	**198**
B4. Other flows 3/	65	66	72	68	59	54	50	46	40	34	32
B5. Depreciation	65	58	53	49	41	36	33	30	25	20	20
B6. Combination of B1-B5	65	98	80	118	103	95	90	82	72	61	58
C. Tailored Tests											
C1. Combined contingent liabilities	65	59	56	53	44	40	37	34	30	24	24
C2. Natural disaster	65	61	58	55	47	43	40	37	33	28	28
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	65	58	55	51	43	38	35	31	27	21	21
Threshold	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	7	8	6	7	**14**	5	4	4	5	6	3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	7	8	6	7	**15**	6	5	6	7	9	6
B. Bound Tests											
B1. Real GDP growth	7	8	6	7	**14**	5	4	4	5	6	3
B2. Primary balance	7	8	6	7	**15**	6	4	4	6	7	3
B3. Exports	7	**13**	**18**	**26**	**46**	**21**	**18**	**21**	**31**	**33**	**23**
B4. Other flows 3/	7	8	6	7	**15**	6	5	5	7	7	4
B5. Depreciation	7	8	6	7	**14**	5	4	4	5	6	3
B6. Combination of B1-B5	7	10	10	**12**	**24**	10	8	9	**11**	**13**	7
C. Tailored Tests											
C1. Combined contingent liabilities	7	8	6	7	**14**	5	4	4	5	6	3
C2. Natural disaster	7	8	6	7	**15**	6	4	4	6	7	3
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	7	8	6	7	**15**	6	7	4	4	6	3
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	**18**	**20**	**14**	**18**	**38**	**14**	11	10	14	**16**	7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	**18**	**21**	**15**	**19**	**40**	**16**	14	**14**	**19**	**22**	**15**
B. Bound Tests											
B1. Real GDP growth	**18**	**27**	**26**	**32**	**67**	**25**	**19**	**19**	**25**	**29**	13
B2. Primary balance	**18**	**20**	**15**	**19**	**38**	**15**	11	11	**15**	**17**	8
B3. Exports	**18**	**25**	**24**	**36**	**63**	**29**	**24**	**29**	**43**	**45**	**31**
B4. Other flows 3/	**18**	**20**	**15**	**20**	**39**	**16**	12	13	**17**	**19**	10
B5. Depreciation	**18**	**26**	**18**	**22**	**47**	**17**	13	13	**17**	**20**	8
B6. Combination of B1-B5	**18**	**25**	**23**	**29**	**56**	**23**	**18**	**21**	**27**	**29**	**17**
C. Tailored Tests											
C1. Combined contingent liabilities	**18**	**20**	**15**	**18**	**38**	**14**	11	11	**14**	**16**	7
C2. Natural disaster	**18**	**20**	**15**	**18**	**38**	**14**	11	11	**14**	**16**	8
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**18**	**20**	**15**	**18**	**38**	**15**	**17**	11	10	**16**	7
Threshold	14	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 4. Maldives: Sensitivity Analysis for Key Indicators for Public Debt-Baseline Scenario, 2022–2032

(In percent)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
					PV of Debt-to-GDP Ratio						
Baseline	**116**	**110**	**110**	**105**	**100**	**96**	**92**	**89**	**86**	**83**	**79**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	**116**	**113**	**113**	**111**	**109**	**108**	**107**	**107**	**106**	**106**	**105**
B. Bound Tests											
B1. Real GDP growth	**116**	**158**	**231**	**242**	**253**	**264**	**274**	**286**	**297**	**308**	**317**
B2. Primary balance	**116**	**116**	**122**	**117**	**112**	**107**	**103**	**99**	**95**	**92**	**88**
B3. Exports	**116**	**133**	**169**	**162**	**155**	**150**	**144**	**138**	**131**	**124**	**117**
B4. Other flows 3/	**116**	**117**	**123**	**118**	**112**	**108**	**104**	**100**	**96**	**92**	**87**
B5. Depreciation	**116**	**118**	**114**	**107**	**100**	**94**	**88**	**83**	**78**	**74**	**69**
B6. Combination of B1-B5	**116**	**119**	**131**	**131**	**130**	**130**	**129**	**130**	**130**	**130**	**130**
C. Tailored Tests											
C1. Combined contingent liabilities	**116**	**117**	**116**	**111**	**106**	**102**	**98**	**94**	**91**	**88**	**84**
C2. Natural disaster	**116**	**122**	**122**	**116**	**111**	**107**	**103**	**100**	**97**	**94**	**90**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**116**	**110**	**110**	**105**	**100**	**96**	**92**	**89**	**86**	**83**	**79**
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35	35
					PV of Debt-to-Revenue Ratio						
Baseline	401	372	377	365	350	336	323	311	301	292	280
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	401	382	386	385	381	377	375	374	373	373	371
B. Bound Tests											
B1. Real GDP growth	401	524	775	825	865	904	946	987	1,028	1,072	1,109
B2. Primary balance	401	392	419	406	389	374	359	347	335	325	312
B3. Exports	401	449	580	564	541	522	504	485	459	437	412
B4. Other flows 3/	401	394	421	409	392	377	363	349	335	323	308
B5. Depreciation	401	398	391	372	348	327	308	291	275	260	242
B6. Combination of B1-B5	401	399	448	453	451	451	452	453	454	457	456
C. Tailored Tests											
C1. Combined contingent liabilities	401	395	399	387	370	355	342	330	318	309	296
C2. Natural disaster	401	411	416	405	388	375	361	350	339	330	319
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	401	372	377	366	350	337	322	311	300	291	279
					Debt Service-to-Revenue Ratio						
Baseline	29	60	74	97	119	108	109	111	116	123	121
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	29	62	76	100	122	111	111	112	116	122	119
B. Bound Tests											
B1. Real GDP growth	29	80	154	234	309	324	357	389	425	463	483
B2. Primary balance	29	60	86	120	140	128	127	127	132	138	134
B3. Exports	29	60	76	104	126	114	115	121	132	138	135
B4. Other flows 3/	29	60	75	99	121	110	110	113	120	127	124
B5. Depreciation	29	60	74	95	124	108	106	107	112	119	114
B6. Combination of B1-B5	29	64	88	116	151	147	157	167	180	194	196
C. Tailored Tests											
C1. Combined contingent liabilities	29	60	87	108	131	118	118	119	124	130	127
C2. Natural disaster	29	61	95	116	139	127	127	128	133	140	137
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	29	60	74	97	120	109	115	112	112	123	121

Sources: Country authorities; and staff estimates and projections.

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

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

Statement by the IMF Staff Representative
November 23, 2022

The information below has become available following the issuance of the staff report. It does not alter the thrust of the staff appraisal.

1. **Parliament approval of tax measures**

- To mobilize revenues, the authorities will increase the General Goods and Services Tax (GST) from 6 to 8 percent and the Tourism Goods and Services Tax (TGST) rate from 12 to 16percent starting on January 1st, 2023. The corresponding bill was approved by parliament on November 16, 2022.

2. **Multiple currency practices and exchange restrictions**

- The Maldives has previously been found to maintain a multiple currency practice (MCP) resulting from the deviation by more than 2 percent between the prevailing market exchange rates and the parallel market exchange rates, and an exchange restriction relating to the additional cost for market participants to obtain foreign exchange (FX) from the parallel market.

- Under the Fund's revised MCP policy adopted on July 1, 2022,[1] MCPs resulting from the exchange rate spreads arising in illegal parallel markets are considered eliminated as of the approval date of the policy since these markets are legally prohibited and thus not the result of official action. Information received by staff recently confirmed that the parallel market in the Maldives is illegal under the national law, and therefore, the MCP arising from a spread between the parallel market and prevailing market exchange rates in the Maldives has been eliminated as of July 1, 2022. Further, the exchange restriction in connection with the additional cost for obtaining FX in the parallel market due to this spread has also been eliminated as of July 1, 2022.

- At the same time, the Maldives continues to maintain an exchange restriction arising from the Maldives Monetary Authority's rationing of its supply of FX to commercial banks, which also resulted in a channeling of FX for current international transactions to the illegal parallel market. In that regard, the authorities should continue undertaking reasonable efforts to eliminate the spread with the parallel market.

- In addition, the Maldives continues to maintain an MCP resulting from the lack of a mechanism to prevent the spread between the official exchange rate used by the MMA for government transactions and the prevailing market exchange rate from deviating by more than 2 percent.

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[1] See IMF Policy Paper No. 2022/036.

Statement by Mahmoud Mohieldin, Executive Director for Maldives,
Ali Alhosani, Alternate Executive Director, and
Mira Merhi, Advisor to Executive Director
November 23, 2022

On behalf of the Maldivian authorities, we would like to thank Mr. Kinda and his entire team for a constructive and effective Article IV consultation as well as for candid policy discussions. The authorities look forward to continuing their close engagement with the Fund, and highly appreciate the IMF's valuable policy advice and technical assistance.

Recent Economic Developments & Outlook

Although the pandemic took a significant toll on the Maldivian economy, the economic recovery from the COVID-19 shock has exceeded expectations with an impressive 41.7 percent growth rate in 2021 and an expected growth rate estimated at above 12 percent in 2022 underpinned by a strong rebound in tourism. In addition, the easing of COVID-19 containment measures led to a strong growth in the transportation communication, construction, and wholesale and retail trade sectors. As an economy that is also heavily import-dependent, Maldives is now facing inflationary pressures as supply chain challenges and geopolitical tensions continue to exert upward pressure on food and energy costs. So far, the pass through from global oil prices to domestic prices was contained owing to the government policies, including energy subsidies to maintain low electricity prices. However, these policies are putting significant pressure on public finances, and as a result, the authorities are planning to reform the subsidies and make them more targeted.

The COVID-19 pandemic was the largest shock to ever hit the Maldives' economy and resulted in a historical GDP contraction of 33.5 percent[1], one of the sharpest economic declines in the world. The social and economic impact of the crisis were devastating, with thousands of livelihoods affected by the shutdown of tourism and construction activities during the lockdown in 2020. Decisive and timely policies[2] to mitigate the health and economic effects of the COVID-19 pandemic on the most vulnerable have allowed Maldives to quickly rebound. The emergency financing received from the Fund under the Rapid Credit Facility, and to some degree the debt suspension from official bilateral creditors under the G20 Debt Service Suspension Initiative, were also helpful in redirecting resources to more pressing needs.

As a small island state vulnerable to external shocks, the authorities are cognizant of the challenging global economic conditions in particular the downside risks emanating from the

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[1] To contain the spread of the virus, the country closed its borders for the first time in history, between March 27 and July 15, 2020, leading to a sudden stop in tourism – the main driver of growth, jobs, and revenues.

[2] The authorities spent significant fiscal resources to deal with the impact of the COVID-19 pandemic, by adopting a "COVID-19 Health and Social Response" and an "Economic Relief Package", totaling around 6 percent of GDP to protect businesses, jobs and incomes. Measures included assistance to 1.5 million vulnerable households, social transfers to assist the unemployed and independent workers, and tax deferrals to households and firms.

conflict in Ukraine, the global commodity price hikes, and the tightening of global monetary conditions. The authorities are more optimistic than staff about the growth outlook and expect that the recovery will gain more momentum in 2023. They are optimistic about the resilience of the tourism sector which has a diversified set of source countries, and due to its strong performance despite the conflict in Ukraine and the closure of the Chinese market. Going forward, the authorities expect a stronger growth momentum due to the significant upside risk from the reopening of the Chinese market in addition to the growth impact of some important projects. These projects include the Velana International Airport Development project, which is expected to increase tourist arrival capacity and help address the primary bottleneck in expanding the economy, as airport capacity has been one of the significant bottlenecks in expanding tourism industry, and cater for a significant demand from airlines, in addition to the Maldives International Port Project, and the Greater Male connectivity bridge project. It also includes projects to develop the agricultural sector, improve food security, ensure access to clean drinking water and sanitation in all the islands by 2023, as well as a high-speed ferry network which is expected to be completed by 2024. Tourism arrivals are expected to reach 1.6 million in 2022 and have already surpassed the total tourist arrivals recorded in 2021 by the end of October 2022. In 2023, tourism arrivals are expected to reach 1.8 million, surpassing the record set in 2019. In the absence of further shocks, the economy is expected to reach pre-Covid levels in 2023. Nevertheless, the authorities will remain vigilant amid the global uncertainties and are committed to prudent macroeconomic policies, rebuilding macroeconomic buffers, and safeguarding macroeconomic stability, as well as enhancing the resilience of the economy.

Fiscal Policy and Reforms

Despite limited policy space, the authorities deployed a prompt and comprehensive set of policy responses to help mitigate the socio-economic impact of the pandemic. Increase in health and social spending to support the vulnerable—including through electricity and water discounts, income support allowance, tax deferrals and food assistance— together with the sharp decline in revenues due to the pandemic resulted in a further deterioration of the fiscal position. Public finances are under pressure and expenditures are expected to be higher than budgeted in 2022 on the back of higher spending on fuel subsidies as a result of the spike in global commodity prices, as well as faster than expected rollout of public sector investment projects.

The authorities have initiated important reforms and developed an ambitious fiscal consolidation plan to rein in fiscal deficits and put public debt on a sustainable path and are committed to implementing it. The 2023 Budget, which is currently under discussion by parliament, has been formulated in this regard with the adjustment measures coming equally from revenues and expenditures (3 percent of GDP respectively). It is worth noting that this will be the first budget since the Covid-19 pandemic where recurrent expenditures will be managed within Government revenues excluding grants. To mobilize revenues, the authorities have increased the General Goods and Services Tax (GST) from 6 to 8 percent and the Tourism Goods and Services Tax (TGST) rate from 12 to 16 percent. The bill has been approved by parliament on November 16 and will be implemented starting January 1st, 2023. In addition, they plan to improve tax compliance as enforcement actions suspended due to the pandemic are now being implemented again and reduce the stock of tax arrears that has accumulated during the pandemic. On the expenditures side, measures include reducing fuel and electricity subsidies, introducing baseline prices for pharmaceuticals and bulk procurement for medical consumables and implementing the public salary harmonization in stages, which will target the health sector professionals in 2023. The GST rate change is expected to have a direct and indirect impact on prices estimated at around 2.5 percent, however, this will be a one-off price hike in goods and services.

The Medium-Term Fiscal Strategy 2023-2025[3] rightly focuses on managing fiscal risks and formulating a sustainable fiscal policy in the medium term. Fiscal consolidation will target the inefficiencies in government subsidy schemes, by introducing targeted subsidies. Significant progress has been made in managing public investment execution to achieve greater transparency, with the support of the World Bank, USAID and ADB. The authorities remain committed to improving the fiscal framework by further enhancing oversight of SOEs[4] and moving forward with a better designed Fiscal Responsibility Act, which is being currently drafted in line with IMF recommendations and which will be submitted to parliament in February 2023. The authorities will continue focusing on updating the PFM roadmap and updating the legal framework including that related to debt management. They are grateful, in this regard, for the extensive IMF support and technical assistance being provided to reform energy subsidies and develop a medium-term revenue strategy[5] as well as providing advice on reforms in tax policy. The authorities are also working on revising the current GST act, which is expected to be completed during 2023.

Debt Sustainability Assessment –The authorities continue to believe that the "Low-Income Country Debt Sustainability Framework (LICDSF)" needs to be adapted for a country with the special circumstances of the Maldives. While most of the Maldives' debt stock is at highly concessional rates, the authorities have been proactively managing to address upcoming rollover risks in 2026. Moreover, and unlike most of the countries in the LICDSF, the Maldives has access to international financial markets. In the fiscal strategy, the government has committed to obtain foreign financing by relying primarily on concessional financing from bilateral or multilateral sources. As the cost of issuing debt from the international debt capital markets is expected to be high during these times, the revised financing strategy does not include issuances of conventional bonds in international markets prior to 2025. Moreover, the authorities are strengthening the sovereign development fund (SDF) established in 2016 to mitigate the rollover risk. Fund TA to support their efforts has been requested. As the economy recovers, the debt-to-GDP will improve with fiscal consolidation

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[3] To support fiscal sustainability, the authorities also developed their medium-term fiscal strategy along four anchors: (i) reducing public debt excluding guarantees to less than 100 percent of GDP by 2025, (ii) reducing the primary budget deficit to less than 5 percent of GDP by 2023, (iii) maintaining public debt as a share to GDP on a downward trend, and (iv) reducing recurrent expenditure to levels that do not exceed government revenue by 2023.

[4] Mechanisms and guidelines have been enhanced, including standardizing the SOEs procurement guidelines, publishing information of large procurements on the Ministry of Finance website, publishing information on small procurements by government agencies on the government gazette, adjusting public finance regulations to facilitate bid protesting mechanism and independent review, and publishing information on ongoing and planned public investments projects.

[5] Along with IMF and SARTTAC, WB and ADB are also assisting us in developing the Medium-Term Revenue Strategy.

measures in place and strong GDP growth expected in the medium term. Finally, the government remains in a comfortable position to honor all its debt obligations.

Monetary Policy and Financial Stability

The Maldives Monetary Authority (MMA) has continued its strong track record of skillful management of monetary and financial policy. The MMA was proactive in implementing policy measures[6] to mitigate the financial and economic disruptions arising from the COVID-19 pandemic and the global challenges, while supporting economic activity and maintaining price stability. As a final step in unwinding COVID-related banking sector support measures, the authorities have reverted the FX MRR back to 10 percent in October 2022. MMA continues to closely coordinate, together with the MoF, SOEs' access to FX for essential needs. The MMA has recently developed a package of measures to reform FX markets and plans to roll it out gradually[7]. In order to ensure an adequate FX buffer, the MMA continues to maintain bilateral liquidity arrangements with other central banks[8].

The MMA continues to ensure that the financial sector is sound and resilient and has a strong and effective prudential and supervisory framework at its disposal. The banking system remains stable even as pandemic-related financial sector support measures have elapsed. Capital and liquidity buffers are ample while nonperforming loans are gradually declining as the economy emerges from the pandemic. Moreover, the MMA's banking sector stress tests reveal that banking sector buffers, notably the high capital adequacy ratio, remain strong against possible shocks arising from credit quality deteriorations, liquidity strains, and sovereign stress. In order to ensure a stable financial system, the MMA continued to formulate and issue regulations that would protect the financial system. The authorities have requested an FSAP to be conducted in 2023. They are also preparing to conduct a national risk assessment for AML/FT expected to be completed by the first quarter of 2023. The MMA authorities will continue to diligently monitor incoming macroeconomic and financial sector data and stand ready to make necessary adjustments to their policy instruments and intervention strategy, should the need arise.

Promoting financial inclusion remains a key priority of the MMA in its function of fostering the development of the financial sector, as it can increase prosperity and reduce regional wealth disparities in the country. The MMA continued the work on formulating the National Financial Inclusion Strategy for the Maldives, and a demand-side survey to gather the necessary data for

[6] These include: (i) reduction of the minimum required reserves (RR) up to 5 percent as and when required; (ii) making available a short-term credit facility to financial institutions as and when required; (iii) introducing regulatory measures to enable a moratorium on loan repayments. Moreover, the MMA intervened at the beginning of the crisis, actively providing liquidity support to the banking sector to mitigate adverse economic impacts.

[7] These include regulating licensing criteria and conditions for money changers, encouraging the use of the Maldivian Rufiyaa in domestic monetary transactions, and limiting the types of transactions allowed through FX accounts.

[8] The foreign exchange swap agreement under the existing 2019-2022 South Asian Association for Regional Cooperation (SAARC) framework, has been extended through June 30, 2023.

formulating the nation-wide strategy has been completed and the report is expected to be soon published.

Sustainable Development & Building Resilience to Climate Change

The authorities have reprioritized the sustainable development goals to reflect urgent developmental needs following the pandemic. While the Maldives ranks better than peers in poverty and inequality, the authorities are aware that more efforts are needed to ensure inclusive growth. With most Maldivians dependent on tourism and fisheries for their livelihoods, the World Bank estimates that the poverty rate increased to 19.8 percent in 2020 due to the impact of the pandemic but is expected to drop to 3.8 percent with the economic rebound by the end of 2022. The government's Strategic Action Plan (2019–23) focuses on decentralization, economic diversification through expanding the fisheries and agricultural sectors, SMEs, labor, employment and migration, social protection, and governance, among others. Many reforms are aimed at enhancing the role of the private sector and boosting competitiveness while supporting inclusive growth.

Addressing the Maldives' exposure to natural disasters and climate change remains a priority that highlights the need for well-planned climate-change adaptation investments. Climate change is an existential threat to the Maldives, as over 80 percent of the land is under threat from rising sea levels and over 64 percent of the islands are reporting severe erosion. The additional challenges associated with the country's dispersed geography include difficult service delivery and limited opportunities for job creation and economic diversification. The authorities have adopted a Climate Emergency Act on April 29, 2021, which introduces guidelines for addressing issues related to climate change, ensures the sustainability of natural resources, and sets out plans to achieve net-zero carbon emissions by 2030.

As a climate vulnerable nation facing multiple challenges with limited resources, the authorities have emphasized the need to secure grants and concessional financing to address climate needs in a sustainable manner and to reach net zero emissions by 2030. The authorities stressed the urgent need for more climate funding and indicated that climate financing for the Maldives is offered at the same market rates as conventional instruments, with additional climate mitigating conditionalities, which does not make for a meaningful alternative among the financing choices. The authorities expressed the need for Fund assistance to secure concessional climate finance and capacity development to facilitate the process of access to climate change financing as they have concerns regarding the lengthy requirements and formalities leading to low access to climate funds.

Conclusion

The past three years have presented unprecedented challenges for the Maldives. Amid elevated global uncertainties, the Maldivian authorities will remain vigilant over global developments and assess how these could affect macroeconomic and financial stability. They remain committed to their fiscal strategy and economic reforms and look forward to continuing to closely work with staff on addressing macroeconomic challenges.