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Maldives: 2009 Article IV Consultation—Staff Report; Staff Supplements; Public Information Notice on the Executive Board Discussion; Press Release on the Executive Board Discussion; 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 2009 Article IV consultation with Maldives, the following documents have been released and are included in this package:

- The staff report for the Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on August 19, 2009, 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 24, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of November 25, 2009 on the joint IMF/World Bank debt sustainability analysis.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its December 4, 2009 discussion of the staff report that concluded the Article IV consultation.

- A Press Release summarizing the views of the Executive Board as expressed during its December 4, 2009 discussion of the staff report that completed the review.

- A statement by the Executive Director for Maldives.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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MALDIVES

Staff Report for the 2009 Article IV Consultation and Request for a Stand-By Arrangement and a 24-Month Arrangement Under the Exogenous Shocks Facility

Prepared by the Asia and Pacific Department
(in consultation with other departments)

Approved by Kalpana Kochhar and Aasim Husain

November 25, 2009

Executive Summary

Context. The Maldivian economy is facing large external and fiscal imbalances, resulting from the severe impact of the global financial crisis and exacerbated by an unsustainable fiscal expansion. The global crisis has led to sharp declines in tourism and related investment, other net capital flows, and exports. This has caused a significant fall in fiscal revenue, compounding a large increase in public spending, and pushed the economy into recession. A rising share of the resulting fiscal deficit has been financed by monetization. Despite foreign exchange rationing by the Maldives Monetary Authority (MMA), international reserves have fallen to about two months of imports.

Program: The authorities are requesting assistance under a blended arrangement (600 percent of quota, or SDR 49.2 million, over 36 months under a Stand-By Arrangement, and 100 percent of quota, or SDR 8.2 million, over 24 months under the Exogenous Shock Facility-High Access Component), designed to provide financing to smooth adjustment to the external shock, restore fiscal and external stability while protecting social spending, and address weaknesses in the banking system. The core of the policy framework is a strong fiscal adjustment to contain aggregate demand and put public finances back on a sustainable medium-term path, complemented by monetary tightening and measures to strengthen the banking sector.

Discussions: A staff team consisting of J. Carter (head), C. Park, A. Pitt (all APD), and M. Oliva (SPR) visited Malé during June 3-16, 2009. Discussions continued in a second visit (August 3–19, 2009), staffed by J. Carter (head), R. Cubero, C. Park, A. Pitt (all APD), R. Basu (SPR), and R. Maino (MCM). The staff met with the President, the Minister of Finance and Treasury, the Governor of the MMA, other officials, members of the Parliament's Public Finance Committee, commercial banks, donors, and private sector representatives.

Previous Article IV Consultation: The Executive Board discussion of the 2008 Article IV Consultation is summarized in the Public Information Notice No. 08/115 at www.imf.org.

Exchange rate system: Maldives has a conventional fixed peg against the U.S. dollar. Maldives continues to avail itself of the transitional provisions of Article XIV, and has not yet accepted the obligations of Article VIII, Sections 2, 3, and 4. It maintains an exchange restriction and a multiple currency practice subject to Fund approval under Article VIII, Sections 2(a) and 3 of the Fund's Articles of Agreement, arising from the MMA's policy of rationing its supply of foreign exchange to commercial banks. The authorities plan to gradually eliminate this restriction over the course of the program.

Data provision is adequate for effective surveillance and program monitoring, but some weaknesses remain.

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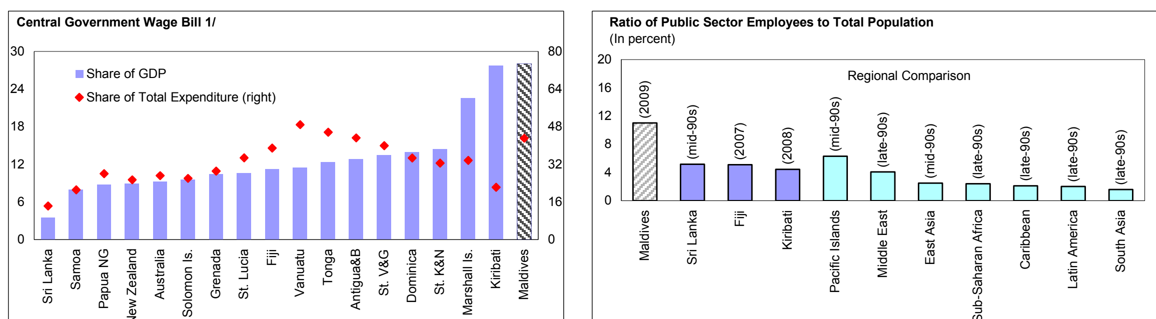
I. Recent Economic Developments and Outlook for 2009

1. **Maldives is facing severe fiscal and external imbalances.** A rapid fiscal expansion after the 2004 tsunami, including steep wage bill increases, pushed public expenditure to 63 percent of GDP in 2008. From mid-2008, the global crisis significantly exacerbated the existing imbalances and severely weakened the country's balance of payments position (Box 1). As in other tourism-based economies, such as those in the Caribbean, tourism revenue has been badly affected by the global downturn, reducing fiscal and foreign exchange earnings and driving the economy into recession. Also, net capital inflows have fallen sharply. The loss in fiscal revenues, combined with the continued growth in public expenditures, have led to a dramatic increase in the fiscal deficit in 2008–09, much of which has been monetized. In the face of lax fiscal policy and the external shocks, supporting a fixed exchange rate—pegged to the U.S. dollar at 12.8 rufiyaas per dollar since 2001—has resulted in significant reserve losses, forcing the MMA to ration foreign exchange.

2. **External shocks have prompted a decline in economic activity and inflation.** After growth of 5¾ percent in 2008, real GDP is expected to shrink by about 4 percent in 2009, driven by the decline in tourism—arrivals are forecast to fall by 7 percent, compared to last year—and a retrenchment of the construction sector, which is projected to shrink by almost one-quarter as tourism projects are delayed. Inflation has been falling rapidly, to 3 percent year-on-year (y/y) in August, on the back of lower import prices. However, an increase in international fuel prices and domestic electricity tariffs is expected to push it up in the second half of 2009 to about 6¾ percent y/y.

3. **The impact of the global crisis has turned an unsustainable fiscal expansion into a serious near-term risk to macroeconomic stability.**

- Government expenditure almost doubled as a share of GDP between 2004 and 2008, and, without adjustment, is on course to reach 69 percent of GDP by end-2009. A key driver has been the wage bill, stemming from large wage increases and a build-up in the number of public sector employees. As the charts below show, public employment and the wage bill are now very high by international standards.

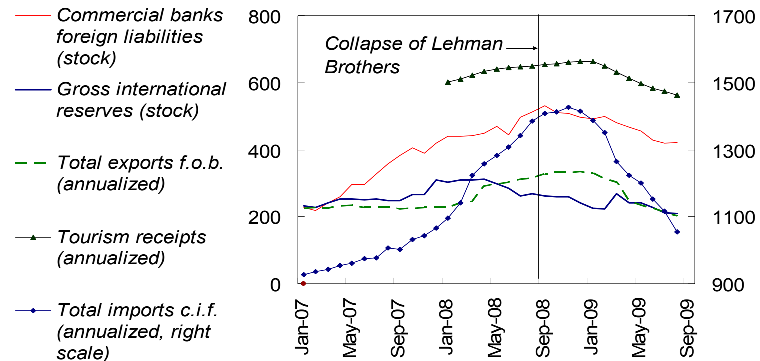


Sources: ILO, WEO, IMF staff reports and country desks, Sugden and Taniguchi (2008), "The Growth Penalty of High Government Pay Rates", ADB.
1/ Ratios are based on 2009 projections for Maldives and on averages for 2000-2008 for other countries.

Box 1. Maldives: Impact of the Global Crisis

The sudden and severe impact of the global economic and financial turmoil has brought the country to the brink of a crisis. Earnings from traditional exports and tourism have turned down sharply. Also, foreign investment inflows into tourism-related activity have suffered a significant set-back, and banks have been having difficulty rolling over existing credit lines after the collapse of Lehman Brothers in September 2008 (see chart).

Maldives: Evolution of Key Exogenous Variables and Impact on Imports and Reserves
(In millions of U.S. dollars)



The net negative impact of the exogenous shock on the balance of payments is estimated at about US$309 million (24½ percent of 2009 GDP) in 2009–10. This includes cumulative losses on exports, tourism and net capital inflows, offset by reduced tourism- and investment-related imports and gains from the decline in food and fuel prices (see table).

Adjustment to these shocks will rely largely on import compression, supported by fiscal retrenchment. Significant import contraction started this year, reflecting reduced private sector income, stagnant domestic credit, and foreign exchange rationing by the MMA. With the large fiscal adjustment envisaged in the program, imports would remain subdued through 2011–12. The shock has also resulted in large reserves losses: reserves will remain below their medium-term target of about 3½–4 months of imports through 2011.

Multilateral financing will be critical to meet the residual balance of payments needs and support the adjustment effort. Total financing from the IMF, World Bank, and ADB is projected at US$81 million for 2009–10. Under the proposed Fund arrangement with an SBA/ESF blend, the ESF would cover the two years that are primarily affected by the fallout from the global crisis, while the 36-month SBA would support the strong fiscal adjustment needed over the medium term to restore the sustainability of the underlying external position.

Box 1. Maldives: Impact of the Global Crisis (concluded)

Maldives: Estimated Net Impact of Export and Capital Account Shock

	2008	2009	2010	Shocks1/ 2009 (change vis-à-vis 2008)	Shocks1/ 2010 (change vis-à-vis 2008)	Total Impact
	(In millions of U.S. dollars, unless otherwise indicated)					
CURRENT ACCOUNT	-647.9	-397.7	-337.6	-250.2	-310.3	-560.5
A) Exports (excluding re-exports)	125.9	88.3	100.2	37.5	25.7	63.2
B(i)) Food and Fuel Imports (price effect)	-448.3	-320.3	-358.9	-128.0	-89.4	-217.4
B(ii)) Tourism & Investment Imports	-253.8	-162.5	-176.4	-91.3	-77.4	-168.7
C) Travel receipts	663.6	521.2	629.9	142.4	33.7	176.1
CAPITAL AND FINANCIAL ACCOUNT	495.9	355.2	252.3	140.7	243.6	384.3
D) FDI, Banks, and other investment (excluding privatization)	431.6	166.2	241.0	265.5	190.6	456.1
EXOGENOUS SHOCK NET & GROSS IMPACT 2009 & 2010						
F) Gross Impact (A+C+D)				445.4	250.0	695.4
G) Net Impact (A+C+D+B(i)+B(ii)))				226.1	83.2	309.3
in percent of 2009 GDP				17.9	6.6	24.5
Memo:						
IMF	0.0	7.8	31.1	7.8	31.1	38.9
of which SBA	0.0	6.2	24.9	6.2	24.9	31.1
of which ESF	0.0	1.6	6.2	1.6	6.2	7.8
Other Multilaterals (World Bank and AsDB)	0.0	18.0	24.0	18.0	24.0	42.0

Source: Staff Estimates
1/ A positive number indicates a detrimental effect.

- The state-owned electricity company (STELCO) has been experiencing large operating losses, as electricity tariffs have not been raised in line with international fuel prices. The implicit electricity subsidies, financed through government transfers, have been budgeted at about 2½ percent of GDP in 2009, and could exceed that in the absence of tariff adjustment.

- The external shocks caused by the global crisis significantly intensified the fiscal imbalances. Revenue has been shrinking on account of slower imports (as customs duties represent a key source of revenue), lower tourism inflows, and postponed lease payments from embattled tourist resort projects.

- As a result, the fiscal deficit rose to 13¾ percent of GDP in 2008 and, if corrective action is not undertaken, could reach 33 percent of GDP in 2009 while public debt would soar to 97 percent of GDP.

4. **The external shocks have caused serious balance of payments difficulties.** With public expenditure rising fast and weaker tourism growth, the current account deficit widened to 51 percent of GDP in 2008. In 2009, the severe negative external shocks from the global crisis contributed to a decline in capital inflows and a domestic slowdown, and led to foreign exchange rationing by the MMA (Box 1). These forces, combined with lower import

prices, have prompted a very sharp import contraction, more than offsetting the decline in tourism inflows. As a result, the current account deficit is expected to moderate significantly in 2009, to 30 percent of GDP. The reduced availability of external financing, including credit lines for banks and funding for tourism projects, has led to an overall balance of payments deficit and continued reserve losses. Even after the recent SDR allocations, gross international reserves stood at 2¼ months of imports at end-September, 2009; usable reserves, which exclude foreign currency deposits at the MMA, were down to less than 3 weeks of imports.[1]

5. **Monetary policy has been constrained** by fiscal dominance—the government had been able to borrow without limit from the MMA—and the fixed exchange rate regime. In the absence of open market operations (introduced only in August 2009), any excess money supply from deficit monetization had ultimately been reabsorbed via reserve losses. Strong capital inflows kept the money supply growing at double-digit rates for several years through mid-2008, but the global shocks led to dollar shortages and significant reserve losses. The MMA has been rationing the supply of foreign exchange to the banking system at US$ 2.3 million per week, and a parallel market has emerged with a premium of around 10 percent over the official peg.[2, 3] While information is scant, this rate has apparently remained relatively stable over the past several months.

6. **The real effective exchange rate (REER) has appreciated recently, but remains below historical averages (Box 2)**. After depreciating steadily from 2001 to mid-2008, the REER appreciated over the last year, on account of a stronger US dollar and higher inflation in Maldives relative to its trading partners. However, the REER remains below its 10-year average, and its path has also remained below those of relevant comparators. A quantitative analysis, based on CGER-type methodologies, suggests that under baseline (adjustment) policies the current peg is consistent with medium-term fundamentals.

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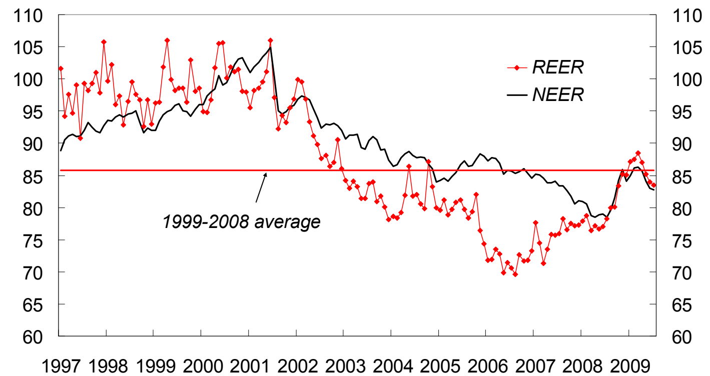
[1] The general SDR allocation provided SDR 6.1 million (US$9.6 million) on August 28, 2009, and a further special allocation of SRD 1.3 million (US$2 million) took place on September 9, 2009.

[2] The official foreign exchange market involves the MMA, commercial banks, and licensed money changers. The MMA sells foreign exchange to banks (at a rate of US$1 = 12.85 rufiyaas) and the public sector (at a rate of US$1 = 12.80 rufiyaas). The amount provided weekly to banks has been similar for several years, but became binding since mid-2008. Foreign exchange supplied to the public sector has so far not been subject to limitations.

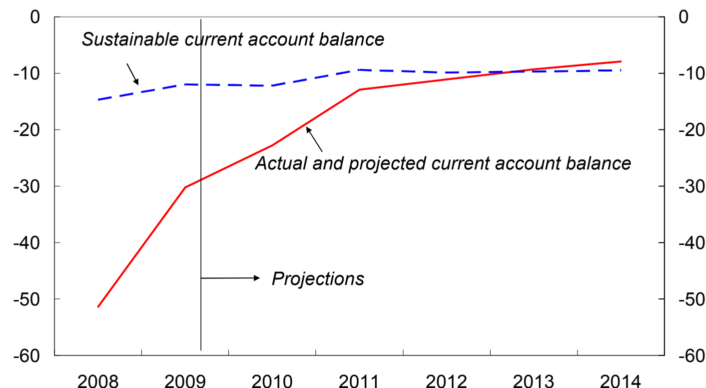
[3] There is no evidence that foreign exchange rationing to the banks has led to external payments arrears by the private sector.

Box 2. Maldives: Exchange Rate, External Sustainability, and Competitiveness

The Maldivian rufiyaa has appreciated in recent months, but remains below historical averages. From 2001 to mid-2008, the rufiyaa depreciated by 27 (25) percent in real (nominal) effective terms, driven mainly by the depreciation of the U.S. dollar against the currencies of Maldives' trading partners. A stronger dollar thereafter and high relative domestic inflation led to a slight real and nominal effective appreciation. Nevertheless, the real effective exchange rate (REER) remains below its average for the period 1999–2008. Unit labor cost data are not available, but would likely show a larger appreciation, as the rapid increase in public sector wages is likely to have had an impact on economy-wide wages.



CGER-type methodologies suggest that the REER is consistent with medium-term fundamentals under the baseline (adjustment) scenario. While the current account is currently inconsistent with its medium-term norm, by 2013 the external accounts would return to equilibrium under the envisaged program adjustment. For given elasticities, this implies that the REER is significantly overvalued at present but its medium term path under the baseline is consistent with fundamentals (Table 1). Risks to the program, including delayed or insufficient fiscal adjustment, would of course also affect external sustainability.



Box 2. Maldives: Exchange Rate, External Sustainability, and Competitiveness (concluded)

Table 1: Quantitative Exchange Rate Assessment 1/

	2014		
	Current Account Balance		Real Effective Exchange Rate
	Norm	Underlying	
Macroeconomic balance 2/	-9.5	-7.9	-3.4
External sustainability 2/	-6.2	-7.9	3.7

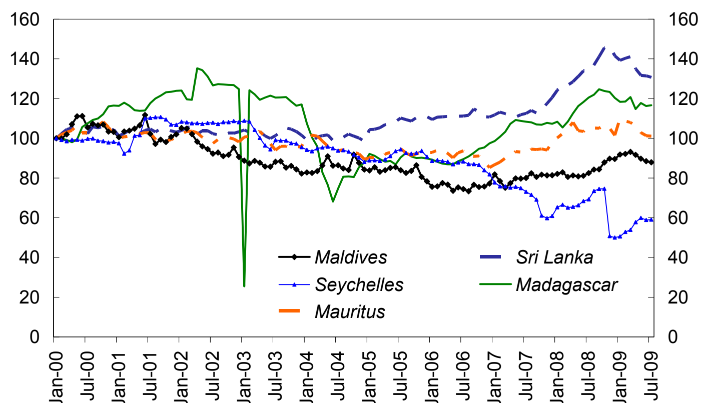
Sources: Fund staff estimates and projections.

1/ All figures are based on five year conditional forecasts, and are expressed in percent. Results reported are based on a GMM estimator applied to 182 countries.(Vitek 2009)

2/ Estimates are based on a medium-run semi-elasticity of the ratio of the current account balance to GDP with respect to the real effective exchange rate of -0.464, a NFA to GDP norm of -90.2, and a medium-run equilibrium nominal GDP growth rate of 7.3 percent.

Cross-country data suggest that the Maldivian economy remains competitive, but faces some structural weaknesses. For the past five years, the path of the Maldives' REER has remained below those of some relevant competitors for high-end tourism, except the Seychelles. Also, growth of international visitor arrivals suggests that Maldives remains competitive in international tourism attraction. However, broader indicators point to challenges to the business climate. Maldives' ranking in the World Bank's *Doing Business* index remains within the median mark, but declined from 71 in 2008 to 87 in 2009.

Real Effective Exchange Rates
(January 2000 = 100)



Maldives: Competitiveness Indicators

Countries	Doing Business 1/ 2008	Doing Business 1/ 2009	Tourism Competitiveness 2/ Average growth in arrivals (in percent)
Mauritius	24	17	4.6
Bahamas, the	59	68	1.1
Dominican Republic	102	86	4.2
Maldives	**71**	**87**	**7.1**
Sri Lanka	97	105	3.6
Seychelles	105	111	n.a.
Madagascar	144	134	22.3

Sources: World Bank, *Doing Business, World Travel & Tourism Council*
1/ Rank among 183 countries.
2/ Average growth in international visitors during the period of 2001-2008.

7. **The global crisis and the domestic downturn have put significant stress on the banking system.** With a high exposure to the tourism sector and the concentration of loans in a few large borrowers, some banks have experienced a significant increase in non-performing loans (NPLs). While banks' reported capital position is still strong, potentially large losses from NPLs could compromise their balance sheets. Also, the global financial crisis has reduced financing options (e.g., lines of credit, parent financing). Banks have substantial domestic liquidity buffers (including excess reserves at the MMA) and long net open positions in foreign exchange. However, their still large (though declining) negative net foreign asset position, large exposure to short-term external financing, and high loan-to-deposit ratio in foreign currency, makes them vulnerable to dollar liquidity shocks. Deteriorating asset quality, a difficult economic outlook, and constrained financing have led private sector credit growth to grind to a halt in 2009, after several years of very high growth rates.

8. **Political context.** President Nasheed was sworn into office in November 2008, following the 30-year tenure of President Gayoom. Parliamentary elections in May 2009,

Maldives: Structure of the Banking Sector

July 2009

		Assets			
	Number of Institutions	Billions of Rufiyaa	Billions of U.S. dollars	% of 2008 GDP	% of Total Assets of Banks
Commercial Banks	6	25.1	2	250	
Domestic	1	11.3	0.9	113	45
State-owned	1	11.3	0.9	113	45
Private	0	0	0	0	0
Foreign-owned	5	13.8	1.1	138	55

Source: Fund staff estimates, based on data from the Maldives Monetary Authorities

however, did not deliver a majority for the President's Maldivian Democratic Party, with the opposition (Mr. Gayoom's party) winning the most seats. Political compromises will therefore be inevitable. Prioritizing the government's ambitious legal reform agenda—which includes legislation on new tax measures, tax administration, privatizations, land tenure, and investment—will therefore be required.

II. MEDIUM-TERM OUTLOOK

9. **In the adjustment scenario, the Maldivian economy is expected to return to fiscal and external sustainability over the medium term.**[4]

- Real GDP growth is expected to rebound in 2010. Tourism inflows and tourism-related investment are projected to recover as global economic activity picks up later this year and international financial markets normalize. This, combined with a more stable macroeconomic environment and renewed confidence in the economy, should boost investment and growth. Real GDP growth is projected to increase to 3½ percent in 2010 and reach about 4½ percent in 2014. The strong fiscal adjustment is expected to be a relatively minor drag on growth, given the high import intensity of public and private spending. But coupled with a more moderate pace of tourist resort expansion and supply constraints on fishing, growth is projected to average around 4 percent in 2010-14, compared with 6½ for the ten years to 2008.

- The moderation in international commodity prices, and tighter fiscal and monetary policies, should help inflation decline gradually to about 3 percent in 2012–14, after a temporary increase in 2011 due to the introduction of a goods and services tax.

- Stronger fiscal revenues, on account of tax reforms and the domestic recovery, combined with a sharp reduction in expenditure, should lead to a rapid fiscal improvement, with the overall deficit falling to 1 percent of GDP by 2014 and the primary balance turning to surplus from 2011.

- With the recovery in tourism, and imports held down by fiscal and monetary adjustment, the current account deficit is projected to narrow sharply to about 8 percent in 2014, within its sustainability bound (Box 2). Gross international reserves are projected to increase gradually to about 3¾ months of imports by 2014.

[4] The adjustment scenario under the program is the baseline scenario for projections in this report and the accompanying debt sustainability analysis. There are considerable upside and downside risks to the outlook. The key risk factors are outlined in section VI below.

Maldives: Key Macroeconomic Indicators, 2008-14
(Baseline scenario)

	2008	2009	2010	2011	2012	2013	2014
	Est.	Proj. (under the program)					
Real GDP (percent change)	5.8	-4.0	3.4	3.7	4.1	4.3	4.5
Inflation (y/y percent change)	11.9	5.5	4.5	6.3	3.5	3.0	3.0
Overall fiscal balance (percent of GDP)	-13.8	-28.8	-17.8	-4.2	-3.6	-2.3	-1.0
Domestic financing (percent of GDP)	10.0	16.1	13.6	2.2	1.1	1.2	0.0
Public debt (percent of GDP)	68.6	91.6	96.0	87.9	82.5	76.6	69.8
Current account (percent of GDP)	-51.4	-29.6	-23.4	-13.1	-11.1	-9.3	-7.9
GIR (in months of GNFS imports)	1.8	3.2	3.1	3.1	3.4	3.6	3.7

Sources: Maldivian authorities, and Fund staff estimates and projections.

Maldives: Key Macroeconomic Indicators, 2008-14 1/
(No adjustment scenario)

	2008	2009	2010	2011	2012	2013	2014
	Est.	Proj. (no policy change)					
Real GDP (percent change)	5.8	-3.8	2.8	2.5	2.8	3.2	3.6
Inflation (y/y percent change)	11.9	7.5	6.0	6.0	6.0	6.0	6.0
Overall fiscal balance (percent of GDP)	-13.8	-32.9	-28.3	-20.7	-20.3	-21.9	-23.4
Domestic financing (percent of GDP)	10.0	24.7	25.0	16.5	16.8	19.0	20.0
Public debt (percent of GDP)	68.6	96.6	113.7	123.1	130.6	138.8	147.5
Current account (percent of GDP)	-51.4	-29.6	-23.3	-16.3	-12.4	-11.0	-10.3
GIR (in months of GNFS imports)	1.8	1.4	1.0	1.0	1.0	1.0	1.0

Sources: Maldivian authorities, and Fund staff estimates and projections.

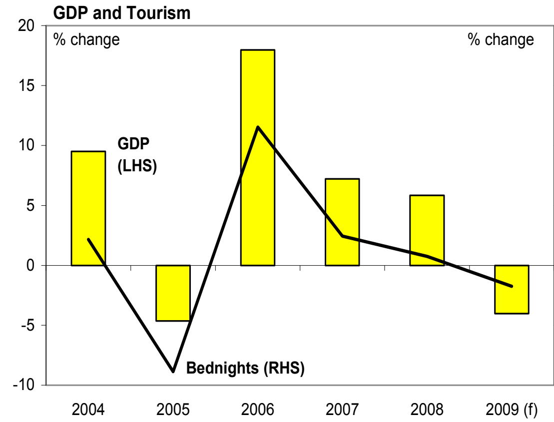
1/ Assumes that reserves will be maintained at 1 month of GNFS imports through borrowing at market rates.

10. **In a scenario with no policy changes, the fiscal and external paths would remain unsustainable.** In the absence of policy adjustment, the fiscal deficit would remain high despite a cyclical (non-discretionary) increase in revenue, deficit monetization would continue, and public debt would soar. The current account deficit would decline more slowly, with international reserves falling to a minimum (assumed here at one month of imports), forcing the country to increasingly ration foreign exchange.[5] While tourism would still recover on the back of a stronger global economy, private investment would be dragged down by a loss of confidence in the domestic economy, and crowded out by high interest

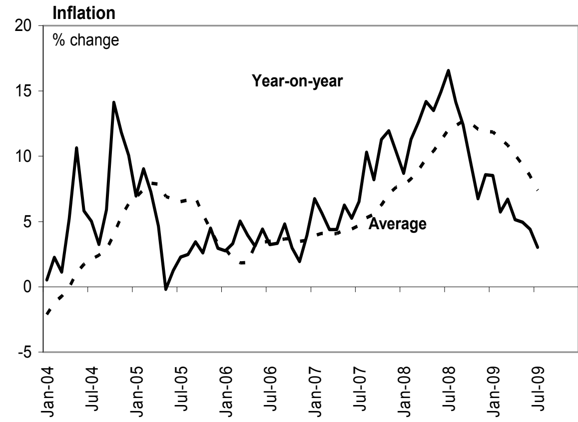
[5]This scenario assumes no currency crisis (the official peg is maintained at the current level), but increasing rationing would force more transactions into the parallel market and keep a lid on the current account deficit.

Figure 1. Macroeconomic Indicators

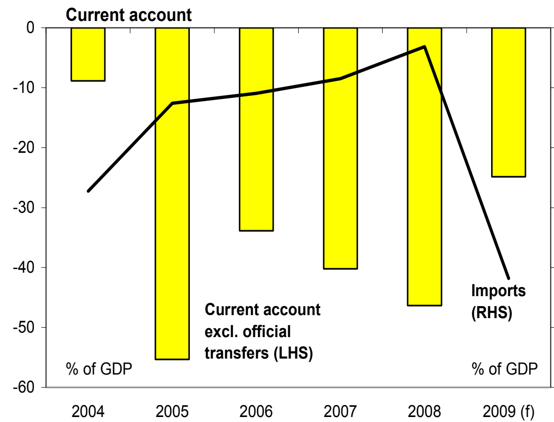
Following a strong post-tsunami recovery, growth of tourism, the main driver of the economy, is declining.



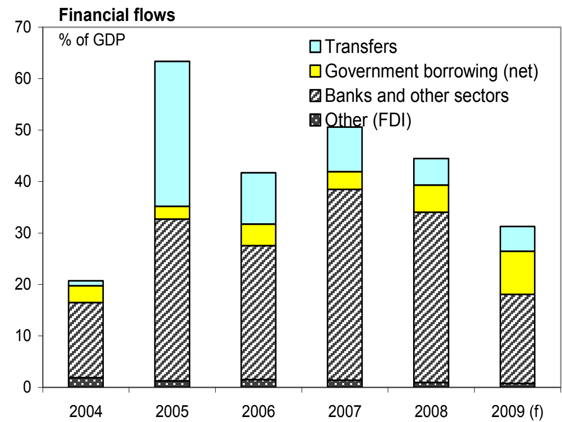
Rising import prices fueled inflation through 2008, …



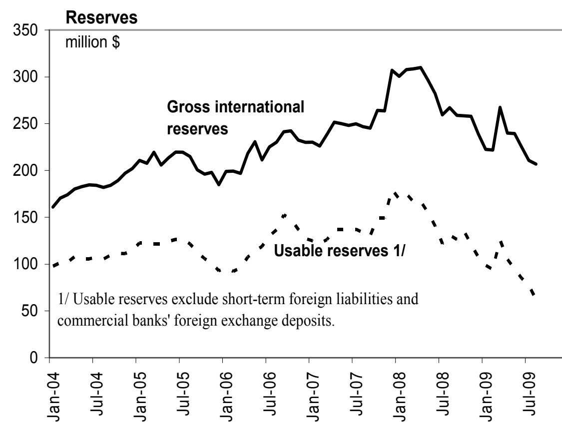
… and contributed to a current account deterioration.



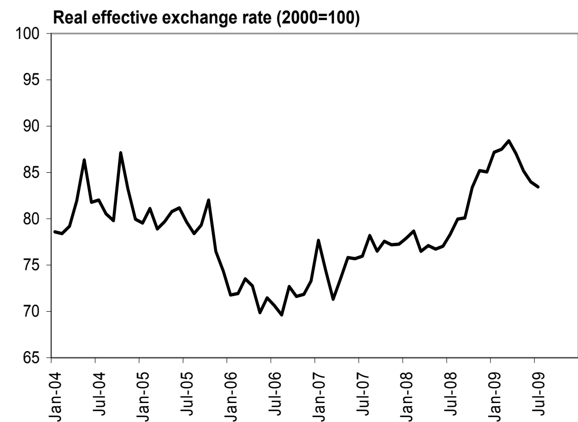
Private capital inflows have fallen as tourism pojects are being delayed and external financing to banks has declined.



Consequently, international reserves have been falling since early 2008.



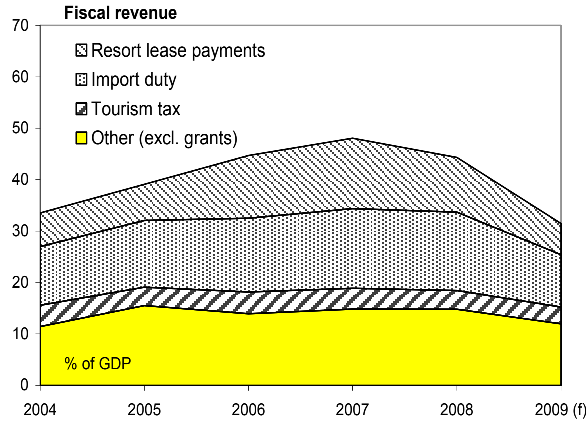
While the REER has recently appreciated, it remains below historical levels.



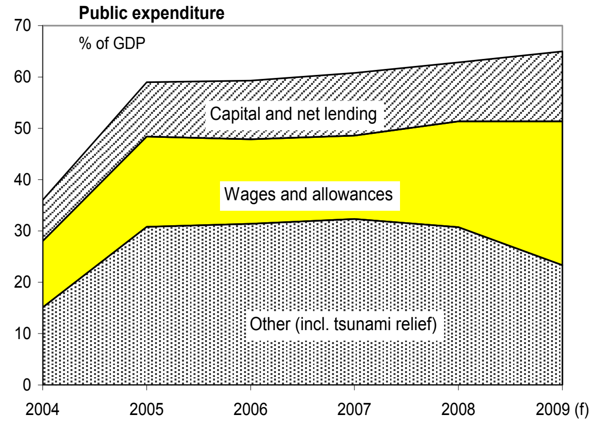
Sources: Maldivian authorities, and Fund staff estimates and projections.

Figure 2. PolicyDevelopments

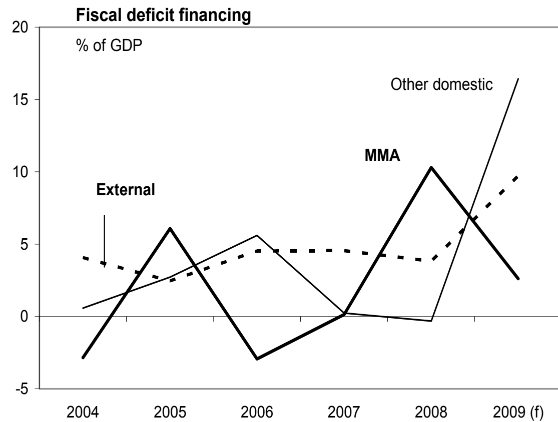
After rising with the domestic economic recovery and post-tsunami grants, fiscal revenue has begun to decline …



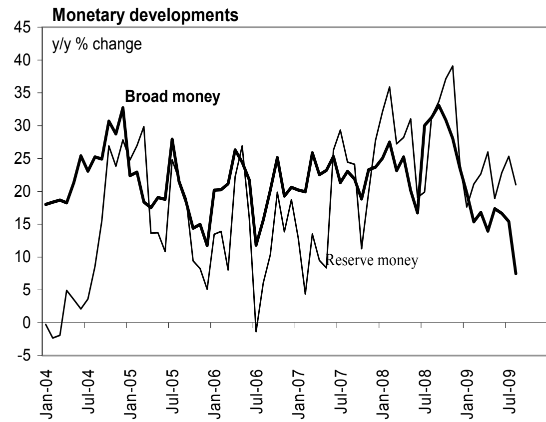
… while spending has risen substantially, driven first by relief operations and later by increases in wages and allowances.



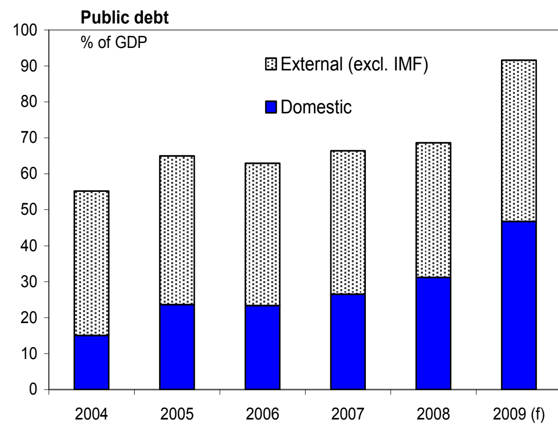
Deficit financing has increasingly relied on unsterilized monetization.



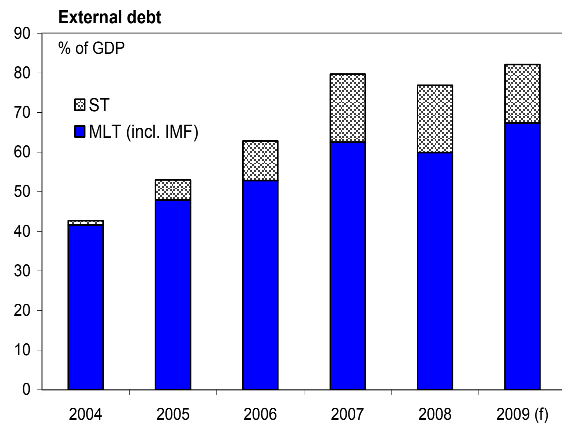
Such loose monetary policy has led to high growth of monetary aggregates.



Public debt has remained broadly stable but is projected to increase …



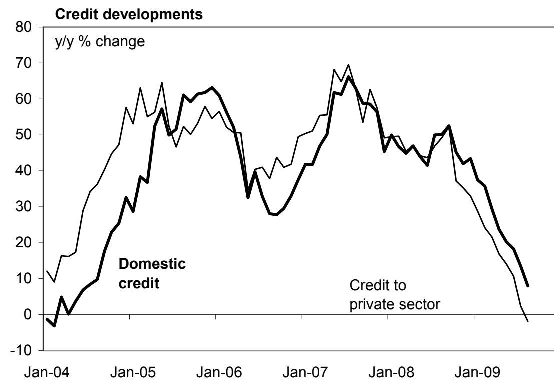
… while external debt had been increasing for some time.



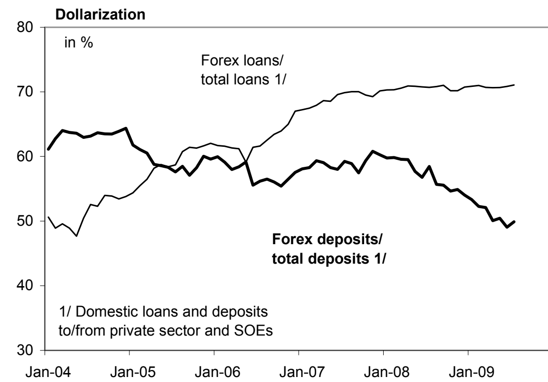
Sources: Maldivian authorities, and Fund staff estimates and projections.

Figure 3. Financial Sector Developments

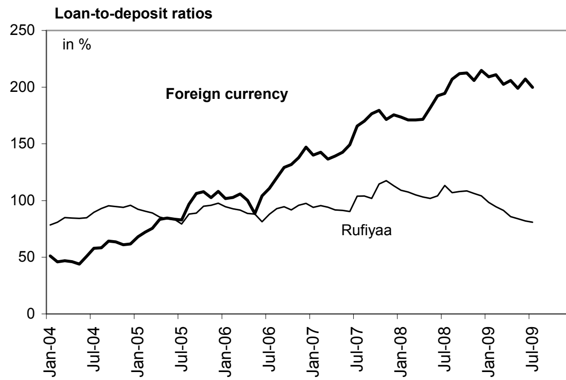
Credit growth has been strong but is declining rapidly, reflecting a more difficult environment for banks.



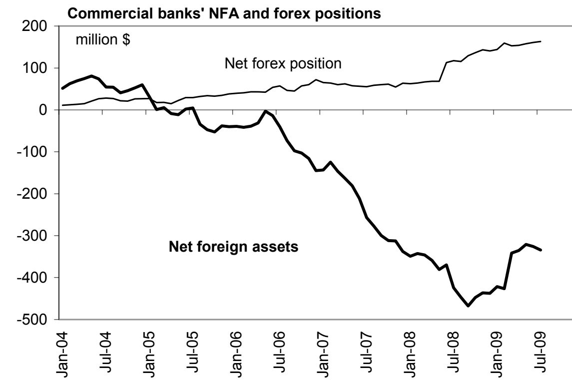
At the same time, loans are made increasingly in dollars, while dollar deposits are declining …



… leading to a sharp increase in the foreign-currency loan-to-deposit ratio …



… and a fall in banks' net foreign assets, reversed more recently due to more difficult external financing conditions.



Sources: Maldivian authorities, and Fund staff estimates.

rates from the government's rising borrowing requirements. As a result, real GDP growth would at best recover along a very slow path, and higher domestic demand and monetization would keep inflation above the baseline projection.

III. Program Discussions

11. **Background.** The authorities are well aware that the current economic situation is very serious, with an unsustainable fiscal policy considerably aggravated by the sudden and temporary exogenous shocks from the global crisis. Confronting this calls for a combination of adjustment, to deal with underlying fiscal imbalances and absorb excess liquidity from deficit monetization, and financing, to accommodate the temporary shocks and rebuild international reserves. The authorities believe that a Fund-supported program would help them achieve those goals, by smoothing the impact of the exogenous shocks—including by mobilizing donor financing—and underpinning a strong macroeconomic policy framework to restore macroeconomic stability, achieve medium-term sustainability, and create the

conditions for strong growth and poverty reduction. (The policies in the authorities' program are described in the attached Memorandum of Economic and Financial Policies, MEFP).

12. **Fiscal policy objectives.** At the core of the program is a very large fiscal adjustment to restore fiscal sustainability. The authorities are committed to drastically bringing down the fiscal deficit, including by unwinding part of the recent large expenditure increases. This is in line with their campaign manifesto's aim to reform the civil service and reduce the state's role in the economy. They are taking immediate action to cut spending, and are planning to introduce new revenue measures. The impact of the adjustment will be limited in 2009, but will be felt more fully in 2010 and beyond. The fiscal deficit is projected to fall from an estimated 33 percent of GDP in 2009 if no corrective action is taken, to under 18 percent of GDP in 2010 and about 4¼ percent of GDP in 2011.

13. **Fiscal adjustment measures.** Fiscal adjustment combines expenditure and revenue measures.

- *Wage bill.* The wage bill, which as explained above has been a key driver of the unsustainable fiscal expansion in recent years, will be reduced through a combination of salary adjustments and staff retrenchment. Effective October 1, 2009, the Civil Service Commission (CSC) implemented a reduction in civil service wages of between 10 and 20 percent, depending on rank, for an average cut of 14 percent. The adjustment will be reversed when central government's domestic revenue reaches 7 billion rufiyaas, which under staff projections would be in 2011. Equivalent cuts have been extended to non-civil service government employees. Staff reductions in the civil service are to be completed by end-2010.[6] Of these, some civil servants will be transferred to the private sector, as part of a process of corporatization of certain public services (airports, public works, schools, hospitals).[7] With these measures, the wage bill is expected to fall from 28 percent of GDP in 2009 to 17½ percent by 2011, but would go up to 19¼ percent in 2012 as the recent wage adjustments are reversed. The 2010 Budget, reflecting these and other measures to be implemented in 2009 and 2010, was submitted to the Majlis (Parliament) in November.

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[6] There are currently about 38,000 central government employees. Staff redundancies entail severance payments, which reduce the net fiscal savings.

[7] The rationale for the corporatization of services is explained in the MEFP.

- *Other spending.* Operational expenses have also been cut by about 2 percent of GDP, and non-priority, domestically-financed capital projects have been postponed, and will be temporarily trimmed by about 1 percent of GDP in 2010.

Maldives: Fiscal Adjustment measures under the Program

	Expected time of implementation	Expected Yield 1/ (In percent of GDP)				
		2009	2010	2011	2012	Full-year impact 2/
Expenditure		2.6	11.1	10.0	6.6	13.9
Reduction of wages and allowances	Oct, 2009	1.0	3.7	3.4		4.0
Staff redundancies	Oct 2009-Dec 2010	0.1	2.7	4.2	4.2	5.4
Cost of staff cuts		-0.1	-0.6			one-off
Increase in electricity tariffs	Nov, 2009	0.5	2.5	2.5	2.5	2.7
Cost of targeted subsidy		0.0	-0.2	-0.2	-0.2	-0.2
Reductions in other current spending	Sept, 2009	1.1	1.9	0.0	0.0	2.0
Reductions in capital spending	2010		1.1			one-off
Revenue		0.2	3.5	10.8	12.2	15.4
Airport tax		0.2	0.8	0.9	0.9	1.1
Transfer to government	Nov, 2009	0.1	0.7	0.6	0.6	0.8
Increase in rates	Nov, 2009	0.0	0.1	0.3	0.3	0.3
Business profit tax	Dec, 2009		1.6	2.9	2.9	3.4
Ad valorem tax	Oct, 2010		1.9	7.9	8.5	10.8
Foregone revenue from tourism tax			-0.8	-3.1	-3.1	-3.7
General sales tax	Jan, 2011			2.3	3.0	3.8
Total		2.7	14.6	20.8	18.8	29.3

Sources: Authorities, and Fund staff estimates and projections.

1/ In terms of each year's GDP, unless otherwise indicated.
2/ In terms of 2009 GDP.

- *Electricity subsidies.* Electricity tariffs have been raised, effective November 1, 2009, with the increase ranging from 40 to 60 percent, depending on consumption brackets, to reduce the impact on smaller consumers. Tariffs will be adjusted in future in line with a cost-based formula linked to fuel prices, with targeted subsidies to protect vulnerable segments of the population. This reform eliminates the need for central government subsidies to STELCO, and enables the electricity company to resume servicing of loans from the government.

- *Revenues.* On the revenue side, the airport tax has been transferred to the central government, effective November 2009, and its rate has been raised by about 29 percent. A business profit tax is planned to be passed by end-2009 (structural benchmark). In addition, in line with longstanding staff advice, the authorities are pressing on to introduce a new *ad valorem* hotel room tax by October 2010, expected to yield almost three times the revenues of the current specific tourism tax of US$8

per bed per night it replaces (structural benchmark).[8] Finally, they plan to introduce a goods and services tax by early 2011, with Fund technical assistance (structural benchmark). Together, the revenue measures are expected to yield as much as 15½ percent of 2009 GDP, once their full-year impact materializes.

- *Deficit financing.* From September, the monetization of the fiscal deficit has been stopped. Domestic deficit financing has been restricted to t-bill sales to commercial banks and state-owned enterprises. An auction system for t-bill placements will be set up by end-2009 (structural benchmark). In addition, the authorities plan to privatize a number of state-owned enterprises. They have already sold a stake of the telecoms company for US$40 million, and a majority stake in the airport is expected to be sold in the coming months. Privatization proceeds will provide a short-term source of financing. Funding is also expected to be assisted by the purchase, by the local branch of the State Bank of India (SBI), of 2–3 year dollar-denominated bonds for US$100 million.

14. **Social protection.** The current economic recession will undoubtedly have a negative impact on the most vulnerable segments of the population. The program aims to protect social spending and lay the foundations for sustained poverty reduction. Under the program, social welfare contributions, pensions, and spending on relief for the tsunami victims will be protected. As mentioned above, the subsidy for electricity—which disproportionately benefited the higher income strata of the population in Malé—has been replaced by a cost-based pricing scheme combined with targeted relief for the poor. The authorities are also committed to enhancing the targeting of food, medicine, water and other subsidies. Adjustments in public sector wages and allowances will be implemented in a manner that affects lower earners proportionally less. Measures are being taken to shield the poor from the effects of public service corporatization (for instance, through scholarships in the case of education). Finally, the authorities are committed to protecting expenditure on social housing and on improving transport links to the outer atolls.

15. **Growth promotion.** The program aims to stimulate faster real GDP growth by providing a stronger macroeconomic policy framework. This should help restore investors' confidence in the economy, and—through this and lower public sector domestic and external debt—reduce the country risk premium. The program also seeks to protect priority capital

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[8] The authorities' planned *ad valorem* tax rate of 6 percent on tourism is low by international standards and relative to competing tourist destinations, and should not materially affect the tourist industry's competitiveness.

expenditure and spending on human development as much as possible. Though not directly part of program conditionality, the authorities' policies for state reform aim to make the public sector leaner and more efficient, including by privatizing enterprises and services that can be more efficiently provided by the private sector (paragraph 19).

16. **Monetary policy.** Monetary policy will support the fiscal adjustment efforts by tightening domestic currency liquidity in order to stem reserve losses. A key step, adopted in September, was to halt the monetization of the deficit. At the same time, the government debt stock with the MMA has been converted into tradable securities. Starting in August, the MMA has been using these securities as underlying collateral to conduct open market operations (OMOs) through reverse repos, contributing to reverse the impact of years of deficit monetization on liquidity (Box 3).

Box 3. Open Market Operations

With the purpose of absorbing the high levels of rufiyaa liquidity that deficit monetization has created, the MMA introduced in August 2009 open market operations through reverse repos (RRP), using government securities as collateral. While the current levels of excess liquidity could have justified the use of outright sales of government securities, RRP were preferred because: (i) the banks' appetite for long-term placements in government bonds was unknown; and (ii) reversible transactions increase the need for subsequent operations and hence contribute to creating a money market.

Features:

- Between August and September 2009, the total debt of the government with the MMA was converted into bonds, with maturities ranging between 1–15 years and fixed interest rates between 6–9 percent, payable semi-annually.
- RRPs are held weekly on Thursdays, with the settlement on Sunday (Friday and Saturday are not working days), overlapping the reporting period for minimum reserve requirements, to facilitate banks' liquidity management.
- The term of the RRPs is one week.
- The MMA does not announce the targeted amounts or interest rates.
- Each bank may submit 3 different bids specifying the amount (number of securities) and interest rate. Bids are binding for the banks.
- The MMA collects the bids and a newly-established Market Operations Committee submits a proposal to the governor regarding the result of the tender (accepted amount, marginal, and average interest rate). The final decision belongs to the governor, and the result (total bids, accepted amount, and average interest rate) is made public the same day.

The first RRPs were encouraging: accepted bids increased every week during the first four weeks, while interest rates remained low. Banks are reluctant to bid amounts that would leave them with low free reserves, and are testing the willingness of the MMA to accept bids at higher rates. Interest rates are likely to go up, once the MMA increases the amounts awarded.

17. **Exchange rate policy.** The authorities and staff concur that the pegged regime and its level remain appropriate, conditional on the implementation of the policy adjustment in line with the program.

- The fixed exchange rate regime has served Maldives well by providing an effective nominal anchor.

- Staff analysis indicates that, on the basis of the policy adjustment envisaged in the program, the peg remains appropriate. The real exchange rate is consistent with the medium-term fundamentals under the baseline scenario (Box 2). This suggests that it is the underlying domestic fiscal and monetary policies that are at the root of the large current external imbalances, not the exchange rate *per se*.

- The authorities and staff agree that a devaluation is not appropriate in current circumstances. A devaluation of the rufiyaa would have only a small impact on the composition of expenditure: given Maldives' high import dependence, based on natural and structural constraints, the scope for expenditure switching is very limited. Instead, a devaluation would impact mainly through expenditure reducing effects, by increasing the domestic currency cost of imports (with a rapid and large pass-through effect on domestic consumer prices). The net fiscal impact in 2009 would be limited if public sector wages are frozen, and could be negative if wages are increased. A devaluation could also lead to a loss of confidence and invite speculation, in a context of low reserves.

- The authorities' program aims to retain the current peg by containing demand pressures through a significant fiscal and monetary tightening, and by boosting confidence through the build-up of international reserves secured by new external financing. Should the policy adjustment not be implemented as envisaged in the program, the peg might become unsustainable. The appropriateness of the exchange rate level and the regime itself will be continuously assessed over the program period.

- As conditions stabilize, the authorities intend to gradually phase out the rationing of foreign exchange supplied to commercial banks, by increasing the amounts provided.

18. **Financial sector policies.** The authorities and staff agree that the financial system needs to be strengthened. The authorities have indicated their intention to restructure the Bank of Maldives (BML)'s portfolio, ensuring speedy action for the recovery of collateral on defaulted debt, and, as necessary, secure a capital infusion. Their preferred option is to find a strategic partner to take over the state's shares. The authorities have also agreed to seek passage of the Banking Law and the reforms to the MMA Act by end-2010 (structural benchmark). This legislation will provide a stronger legal framework for the operation, supervision, regulation, intervention and liquidation of commercial banks.

IV. OTHER (ARTICLE IV) POLICY DISCUSSIONS

19. **Staff supports the authorities' plans for the privatization of a number of state-owned enterprises and services.** The government has set up a Privatization Committee to

conduct and oversee the process. A central plank will be the privatization of the airport, but stakes in the telecommunications company have already been sold and other enterprises and services (such as electricity, water and sewage) could also be divested. The main goal of the government's privatization plan is to enhance the economy's productivity and boost long-term growth through the transfer of activities that can be more efficiently conducted by the private sector. In addition, privatization proceeds provide a helpful, though finite, source of deficit financing and, in case of foreign investor participation, provide a relief to dollar shortages. Privatization efforts, however, are not part of program conditionality.

20. **The authorities have initiated actions to improve public financial management**, with Fund and World Bank assistance. A recently completed Public Expenditure and Financial Accountability (PEFA) report concludes that there are significant shortfalls in the predictability and control of budget execution and in the management of cash, debt, and guarantees, and recommends preparing a comprehensive framework for fiscal risk assessment and management. Some steps have already been taken. The introduction of a treasury single account has strengthened the government's control of public revenue and spending, but several budget entities still retain separate bank accounts. The authorities are also adopting a new Public Accounting System (PAS), to enhance accounting and reporting, as well as budget control and execution. Staff welcome the commitment to introduce debt management units at the MMA and the Ministry of Finance, along with transparent guidelines on borrowing, on-lending and the provision of public guarantees. The staff supports the President's planned administrative decentralization, including the transfer of competencies to provincial and local authorities. This, however, should be achieved without increasing public expenditures.

21. **Some progress has been made in financial regulation and supervision, but significant weaknesses and vulnerabilities remain.** Loan classification and provisioning are inadequate. Loan portfolio concentration has exposed banks to severe risks in case of impaired loans from a few borrowers. Banks have accumulated large imbalances between foreign currency-denominated assets and liabilities, i.e. long open positions in foreign currencies. In response, the authorities issued in May 2009 several regulations to strengthen the prudential framework, in line with Fund technical assistance, comprising *inter alia* rules on capital adequacy; limits on loans to related persons and single borrowers; asset classification and provisioning; external audits; publication and disclosure; and corporate governance. However, supervision and enforcement need to be strengthened, including standing firm on asset classification and provisioning rules. Staff also recommended adopting the regulation to limit open foreign currency positions, implementing and diligently enforcing the licensing regulatory framework, and passing the Banking Law and the reforms to the MMA Act (a structural benchmark under the program).

V. Program Modalities

22. **Facilities and access level.** The Maldivian economy has been hit by large sudden and exogenous shocks to exports, tourism, tourism-related investment, and external financing. These shocks exacerbated an unsustainable fiscal expansion and led to a significant balance of payments need (Box 1). Accordingly, the authorities have requested a blended arrangement, comprising a Stand-By Arrangement with access of 600 percent of quota (SDR 49.2 million) over 36 months, and an arrangement under the Exogenous Shock Facility (High Access Component), with access of 100 percent of quota (SDR 8.2 million), over 24 months.[9] The ESF would help smooth adjustment to the global shocks over the next two years, and the SBA extends over a third year to ensure that a sustainable fiscal position is reached (Box 1). The overall access level reflects the large financing needs caused by the exogenous shocks and the underlying fiscal imbalances, and takes into account the strong medium-term adjustment effort.

23. **Phasing.** Staff proposes an even pattern of disbursements for Fund financing under both the SBA and the ESF (Table 7).

24. **Financing.** Financing assurances from the World Bank and ADB in the amount of US$59 million over the program period have been secured. Together with the proposed Fund financing, these assurances would cover 100 percent of the projected residual external financing gap over the program period. In addition, the World Bank is organizing a donor meeting to seek further pledges from regional and bilateral sources. The additional financing would help the economy smooth out the adjustment and build up reserves, reduce the pressure on the private sector of increased domestic financing of the deficit, and support public spending on capital projects. The recent allocations of special drawing rights (SDRs) are reflected in gross and net international reserves. The authorities intend to save them to bolster the weak reserve position.

25. **Conditionality.** Program conditionality is focused on achieving the required fiscal adjustment and monetary policy tightening, while protecting spending on the poor. The quantitative and structural conditionality, including prior actions, are described in Tables 1–2, attached to the authorities' Memorandum of Economic and Financial Policies (MEFP). The fiscal targets are monitored through a deficit financing performance criterion (a below-

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[9] Maldives qualifies for the ESF (the primary source of its balance of payments need is a sudden and exogenous shock; see Box 1). Fund support for Maldives is presumed to be a blend of GRA and concessional resources, given the country's relatively high per capita income level. The requested access level under the ESF is consistent with the new blending rules elaborated in SM/09/160.

the-line measure of the fiscal deficit), given the data limitations reported in paragraph 28. International reserves are monitored through a target on usable reserves, a variable which the authorities monitor regularly and which excludes encumbrances. The program allows nonconcessional external borrowing up to US$120 million through end-2010 for socially useful and economically viable projects, and because financing of the deficit entirely from concessional sources is not feasible.

26. **Prior actions.** All the prior actions have been implemented. The authorities have announced and mandated reductions in salaries and allowances, as well as adjustments in staffing levels, to reduce the government's wage bill in line with the program. The authorities have also raised electricity tariffs and introduced an automatic, cost-based electricity pricing formula, as well as a subsidy mechanism for the poor. They have converted the totality of the government's outstanding debt to the MMA into tradable securities. The airport tax has been transferred from the airport operator to the government. A 2010 Budget in line with the agreed measures and targets was submitted to the Majlis in mid-November.

27. **Reviews.** Quarterly program reviews will be based on quantitative performance criteria and indicative targets assessed quarterly during the program period, and on implementation of structural benchmarks. The first review is expected to be completed in March 2010, based on end-December 2009 performance criteria, indicative targets and benchmarks, while the second review is expected to be completed in June 2010, based on end-March 2010 performance criteria and indicative targets. The authorities will consult with Fund staff on the appropriate policy responses if there is a significant fall in usable reserves.

28. **Data issues.** Monetary and financial statistics are reported on a monthly basis. Upon request, preliminary monthly data on public expenditure and revenue have recently begun to be produced by the authorities, but the new reporting system is as yet untested. Staff will work with the authorities over the course of the program to improve the quality and timeliness of data provision, including possibly through technical assistance.

29. **Capacity to repay.** The government is committed to implementing the policy program outlined in the Memorandum of Economic and Financial Policies. The authorities' program represents a significant adjustment effort, and should restore Maldives' domestic and external stability reasonably quickly. In addition, the balance of payments need generated by the exogenous shock is expected to ease out over the next two years (Box 1). In particular, the tourism sector—a key source of economic activity and fiscal revenue—is expected to recover and further expand from 2010 onwards, on the back of the global recovery, and external financing should gradually normalize. Moreover, the Fund's exposure is relatively small, compared to Maldives' external payment flows (Table 8). These factors should give reasonable assurances of Maldives' capacity to repay the Fund. If disbursements are made as scheduled, there will be a peak in repayments to the Fund in 2015. Staff analysis shows that the MMA would accumulate enough reserves to repay the Fund and maintain a level of international reserves of more than 4 months of imports.

30. **Debt sustainability analysis (DSA).** Maldives' DSA indicates that the risk of distress for external public and publicly guaranteed (PPG) debt remains moderate; also, risks to total public debt are considerable.[10] The accumulation of large current account and fiscal imbalances in recent years has led to rapid increases in the country's external and public debt stocks. With the strong fiscal adjustment envisaged in the program, external and public debt would steadily decline, and no external PPG debt burden indicators would breach their indicative thresholds. The upward trajectory of the debt-to-GDP ratio under the historical scenario shows that fiscal policy in the recent past was not sustainable. Going forward, the key risks for debt sustainability are large export (tourism) shocks—which would simultaneously affect growth and the external and fiscal positions—and fiscal policy slippages.

31. **Safeguards.** A safeguards assessment of the MMA is currently in progress and will be completed before the first review of the proposed arrangement. The ongoing assessment notes that there are vulnerabilities in the present external audit of the MMA conducted by the Auditor General. The authorities have agreed to appoint an international firm to perform MMA's audit in accordance with international standards on auditing, and to take steps to modernize the MMA Act, strengthen its financial reporting practices, and develop its internal audit function.

32. **Exchange restrictions and multiple currency practices.** The rationing of foreign exchange provided to the commercial banks by the MMA is forcing some current international transactions to be conducted in the parallel market at a premium of around 10 percent over the official peg. This action by a government agency has given rise to a multiple currency practice due to the spread of more than 2 percent between the exchange rates in the official and parallel markets, as well as to an exchange restriction arising from the additional premium that has to be paid in the parallel market.

VI. RISKS

33. **There are substantial risks to the program.** These relate to political factors as well as to external and domestic economic factors.

[10] Additionally, external inflows to the private sector (comprising financing for privatization and tourism projects) are treated, consistent with the authorities, as non-debt creating. The authorities do not have adequate information to disaggregate these flows into FDI and arm's length borrowing. To the extent that part of these flows may be debt, the liquidity and solvency risks associated with external private debt may be higher. This also implies that the FDI account in the balance of payments is considerably underestimated.

- *Fiscal adjustment.* Resistance from civil servants or the broader public, and political opposition, could undermine the very large budget correction as well as the tax reforms that are key to the program's success. This risk is heightened by the government's lack of parliamentary majority. Delayed or insufficient implementation of the envisaged expenditure or revenue measures is a major risk for the program.

- *The global economy.* The turnaround of the economy and of fiscal revenues, the restoration of access to international market financing, the expansion of foreign direct investment, the recovery in external inflows to the private sector (projected to sum about 60 percent of GDP between 2009–2012, and which comprise flows to privatization and tourism projects), depend on a reasonably solid recovery of global economic activity, a normalization of international financial markets, and a pick up in tourism inflows. The global economic environment entails risks both to the upside and the downside.

- *Confidence.* The preservation of confidence in the economy is critical for the success of the program. The path of international reserves and the perceived sustainability of the peg are particularly important. Approval of the program itself should help boost confidence by boosting reserves and easing foreign exchange shortages. Nonetheless, a sudden shift in sentiment, resulting in losses of reserves or deposit withdrawals, cannot be ruled out.

- *Monetary policy.* Open market operations are new in Maldives; a more stable economic environment would have been desirable for their introduction. In addition, even though a strong fiscal adjustment effort is being made, substantial domestic financing requirements remain. These will compete with, and to a certain extent crowd out, the MMA's operations to absorb excess domestic liquidity.

- *Privatization.* The fiscal projections reflect substantial privatization revenues in 2010 and beyond, especially from the airport (also reflected as capital inflows to other sectors in the balance of payments). Although projections for such revenues have been made cautiously, there is a risk that unforeseen events, including political resistance, could postpone or derail the planned privatizations.

- *Financial system.* If banks' NPLs were to remain high or deteriorate further, credit growth could remain subdued. In the case of BML, the risk to the budget could increase.

34. **If any of these risks materializes to a significant extent, the policy measures in the program would have to be reassessed.**[11] This would involve a reevaluation of monetary, exchange rate, and fiscal policies, possibly including further tightening of monetary policy and additional fiscal policies, particularly on the revenue side.

VII. Staff Appraisal

35. **Overview.** The global crisis has hit Maldives hard. Growth, external financing, and budget revenues have all been adversely affected by the global economic downturn and the international financial crisis. This, combined with an unsustainable fiscal expansion, led to severe balance of payments pressures and put the economy on the brink of a currency crisis.

36. **Program.** The authorities have committed to a very significant adjustment program, aimed at addressing the severe impact of the global economic crisis and restoring macroeconomic stability and fiscal sustainability, thereby setting the conditions for renewed economic growth. In particular, they plan to: (i) bring about the large budget deficit reduction required to restore stability and medium-term fiscal sustainability; (ii) reduce excess rufiyaa liquidity and rebuild reserves to prudent levels; and (iii) strengthen the financial system.

37. **Fiscal policy.** The core of the program is a very large fiscal adjustment, intended to reduce aggregate demand pressures and restore fiscal sustainability. The adjustment comprises a partial reversal of the recent large increases in the wage bill, as well as cuts in other operational expenses and non-priority capital, complemented by revenue measures. Given its magnitude, implementing the programmed adjustment will require the authorities' full determination. The authorities' program should be commended for placing the burden of adjustment on current expenditure, while protecting the poor and keeping cuts in capital expenditure relatively modest. The authorities' resolve is buttressed by the fact that the envisaged fiscal policies are consistent with structural public sector reforms that the government intended to pursue from the outset. In addition to the fiscal policy measures under the program, sustained efforts are needed to strengthen public financial management.

38. **Monetary policy.** A shift towards a more active monetary policy is important to complement fiscal adjustment and reduce pressures on reserves. In this regard, the recent introduction of effective monetary policy instruments and the cessation of fiscal deficit

[11] A no-adjustment scenario is presented and briefly discussed in Section II. Staff discussed with the authorities the implications of failing to implement the necessary adjustment, as well as the emergency measures that would be required to attempt to avert, or to deal with the consequences of, a full-blown currency and fiscal crisis.

monetization represent a major step forward. The authorities are determined to pushing forward this transition. In this they have been, and continue to be, supported by extensive Fund technical assistance.

39. **Exchange rate policy.** The authorities' program aims to preserve the current exchange rate regime and the peg's current level. A balanced analysis suggests that the gains from a devaluation, or a move to a floating regime, would be small and uncertain, while the costs would be substantial. The envisaged fiscal adjustment and monetary policy tightening are designed to achieve the correction in demand required to maintain the viability of the current peg. External financing, including from the Fund, should boost confidence by increasing reserves. Staff supports the authorities' request for temporary Fund approval of the exchange restriction and multiple currency practice discussed above, which have been imposed for balance of payments reasons, are temporary, and do not discriminate against Fund members.

40. **Financial sector policies.** The program's financial sector reform agenda addresses the weaknesses in the system. The authorities' willingness to explore a range of options to strengthen BML is commendable. The MMA also needs to act decisively to ensure early compliance by all banks with new MMA regulations on loan classification and provisioning, as well as on foreign currency position, at the earliest possible date.

41. **Risks.** While risks to the program, as outlined above, are substantial, they need to be weighed against the benefits of Fund financial support. Those benefits are significant: without Fund support and the additional external financing it catalyzes, the authorities' very large adjustment effort could be insufficient to avoid a balance of payments crisis. This would imply a disorderly adjustment in the currency and potentially, given the economy's high import dependence, widespread social instability.

42. **The authorities' program is strong, comprehensive, and well-focused, and merits the Fund's support.** Staff recommend the approval of the requested blend arrangement, comprising a Stand-By Arrangement and an arrangement under the Exogenous Shock Facility.

43. It is expected that the next Article IV consultation be held in accordance with Decision No. 12794-(02/76), as amended.

Table 1. Maldives: Selected Economic and Vulnerability Indicators, 2004-12

Population (in 1,000; 2008 est.) 310
GDP per capita (in U.S. dollars; 2008 est.): 4,072
Quota (in million SDRs): 8.2

	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.		Projection		
OUTPUT AND PRICES				(Annual percentage change)					
Real GDP	9.5	-4.6	18.0	7.2	5.8	-4.0	3.4	3.7	4.1
Inflation (end-of-period)	10.1	2.9	3.9	10.4	8.6	6.7	4.7	6.3	3.5
Inflation (period average)	6.3	2.5	3.6	7.6	11.9	5.5	4.5	6.3	3.5
GDP deflator	2.4	1.2	3.5	7.4	13.0	11.0	4.0	6.3	3.5
CENTRAL GOVERNMENT FINANCES				(In percent of GDP)					
Revenue and grants	34.2	47.7	52.1	55.8	49.0	36.3	37.0	43.4	44.2
Expenditure and net lending	36.0	59.0	59.3	60.8	62.8	65.0	54.8	47.5	47.9
Overall balance	-1.8	-11.3	-7.2	-4.9	-13.8	-28.8	-17.8	-4.2	-3.6
Overall balance excl. grants	-2.5	-19.8	-14.6	-12.7	-18.5	-33.6	-18.9	-5.2	-4.6
Financing	1.8	11.3	7.2	4.9	13.8	28.8	17.8	4.2	3.6
Foreign	4.1	2.4	4.5	4.6	3.8	12.7	4.2	2.0	2.6
Of which: Privatization receipts	0.0	0.0	0.0	0.0	0.0	3.0	4.4	2.1	1.9
Domestic	-2.3	8.8	2.7	0.4	10.0	16.1	13.6	2.2	1.1
Of which: Privatization receipts	0.2	0.4	0.4	0.3	0.3	0.1	2.6	1.3	0.8
Public and publicly guaranteed debt	55.2	64.9	62.9	66.4	68.6	91.6	96.0	87.9	82.5
Domestic	15.1	23.6	23.4	26.5	31.2	46.8	54.5	50.4	47.0
External (excl. IMF and currency swaps by MMA)	40.1	41.3	39.6	39.8	37.4	44.8	41.5	37.5	35.5
MONETARY ACCOUNTS				(Annual percentage change, unless otherwise indicated)					
Broad money	32.8	11.7	20.6	23.7	23.6	9.4	6.7	…	…
Domestic credit	32.6	63.2	37.6	45.8	43.4	5.7	7.5	…	…
Of which: To private sector	57.6	54.5	49.5	49.2	33.0	-4.1	-2.1	…	…
NFA of commercial banks (in millions of US$, e.o.p.)	60	-40	-145	-338	-437	-416	-466	…	…
Net forex position of commercial banks (in millions of US$, e.o.p.)	27	38	72	64	141	…	…	…	…
BALANCE OF PAYMENTS				(In percent of GDP, unless otherwise indicated)					
Current account	-15.8	-36.4	-33.0	-41.5	-51.4	-29.6	-23.4	-13.1	-11.1
Of which:									
Exports	23.3	21.6	24.6	21.6	26.2	16.1	17.7	17.7	17.8
Domestic	15.8	13.8	14.8	10.2	10.0	6.6	6.9	6.8	6.8
Re-exports	7.5	7.8	9.9	11.4	16.2	9.5	10.7	10.8	11.0
Imports	-72.7	-87.4	-89.1	-91.5	-96.8	-58.2	-58.8	-55.9	-55.9
Nonfactor services, net	45.1	14.6	35.0	36.0	29.4	22.0	28.4	33.0	36.3
Capital and financial account (incl. e&o)	21.4	34.1	37.9	48.8	46.0	30.5	20.6	11.1	12.5
Of which:									
General government, net	3.2	2.5	4.2	3.4	5.3	8.4	-1.9	-1.2	0.6
Banks and other sectors, net	14.6	30.6	26.0	37.1	33.3	14.6	20.4	10.3	11.1
Overall balance	5.7	-2.3	4.9	7.3	-5.4	0.9	-2.8	-2.0	1.4
Gross international reserves (in millions of US$; e.o.p.) 1/	204	187	232	310	241	277	291	305	347
In months of GNFS imports	3.4	2.6	2.7	3.0	1.8	3.2	3.1	3.1	3.4
In percent of short-term debt at remaining maturity	585	261	168	121	80	81	88	118	143
Usable reserves (in millions of US$; e.o.p.) 1/	117	95	129	182	110	105	130	108	132
In percent of short-term debt at remaining maturity	335	133	93	71	38	31	39	42	54
External debt 2/	43	53	63	80	77	82	80	71	65
Medium- and long-term	42	48	53	63	60	67	68	60	56
Short-term	1	5	10	17	17	15	13	10	8
In percent of domestic GNFS exports	53	93	84	111	114	169	147	124	109
External debt service (in percent of domestic GNFS exports)	5	9	9	12	12	17	24	22	15
Exchange rate (rufyiaa/US$, e.o.p.)	12.8	12.8	12.8	12.8	12.8	…	…	…	…
MEMORANDUM ITEMS									
GDP (in millions of rufyiaa)	9,939	9,596	11,717	13,493	16,137	17,192	18,480	20,354	21,935
GDP (in millions of US$)	776	750	915	1,054	1,261	1,343	1,444	1,590	1,714

Sources: Maldivian authorities, and Fund staff estimates and projections.
1/ MMA liabilities, include SDR allocation of SDR 7.4 million, equivalent to US$11.7 million, made available in Q3 2009, see http://www.imf.org/external/np/tre/sdr/proposal/2009/0709.htm. These are treated as long term liabilities of the MMA.
2/ Includes IMF but excludes domestic foreign-currency denominated debt.

Table 2. Maldives: Central Government Finance, 2004-12

	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.	Projection			
	(In millions of rufiyaa)								
TOTAL REVENUE AND GRANTS	3,404	4,578	6,105	7,535	7,913	6,235	6,829	8,824	9,706
Revenue (excl. privatization receipts)	3,331	3,753	5,237	6,491	7,159	5,410	6,628	8,610	9,489
Tax revenue	1,647	1,723	2,370	2,905	3,393	2,674	3,301	5,017	5,725
Import duties	1,136	1,246	1,684	2,087	2,460	1,752	1,793	1,821	1,963
Tourism tax 1/	410	345	496	547	589	557	444	0	0
Other	102	132	191	271	344	366	1,064	3,195	3,762
Of which: New measures 1/	0	0	0	0	0	26	796	2,834	3,351
Nontax revenue	1,684	2,031	2,867	3,586	3,766	2,735	3,327	3,593	3,764
SOE profit transfers	555	609	727	789	1,135	913	539	565	625
Lease payments	646	675	1,424	1,854	1,723	1,041	1,863	1,916	2,003
Other	484	747	716	943	908	782	926	1,113	1,137
Grants	73	825	867	1,044	754	826	201	213	217
EXPENDITURE AND NET LENDING	3,583	5,658	6,948	8,201	10,142	11,179	10,123	9,676	10,505
Current expenditure	2,788	4,643	5,608	6,560	8,290	8,834	8,356	8,355	9,108
Of which: Salaries and allowances	1,286	1,687	1,925	2,196	3,332	4,824	3,910	3,592	4,227
Interest	139	155	199	234	325	339	656	876	854
Capital expenditure	991	1,132	1,458	1,765	2,027	2,353	2,014	1,596	1,644
Net lending	-197	-118	-118	-125	-175	-8	-248	-275	-247
OVERALL BALANCE	-179	-1,080	-844	-666	-2,229	-4,943	-3,294	-852	-799
OVERALL BALANCE, EXCL. GRANTS	-252	-1,904	-1,711	-1,710	-2,983	-5,769	-3,495	-1,066	-1,016
FINANCING	179	1,080	844	666	2,229	4,943	3,294	852	799
Privatization	21	35	50	37	41	524	1,300	700	600
External sources	0	0	0	0	0	512	811	427	427
Domestic sources	21	35	50	37	41	12	489	273	173
External debt	404	235	529	615	617	1,668	-39	-24	138
Domestic debt	-246	810	265	15	1,572	2,751	2,033	176	61
	(In percent of GDP)								
TOTAL REVENUE AND GRANTS	34.2	47.7	52.1	55.8	49.0	36.3	37.0	43.4	44.2
Revenue	33.5	39.1	44.7	48.1	44.4	31.5	35.9	42.3	43.3
Tax revenue	16.6	18.0	20.2	21.5	21.0	15.6	17.9	24.6	26.1
Import duties	11.4	13.0	14.4	15.5	15.2	10.2	9.7	8.9	8.9
Tourism tax 1/	4.1	3.6	4.2	4.1	3.6	3.2	2.4	0.0	0.0
Other	1.0	1.4	1.6	2.0	2.1	2.1	5.8	15.7	17.2
Of which: New measures 1/	0.0	0.0	0.0	0.0	0.0	0.2	4.3	13.9	15.3
Nontax revenue	16.9	21.2	24.5	26.6	23.3	15.9	18.0	17.7	17.2
SOE profit transfers	5.6	6.3	6.2	5.8	7.0	5.3	2.9	2.8	2.8
Lease payments	6.5	7.0	12.2	13.7	10.7	6.1	10.1	9.4	9.1
Other	4.9	7.8	6.1	7.0	5.6	4.5	5.0	5.5	5.2
Grants	0.7	8.6	7.4	7.7	4.7	4.8	1.1	1.0	1.0
EXPENDITURE AND NET LENDING	36.0	59.0	59.3	60.8	62.8	65.0	54.8	47.5	47.9
Current expenditure	28.1	48.4	47.9	48.6	51.4	51.4	45.2	41.0	41.5
Of which: Salaries and allowances	12.9	17.6	16.4	16.3	20.6	28.1	21.2	17.6	19.3
Interest	1.4	1.6	1.7	1.7	2.0	2.0	3.5	4.3	3.9
Capital expenditure	10.0	11.8	12.4	13.1	12.6	13.7	10.9	7.8	7.5
Net lending	-2.0	-1.2	-1.0	-0.9	-1.1	0.0	-1.3	-1.4	-1.1
OVERALL BALANCE	-1.8	-11.3	-7.2	-4.9	-13.8	-28.8	-17.8	-4.2	-3.6
OVERALL BALANCE, EXCL. GRANTS	-2.5	-19.8	-14.6	-12.7	-18.5	-33.6	-18.9	-5.2	-4.6
FINANCING	1.8	11.3	7.2	4.9	13.8	28.8	17.8	4.2	3.6
Privatization	0.2	0.4	0.4	0.3	0.3	3.0	7.0	3.4	2.7
External sources	0.0	0.0	0.0	0.0	0.0	3.0	4.4	2.1	1.9
Domestic sources	0.2	0.4	0.4	0.3	0.3	0.1	2.6	1.3	0.8
External debt	4.1	2.4	4.5	4.6	3.8	9.7	-0.2	-0.1	0.6
Domestic debt	-2.5	8.4	2.3	0.1	9.7	16.0	11.0	0.9	0.3
MEMORANDUM ITEMS									
Current balance	5.5	-9.3	-3.2	-0.5	-7.0	-19.9	-9.4	1.3	1.7
Primary balance	-0.4	-9.6	-5.5	-3.2	-11.8	-26.8	-14.3	0.1	0.3
Public and publicly guaranteed debt	55.2	64.9	62.9	66.4	68.6	91.6	96.0	87.9	82.5
Domestic	15.1	23.6	23.4	26.5	31.2	46.8	54.5	50.4	47.0
External (excl. IMF and currency swaps by MMA)	40.1	41.3	39.6	39.8	37.4	44.8	41.5	37.5	35.5
GDP	9,939	9,596	11,717	13,493	16,137	17,192	18,480	20,354	21,935

Sources: Maldivian authorities, and Fund staff estimates and projections.

1/ The tourism tax is expected to be replaced by an ad valorem tax in mid 2010 (receipts under which are shown under new measures).

Table 3. Maldives: Monetary Accounts, 2004-10

	2004	2005	2006	2007	2008	2009				2010
					Est.	Mar.	Jun.	Sep.	Dec.	
						Act.	Act.	Proj.	Proj.	Proj.
	(In millions of rufiyaa, e.o.p.)									
NET FOREIGN ASSETS	3,375	1,788	1,032	-458	-2,572	-968	-1,321	-1,843	-2,212	-2,739
Maldives Monetary Authority, net	2,605	2,303	2,881	3,866	3,027	3,399	2,847	2,551	3,109	3,221
Assets	2,616	2,395	2,973	3,957	3,089	3,450	2,899	2,582	3,552	3,732
Liabilities	-11	-91	-91	-91	-62	-50	-51	-31	-443	-510
Commercial banks, net	770	-516	-1,850	-4,324	-5,600	-4,367	-4,169	-4,394	-5,321	-5,961
NET DOMESTIC ASSETS	2,609	4,897	7,032	10,430	14,899	13,914	14,463	15,391	15,696	17,132
Domestic credit	4,223	6,890	9,478	13,820	19,813	19,617	19,910	20,737	20,941	22,520
Public sector	675	1,410	1,286	1,600	3,565	3,865	4,448	5,241	5,361	7,260
Central govt (net)	425	922	714	584	2,189	2,609	3,324	4,032	4,211	6,080
Public enterprises	250	488	573	1,017	1,376	1,256	1,124	1,209	1,150	1,180
Private sector	3,548	5,480	8,192	12,220	16,248	15,752	15,462	15,496	15,580	15,260
Other items (net)	-1,614	-1,993	-2,446	-3,390	-4,914	-5,703	-5,446	-5,346	-5,245	-5,388
BROAD MONEY	5,984	6,685	8,063	9,972	12,326	12,946	13,142	13,548	13,484	14,392
Narrow money	2,477	3,033	3,707	4,405	6,082	6,624	6,861	7,045	7,012	7,484
Currency	763	883	1,068	1,142	1,510	1,536	1,557	1,657	1,659	1,719
Public enterprise & local gov't deposits	52	44	15	42	11	6	21	19	17	18
Demand deposits	1,662	2,106	2,625	3,221	4,562	5,082	5,283	5,369	5,336	5,747
Quasi-money	3,507	3,652	4,356	5,567	6,244	6,322	6,281	6,503	6,472	6,908
MEMORANDUM ITEMS										
Velocity	1.66	1.44	1.45	1.35	1.31	1.33	1.31	1.27	1.28	1.28
Money multiplier	2.18	2.32	2.36	2.28	2.26	2.29	2.20	2.28	2.24	2.53
Reserve money	2,743	2,883	3,424	4,374	5,444	5,662	5,967	5,948	6,022	5,680
	(Percent change with respect to end of previous year)									
Broad money	32.8	11.7	20.6	23.7	23.6	5.0	6.6	9.9	9.4	6.7
Narrow money	19.7	22.5	22.2	18.8	38.1	8.9	12.8	15.8	15.3	6.7
Domestic credit, net	32.6	63.2	37.6	45.8	43.4	-1.0	0.5	4.7	5.7	7.5
Central government	-49.6	116.8	-22.6	-18.2	275.0	19.2	51.9	84.2	92.4	44.4
Public enterprises	176.6	95.2	17.3	77.6	35.3	-8.7	-18.3	-12.1	-16.4	2.6
Private sector	57.6	54.5	49.5	49.2	33.0	-3.1	-4.8	-4.6	-4.1	-2.1
	(In percent of GDP)									
Broad money	60	70	69	74	76	75	76	79	78	78
Narrow money	25	32	32	33	38	39	40	41	41	40
Domestic credit, net	42	72	81	102	123	114	116	121	122	122
Central government	4	10	6	4	14	15	19	23	24	33
Public enterprises	3	5	5	8	9	7	7	7	7	6
Private sector	36	57	70	91	101	92	90	90	91	83
	(In millions of U.S. dollars)									
Gross foreign assets of MMA	204	187	232	310	241	270	227	201	277	291
Usable reserves	117	95	129	182	110	128	87	64	105	130
Commercial banks NFA	60	-40	-145	-338	-437	-341	-326	-343	-416	-466
Commercial banks forex position, net	27	38	72	64	141	153	161	…	…	…
Assets	321	417	630	940	1,160	1,273	1,213	…	…	…
Liabilities	295	379	558	876	1,020	1,120	1,052	…	…	…
Of which: forex deposits	275	290	338	451	489	592	573	…	…	…

Sources: Maldivian authorities, and Fund staff estimates and projections.

Table 4. Maldives: Balance of Payments, 2004-12

	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.	Projection			
	(In millions of U.S. dollars, unless otherwise indicated)								
CURRENT ACCOUNT	-122	-273	-302	-438	-648	-398	-338	-209	-190
Balance of goods and nonfactor services	-34	-384	-269	-357	-520	-271	-183	-84	-32
Trade balance	-384	-494	-590	-737	-891	-566	-593	-609	-653
Exports (fob)	181	162	225	228	330	216	255	281	306
Domestic exports	122	103	135	108	126	88	100	108	116
Re-exports	59	58	90	120	205	128	155	173	189
Imports (fob)	-565	-655	-815	-965	-1,221	-782	-849	-889	-959
Tourism-related	-137	-142	-171	-232	-254	-162	-176	-185	-199
Other	-428	-514	-645	-733	-967	-619	-672	-704	-759
Nonfactor services, net	350	110	321	380	370	295	410	525	621
Of which: Travel receipts	471	287	512	602	664	521	630	701	774
Income, net	-35	-31	-41	-67	-64	-63	-65	-67	-73
Current transfers, net	-54	142	8	-14	-63	-64	-90	-58	-85
Receipts	8	211	91	91	65	65	21	17	17
Payments	-61	-70	-83	-105	-128	-128	-111	-75	-102
CAPITAL AND FINANCIAL ACCOUNT	153	264	291	442	496	355	252	156	214
Of which: 1/									
Foreign direct investment, net	15	9	14	15	12	10	10	11	12
Other investment, net	138	254	277	427	484	345	242	145	202
Monetary authorities 2/	0	6	0	0	-2	37	-25	0	0
General government	25	19	39	36	67	112	-27	-19	11
Of which: Disbursements of loans	47	43	63	65	101	154	72	86	65
Amortization	-22	-24	-24	-29	-35	-42	-99	-105	-54
Banks	-12	99	104	193	100	-22	50	-62	-43
Other sectors 3/	125	130	134	198	320	218	244	226	234
ERRORS AND OMISSIONS	13	-8	56	73	84	55	45	20	0
OVERALL BALANCE	44	-17	45	77	-68	13	-40	-32	23
Gross international reserves (increase: -)	-44	11	-45	-77	70	-35	-14	-14	-42
Use of Fund credit, net	0	6	0	0	-2	-3	0	0	0
FINANCING GAP	0	0	0	0	0	26	55	47	19
Of which: IMF	0	0	0	0	0	8	31	29	19
World Bank and ADB	0	0	0	0	0	18	24	17	0
MEMORANDUM ITEMS									
Gross international reserves (stock; e.o.p.) 2/	204	187	232	310	241	277	291	305	347
In months of GNFS imports	3.4	2.6	2.7	3.0	1.8	3.2	3.1	3.1	3.4
In percent of short-term debt at remaining maturity	585	261	168	121	80	81	88	118	143
Usable reserves (stock; e.o.p.) 2/	117	95	129	182	110	105	130	108	132
In percent of short-term debt at remaining maturity	335	133	93	71	38	31	39	42	54
Current account (in percent of GDP)	-15.8	-36.4	-33.0	-41.5	-51.4	-29.6	-23.4	-13.1	-11.1
GNFS balance (in percent of GDP)	-4.3	-51.2	-29.4	-33.9	-41.3	-20.2	-12.7	-5.3	-1.9
Exports (volume, percent change)	7.6	-12.7	29.6	-9.5	25.5	-24.9	17.4	9.3	7.7
Imports (volume, percent change)	19.7	4.4	12.4	7.3	9.8	-21.8	3.2	2.3	5.7
Tourism: bednights (percent change)	8.6	-35.4	46.1	9.8	3.0	-7.0	8.0	6.0	6.0
External debt (in percent of GDP) 4/	42.7	53.0	62.8	79.7	76.9	82.1	80.1	70.5	64.7
Medium- and long-term	41.6	47.9	52.8	62.6	59.9	67.4	67.5	60.5	56.2
Short-term	1.1	5.0	10.0	17.1	17.0	14.8	12.6	10.0	8.4
Debt service (in percent of domestic GNFS exports)	5.0	9.1	8.6	12.1	12.5	17.5	23.5	22.2	14.5
Exchange rate (rufiyaa per $; average)	12.8	12.8	12.8	12.8	12.8	…	…	…	…
GDP (in millions of US$)	776	750	915	1,054	1,261	1,343	1,444	1,590	1,714

Sources: Maldivian authorities, and Fund staff estimates and projections.

1/ There are no capital transfers or portfolio investments.
2/ MMA liabilities, include SDR allocation of SDR 7.4 million, equivalent to US$11.7 million, made available in Q3 2009, see http://www.imf.org/external/np/tre/sdr/proposal/2009/0709.htm. These are treated as long term liabilities of the MMA.
3/ These flows are treated as non-debt creating, as they mainly reflect intra-company financing for tourism-related projects.
4/ Includes IMF but excludes domestic foreign-currency denominated debt.

Table 5. Maldives: Medium-Term Projections, 2006-14

	2006	2007	2008	2009	2010	2011	2012	2013	2014
			Est.	Projection					
OUTPUT AND PRICES	(Annual percentage change)								
Real GDP	18.0	7.2	5.8	-4.0	3.4	3.7	4.1	4.3	4.5
Inflation (end-of-period)	3.9	10.4	8.6	6.7	4.7	6.3	3.5	3.0	3.0
Inflation (period average)	3.6	7.6	11.9	5.5	4.5	6.3	3.5	3.0	3.0
GDP deflator	3.5	7.4	13.0	11.0	4.0	6.3	3.5	3.0	3.0
CENTRAL GOVERNMENT FINANCES	(In percent of GDP, unless otherwise indicated)								
Revenue and grants	52.1	55.8	49.0	36.3	37.0	43.4	44.2	44.1	43.9
Tax revenue	20.2	21.5	21.0	15.6	17.9	24.6	26.1	26.3	26.5
Nontax revenue 1/	24.5	26.6	23.3	15.9	18.0	17.7	17.2	16.8	16.4
Grants	7.4	7.7	4.7	4.8	1.1	1.0	1.0	0.9	0.9
Expenditure and net lending	59.3	60.8	62.8	65.0	54.8	47.5	47.9	46.4	44.9
Current expenditure	47.9	48.6	51.4	51.4	45.2	41.0	41.5	39.1	37.6
Capital expenditure	12.4	13.1	12.6	13.7	10.9	7.8	7.5	7.5	7.5
Net lending	-1.0	-0.9	-1.1	0.0	-1.3	-1.4	-1.1	-0.3	-0.2
Overall balance	-7.2	-4.9	-13.8	-28.8	-17.8	-4.2	-3.6	-2.3	-1.0
Overall balance excl. grants	-14.6	-12.7	-18.5	-33.6	-18.9	-5.2	-4.6	-3.2	-1.9
Primary balance	-5.5	-3.2	-11.8	-26.8	-14.3	0.1	0.3	1.2	2.2
Financing	7.2	4.9	13.8	28.8	17.8	4.2	3.6	2.3	1.0
Foreign	4.5	4.6	3.8	12.7	4.2	2.0	2.6	1.1	1.0
Of which: Privatization receipts	0.0	0.0	0.0	3.0	4.4	2.1	1.9	0.0	0.0
Domestic	2.7	0.4	10.0	16.1	13.6	2.2	1.1	1.2	0.0
Of which: Privatization receipts	0.4	0.3	0.3	0.1	2.6	1.3	0.8	2.5	2.4
Public and publicly guaranteed debt	62.9	66.4	68.6	91.6	96.0	87.9	82.5	76.6	69.8
Domestic	23.4	26.5	31.2	46.8	54.5	50.4	47.0	42.5	37.1
External (excl. IMF and currency swaps by MMA)	39.6	39.8	37.4	44.8	41.5	37.5	35.5	34.1	32.7
BALANCE OF PAYMENTS									
Current account	-33.0	-41.5	-51.4	-29.6	-23.4	-13.1	-11.1	-9.3	-7.9
Of which:									
Exports	24.6	21.6	26.2	16.1	17.7	17.7	17.8	17.9	18.0
Domestic	14.8	10.2	10.0	6.6	6.9	6.8	6.8	6.8	6.8
Re-exports	9.9	11.4	16.2	9.5	10.7	10.8	11.0	11.1	11.2
Imports	-89.1	-91.5	-96.8	-58.2	-58.8	-55.9	-55.9	-55.8	-55.9
Nonfactor services, net	35.0	36.0	29.4	22.0	28.4	33.0	36.3	38.1	39.7
Of which: Travel receipts	56.0	57.1	52.6	38.8	43.6	44.1	45.1	46.2	47.3
Capital and financial account	37.9	48.8	46.0	30.5	20.6	11.1	12.5	12.5	11.1
Of which:									
General government, net	4.2	3.4	5.3	8.4	-1.9	-1.2	0.6	1.1	1.0
Banks and other sectors, net	26.0	37.1	33.3	14.6	20.4	10.3	11.1	10.7	9.4
Overall balance	4.9	7.3	-5.4	0.9	-2.8	-2.0	1.4	3.2	3.2
MEMORANDUM ITEMS									
Gross international reserves (in millions of US$; e.o.p.) 2/	232	310	241	277	291	305	347	398	441
In months of GNFS imports	2.7	3.0	1.8	3.2	3.1	3.1	3.4	3.6	3.7
In percent of short-term debt at remaining maturity	168	121	80	81	88	118	143	188	221
Usable reserves (in millions of US$; e.o.p.) 2/	129	182	110	105	130	108	132	190	253
In percent of short-term debt at remaining maturity	93	71	38	31	39	42	54	90	127
External debt 3/	62.8	79.7	76.9	82.1	80.1	70.5	64.7	60.0	55.8
Medium- and long-term	52.8	62.6	59.9	67.4	67.5	60.5	56.2	52.5	48.9
Short-term	10.0	17.1	17.0	14.8	12.6	10.0	8.4	7.6	6.8
External debt service (in percent of domestic GNFS exports)	8.6	12.1	12.5	17.5	23.5	22.2	14.5	13.0	9.8
GDP (in millions of rufyiaa)	11,717	13,493	16,137	17,192	18,480	20,354	21,935	23,559	25,354
GDP (in millions of US$)	915	1,054	1,261	1,343	1,444	1,590	1,714	1,841	1,981

Sources: Maldivian authorities, and Fund staff estimates and projections.

1/ Excludes privatization receipts.
2/ MMA liabilities, include SDR allocation of SDR 7.4 million, equivalent to US$11.7 million, made available in Q3 2009, see http://www.imf.org/external/np/tre/sdr/proposal/2009/0709.htm. These are treated as long term liabilities of the MMA.
3/ Includes IMF but excludes domestic foreign-currency denominated debt.

Table 6: Maldives: Financing Requirements and Sources, 2004-12

	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.	Projection			
External				(In millions of U.S. dollars)					
FINANCING REQUIREMENTS	197	308	419	653	905	737	695	553	491
Current account deficit	122	273	302	438	648	398	338	209	190
Amortization of MLT debt	23	26	34	47	74	87	144	149	99
ST debt (stock at end of previous year)	7	9	38	91	181	214	198	181	160
Increase in gross international reserves	44	0	45	77	0	35	14	14	42
Repurchases from the Fund	0	0	0	0	2	3	1	0	0
FINANCING SOURCES	197	308	419	653	905	711	639	507	472
FDI (net)	15	9	14	15	12	10	10	11	12
Porfolio investment (net)	0	0	0	0	0	0	0	0	0
Other assets (net)	110	162	113	183	342	226	244	226	234
MLT loans disbursement 1/	47	43	63	65	101	154	72	86	65
New ST debt	9	38	91	181	214	198	181	160	145
Other net flows 2/	17	39	138	209	166	123	132	24	17
Decrease in gross international reserves	0	11	0	0	70	0	0	0	0
Purchases from the Fund	0	6	0	0	0	0	0	0	0
Exceptional financing	0	0	0	0	0	0	0	0	0
FINANCING GAP	0	0	0	0	0	26	55	47	19
Of which: IMF	0	0	0	0	0	7.8	31.1	29.5	18.7
World Bank and ADB	0	0	0	0	0	18	24	17	0
MEMORANDUM ITEMS									
Rollover rate of ST debt (in percent)	122	433	243	198	118	93	91	88	91
GIR (million $, e.o.p.)	204	187	232	310	241	277	291	305	347
Usable reserves (million $, e.o.p.)	117	95	129	182	110	105	130	108	132
External financing requirement (in percent of GDP)	25.4	41.1	45.7	62.0	71.8	54.8	48.1	34.8	28.6
Fiscal				(In millions of rufyiaa)					
FINANCING REQUIREMENTS	415	461	507	605	768	876	1,927	2,216	1,549
External principal payments	276	307	308	371	443	537	1,271	1,340	695
Interest payments	139	155	199	234	325	339	656	876	854
Domestic	50	63	97	102	134	163	451	587	557
External	89	92	102	132	191	176	204	289	298
FINANCING SOURCES	415	461	507	605	768	646	1,619	1,998	1,549
Primary balance	-40	-925	-645	-432	-1,904	-4,604	-2,639	24	55
Privatizations	21	35	50	37	41	524	1,300	700	600
Domestic (net)	-246	810	265	15	1,572	2,751	2,033	176	61
External disbursements	680	542	837	986	1,060	1,974	925	1,098	832
FINANCING GAP	0	0	0	0	0	230	307	218	1
MEMORANDUM ITEM									
Fiscal financing requirement (in percent of GDP)	4.2	4.8	4.3	4.5	4.8	5.1	10.4	10.9	7.1

Sources: Maldivian authorities, and Fund staff estimates and projections.

1/ 2009 includes a US$100 million loan from India.

2/ Includes flows to the nonfinancial public and private sectors.

Table 7. Maldives: Reviews and Disbursements under the Proposed Arrangements

Date	Amount of Purchase				Condition
	In percent of quota		In millions of SDRs		
	SBA	ESF	SBA	ESF	
December 4, 2009	50.0	12.5	4.1	1.025	Approval of SBA and ESF arrangements
March 25, 2010	50.0	12.5	4.1	1.025	Completion of first review and observance of end-December 2009 performance criteria
June 25, 2010	50.0	12.5	4.1	1.025	Completion of second review and observance of end-March 2010 performance criteria
September 25, 2010	50.0	12.5	4.1	1.025	Completion of third review and observance of end-June 2010 performance criteria
December 25, 2010	50.0	12.5	4.1	1.025	Completion of fourth review and observance of end-September 2010 performance criteria
March 25, 2011	50.0	12.5	4.1	1.025	Completion of fifth review and observance of end-December 2010 performance criteria
June 25, 2011	50.0	12.5	4.1	1.025	Completion of sixth review and observance of end-March 2011 performance criteria
September 25, 2011	50.0	12.5	4.1	1.025	Completion of seventh review and observance of end-June 2011 performance criteria
December 25, 2011	50.0	0	4.1	0	Completion of eighth review and observance of end-September 2011 performance criteria
March 25, 2012	50.0	0	4.1	0	Completion of ninth review and observance of end-December 2011 performance criteria
June 25, 2012	50.0	0	4.1	0	Completion of tenth review and observance of end-March 2012 performance criteria
September 25, 2012	50.0	0	4.1	0	Completion of eleventh review and observance of end-June 2012 performance criteria
Total	600	100	49.20	8.20	

Source: Fund staff projections.

Table 8. Maldives: Indicators of Capacity to Repay the Fund, 2006-21 1/

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Projections												
Fund obligations based on existing credit																
(in millions of SDRs)																
Principal	0.0	0.0	1.5	2.1	0.5	-	-	-	-	-	-	-	-	-	-	-
Charges and interest 2/	0.2	0.2	0.2	0.0	0.0	-	-	-	-	-	-	-	-	-	-	-
Fund obligations based on existing and prospective credit																
(in millions of SDRs)																
Principal	0.0	0.0	1.5	2.1	0.5	-	-	5.1	13.3	16.8	12.5	4.7	1.6	1.6	1.2	0.4
Charges and interest 2/	0.2	0.2	0.2	0.1	0.2	0.5	1.0	1.2	1.0	0.5	0.2	0.1	0.0	0.0	0.0	-
Total obligations based on existing and prospective credit																
In millions of SDRs	0.2	0.2	1.7	2.1	0.7	0.5	1.0	6.3	14.3	17.3	12.7	4.8	1.7	1.7	1.2	0.4
In millions of Rfs	3.8	4.3	34.3	41.1	14.0	9.1	18.6	122.2	278.6	337.7	247.6	93.2	32.4	32.2	24.2	8.0
In percent of government revenue 3/	0.1	0.1	0.5	0.8	0.2	0.1	0.2	1.2	2.6	2.9	1.9	0.7	0.2	0.2	0.1	0.0
In percent of exports of goods and services	0.0	0.0	0.3	0.4	0.1	0.1	0.1	0.7	1.5	1.7	1.1	0.4	0.1	0.1	0.1	0.0
In percent of debt service 4/	0.5	0.4	2.5	2.8	0.6	0.4	1.0	6.5	18.0	23.5	17.4	6.4	2.5	3.0	2.2	0.7
In percent of GDP	0.0	0.0	0.2	0.2	0.1	0.0	0.1	0.5	1.1	1.2	0.8	0.3	0.1	0.1	0.1	0.0
In percent of quota	2.4	2.7	20.7	25.8	8.8	5.7	11.7	76.6	174.3	211.2	154.9	58.3	20.2	20.1	15.1	5.0
In percent of GIR	0.1	0.1	1.1	1.2	0.4	0.2	0.4	2.4	4.9	5.4	3.6	1.3	0.4	0.4	0.3	0.1
Outstanding Fund credit 4/																
In millions of SDRs	4.1	4.1	2.6	5.6	25.6	45.1	57.4	52.3	39.0	22.1	9.6	4.9	3.3	1.6	0.4	-
In millions of Rfs	77.2	80.3	51.9	109.5	497.7	874.3	1,114.6	1,017.5	759.4	431.7	188.0	95.9	64.0	32.0	8.0	-
In percent of government revenue 3/	1.5	1.2	0.7	2.0	7.5	10.2	11.7	10.0	7.0	3.7	1.5	0.7	0.4	0.2	0.0	-
In percent of exports of goods and services	0.8	0.7	0.4	1.1	4.1	6.3	7.2	6.0	4.1	2.1	0.9	0.4	0.3	0.1	0.0	-
In percent of debt service 4/	10.2	6.9	3.8	7.5	21.1	34.0	58.7	54.4	49.0	30.0	13.2	6.6	4.9	3.0	0.7	-
In percent of GDP	0.7	0.6	0.3	0.6	2.7	4.3	5.1	4.3	3.0	1.6	0.6	0.3	0.2	0.1	0.0	-
In percent of quota	50.0	50.0	31.3	68.8	312.6	550.0	700.0	637.6	475.0	270.0	117.6	60.0	40.0	20.0	5.0	-
In percent of GIR	2.6	2.0	1.7	3.1	13.4	22.4	25.1	20.0	13.5	6.9	2.7	1.3	0.8	0.4	0.1	-
Net use of Fund credit (millions of SDRs)	-	-	(1.5)	3.1	20.0	19.5	12.3	(5.1)	(13.3)	(16.8)	(12.5)	(4.7)	(1.6)	(1.6)	(1.2)	(0.4)
Disbursements	-	-	-	5.1	20.5	19.5	12.3	-	-	-	-	-	-	-	-	-
Repayments and Repurchases	-	-	1.5	2.1	0.5	-	-	5.1	13.3	16.8	12.5	4.7	1.6	1.6	1.2	0.4
MEMORANDUM ITEMS																
Nominal GDP (in millions of Rfs)	11,717	13,493	16,137	17,192	18,480	20,354	21,935	23,559	25,354	27,290	29,373	31,616	34,030	36,628	39,425	42,435
Exports of goods and services (in millions of Rfs)	9,947	11,226	13,457	10,011	12,027	13,829	15,486	16,959	18,603	20,133	21,788	23,546	25,446	27,498	29,677	32,028
Government revenue (in millions of Rfs) 3/	5,237	6,491	7,159	5,410	6,628	8,610	9,489	10,159	10,896	11,755	12,711	13,714	14,795	15,961	17,179	18,491
Debt service (in millions of Rfs) 4/	754	1,170	1,352	1,466	2,363	2,575	1,898	1,871	1,548	1,440	1,426	1,457	1,311	1,072	1,122	1,144
GIR (in millions of USD)	232.3	309.5	241.5	276.7	290.8	304.9	347.1	397.6	440.5	486.0	534.5	579.7	634.9	694.1	748.9	804.1

Source: Fund staff estimates.

1/ Arising from projected disbursements under the proposed stand-by arrangement and Exogenous Shocks Facility.
2/ No temporary interest relief assumed pending receipt of required consents to the LIC reforms from lenders and contributors to the PRGF-ESF Trust.
3/ Excludes privatization receipts.
4/ Total debt service includes IMF repurchases and repayments.

Appendix I: Maldives: Table of Implementation of past Fund advice

Advice from the 2008 Article IV Discussions	Implementation
Adhere to zero domestic financing of the 2008 budget as intended; identify contingent expenditure cuts in the event that revenues do not materialize.	The authorities did not contain spending in 2008, and revenues, in particular from land leases, fell significantly short of budget projections. As a result, domestic financing of the budget, excluding proceeds from the sale of assets, rose to 9½ percent of GDP, much of which was monetized.
Contain the wage bill through civil service reform.	A rationalization of the civil service pay scale was undertaken in March 2009, but this has led to substantial increases in wages. Recently, the government has announced cuts in wages and allowances, and in civil service staffing levels.
Reduce subsidies to the state-owned electricity company (STELCO), by increasing electricity tariffs.	The authorities have raised electricity tariffs and are introducing a cost-based formula for further price adjustments. A transfer scheme to protect vulnerable segments of the population is being implemented.
Enhance revenues in the medium term through the introduction of corporate taxation, broad-based sales tax, and an ad-valorem tourism tax.	The authorities are planning to transfer the airport tax to the central government, and introduce an ad-valorem tourism tax in 2010, and a business profits tax and a general sales tax in 2011.
Develop a medium-term expenditure framework (MTEF).	An MTEF was presented at a donors' meeting in May 2009. However, this will need to be revised in light of recently announced revenue and expenditure measures to reduce the fiscal deficit.
Pass Banking Act, AML/CFT legislation.	A draft Banking Act has been prepared with technical assistance from the IMF, and submitted to Parliament. A draft AML/CFT law, prepared also with IMF assistance, has passed various review stages and will be submitted to Parliament this year. Maldives has established a financial intelligence unit within the MMA.

ATTACHMENT I

Malé, November 24, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

The economy of the Maldives is facing a critical economic situation. The impact of the global economic crisis on exports and tourism inflows, external financing, and fiscal revenue, has exacerbated an increase in public spending by the previous administration, and led to very large fiscal and external imbalances, and a loss of international monetary reserves.

To address these challenges, the Government of Maldives has adopted a package of economic policy measures for 2009-11, described in the attached Memorandum of Economic and Financial Policies (MEFP). In support of these policies, we request a blended arrangement with the International Monetary Fund, comprising a Stand-By Arrangement (SBA) for SDR 49.2 million (equivalent to about US$ 78.2 million, or 600 percent of quota) for a period of 36 months, and an arrangement under the Exogenous Shock Facility (High Access Component) for SDR 8.2 million (about US$ 13 million, or 100 percent of quota) over 24 months. We are also securing significant additional support from other international financial institutions and bilateral partners.

The Government of Maldives believes that the policies set forth in the attached MEFP are adequate to stabilize the economy and put it back on a path of sustainable and equitable growth. However, if needed, the Government stands ready to take additional policy measures to meet the objectives of our program. The Government will consult with the Fund on the implementation of the policies contained in the MEFP, and in advance of revisions to these policies, in accordance with the Fund's policies on such consultation.

The Government of Maldives has authorized the publication of the attached MEFP.

Sincerely yours,

/s/	/s/
Ali Hashim	Fazeel Najeeb
Minister of Finance and Treasury	Governor, Maldives Monetary Authority

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. Background: Recent Developments and Outlook

1. **Maldives recently experienced a peaceful transition to democracy after the first ever multi-party presidential elections held in October 2008.** The new President Mohamed Nasheed was sworn in in November 2008, following the 30 year-rule of President Maumoon Abdul Gayoom. One of the key objectives of President Nasheed's Government is to strengthen Maldives' prospects for sustained economic growth and consolidate the gains achieved over the last three decades in poverty reduction and human development outcomes.

2. **While the Maldivian economy rebounded strongly from the 2004 tsunami, propelled by tourism-related investment and public spending, the new Government took office against a background of major economic challenges.** Even before the presidential elections, the global financial and economic crises had already started affecting Maldives' vitally important tourism sector from September 2008 onwards, as reflected in the falling tourist arrivals. It also lowered the public and private sector's access to international credit markets, and was the primary cause of the country's balance of payments need.

3. **The new Government also inherited serious fiscal imbalances.** The expansionary fiscal policy of the past two years, not related to post-tsunami reconstruction expenditures, combined with a dramatic fall in fiscal revenue since the latter part of 2008 driven by the global downturn and its negative impact on tourism, has led to very large budget deficits. The main source have been rapid increases in current expenditures, particularly in salaries and wage allowances—the wage bill rose from 13 percent of GDP in 2004 to 21 percent of GDP in 2008. As provided for by the Finance Act, the initial budget for 2009 had to be presented to Parliament by end-November, 2008, leaving no time for the new Government to reduce the unacceptably high budget deficit. In addition, the Government had to put in place in February 2009 a wage restructuring, including a significant rise, agreed to by the previous administration. As a result, the fiscal deficit in the first half of 2009 was running at an annual rate of over 30 percent of GDP.

4. **Moreover, greater recourse to monetization of the deficit has increased inflationary pressures and led to reserve losses .** Large and rapidly increasing fiscal deficits, combined with a rise in oil and food prices through mid-2008, and since late 2008 with a dramatic fall in external financing and foreign currency earnings associated with the global downturn, have caused the current account deficit to soar and led to a loss of usable foreign reserves down to below 1 month of imports. This forced the Maldives Monetary Authority (MMA) to limit the amount of foreign exchange sold weekly to commercial banks as a short-term measure to stem reserve losses and defend the fixed peg to the US dollar, which has served economy well as a nominal anchor since 2001.

5. **The domestic economic downturn has put significant stress on the domestic banking system.** With a high exposure to the tourism sector, some banks, including the Bank of Maldives (BML), have experienced a significant increase in non-performing

loans. Combined with a more difficult external financing environment, this has also provoked stress in the foreign-currency liquidity position of some banks.

6. **The near-term outlook remains challenging.** In 2009, tourism receipts are projected to decline by around 7 percent. We anticipate real GDP to fall by up to 4 percent in 2009, dragged down mainly by a decline in tourism and related activities. Budgetary revenues from the tourism tax and from customs duties are also expected to fall. Assuming that the global recession starts abating in late 2009, growth for 2010 should recover to about 3½ percent, leading to a pick up in fiscal revenue. Global economic conditions, however, are unusually uncertain, and could affect the strength and timing of domestic recovery as well as the availability of external financing and, through these, the health of the banking sector. Whereas lower commodity prices have reduced inflationary pressures and should help moderate the current account deficit, a sharp reduction in non-oil import demand would be necessary to stem reserve losses. Despite having received substantial financial support from the Indian Government, Maldives could have faced a severe fiscal and balance of payments crisis, unless a substantial policy adjustment was put in place.

7. **Against this background, the Government of Maldives is committed to implementing a policy strategy, under an IMF-supported arrangement, to restore domestic and external stability, while protecting the poor.** The key elements of the policy program are to: (i) bring public finances on a sustainable path, including through a continuous reduction in public debt from 2011; (ii) tighten monetary policy, including by halting deficit monetization and conducting open market operations to absorb excess liquidity; (iii) muster adequate multilateral and bilateral financing to smooth the path of internal and external adjustment; and (iv) strengthen the liquidity and capital position of the banking system. These policies to strengthen the macroeconomic position will be complemented by broader and deeper policy and institutional reforms to improve the microeconomic fundamentals and the investment environment by boosting productivity growth and addressing key bottlenecks to private economic activity.

II. Fiscal Policy

8. **Fiscal policy will aim at bringing government finances back to a sustainable medium-term trajectory.** Without corrective action, the fiscal deficit would have soared to about 33 percent of GDP in 2009, reflecting a sharp fall in revenue and continued spending growth. Starting with the wage restructuring announced by President Nasheed on August 12, 2009, we have initiated a comprehensive package of reforms to not only improve the public finances but also achieve a leaner and more efficient public sector. These reforms aim to reduce the fiscal deficit to 29 percent of GDP in 2009, and to 18 percent of GDP in 2010. The 2010 Budget, submitted to Parliament in mid-November, reflects the proposed fiscal adjustment measures and is consistent with the achievement of the fiscal targets in the program.

9. **The adjustment focuses primarily on expenditure restraint.** A key part of our program, in line with the present government's Manifesto, is to reduce the size and revise the pay structure of the civil service. Savings will come from an ongoing restructuring of wages, allowances and overtime payments, implemented in a progressive manner such

that lower earners are proportionally less affected. Effective October 1, 2009, the Civil Service Commission (CSC) implemented a temporary reduction in civil service wages of between 10 and 20 percent, depending on rank. This adjustment will be reversed when central government's domestic revenue reaches Rf 7 billion. Equivalent cuts have been extended to non-civil service government employees. In April 2009, the Government instructed the CSC, the Maldives Police Services and the Maldives National Defence Force, to freeze the number of positions allowed in their institutions. In addition, we have announced and initiated the transfer of certain services (airports, public works, schools, hospitals) to the private sector, with the aim of improving efficiency and reducing costs. In the case of education, this process will be complemented by scholarships for poorer children. Transferred employees will have access to training to facilitate their incorporation into the private sector. These transfers, together with direct redundancies to begin this year, will significantly reduce the number of staff on government payroll by end-2010, compared to June 2009 staffing levels. Finally, we are introducing cuts in other operational expenses (mainly travel expenses and supplies), and postponing domestically-financed, non-priority capital projects. The expected full-year impact of the expenditure measures is Rf 2½ billion (14 percent of GDP), bringing overall central government spending down to just over Rf 10 billion (about 55 percent of GDP) by end-2010.

10. **We will also take decisive action on the revenue side, and have already announced important tax reforms.** The aim is to broaden the overall tax base and reduce reliance on import taxes. The airport tax has been transferred to the central government, effective November 2009, and Parliament recently passed an amendment to the airport tax law raising its rate by about 29 percent. We plan to introduce by end-2009 a business profit tax on all enterprises earning above a certain threshold (structural benchmark). Also, by end-September 2010, a new *ad valorem*-based tourism tax to substitute for the existing $8/per night/per person tax will be introduced (structural benchmark). For 2011, we plan to put in place a goods and services tax (GST) (structural benchmark). On a conservative basis, these revenue measures are expected to yield 3½ percent of GDP in 2010, with a much larger impact in later years (over 15 percent of 2009 GDP), when the full-year impact of the ad-valorem tax is felt, and the other revenue measures come on stream.

11. **The Government is determined to support the most vulnerable sectors of the population.** Our program will protect spending on tsunami relief and social welfare contributions, while broadening the coverage of the pension system. We are also enhancing the targeting of food, medicine and other subsidies to the poor, including through cuts in non-targeted transfers. In particular, starting from November 2009, electricity subsidies have been restructured from a universal-based system to a targeted approach. The electricity tariff has been raised and based on a cost-linked formula, but the pricing scheme provides relief on the cost of electricity to the most vulnerable. This will eliminate the need for central government transfers to STELCO and enable the company to repay loans on-lent to it by the government.

12. **In line with the main tenets of its Manifesto, the Government has put in place a privatization program, which will continue to reduce the direct involvement of the state in production activities that can be more efficiently carried out by the private sector.** This includes the transfer of services referred to above, as well as the privatization

of state-owned enterprises and other assets. In particular, we have already sold a stake of the telecommunications company for US$40 million, and plan to sell a majority of the shares of the Maldives Airports Company, with substantial proceeds to be received over three years. The President's Office also set up a Privatization Committee to program the privatization of other state-owned enterprises. Privatization receipts will provide a short-term source of financing the deficit, while the public finances are put back on a sustainable footing.

13. **We acknowledge that financing the large fiscal deficit, even with a significant adjustment and with the privatization proceeds, will be challenging.** However, we have already halted the monetization of the deficit, and switched to other sources of financing, including through t-bill and bond sales. We intend to initiate auctions of t-bills in the primary market by the end of 2009 (structural benchmark). Additionally, we are seeking budget support from multilateral and bilateral sources. The IMF-supported arrangement will be complemented by direct budget support loans from the World Bank (about US$24 million) and the Asian Development Bank (about US$35 million). We have also secured additional external financial support, in particular further funds from India. A donors meeting is being organized by the World Bank to secure further pledges.

14. **The fiscal adjustment measures will be complemented by actions to improve public financial management over the medium term.** We are committed to adopting the recommendations of the recent IMF/World Bank Public Expenditure and Financial Accountability (PEFA) assessment. A single treasury account at the MMA has been introduced. We are completing the transition to a new Public Accounting System (PAS) that will enhance budget execution, internal control, cash management, accounting and fiscal reporting. We are in the process of establishing effective debt management units, accompanied by transparent procedures on borrowing, on-lending, and the provision of government guarantees.

III. Exchange Rate Regime and Monetary Policy

15. **Since 2001, the exchange rate has been pegged to the US dollar at Rf 12.8 per dollar.** In a small, highly open economy with very limited instruments for the independent conduct of monetary policy, the peg has provided a strong and credible nominal anchor, while reducing transaction costs and uncertainty. The Government is committed to reducing the pressures on the currency through a combination of strong fiscal adjustment and monetary tightening, thus supporting the exchange rate peg at its current level. Should usable reserves fall at any time during a given quarter by more than a predefined amount relative to the performance criterion of the previous quarter, we will consult with the IMF staff.

16. **We will gradually ease the rationing of foreign exchange as conditions improve.** At present, the MMA is rationing the amounts of foreign exchange it supplies to commercial banks on a weekly basis. This practice has given rise to a multiple currency practice and an exchange restriction subject to International Monetary Fund's jurisdiction. We hereby request approval by the IMF of the maintenance of the exchange restriction and multiple currency practice under the program. We undertake not to intensify the restriction nor modify the multiple currency practice during the length of the Fund arrangement. As the foreign currency market stabilizes, the MMA will phase out the

current rationing of foreign exchange by gradually increasing the maximum amount supplied to banks, thereby re-channeling transactions back to the formal foreign exchange market.

17. **To support the external and internal adjustment, the MMA is focusing on tightening monetary policy.** A key step has been the halting of deficit monetization starting in September 2009. Also, the totality of the stock of government debt with the MMA was converted into negotiable securities with varying maturities. This has allowed the MMA to begin conducting open market operations to reabsorb the excess liquidity generated by years of monetizing the deficit. These operations, as well as the auctions of government securities, will yield market interest rates. The increased volumes of government securities should eventually facilitate the emergence of secondary markets, including a money market, that would provide a source of liquidity for banks and the non-financial private sector.

18. **The Government is committed to seeking passage, by end-2010, of a set of reforms to the MMA Act** (structural benchmark)**.** Among other things, these reforms will strengthen the autonomy of the MMA, define its relations with the Government (including by limiting its financing of the fiscal deficit), improve its governance and accountability, and provide it with instruments to conduct an independent monetary policy.

IV. Financial Sector Policy

19. **The banking system is well capitalized and has long net open positions in foreign exchange, but some of the banks are facing an increase in non-performing loans associated with the downturn in the tourism sector.** The global crisis has also impacted banks through a reduced access to external financing. This is particularly relevant in the case of the Bank of Maldives (BML), which, unlike the rest of the commercial banks, is not a branch of a foreign bank and hence lacks access to the credit lifelines that parent banks can extend.

20. **The Government of Maldives is determined to maintaining the health of the banking system, including by strengthening BML.** The MMA, together with the Ministry of Finance and Treasury, is implementing a clear plan to address BML's problems. As a first step, the management of the bank has been replaced. Going forward, the intention is to restructure its portfolio and, as required, secure a capital infusion, possibly by attracting a strategic partner.

21. **We will expedite passage of the Banking Law** (structural benchmark)**.** In conjunction with reforms to the MMA Act, this legislation will provide an enhanced legal framework for the operation, supervision, regulation, intervention, and resolution of commercial banks.

V. Safeguards Assessment

22. **We welcome the safeguards assessment currently in progress.** Following on the recommendations of a mission conducted by the IMF in October 2009, the MMA has already taken steps to appoint an international audit firm to conduct the audit of the

MMA's financial statements in accordance with international standards. The MMA is committed to implementing the other priority recommendations of the safeguards assessment.

VI. Program Monitoring

23. **The program will be monitored on the basis of quarterly reviews, with quantitative performance criteria, indicative targets, and structural benchmarks.** Completion of the first and second reviews, scheduled for March 2010 and June 2010, will require observance of the quantitative performance criteria for end-December 2009 and end-March 2010, respectively. These performance criteria are specified in Table 1. The first review will also assess progress towards observance of the structural benchmarks specified in Table 2. Program conditionality is further specified in the accompanying Technical Memorandum of Understanding (TMU).

24. **The Government authorizes the IMF to publish this Letter of Intent and its attachments, Tables 1 and 2.**

Table 1. Maldives: Quantitative Performance Criteria and Indicative Targets

	2009				2010			
	Mar. Act.	Jun. Act.	Sep. Proj.	Dec. PC	Mar. PC	Jun. IT	Sep. IT	Dec. IT
I. Performance criteria 1/								
Usable reserves of MMA (floor on stock, in million $)	128	87	64	100	120	120	120	127
Reserve money (ceiling on stock, in million MRF)	5,669	5,974	5,948	6,050	5,950	5,900	5,750	5,750
Total financing of the central government's budget deficit (ceiling on cumulative flow from beginning of FY, in million MRF)	1,335	2,888	4,061	4,970	1,170	2,200	2,865	3,320
Net credit of MMA to central government (ceiling on cumulative flow from beginning of FY, in million MRF)	340	568	1,143	750	100	100	100	100
Contracting or guaranteeing of new nonconcessional external debt 2/ (ceiling on stock, in million $)	…	…	…	70	120	120	120	120
Accumulation of external payments arrears 3/ (ceiling on stock, in million $)	0	0	0	0	0	0	0	0
II. Indicative target								
Domestically financed expenditure by government (ceiling on cumulative flow from beginning of FY, in million MRF)	2,248	4,958	7,265	8,800	2,500	5,000	7,500	10,000
III. Adjusters								
External financial support to the government and MMA (grants and loans), excl. IMF 4/ (cumulative flow from beginning of FY, in million $)	121	138	196	287	37	112	147	168
Central government revenue (cumulative flow from beginning of FY, in million $)	1,157	2,561	4,022	5,410	1,374	2,817	4,664	6,628
IV. Memorandum items								
Program exchange rates								
MRF/$	12.80	12.80	12.80	12.80	12.80	12.80	12.80	12.80
$/SDR	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50

V. Consultation clause

If the level of usable reserves falls at any time during a given quarter by more than a predefined amount below the performance criterion for the previous quarter, the authorities will consult with the IMF staff.

1/ Evaluated at the programmed exchange rate.
2/ The ceiling is set on the stock of new debt contracted or guaranteed at any time after the approval of the program.
3/ This performance criterion is assessed on a continuous basis.
4/ Includes $100 million in dollar-denominated bonds to be purchased by the Male branch of the State Bank of India; excludes swap arrangement with Sri Lanka.

Table 2. Maldives: Prior Actions (PA) and Structural Benchmarks (SB)

Actions	Type	Test date
Conversion of the government's outstanding debt with the MMA into negotiable securities.	PA	Implemented
Directives from the relevant authorities mandating adjustments in wages, allowances and staffing levels to achieve a reduction in the central government's wage bill in line with the program.	PA	Implemented
Transfer of revenue from airport tax to the central government.	PA	Implemented
Introduction of a cost-based formula to govern electricity tariff adjustments; approval by the Maldives Energy Authority of an electricity tariff increase in line with that formula; and introduction of an electricity subsidy scheme targeted to the poor.	PA	Implemented
Submission to Parliament of 2010 Budget in line with the program	PA	Implemented
Launch of t-bill auctions	SB	December, 2009
Passage by Parliament and entry into effect of business profit tax	SB	December, 2009
Passage by Parliament and entry into effect of ad valorem tax on tourism industry	SB	September, 2010
Passage by Parliament of revised Banking Bill and MMA act	SB	December, 2010
Passage by Parliament and entry into effect of goods and services tax (GST)	SB	January, 2011

ATTACHMENT II

Technical Memorandum of Understanding

1. **This Technical Memorandum of Understanding sets out a framework for monitoring the performance of Maldives under the program, supported by a Stand-by Arrangement (SBA) and an arrangement under the Exogenous Shock Facility (ESF).** It specifies the definitions for quantitative performance criteria and indicative targets, on the basis of which Maldives's performance under the program will be assessed through quarterly reviews. Monitoring procedures and reporting requirements are also specified. The first review will take place in or after March 2010 and the second review in or after June 2010.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

2. Performance criteria for end-December 2009 and end-March 2010 have been established. The targets in Table 2 for end-June 2010, end-September 2010, and end-December 2010 are indicative and will be converted to performance criteria at the time of the reviews. Targets have been set with respect to:

- Floor on the level of usable reserves of the MMA;
- Ceiling on the level of reserve money of the MMA;
- Ceiling on the level of total financing of the central government's deficit;
- Ceiling on the level of net credit of MMA to central government;
- Ceiling on the contracting and guaranteeing by the central government or the MMA of new nonconcessional external debt.
- Ceiling on the accumulation of new external payment arrears of the central government and the MMA. This performance criterion is applicable on a continuous basis.

3. Indicative targets for end-December 2009, end-March 2010, end-June 2010, end-September 2010 and end-December 2010 have been established with respect to a ceiling on the overall domestically financed expenditure by the government, excluding debt amortization payments.

II. INSTITUTIONAL DEFINITIONS

4. The central government includes all units of budgetary central government.

5. The domestic banking system is defined as the MMA, the existing and any newly licensed commercial banks incorporated in Maldives, and their branches.

6. The domestic non-bank sector is defined as comprising private individuals as well as any business or institution, private or public, that is not classified as part of the domestic banking system.

III. Monetary Aggregates

7. **Valuation**. Foreign currency-denominated accounts will be valued in rufiyaa at the program exchange rate between the rufiyaa and the U.S. dollar of Rf 12.80 per U.S. dollar. Foreign currency accounts denominated in currencies other than the U.S. dollar, excluding SDRs, will first be valued in U.S. dollars at actual end-of-period exchange rates used by the MMA to calculate the official exchange rates. SDR-denominated accounts will be valued at the program exchange rate of U.S. dollar 1.50 per SDR. Monetary gold will be valued at US$950 per ounce.

A. Usable Reserves of the MMA

8. A floor applies to the level of usable reserves of the MMA. The floor on usable reserves will be adjusted upward (downward) by the amount of external support (loans and grants) to the government and MMA (excluding from the IMF) in excess (short) of the programmed level.

9. Usable reserves will be calculated as gross international reserves less international reserve liabilities less foreign currency deposits at the MMA. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the MMA shall be valued at program exchange rates and gold price as described in paragraph 7 above.

10. **Gross international reserves** of the MMA are defined as the sum of

- Monetary gold holdings of the MMA;
- Holdings of SDRs;
- Maldives's reserve position in the IMF;
- Cash in foreign currencies
- Foreign currency assets held abroad that are under the direct and effective control of the MMA and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution.

11. **International reserve liabilities** of the MMA are defined as the sum of

- All outstanding liabilities of Maldives to the IMF[1]; and
- Any foreign convertible currency liabilities of the MMA to nonresidents with an original maturity of up to and including one year.

12. **Foreign currency deposits** at the MMA include foreign currency deposits of comme rcial banks, state-owned enterprises and the government held with the MMA.

B. Reserve Money of the MMA

13. A ceiling applies to the level of reserve money of the MMA.

14. Reserve money consists of currency issued by the MMA (excluding MMA holdings of currency), commercial banks' deposits held with the MMA and public enterprises' deposits held with the MMA.

C. Net Credit of the MMA to the Central Government

15. A ceiling applies to the net credit of MMA to the central government measured cumulatively from the beginning of the year.

16. Net credit of the MMA to the central government is defined as the net borrowing of the central government from the MMA (ways and means advances, loans, overdrafts, holdings of restructuring bonds, holdings of treasury bills or other government bonds, and all other accounts on account of the government, minus central government deposits at the MMA).

IV. Fiscal Aggregates

A. Total Financing of the Central Government's Deficit

17. A ceiling applies to the total financing of the deficit of the central government, measured cumulatively from the beginning of the year. The ceiling on the total financing of the central government's deficit will be adjusted downward by eighty percent of the amount of total central government's revenue in excess of the programmed levels.

18. For the purpose of program monitoring, total financing of the central government's deficit is defined as the sum of (i) net domestic financing; (ii) net external financing and (iii) privatization receipts.

[1] Allocations of special drawing rights (for a total of 7,691,108 SDRs) are reflected in the capital accounts of the MMA. The asset counterpart of these allocations (holdings of SDRs) is reflected in the gross international reserves of the MMA. Therefore, the recent general and special SDR allocations, for a total of 7,408, 708 SDRs, resulted in an increase in the gross international reserves and the net usable reserves of the MMA.

- Net domestic financing is the sum of net domestic bank financing and net nonbank domestic financing.

- Net domestic bank financing is defined as the sum of: (i) net MMA credit to the central government (defined above), and (ii) the change in the commercial banks' claims on the central government in domestic and foreign currency, including the change in the holdings of government securities by the commercial banks; minus the balances of the central government held in the commercial banks.

- Net nonbank domestic financing is defined as the sum of: (i) the change in the holdings of government securities by the domestic non-bank sector, calculated as the difference between the change in the stock or net issuance of government securities and the change in the holdings of government securities by the banking system; and (ii) the net change in the float. The float consists of the value of checks issued and not yet cashed by the beneficiaries.

- Net external financing is the sum, in national currency valued at program exchange rates, of (i) the disbursements of external loans to the central government; (ii) exceptional financing (rescheduled principal plus interest); (iii) proceeds from bonds issued abroad; less (iv) amortization due; (v) net reduction in external arrears; and (vi) changes in cash, deposits, and securities held for liquidity purposes outside the domestic banking system.

- Privatization proceeds are defined as the cash receipts from asset sales by the government from abroad or domestically.

19. For the purposes of program monitoring, total central government revenue is defined as the sum of tax revenue and non-tax revenue, and excludes (i) subsidiary loan repayments; (ii) government loan account repayments; (iii) the MMA revaluation account; and (iv) any receipts from privatization.

B. Domestically Financed Expenditure by Government

20. An indicative ceiling target applies to the central government domestically financed expenditure, measured cumulatively from the beginning of the year.

21. The central government domestically financed expenditure, excluding amortization payments, is defined as actual domestically financed central government expenditure on a cash basis, excluding amortization payments, calculated on the basis of expenditure reports submitted by Accountable Government Agencies.

V. PUBLIC DEBT

A. External Debt

22. A ceiling applies to the contracting and guaranteeing by the central government, the MMA, or other agencies on behalf of the central government, that takes place after the approval of the program, of new non-concessional debt of any maturity with nonresidents. The ceiling applies to the total amounts of the debt and commitments contracted or guaranteed after program approval, regardless of when the corresponding disbursements are made.

23. The definition of debt, for the purposes of the program, is set out in Executive Board Decision No. 12274, Point 9, as revised on August 24, 2000 (see Annex I).

24. Excluded from the ceiling are (i) the use of Fund resources; (ii) lending from the World Bank, the Asian Development Bank, and the International Fund for Agricultural Development; (iii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt; (iv) concessional debts; (v) any rufiyaa-denominated treasury bills and government bonds, and MMA bills held by nonresidents; (vi) debts classified as international reserve liabilities of the MMA; (vii) debts to restructure, refinance, or prepay existing debts; and (viii) normal import financing. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

25. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the central government, the MMA, or other agencies on behalf of the central government to service a loan in the event of nonpayment by the recipient (involving payments in cash or in kind), or indirectly through any other obligation of the central government, the MMA, or other agencies on behalf of the central government to finance a shortfall incurred by the loan recipient.

26. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The NPV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the Organization for Economic Cooperation Development (OECD). For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. To both the ten-year and six-month averages, the same margins for differing repayment periods as those used by the OECD would continue to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to

19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more). Loans provided by a private entity will not be considered concessional unless accompanied by a grant or grant element provided by a foreign official entity, such as both components constitute an integrated financing package with a combined grant element equal to at least 35 percent.

VI. External Payment Arrears

27. A continuous performance criterion applies to the nonaccumulation of external payments arrears on external debt contracted or guaranteed by the central government or the MMA. External payments arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreements. However, overdue debt and debt service obligations that are in dispute will not be considered as external payments arrears for the purposes of program monitoring.

VII. Data Provision

28. The authorities have committed to using the best available data, so that any subsequent data revisions will not lead to a breach of a performance criterion. All revisions to data will be promptly reported to the Fund's Asia and Pacific Department. The likelihood of significant data changes, including definitional changes, will be communicated to Fund staff as soon as the risk becomes apparent to the authorities.

29. Data required to monitor performance under the program, including those related to performance criteria and indicative targets, will be provided electronically or in hard copy to the Fund. The data to be reported are listed below, and the reporting responsibilities are indicated in parentheses.

A. Monetary Data (MMA)

- The monetary survey, the balance sheet of the MMA, and the consolidated balance sheets of the commercial banks. Data will be provided on a monthly basis, with the exception of the balance sheet of the MMA and the consolidated balance sheets of the commercial banks, which will be provided on a weekly basis within ten working days of the end of the respective week and on a monthly basis within fifteen working days of the end of the respective month.

- Interest rates and volume on standing facilities and market operations, to be provided on a weekly basis within ten working days of the end of the respective week, and on a monthly basis within fifteen working days of the end of the respective month.

- A detailed breakdown of net credit to the central government from the MMA, the commercial banks and the nonbank sector, to be provided on a weekly basis withing

ten working days of the end of the respective week and on a monthly basis within fifteen working days of the end of the respective month.

- Results of reverse repurchase operations by the MMA, to be provided within five working days of each operation, including total bids received, accepted amount, and average interest rate.

B. Fiscal Data (Ministry of Finance and Treasury—MOFT)

- Domestically financed central government expenditure on a cash basis, excluding amortization payments, calculated on the basis of expenditure reports submitted by Accountable Government Agencies to be provided on a monthly basis within four weeks of the end of the respective month.

- Net domestic bank financing to the central government (as defined above), to be provided on a monthly basis within four weeks of the end of the respective month.

- Net nonbank domestic financing to the central government (as defined above), to be provided on a monthly basis within four weeks of the end of the respective month.

- Net external financing to the central government (as defined above), to be provided on a monthly basis within four weeks of the end of the respective month.

- Privatization receipts from asset sales by the government on a cash basis, to be provided on a monthly basis within 4 weeks of the end of the respective month.

- Results of outright sales and auctions of treasury bills, to be provided within five working days of each operation, including total amounts sold to banks and the non-bank sector, and the average yield.

C. External Sector Data (MMA and MOFT)

- Outstanding stock, disbursements, amortization, and interest payments of short-term external debt contracted or guaranteed by the government or the MMA by creditor in original currency and U.S. dollars, to be provided on a quarterly basis within four weeks of the end of the respective quarter.

- Outstanding stock, disbursements, amortization, and interest payments of medium- and long-term external debt contracted or guaranteed by the government or the MMA by creditor in original currency and U.S. dollars, to be provided on a quarterly basis within four weeks of the end of the respective quarter.

- External debt newly contracted or guaranteed by the government or the MMA, including terms (interest rate and grace and repayment periods), to be provided on a quarterly basis within 4 weeks of the end of the respective quarter.

- Arrears on the external debt contracted or guaranteed by the government or the MMA by creditor in original currency and U.S. dollars, to be provided on a quarterly basis within four weeks of the end of the respective quarter.

- Exports and imports in value terms, to be provided by the MMA on a monthly basis within four weeks of the end of the respective month.

D. Other Data (Department of National Planning)

- Consumer price index data, including a detailed breakdown by major categories of goods and services, to be provided on a monthly basis within four weeks of the end of the respective month.

ANNEX I. GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO FOREIGN DEBT

Excerpt from Executive Board Decision No. 12274, as revised on August 24, 2000

9. (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

MALDIVES

Joint IMF/World Bank Debt Sustainability Analysis under the Debt Sustainability Framework for Low Income Countries[1]

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

Approved by Kalpana Kochhar and Aasim Husain (IMF)
and Carlos Braga and Ernesto May (IDA)

November 25, 2009

Based on the low-income country debt sustainability analysis (LIC DSA), Maldives' is rated to be at a moderate risk of debt distress. Vulnerabilities for total public debt are higher, and addressing them will require timely implementation of the authorities' strong fiscal adjustment program. The borrowing space in the short and medium terms has shrunk after the recent accumulation of large fiscal and external deficits. The build-up of private external debt prior to the onset of the global financial crisis and of public domestic debt (mainly owed to the Maldives Monetary Authority, MMA) in the last two years has intensified the debt burden. Key risks for debt sustainability are large future shocks to exports or fiscal policy slippages. Satisfactory implementation of the fiscal adjustment proposed under the program would lead to a sustained downward path in the public and external debt stocks.[2]

I. The Debt Portfolio

1. **The total debt to GDP ratio has increased fast since 2004, and reached almost 110 percent of GDP in 2008[3].** Each major category of debt has shown strong growth rates following the 2004 tsunami. Growth in private external debt, used to finance a rapidly expanding

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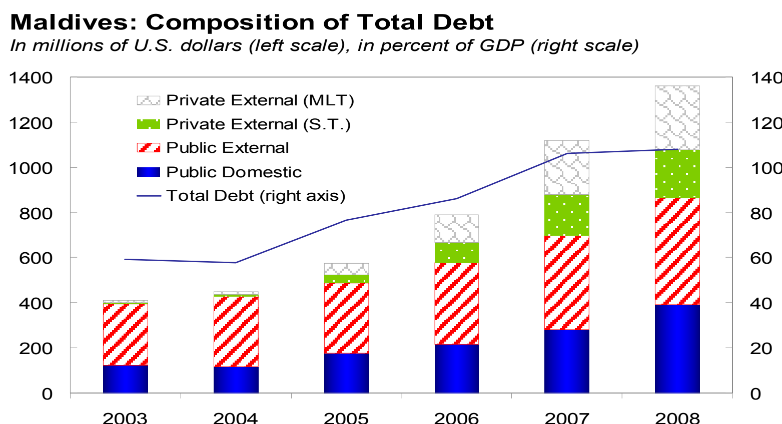
[1] This DSA was prepared jointly by the staffs of the IMF and the World Bank. The staffs also consulted with the Asian Development Bank. The debt data underlying this exercise were provided by the Maldivian authorities. The fiscal year for Maldives is January-December.

[2] Maldives' policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA), averaged 3.53 over the past three years (2006-2008), placing it as a "medium performer." The relevant indicative thresholds for this category are: 40 percent for the NPV of debt-to-GDP ratio, 150 percent for the NPV of debt-to-exports ratio, 250 percent for the NPV of debt-to-revenue ratio, 20 percent for the debt service-to-exports ratio, and 30 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed (PPG) external debt.

[3] In this section, total debt refers to total PPG debt (external and domestic) and private external debt.

tourism sector, has been particularly fast. An increasing fiscal deficit in the last two years has also led to a build up of public debt, much of it domestic. With external financing sources limited for much of 2009 and a fiscal deficit running close to 30 percent of GDP, a further build-up of domestic debt has been observed so far this year, which largely explains the projected increase in the total debt-to-GDP ratio to about 129 percent in 2009.



2. **Public external debt rose rapidly after the 2004 tsunami**, as donor funds flowed into the country for reconstruction needs. It reached US$472 million (37½ percent of GDP) in 2008. About 70 percent (or one third of the total debt stock) is from multilateral and bilateral creditors. This fact, and the assumption that new borrowing is expected to be contracted from multilateral and bilateral creditors throughout the projection period, motivates the use of the low-income country (LIC) framework for the DSA.[4]

II. Macroeconomic Assumptions

3. **Maldives is facing severe fiscal and external imbalances.** For the first three years after the 2004 tsunami disaster, the authorities pursued a growth strategy based on infrastructure spending and expansion of tourism, financed by both official grants and loans and private sector foreign borrowing. However, the global economic downturn has had a significant negative impact on export and tourism receipts, as well as government revenue. Moreover, private sector financing has contracted sharply. Combined with excessive government spending, this has led to a growing fiscal deficit, much of which has been monetized by the central bank. To address these challenges, the Government of Maldives has adopted a package of economic policy measures as described in their Memorandum of Economic and Financial Policies (MEFP). The DSA that follows builds on the program baseline scenario (Box 1).

[4] This is the first DSA for Maldives that uses the LIC framework. Previous DSAs were conducted using the template designed for Middle-Income Countries (MICs). Thus, no debt distress rating was previously assigned. Although a comparison of ratings is therefore not possible, a qualitative comparison with the last DSA (IMF Country Report No. 09/97) suggests that the risk of debt distress has increased.

Box 1: Main Assumptions for the Debt Sustainability Analysis (2009-2029)

- **Real GDP growth** in 2009-14 is projected to average 2½ percent a year compared with an average of 7¼ percent over the previous five years. Negative growth in 2009, projected at -4 percent, is mainly due to reduced activity in the tourism sector, which has been adversely affected by global economic downturn. Growth is expected to recover thereafter to around 4½ percent, as global and domestic conditions improve, but to remain below the recent historical average. This assumes that resort development takes place at a more sustainable pace than that observed since the tsunami, and that supply constraints will hold back the fisheries sector.

- **Inflation** (which drives the GDP deflator) is projected to average 4¼ percent a year in 2009-14, compared with an average of 6½ percent over the previous five years, thanks to a moderation of global prices and the fiscal adjustment effort. Inflation is expected to stay at 3 percent thereafter, in line with trading partners' rates, reflecting continued fiscal consolidation and a tighter monetary policy.

- **Interest rates** on public debt are assumed to increase to 4½ percent by 2011 (compared with an average of 3¼ percent over the previous five years), reflecting a tighter domestic liquidity. They are assumed to decline thereafter.

- **The external current account deficit** (including grants) in 2009-14 is projected to average 15½ percent of GDP a year and decline to 5 percent by 2019 reflecting a significant fiscal retrenchment, compared to 51½ percent in 2008. Thereafter, it would remain at below its pre-tsunami level (2003).

- **The overall fiscal deficit** (including grants) is projected at 28¾ percent of GDP in 2009, as the full impact of the adjustment effort will only be felt in 2010. The deficit is expected to decline to an average of 5¾ percent of GDP in 2010-14, owing to a strong fiscal consolidation. The budget is expected to remain in balance thereafter. As a result, the volume of domestic borrowing will decline, although its cost may rise somewhat as the stock of outstanding obligations from the government to the MMA are securitized at a slightly higher average market rate than the penal rate charged by the MMA on the government's overdraft account. Public external debt is assumed to be contracted mainly on concessional terms until the end of the projection period.

- **Government expenditures** are expected to decline from 63 percent of GDP in 2008 to 45 percent by 2014, mainly reflecting civil service reforms. The **government's revenue** measures—airport tax, ad valorem bed tax, business profits tax, and the general sales tax—are expected to yield about 15 percent of 2009 GDP once their full impact is felt. These new taxes will partly offset steep falls in import duties, lease payments, and profits transfers from SOEs, stemming, respectively, from the fall in public expenditure, a moderation in future lease payments from resorts, and privatization.

III. EXTERNAL DEBT SUSTAINABILITY[5]

Baseline Scenario

4. **Maldives' external debt has increased rapidly since the Tsunami,** reflecting an increase in both public external financing and private foreign-financed investment. As of end-2008, PPG debt represented 49 percent of total external debt. The external debt path is expected to worsen in the near term, as the Maldivian authorities seek external assistance to tide over the difficult economic situation. In particular, this includes financial assistance from the Indian government totaling US$200 million,[6] and borrowing from IFIs (IMF, World Bank, and Asian Development Bank) projected at US$146 million. The authorities are also expecting additional nonconcessional external borrowing through end-2010.[7] This borrowing explains the hump in the path of external debt service in 2010–11. The external-debt-to-GDP ratio, however, is projected to decline from 2010 onwards.

5. **With one minor and temporary exception, all external debt indicators remain below the debt burden thresholds under the baseline scenario.** The PV of external public debt-to-GDP ratio is projected to be slightly above the 40 percent threshold this year, but trend down thereafter as expected program implementation helps reduce the current account deficit to sustainable levels. This marginal and temporary breach of the threshold is due in large part to the extraordinary fiscal and current account imbalances of the past two years, which the Fund-supported program aims to address. The program also places a ceiling on non-concessional public external borrowing going forward. All other public external debt burden indicators remain well below thresholds throughout the projection period. While there is a hump in debt service payments over the next two years as a result of a repayment of a large loan from the Indian government, both debt service ratios remain well within the thresholds.

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[5] External debt sustainability analysis is focused on PPG external debt, to which thresholds are applicable. Private external debt is not considered for the purpose of IDA grant allocations.

[6] A credit of US$100 million was made available to the government of Maldives by the government of India in early 2009, and repayments in the tune of US$50 million in two tranches are expected to be made in 2010 and 2011, respectively. Also, the Male branch of the State Bank of India (SBI) is expecting to contract a US$100 million two-year non-concessional loan (subject to fifty percent rollover) from its parent by end 2009 and early 2010, and on-lend it to the government of Maldives in exchange for foreign currency-denominated domestic bonds.

[7] Such borrowing includes a foreign exchange swap with the Central Bank of Sri Lanka for at least US$25 million to boost international reserves, as well as the following infrastructure and development projects: (i) the construction of ten harbors, which has been favorably assessed by the Board of the Islamic Development Bank (IDB) and is being financed as follows—Saudi Fund ($15 million), the IDB ($15 million), and OFID ($10 million); (ii) an infrastructure development project (housing, sewerage, electricity, and desalination) in tsunami affected areas funded by Abu Dhabi ($15 million); and (iii) reclamation projects and supply of equipment to be financed by loans under negotiation. The terms of such financing vary, but are generally very favorable in relation to terms that Maldives may have received had it sought to borrow on international or domestic financial markets.

Stress Tests and Alternative Scenarios

6. **Stress tests indicate vulnerability to exogenous export shocks.** The PV of debt-to-GDP ratio, debt-to-exports ratio and debt service-to-exports ratios breach the thresholds under the most extreme standard stress test. For the former, the most extreme stress test is the combination shock—a one standard deviation shock to growth, exports, GDP deflator and non-debt flows—while in the latter two cases the most extreme shock is the export shock—an export value growth at historical average minus one standard deviation in 2010–11 relative to the 2008 baseline. This highlights the vulnerability of the economy to the variability of tourism receipts.

7. **The historical scenario indicates unsustainable debt dynamics.** When key macroeconomic variables are set to their historical averages all stock debt burden indicators breach respective thresholds, while the debt service burden indicators show an increasing trend after 2014. The key factor driving this scenario is the non-interest current account deficit, which averaged 20 percent of GDP over the 10-year period to 2008. This 10-year average contains three rather extreme events that drove the current account deficit to unprecedented highs: the 2004 tsunami, the extraordinary run-up in food and fuel prices in 2007 and 2008, and the rising fiscal deficit of the past few years. To the extent that the magnitudes of these events can be considered unique, the historical scenario may overestimate potential risks of debt distress. Nevertheless, the simulations illustrate that without significant fiscal consolidation the debt path would become unsustainable.

8. **Private external debt may increase the risks to debt sustainability.** Private external debt accounts for over one half of the external debt-to-GDP ratio. Much of this debt is at maturities of less than 10 years, at market interest rates, and denominated in U.S. dollars. To the extent that private external debt may increase liquidity and re-financing risks for the country as a whole, or entail contingent liabilities for the sovereign, the risks to debt sustainability could be higher than an analysis of external PPG data alone may suggest. Moreover, private external debt may be underestimated in Maldives: non-FDI external inflows to the non-financial private sector─which comprise mainly financing for privatization and tourism projects, and which sum to about 60 percent of GDP over 2009─2012─are treated as non-debt creating in both observed data and projections. Part of these flows, however, could be debt creating. [8]

9. **In the staff's view, the risk of public external debt distress for Maldives is moderate.** With one exception, no external debt burden indicator breaches the thresholds in the baseline scenario. Staff judges the marginal and temporary breach in the external debt-to-GDP ratio to be a function of the severe fiscal and current account imbalances over the past two years that the

[8] The authorities do not have adequate information to disaggregate these flows into FDI and arm's length borrowing. Accordingly, the FDI account in the balance of payments may also be underestimated.

program aims to address.[9] The steady decline in external debt burden indicators under the program indicates that the risk of debt distress declines significantly with the proposed fiscal adjustment. However, stress tests illustrate that the debt path is particularly vulnerable to export shocks and decline in non-debt creating inflows, while the historical scenario shows unsustainable debt dynamics.

IV. Public Debt Sustainability

Baseline Scenario

10. **The stock of Maldives' nominal public debt has increased rapidly since the 2004 tsunami**, from 55 percent of GDP in 2004 to around 69 percent in 2008, and is expected to reach 94 percent of GDP (including IMF loans and some transactions of financial entities) in 2009.[10] This sharp increase has been driven by an expansionary fiscal policy combined with a dramatic shortfall in fiscal revenue. Much of the fiscal deficit over the next two years has been financed domestically, through MMA credit to the government (which in 2008 represented 75 percent of the central government's domestic debt and 55 percent of the total public domestic debt stock) and sales of t-bills, held mainly by commercial banks. Total public debt service cost has remained at an average of 7 percent of GDP a year in 2003–2008, and is expected to increase to 17.2 percent by 2010 before shifting to a downward trajectory later in the projection period.

[9] Recent experience has demonstrated flexibility in rating of external debt distress (SM/09/216), including in Mongolia (2009), Madagascar (2008), Mali (2008) and in Bhutan (2007). In the case of Bhutan, the incorporation of two new largely debt financed hydropower projects in the baseline scenario caused some external debt indicators to breach their thresholds in both the baseline and the alternative scenarios/stress tests. However, on account of several country-specific mitigating factors a moderate risk of debt distress rating was retained. Other recent cases of flexible treatment on ratings include Mongolia (2009).

[10] Public debt refers here to the debt of the non-financial public sector, comprising the central government and state-owned enterprises, as well as publicly guaranteed debt. In line with inclusion of IMF debt contracted by the central banks, it also includes a currency swap between the MMA and the central bank of Sri Lanka for $25 million currently being negotiated. The central government accounted in 2008 for 79 percent of the total public debt. The present value of total public debt in 2008 was 67 percent of GDP.

Maldives: Total Public and Publicly Guaranteed (PPG) Debt by Creditor
(In percent of GDP)

	2004	2005	2006	2007	2008	2009 Proj.	2010 Proj.
Total PPG debt	55.2	64.9	62.9	66.4	68.6	94.0	98.7
PPG external 1/	40.1	41.3	39.6	39.8	37.4	47.3	44.2
Multilateral	23.5	24.2	24.8	25.8	22.5	26.9	25.2
Bilateral	3.9	5.2	4.8	4.3	4.6	8.8	8.2
Private creditor	12.8	11.9	10.0	9.7	10.2	11.6	10.8
PPG domestic	15.1	23.6	23.4	26.5	31.2	46.8	54.5
MMA	8.7	15.0	9.4	8.1	17.0	20.1	19.3
Commercial banks	2.6	5.1	7.7	11.5	13.5	24.9	29.0
Others	3.8	3.5	6.3	6.9	0.7	1.8	6.2
Total PPG debt service	6.8	7.9	7.1	7.3	7.8	9.0	17.2

1/ Includes IMF and currency swaps by MMA, but excludes domestic foreign-currency denominated debt.

11. **The PV of the public debt-to-GDP ratio is projected to fall sharply under the baseline scenario**, from 91 percent in 2009 to 17 percent by 2029, owing to strong fiscal adjustment efforts on both the revenue and expenditure sides (Table 2a). The PV of the public debt-to-revenue (including grants) ratio would decline from a projected 252 percent in 2009 to 39 percent by 2029. The public debt service-to-revenue (including grants) ratio would increase to 28 percent by 2010 before shifting to a downward trajectory later in the projection period (Figure 2 and Table 2a). New public borrowing from all sources in the context of the program, including Fund financing, has been considered, and risks to debt sustainability appear manageable in the context of the programmed fiscal adjustment.

Stress Tests and Alternative Scenarios

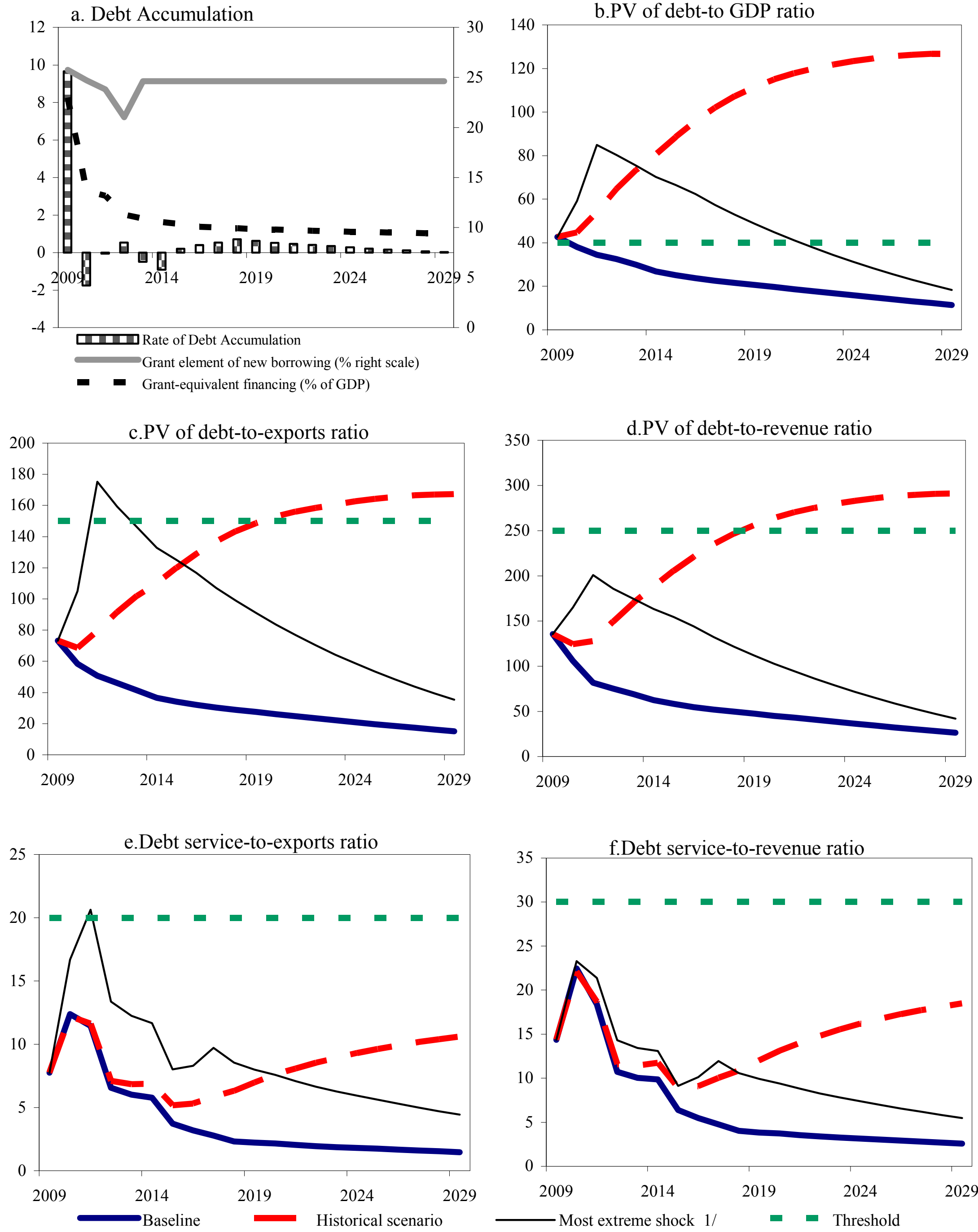
12. **Maldives' high level of public debt makes its sustainability vulnerable to exogenous shocks or fiscal policy slippages.** The stress tests indicate that the debt path is particularly vulnerable to shocks to the primary balance and long term growth. If the primary deficit remains fixed at the elevated level of 26½ percent of GDP (as in 2009), the debt ratio would continue to expand and would reach 416 percent of GDP by 2029. This, of course, illustrates that the current fiscal stance is not sustainable. It also points to the risks arising from insufficient or delayed implementation of the fiscal adjustment measures envisaged in the program. Sensitivity tests also show that the public debt path is susceptible to shocks to long-term real GDP growth, with a one standard deviation permanent shock to growth leading to a PV public debt ratio of 124 percent of GDP in 2029, compared with a baseline projection of 17 percent.

V. Conclusion

13. **Maldives faces a moderate risk of external PPG debt distress.** With the exception of a one-time breach in the PV of debt-to-GDP threshold in 2009, no thresholds are breached under the baseline scenario, but the analysis indicates the country's vulnerability to shocks to the tourism sector (which are also shocks to growth), non-debt creating inflows and the primary

balance. This suggests the need to diversify, to the extent possible within the country's geographical constraints, the structure of the economy. Maldives also faces considerable risks to debt sustainability based on its overall public debt level. This underscores the need for strong fiscal adjustment: should the authorities fall short on their fiscal consolidation efforts, the risk of the public and external debt ratio moving on to an unsustainable trajectory would significantly increase.

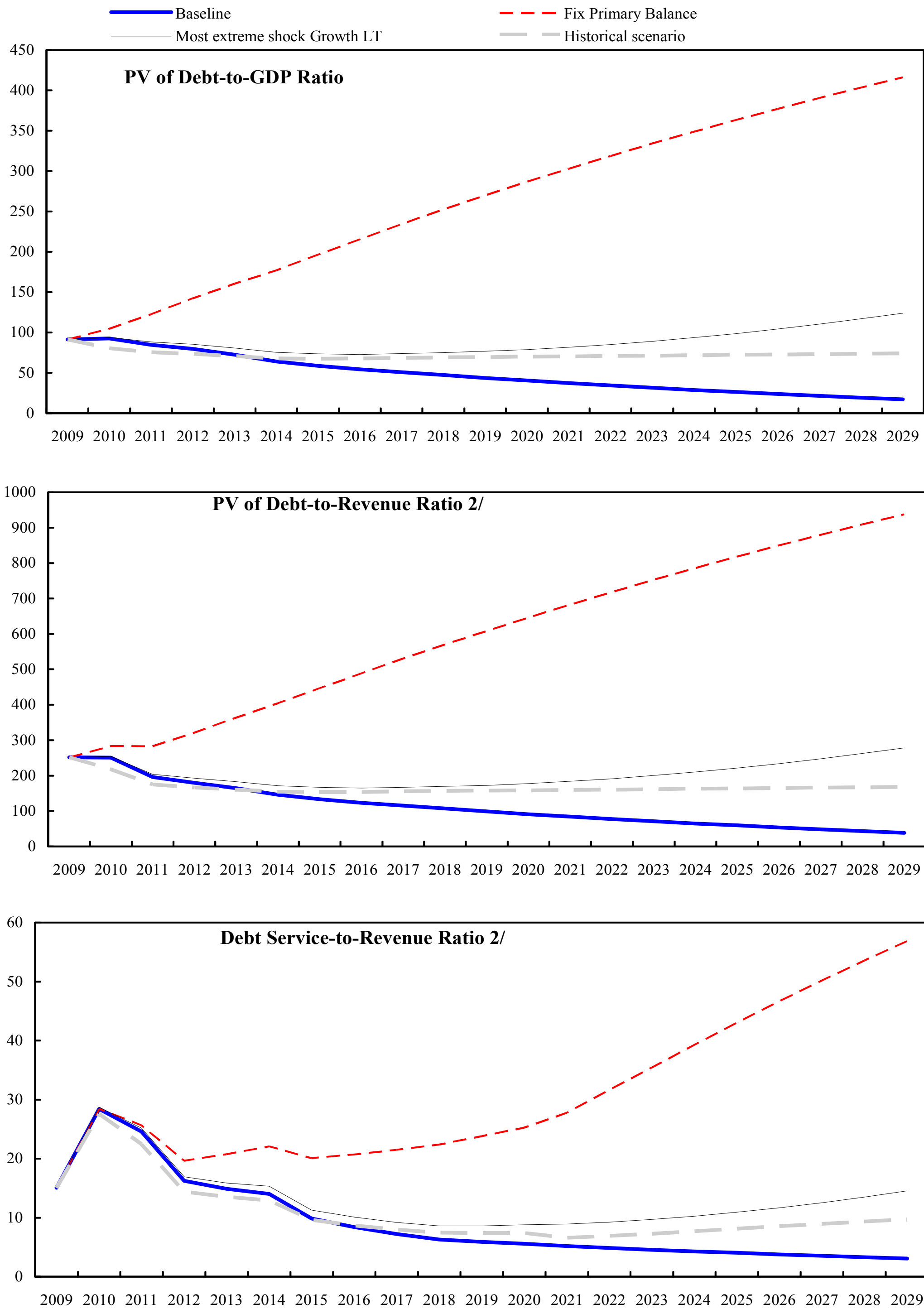
Figure 1. Maldives: Indicators of Public and Publicly Guaranteed External Debt under Baseline and Alternative Scenarios, 2009-2029 1/



Source: Staff projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2019. In figure b. it corresponds to a Combination shock; in c. to a Exports shock; in d. to a Combination shock; in e. to a Exports shock and in figure f. to a Combination shock

Figure 2. Maldives: Indicators of Public Debt Under Baseline and Alternative Scenarios, 2009-2029 1/



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

1/ The most extreme stress test is the test that yields the highest ratio in 2019.

2/ Revenues are defined inclusive of grants.

Table 1a.: External Debt Sustainability Framework, 2006-2029 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 7/	Standard Deviation 7/	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009-2014 Average	2019	2029	2015-2029 Average
External debt (nominal) 1/	**62.8**	**79.7**	**76.9**			**83.9**	**86.2**	**74.2**	**66.4**	**60.1**	**54.4**		**40.5**	**21.1**	
o/w public and publicly guaranteed (PPG)	39.6	39.8	37.4			49.1	50.4	45.5	42.3	38.5	34.3		26.6	14.4	
a. Change in external debt	9.8	16.9	-2.8			7.1	2.3	-12.1	-7.7	-6.3	-5.6		-2.4	-1.6	
b. Identified net debt-creating flows	7.5	13.9	12.7			16.2	3.9	-3.8	-5.5	-5.1	-4.4		-2.9	-2.7	
Non-interest current account deficit	**30.3**	**37.3**	**48.9**	**21.1**	**16.9**	**27.2**	**20.5**	**10.2**	**8.5**	**7.1**	**5.9**		**3.9**	**2.2**	3.3
Deficit in balance of goods and services	29.4	33.9	41.3			20.2	12.7	5.3	1.9	-0.2	-1.8		-3.8	-4.8	
Exports	84.9	83.2	83.4			58.2	65.1	67.9	70.6	72.0	73.4		75.1	75.9	
Imports	114.3	117.1	124.7			78.4	77.8	73.2	72.5	71.8	71.5		71.2	71.0	
Net current transfers (negative = inflow)	-0.9	1.3	5.0	1.8	7.7	4.8	6.2	3.7	5.0	5.0	5.1		5.5	5.5	5.4
o/w official	-7.4	-7.7	-4.7			-4.8	-1.1	-1.0	-1.0	-0.9	-0.9		-0.8	-0.8	
Other current account flows (negative = net inflow)	1.7	2.2	2.6			2.2	1.6	1.3	1.7	2.2	2.6		2.3	1.5	
Net FDI (negative = inflow) 2/	**-16.1**	**-20.2**	**-26.3**	**-7.6**	**9.5**	**-17.0**	**-17.6**	**-14.9**	**-14.3**	**-12.2**	**-10.1**		**-6.5**	**-4.6**	-6.0
Endogenous debt dynamics 3/	**-6.6**	**-3.3**	**-9.9**			**6.0**	**1.0**	**0.9**	**0.3**	**0.0**	**-0.1**		**-0.4**	**-0.3**	
Contribution from nominal interest rate	3.0	5.0	3.1			3.1	3.6	3.7	3.1	2.7	2.4		1.4	0.7	
Contribution from real GDP growth	-7.8	-3.9	-3.9			2.9	-2.6	-2.9	-2.8	-2.6	-2.5		-1.8	-0.9	
Contribution from price and exchange rate changes	-1.8	-4.3	-9.2			…	…	…	…	…	…		…	…	
Residual (a-b) 4/	**2.3**	**3.0**	**-15.5**			**-9.2**	**-1.6**	**-8.2**	**-2.2**	**-1.2**	**-1.3**		**0.6**	**1.1**	
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 5/	...	...	75.3			77.5	73.9	63.2	56.6	51.4	47.0		34.6	18.1	
In percent of exports	...	...	90.2			133.1	113.6	93.0	80.2	71.5	64.0		46.0	23.9	
PV of PPG external debt	**...**	**...**	**35.8**			**42.7**	**38.1**	**34.5**	**32.5**	**29.8**	**26.9**		**20.6**	**11.5**	
In percent of exports	**...**	**...**	**42.9**			**73.3**	**58.5**	**50.8**	**46.1**	**41.4**	**36.6**		**27.5**	**15.1**	
In percent of government revenues	**...**	**...**	**80.7**			**135.6**	**106.1**	**81.6**	**75.2**	**69.1**	**62.5**		**47.4**	**26.3**	
Debt service-to-exports ratio (in percent)	**7.6**	**10.4**	**10.0**			**15.3**	**19.8**	**18.3**	**12.4**	**11.2**	**8.2**		**3.3**	**2.0**	
PPG debt service-to-exports ratio (in percent)	**4.1**	**4.5**	**4.7**			**7.8**	**12.4**	**11.4**	**6.6**	**6.0**	**5.8**		**2.2**	**1.5**	
PPG debt service-to-revenue ratio (in percent)	**7.8**	**7.8**	**8.9**			**14.4**	**22.5**	**18.4**	**10.7**	**10.0**	**9.9**		**3.8**	**2.6**	
Total gross financing need (Millions of U.S. dollars)	225.8	363.8	571.1			470.3	425.4	303.8	210.6	198.4	175.7		118.0	65.9	
Non-interest current account deficit that stabilizes debt ratio	20.4	20.4	51.7			20.1	18.2	22.3	16.3	13.4	11.5		6.3	3.7	
Key macroeconomic assumptions															
Real GDP growth (in percent)	18.0	7.2	5.8	6.6	5.6	-4.0	3.4	3.7	4.1	4.3	4.5	2.6	4.5	4.5	4.5
GDP deflator in US dollar terms (change in percent)	3.5	7.4	13.0	2.3	4.9	11.0	4.0	6.3	3.5	3.0	3.0	5.1	3.0	3.0	3.0
Effective interest rate (percent) 6/	6.9	9.1	4.7	4.3	2.1	4.3	4.6	4.8	4.5	4.3	4.2	4.5	3.5	3.3	3.5
Growth of exports of G&S (US dollar terms, in percent)	60.4	12.9	19.9	11.5	22.3	-25.6	20.1	15.0	12.0	9.5	9.7	6.8	8.1	7.6	7.9
Growth of imports of G&S (US dollar terms, in percent)	20.5	17.9	27.4	15.0	12.3	-33.0	6.6	3.7	6.7	6.4	7.3	-0.4	7.6	7.6	7.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	25.8	24.7	23.8	21.0	24.6	24.6	24.1	24.6	24.6	24.6
Government revenues (excluding grants, in percent of GDP)	44.7	48.1	44.4			31.5	35.9	42.3	43.3	43.1	43.0		43.6	43.6	43.5
Aid flows (in Millions of US dollars) 8/	118.3	128.6	83.7			104.4	42.1	42.3	29.9	30.2	29.6		33.5	58.0	
o/w Grants	67.8	81.6	58.9			64.5	15.7	16.7	16.9	17.2	17.6		22.5	47.0	
o/w Concessional loans	50.6	47.1	24.8			39.8	26.5	25.7	13.0	13.0	12.0		11.0	11.0	
Grant-equivalent financing (in percent of GDP) 9/	...	...	...			8.3	3.3	3.0	2.0	1.8	1.6		1.3	1.0	1.2
Grant-equivalent financing (in percent of external financing) 9/	...	...	...			45.3	33.0	32.3	34.3	40.4	41.7		46.5	59.4	50.5
Memorandum items:															
Nominal GDP (Millions of US dollars)	915.4	1054.2	1260.7			1343.2	1443.7	1590.2	1713.7	1840.5	1980.8		2861.6	5972.2	
Nominal dollar GDP growth	22.1	15.2	19.6			6.5	7.5	10.1	7.8	7.4	7.6	**7.8**	7.6	7.6	7.6
PV of PPG external debt (in Millions of US dollars)			451.2			573.0	549.5	548.7	557.2	548.8	532.1		590.9	684.3	
(PVt-PVt-1)/GDPt-1 (in percent)						**9.7**	-1.7	-0.1	0.5	-0.5	-0.9	1.2	0.6	0.0	0.3

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ includes other non-debt creating flows.
3/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
4/ 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.
Very large residuals come from errors & omissions.
5/ Assumes that PV of private sector debt is equivalent to its face value.
6/ Current-year interest payments divided by previous period debt stock.
7/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
8/ Defined as grants, concessional loans, and debt relief.
9/ 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).
10/ The government can contract up to 120 million USD in additional nonconcessional external debt from the beginning of the Fund-supported program to end-2010, as per the PCs on contracting and guaranteeing of new nonconcessional external debt.

Table 1b.Maldives: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009-2029
(In percent)

	Projections																				
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	**2019**	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
										PV of debt-to GDP ratio											
Baseline	43	38	35	33	30	27	25	24	23	22	**21**	20	19	18	17	16	15	14	13	12	11
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2009-2029 1/	43	45	54	65	73	81	89	96	102	107	**112**	115	118	120	122	123	125	126	126	127	127
A2. New public sector loans on less favorable terms in 2009-2029 2	43	40	38	37	35	33	31	30	29	29	**28**	27	26	26	25	24	23	22	21	20	19
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	43	38	35	32	29	26	24	23	21	20	**19**	18	17	17	16	15	14	13	12	11	11
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	43	51	68	65	60	56	53	50	46	42	**39**	36	33	31	28	26	23	21	19	17	15
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	43	40	39	36	33	29	27	25	24	23	**22**	20	19	18	17	16	16	15	14	13	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	43	55	68	64	60	56	53	49	45	42	**39**	36	33	30	28	25	23	21	19	17	15
B5. Combination of B1-B4 using one-half standard deviation shocks	43	59	85	80	75	70	67	62	57	53	**49**	45	41	38	34	31	28	26	23	21	18
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	43	53	47	43	39	35	32	30	29	27	**26**	25	23	22	21	20	19	18	16	15	14
										PV of debt-to-exports ratio											
Baseline	73	58	51	46	41	37	34	32	30	29	**28**	26	25	23	22	21	20	19	17	16	15
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2009-2029 1/	73	69	80	92	102	110	120	129	137	143	**149**	153	156	159	161	163	164	166	166	167	167
A2. New public sector loans on less favorable terms in 2009-2029 2	73	62	56	52	49	44	42	41	40	38	**37**	36	35	34	33	32	30	29	28	27	26
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	73	58	49	44	39	34	31	29	27	26	**25**	23	22	21	20	19	18	16	15	14	13
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	73	105	175	159	146	133	125	117	107	99	**91**	84	77	70	64	59	53	49	44	39	35
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	73	58	49	44	39	34	31	29	27	26	**25**	23	22	21	20	19	18	16	15	14	13
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	73	85	100	91	83	76	71	66	61	56	**52**	48	44	40	37	33	30	28	25	22	20
B5. Combination of B1-B4 using one-half standard deviation shocks	73	105	156	142	131	119	112	105	96	88	**81**	74	68	62	56	51	47	42	38	34	30
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	73	58	49	44	39	34	31	29	27	26	**25**	23	22	21	20	19	18	16	15	14	13
										PV of debt-to-revenue ratio											
Baseline	136	106	82	75	69	63	58	55	52	50	**47**	45	43	41	39	36	34	32	30	28	26
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2009-2029 1/	136	125	128	149	170	188	206	221	235	247	**256**	264	270	275	280	283	286	288	290	291	291
A2. New public sector loans on less favorable terms in 2009-2029 2	136	112	90	85	81	76	73	70	68	66	**64**	63	61	59	57	55	53	51	49	47	45
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	136	107	83	75	68	61	56	52	49	47	**44**	42	40	38	36	34	32	30	28	26	25
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	136	141	162	149	140	130	123	115	106	98	**90**	83	76	70	64	59	54	49	44	40	35
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	136	112	92	83	76	67	62	58	55	52	**49**	47	45	42	40	38	36	33	31	29	27
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	136	155	161	148	139	129	122	114	105	97	**89**	82	76	69	64	58	53	48	43	39	35
B5. Combination of B1-B4 using one-half standard deviation shocks	136	165	201	186	175	163	154	144	132	122	**112**	103	94	86	79	72	65	59	53	47	42
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	136	147	111	101	91	81	75	70	66	63	**60**	57	54	51	48	46	43	40	38	35	33

Table 1b.Maldives: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009-2029 (continued)

(In percent)

Debt service-to-exports ratio

Baseline	8	12	11	7	6	6	4	3	3	2	**2**	2	2	2	2	2	2	2	2	2	1
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2009-2029 1/	8	12	12	7	7	7	5	5	6	6	**7**	8	8	9	9	9	10	10	10	10	11
A2. New public sector loans on less favorable terms in 2009-2029 2	8	12	11	6	5	4	2	3	3	3	**2**	2	2	2	2	2	2	2	2	2	2
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	8	12	11	7	6	6	4	3	3	2	**2**	2	2	2	2	2	2	1	1	1	1
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	8	17	21	13	12	12	8	8	10	9	**8**	8	7	7	6	6	6	5	5	5	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	8	12	11	7	6	6	4	3	3	2	**2**	2	2	2	2	2	2	1	1	1	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	8	12	12	8	7	7	5	5	6	5	**5**	4	4	4	4	3	3	3	3	3	3
B5. Combination of B1-B4 using one-half standard deviation shocks	8	15	17	11	10	10	7	7	9	8	**7**	7	6	6	6	5	5	5	4	4	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	8	12	11	7	6	6	4	3	3	2	**2**	2	2	2	2	2	2	1	1	1	1

Debt service-to-revenue ratio

Baseline	14	22	18	11	10	10	6	5	5	4	**4**	4	4	3	3	3	3	3	3	3	3
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2009-2029 1/	14	22	19	12	11	12	9	9	10	11	**12**	13	14	15	16	16	17	17	18	18	18
A2. New public sector loans on less favorable terms in 2009-2029 2	14	22	17	9	8	7	4	4	5	4	**4**	4	4	4	4	4	4	4	4	4	4
B. Bound Tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	14	23	19	11	10	10	7	6	5	4	**4**	4	3	3	3	3	3	3	3	3	2
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	14	22	19	13	12	11	8	8	10	8	**8**	8	7	7	6	6	6	5	5	5	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	14	24	21	12	12	11	7	6	5	4	**4**	4	4	4	3	3	3	3	3	3	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	14	22	19	13	12	11	8	9	10	8	**8**	7	7	7	6	6	6	5	5	5	4
B5. Combination of B1-B4 using one-half standard deviation shocks	14	23	21	14	13	13	9	10	12	11	**10**	9	9	8	8	7	7	7	6	6	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	14	32	26	15	14	14	9	7	6	5	**5**	5	5	4	4	4	4	4	4	3	3
Memorandum item:																					
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	21	21	21	21	21	21	21	21	21	21	**21**	21	21	21	21	21	21	21	21	21	21

Source: Staff projections and simulations.

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

Table 2a. Maldives: Public Sector Debt Sustainability Framework, 2006-2029

(In percent of GDP, unless otherwise indicated)

	Actual			Average	Standard Deviation	Estimate	Projections								
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009-14 Average	2019	2029	2015-29 Average
Public sector debt 1/	62.9	66.4	68.6			94.0	98.7	92.1	87.0	79.8	71.4		49.8	20.1	
o/w foreign-currency denominated	39.6	39.8	37.4			49.1	50.4	45.5	42.3	38.5	34.3		26.6	14.4	
Change in public sector debt	-2.0	3.4	2.2			25.4	4.7	-6.6	-5.1	-7.2	-8.4		-4.0	-2.4	
Identified debt-creating flows	-5.0	-3.6	2.7			21.5	4.3	-8.3	-5.7	-6.2	-7.0		-3.9	-2.4	
Primary deficit	5.5	3.2	11.8	4.5	3.5	26.4	14.2	0.2	0.1	-0.9	-1.7	6.4	-1.4	-1.2	-1.4
Revenue and grants	52.1	55.8	49.0			36.3	37.0	43.4	44.2	44.1	43.9		44.4	44.4	
of which: grants	7.4	7.7	4.7			4.8	1.1	1.0	1.0	0.9	0.9		0.8	0.8	
Primary (noninterest) expenditure	57.6	59.0	60.8			62.7	51.2	43.6	44.3	43.2	42.1		42.9	43.1	
Automatic debt dynamics	-10.1	-6.5	-8.9			-1.9	-2.8	-5.1	-3.1	-2.8	-2.9		-2.5	-1.1	
Contribution from interest rate/growth differential	-10.0	-5.1	-5.3			1.5	-1.9	-3.1	-2.4	-2.4	-2.5		-2.2	-1.0	
of which: contribution from average real interest rate	-0.1	-0.9	-1.7			-1.4	1.2	0.4	1.3	1.2	0.9		0.1	0.0	
of which: contribution from real GDP growth	-9.9	-4.2	-3.7			2.9	-3.1	-3.5	-3.6	-3.6	-3.4		-2.3	-1.0	
Contribution from real exchange rate depreciation	-0.1	-1.5	-3.5			-3.4	-1.0	-2.0	-0.7	-0.4	-0.4		...	...	
Other identified debt-creating flows	-0.4	-0.3	-0.3			-3.0	-7.0	-3.4	-2.7	-2.5	-2.4		0.0	0.0	
Privatization receipts (negative)	-0.4	-0.3	-0.3			-3.0	-7.0	-3.4	-2.7	-2.5	-2.4		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	3.0	7.1	-0.4			3.9	0.3	1.8	0.6	-0.9	-1.4		-0.1	0.0	
Other Sustainability Indicators															
PV of public sector debt	23.4	26.5	67.0			91.3	92.6	84.9	79.5	72.3	63.9		43.8	17.1	
o/w foreign-currency denominated	0.0	0.0	35.8			46.4	44.3	38.3	34.9	30.9	26.9		20.6	11.5	
o/w external	...	...	35.8			42.7	38.1	34.5	32.5	29.8	26.9		20.6	11.5	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	29.2	28.0	38.7			61.2	70.0	60.4	54.0	49.5	43.9		25.2	6.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	44.8	47.5	136.6			251.7	250.6	195.8	179.7	164.1	145.8		98.8	38.6	
PV of public sector debt-to-revenue ratio (in percent)	52.3	55.2	151.0			290.1	258.1	200.6	183.8	167.6	148.8		100.5	39.3	
o/w external 3/	…	…	80.7			135.6	106.1	81.6	75.2	69.1	62.5		47.4	26.3	
Debt service-to-revenue and grants ratio (in percent) 4/	8.3	8.0	9.7			15.1	28.4	24.6	16.2	14.9	14.0		5.9	3.1	
Debt service-to-revenue ratio (in percent) 4/	9.7	9.3	10.7			17.4	29.3	25.2	16.6	15.2	14.3		6.0	3.1	
Primary deficit that stabilizes the debt-to-GDP ratio	7.5	-0.2	9.6			1.0	9.5	6.8	5.2	6.3	6.7		2.6	1.1	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	18.0	7.2	5.8	6.6	5.6	-4.0	3.4	3.7	4.1	4.3	4.5	2.6	4.5	4.5	4.5
Average nominal interest rate on forex debt (in percent)	2.6	2.9	3.6	2.6	0.4	4.0	2.6	2.4	2.4	2.4	2.3	2.7	1.6	1.6	1.7
Average real interest rate on domestic debt (in percent)	0.8	-3.4	-8.2	1.0	3.9	-7.0	2.0	0.3	2.3	2.3	1.9	0.3	0.9	0.8	1.0
Real exchange rate depreciation (in percent, + indicates depreciation)	-0.3	-4.0	-9.2	0.3	5.6	-8.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	3.5	7.4	13.0	3.1	4.1	11.0	4.0	6.2	3.5	3.0	3.0	5.1	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.2	0.1	0.1	0.2	0.2	0.0	-0.2	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	…	…	25.8	24.7	23.8	21.0	24.6	24.6	24.1	24.6	24.6	...

Sources: Maldivian authorities; and staff estimates and projections.

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

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

3/ Revenues excluding grants.

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

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

Table 2b.Maldives: Sensitivity Analysis for Key Indicators of Public Debt 2009-2029

	Projections							
	2009	2010	2011	2012	2013	2014	2019	2029
PV of Debt-to-GDP Ratio								
Baseline	91	93	85	80	72	64	44	17
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	91	80	76	74	71	68	70	74
A2. Primary balance is unchanged from 2009	91	105	123	142	160	177	270	416
A3. Permanently lower GDP growth 1/	91	94	88	85	81	75	77	124
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	91	95	92	88	83	76	63	49
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	91	86	87	81	74	66	45	18
B3. Combination of B1-B2 using one half standard deviation shocks	91	84	83	77	70	61	40	12
B4. One-time 30 percent real depreciation in 2010	91	110	101	95	87	78	56	28
B5. 10 percent of GDP increase in other debt-creating flows in 2010	91	102	94	89	81	72	51	22
PV of Debt-to-Revenue Ratio 2/								
Baseline	252	251	196	180	164	146	99	39
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	252	218	175	167	161	155	158	168
A2. Primary balance is unchanged from 2009	252	283	283	321	364	404	608	938
A3. Permanently lower GDP growth 1/	252	254	203	193	183	171	172	278
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	252	258	212	199	187	173	143	110
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	252	234	200	184	168	150	102	41
B3. Combination of B1-B2 using one half standard deviation shocks	252	228	191	175	159	140	91	28
B4. One-time 30 percent real depreciation in 2010	252	299	232	214	197	177	126	62
B5. 10 percent of GDP increase in other debt-creating flows in 2010	252	277	217	200	184	165	115	50
Debt Service-to-Revenue Ratio 2/								
Baseline	15	28	25	16	15	14	6	3
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	15	28	22	14	14	13	7	10
A2. Primary balance is unchanged from 2009	15	28	26	20	21	22	24	57
A3. Permanently lower GDP growth 1/	15	29	25	17	16	15	9	15
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	15	29	26	17	16	15	8	7
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	15	28	24	16	15	14	6	3
B3. Combination of B1-B2 using one half standard deviation shocks	15	28	24	16	15	14	6	2
B4. One-time 30 percent real depreciation in 2010	15	33	32	21	20	19	9	7
B5. 10 percent of GDP increase in other debt-creating flows in 2010	15	28	25	17	16	15	7	4

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

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

2/ Revenues are defined inclusive of grants.

INTERNATIONAL MONETARY FUND

MALDIVES

Staff Report for the 2009 Article IV Consultation and Request for a Stand-By Arrangement and a 24-Month Arrangement Under the Exogenous Shocks Facility

Informational Annex

Prepared by the Asia and Pacific Department
(in consultation with other departments)

November 25, 2009

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ANNEX I. MALDIVES: FUND RELATIONS

(As of October 31, 2009)

I. **Membership Status**: Joined 1/13/78; Article XIV

II. **General Resources Account**:

	SDR Million	% Quota
Quota	8.20	100.00
Fund holdings of currency	7.67	93.55
Reserve position in Fund	1.55	18.95

III. **SDR Department**:

	SDR Million	% Allocation
Net cumulative allocation	7.69	100.00
Holdings	7.81	101.50

IV. **Outstanding Purchases and Loans**:

	SDR Million	% Quota
Emergency assistance	1.03	12.50

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund**:
(SDR million; based on existing use of resources and present holdings of SDR):

	Forthcoming			
	2009	2010	2011	2012
Principal	0.51	0.51		
Charges/interest	0.01	0.00	0.00	0.00
Total	0.52	0.52	0.00	0.00

VII. **Exchange Arrangements**

From March 1, 1982 to June 30, 1985, the Maldivian rufiyaa was pegged to the U.S. dollar. Beginning in July 1985, the exchange rate of the rufiyaa was linked to a trade-weighted basket of currencies, but the exchange rate vis-à-vis the U.S. dollar remained relatively stable until February 1987. On March 1, 1987, the rufiyaa was devalued by 29 percent vis-à-vis the U.S. dollar. From 1987 to 1994, the exchange rate of the rufiyaa was adjusted periodically. Since October 1994, the exchange rate of the rufiyaa remained unchanged at Rf 11.77 per U.S. dollar, until July 25, 2001, when the

rufiyaa was devalued to Rf 12.80 per U.S. dollar. Maldives continues to avail itself of the transitional provisions of Article XIV, and has not yet accepted the obligations Article VIII, Sections 2, 3, and 4. It maintains an exchange restriction and a multiple currency practice subject to Fund approval under Article VIII, Sections 2(a) and 3 of the Fund's Articles of Agreement, arising from the MMA's policy of rationing its supply of foreign exchange to commercial banks. This action by a governmental agency has caused the channeling of foreign exchange transactions for current international transactions to the parallel market at an exchange rate that deviates by more than 2 percent from the official exchange rate (i.e., a premium of around 10 percent over the official peg), thus giving rise to an additional cost to obtain foreign exchange in such a market.

VIII. **Last Article IV Consultation**

The 2008 Article IV consultation was concluded by the Executive Board on September 3, 2008.

IX. **Technical Assistance**

FAD: In April 1994, Mr. Potter and Ms. Bédague visited Male to advise on budget management. This was followed by periodic assistance from Mr. Webber (consultant) over the period November 1994 to December 1995. In July 1994, Mr. Faria and Mr. Kambil (consultant) assisted in formulating a strategy for revenue reform. This was followed by a visit by Mr. Kambil in August/September 1995 to draft tax legislation. In October 1996, a tax administration mission developed a strategy to establish an Inland Revenue Department and a follow-up mission by a consultant took place in June 1997. In May 2007, a mission conducted a diagnostic review of tax and tariff policy and administration. In October 2008 and April 2009, a series of PFM missions provided peripatetic support for the design and implementation of a new government integrated financial management information system (GIFMIS). A joint mission with the World Bank visited Male in April-May 2009 to complete a PEFA assessment.

LEG: In October 2003, Mr. Head provided assistance on the revision of the Maldives Monetary Authority Act (MMA Act). A series of missions (March and September 2005, and April 2006) were provided to revamp the banking law. In August 2009, a mission provided assistance on the MMA Act (jointly with MCM).

MCM: In March 1993, a consultant provided assistance on the introduction of treasury bills. In November 1994, a mission headed by Mr. Taniguchi provided assistance on monetary management, foreign exchange operations, and bank supervision. In February/June 1995, a consultant provided assistance for the development of a treasury bill and MMA certificate market. In February/March 1996, a mission headed by Mr. Swinburne provided advice on the reform of monetary operations and exchange system. This was followed by a visit of a foreign exchange advisor in May 1997. In early

2001, two consultants provided assistance on foreign exchange and monetary management, of two missions each. In July 2001, a consultant provided assistance on monetary management following the lifting of credit ceilings and further impending changes in the monetary framework. In October 2002, a multi-purpose mission took stock of developments and provided recommendations in the areas of banking, foreign exchange operations, and foreign exchange reserves management. In October 2003, in cooperation with the legal consultant, Mr. Dornseif (Deutsche Bundesbank) provided assistance on the drafting of the amended MMA Act. Two missions visited in 2006 on monetary operations, financial market development, and banking issues. In 2007, a series of mission were provided on debt management, monetary policy and financial supervision. In 2008, three missions visited on monetary operations and liquidity management, monetary policy and financial supervision issues. In November 2008 and March/May/August 2009 a series of mission were provided on research capacity building, bank supervision, monetary policy and the MMA act.

STA: In June 1993 and February 1994, assistance was provided on monetary and balance of payments statistics, respectively. In May 1995, a STA consultant provided assistance on the compilation of a new consumer price index, which was followed by further assistance in August 1996. In November 2005, TA was given on monetary and banking issues. In April 2006, STA provided advice on government finance statistics. In January 2007, STA provided advice on balance of payments statistics. In May 2007, STA conducted a mission on Money and Banking Statistics.

X. **Safeguards Assessment**

A safeguards assessment of the MMA is currently in progress. The assessment evaluates the adequacy of MMA's external and internal audit mechanisms, legal framework with regard to financial safeguards, financial reporting practices, and systems of internal control. The ongoing assessment notes that there are vulnerabilities in the present external audit of the MMA conducted by the Auditor General. The authorities have agreed to appoint an international firm to perform MMA's audit in accordance with international standards on auditing, and to take steps to modernize the MMA Act, strengthen its financial reporting practices, and develop its internal audit function.

ANNEX II. MALDIVES: RELATIONS WITH THE WORLD BANK GROUP[1]

(As of October 2009)

The World Bank's Country Assistance Strategy

The Bank's Country Assistance Strategy (CAS) FY08–12 aligns a joint IDA/IFC assistance program behind the Government of Maldives' (GoM) development strategy. The overarching objective is to contribute to policy and institutional reforms to help maintain the country's successful development trajectory of the last two decades.

The CAS FY08–12 has built in flexibility, and it envisioned a midterm review in FY10. Two of the IDA operations proposed, in mobile phone banking and pension administration were approved by the Bank's Board in FY08 and FY09 respectively. The strategy proposed a programmatic, policy-based investment model for the second half of the CAS period. The eligibility for the Maldives for IBRD funds was also to be reviewed at that time.

The CAS was prepared jointly by the World Bank and IFC and as such presents a common view of development objectives in the Maldives, together with a commitment to a shared strategy. During the previous CAS period, the IFC had committed a total of US$47.8 million (US$ 46.5 million in debt and the remainder in equity), consisting of four projects in the financial, tourism, logistics and telecommunications sectors. During the first part of the current CAS period (2008 to June 2009) the IFC has more than doubled its commitments to about US$103 million (or roughly twice that of IDA).

As of June 30, 2009 IFC investments spanned three sectors - tourism (72%), telecom (13%) & financial services (15%). During the CAS period to date, IFC further increased its investment in both the tourism and the financial sector through investments in Hotel Shangri La (US $50 million) and HDFC (US $12 million) respectively. In the financial sector, IFC's advisory services program (US$ 0.8 million) assisted the Maldives Monetary Authority (MMA) in establishing and strengthening prudential guidelines (e.g. Islamic Banking) and also provided technical assistance to help set up a Credit Bureau. Looking ahead, IFC is exploring the possibility of extending the Global Trade Finance Program through the Bank of Maldives. Two of IFC's 8 investment projects (MFLC-Maldives Finance and Leasing Company and HDFC) have an Advisory Services component. The Advisory Services component to MFLC involves capacity building and SME finance training.

The CAS was designed to mitigate the risks that could reduce the effectiveness of the World Bank Group's operations and to further develop the ability to monitor the impact of interventions. These include the immediate fiscal risks as well as the political risks due to the

[1] Prepared by World Bank staff.

democratic transition. To mitigate these risks, the Bank Group maintains dialogue with the authorities and with other donor partners. In addition, the Bank Group is in close dialogue with the authorities and staff of the IMF with regard to the country's fiscal situation. Finally, given shallow capacity in many of the implementing agencies, there are some implementation risks. Hence operations were to be designed simply and in close coordination with the government. Where possible, government M&E systems were to be upgraded as part of the Bank Group's interventions so as to avoid the expense of developing project-specific monitoring systems.

Interventions were proposed that build on progress and relationships established by previous operations. They also aim to establish a three pillar platform: (i) economic and fiscal governance, (ii human development and social protection, and (iii) environmental management; for a more long-term or programmatic approach to Bank Group assistance, as proposed by the previous CAS, toward ensuring relevance over the next five years. Despite the short-term risks posed by an expansionary fiscal policy, World Bank Group management committed to stay engaged with the authorities through a program that supports the long-term growth path.

The proposed CAS program is laid out in table at the end of this annex. The CAS allowed for the programs of FY10, FY11 and FY12 to be further elaborated during the CAS period and reviewed as part of the CAS Progress Report (CASPR). The CASPR is currently under preparation.

Lending and AAA program

Applying the principle of selectivity and taking into account the changing country context and challenges facing the Maldives, the proposed World Bank Group assistance program sought to further three strategic development outcomes: (i) a well-managed economy attracting increased investment; (ii) increased quality of education in support of a better skilled workforce; and (iii) improved capacity to manage the country's pristine, but fragile, natural environment. These strategic outcomes will be supported through IDA credits (mobile phone banking, education, and environmental management), strategic IFC investments and TA and a flexible program of AAA. In addition, two cross-cutting development themes were identified as essential ingredients to the country's overall development program. These are: building stronger institutions and capacity to levels commensurate with the socio-economic development of the Maldives; and decentralization.

Given the relatively small IDA allocation, making an effective contribution will mean that the Bank Group's work must be selective, catalytic and well-coordinated with other donors. The CAS extends from the last year of IDA14 through the first year of IDA16.[2] The overall size of

[2] Under the small island exception, in recognition of exceptional vulnerability of small island states, the Maldives has access to IDA despite having per capita income in excess of the IDA cut-off.

the IDA envelope during this five-year period was assumed to be about SDR 30 million (about US$45 million). There was US$20 million available in FY08, and about $17 million (SDR 10.9 million) was allocated to the Maldives for all of IDA 15. However, it was recently agreed that a regional re-allocation would be made which will increase the country's IDA allocation by about USD 10.5 million (from SDR 10.9 million to SDR 17.9 million). Therefore there are somewhat more resources available than was anticipated in the CAS.

Given the need for policy reform in the country and the limited resources available for project preparation and AAA, the preferred approach for IDA is to use the DPC instrument unless there is an investment loan that can leverage additional resources. IDA is planning to employ about half of the remaining IDA15 allocation in a DPC for FY10 that would support Government efforts to improve its fiscal situation and meet the targets set in the IMF program. The remaining half (about USD 12 million) will be available to fund some combination of a second phase of the DPC, a new DPC, or new investment lending. Regarding AAA, as recommended in the September brainstorming session, TA would be offered in a few areas, including some where the Bank is already active.

While the IDA allocation is fixed, the mix of products is not. The World Bank Group is working to ensure that the instruments used are consistent with the country's development context. In particular, a responsive program of analytical work has proved constructive in the Maldives in the past and is consistent with the World Bank Group's strategy for middle income countries. In addition, the proposed sector lending program assumes that authorities manage the current risks and avert a crisis. Development policy lending is preferable, but will be contingent on demonstrated reforms. To this end, a DPL operation is under consideration for FY10, and is reflected in the program table.

IFC's focus for the remaining period of the CAS will be to further step up its work in climate change through clean energy audits with clients and also in collaborating with the World Bank on other areas of the climate change agenda (see below). Infrastructure will also remain a focus area for both IFC investment and advisory work especially in supporting the government's privatization agenda through advisory work on setting up PPPs. IFC will also be working to respond to the Government's request to help with exploring opportunities to expand financing to SMEs, and also to support student loans, in the coming years.

The teams of the IMF and other IFIs have been working closely with the World Bank's macro and fiscal team.

IBRD/IDA Lending Operations

	Net Commitments	Disbursements 1/	Undisbursed 5/
Maldives Environment Management Project	13.15	1.27	11.52
Mobile Phone Banking Project	7.7	2.68	5.15
Post Tsunami Emergency Project	14.0 3/	8.94	0.015
Integrated Human Development	21.3 2/	9.28	2.96
Pension and Social Protection Administration	3.8	0	4.16
Sub-total	59.95	22.17	23.80
Closed projects (IDA)			
Fisheries I	3.2	1.6	...
Fisheries II	5.0	5.0	...
Fisheries III	10.7	9.4	...
Male Airport Upgrading	7.5	7.5	...
Education and Training	8.2	7.3	...
Education and Training II	13.4	12.9	...
Education and Training III	18.6 4/	16.8	...
Sub-total	66.6	61.0	...
Total	126.55	83.17	23.80

1/ Note: Disbursement figures subject to SDR/USD exchange rate fluctuations. Source: WB Operations Portal and Client Connection.
2/ US$10 million were cancelled to make IDA resources available under the Maldives Post-Tsunami Emergency Recovery Credit and Grant. Original commitment was US$21.3 million. US$5.7 million were then regranted as additional financing in 2006.
3/ Of this total, $8.4 million provided as credit and $5.6 million (40 percent of total financing) as grant.
4/ US$2 million cancelled to make IDA resources available under the Maldives Post-Tsunami Emergency Recovery Credit and Grant. US$1.4 million in additional financing was contributed to the project in 2006.
5/ At current SDR/USD rates.

Program Proposed in CAS (FY08–12)

Pillar	I: Economic governance	II: Human development	III: Environmental management
	IDA Credits (TA & Investment) (New projects - Ongoing projects)		
FY08	• **Mobile phone banking (CGAP/IDA)** • Public accounting system (EC Trust Fund) • NLTA: Public Financial Management • NLTA: MTFF & macro-fiscal	• IHDP & Post-tsunami Reconstruction activities	• **Environmental management**
FY09	• **Follow-up NLTA on PFM & MTFF**	• **Additional financing for Human Development** • **Pension Administration Project**	
FY10	**Possible DPL**		
FY11		• **Possible follow-on financing**	• **Possible follow-on financing**
FY12	*tbd*	*tbd*	*Tbd*
	AAA (TA & ESW)		
FY08			
FY09	• Cross-cutting AAA on economic diversification & population consolidation		
FY10	• PEFA		
FY11	• ROSC		
FY12	*tbd*	*tbd*	• Fisheries Strategy follow-up
	IFC Investment & Advisory Services		
FY08	• Investment and advisory services to the leasing sector. • Possible advisory work with the Bank of Maldives to enhance SME financing. • Advisory services to HDFC and possible investment in case of privatization. • SME linkage program with existing investments. • Possible advisory and/or investments in infrastructure and tourism	• Training programs as part of advisory work in: access to finance and SME linkages	• Environmental & Social due diligence on any future investments. • Advisory work as necessary to help clients meet IFC Environmental Performance Standards
FY09	▪ As above	▪ As above	▪ As above
FY10	▪ As above	▪ As above	▪ As above

ANNEX III. MALDIVES: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[3]

(As of 30 September 2009)

Loans

- Since 1981, Asian Development Bank (AsDB) has provided 17 loans with total approved amount of $104.31 million.
- As of 30 September 2009, seven loans were active with a net loan amount of $47.93 million comprising of two projects in transport and communication amounting to $17.09 million (36 percent), one for energy for $9.62 million (20 percent), one for industry and trade for $7.21 million (15 percent), one for education for $6.12 million (13 percent), one for water supply, sanitation, and waste management for $6.11 million (13 percent) and one for multisector for $1.77 million (4 percent).
- As of 30 September 2009, contract awards totaled $2.45 million, bringing the cumulative figure to $28.03 million. Of the total contract awards, $2.292 million (93 percent) went for the single education project, followed by $0.134 million (6 percent) for the energy project and by $0.026 million for the two transport and communications projects.
- Disbursements as of 30 September 2009 totaled $3.991 million, bringing cumulative disbursements to $20.34 million. The disbursement ratio was 12.82 percent.

Technical assistance

- As of 30 September 2009, AsDB had approved 56 technical assistance (TA) projects for a total amount of $19.5 million of which 16 had been project preparatory and 40 had been advisory TAs addressing institutional strengthening and capacity development.
- In terms of TA amount, assistance is largest for law, economic management, and public policy at 47 percent for 22 projects, followed by transport and communications at 15 percent for 11 projects, education at 10 percent for 6 projects, energy at 7 percent for 6 projects, industry and trade at 7 percent for 2 projects, agriculture at 6 percent for 3 projects, finance at 5 percent for 4 projects, urban development and multisector at 3 percent for 2 projects.

As of 30 September 2009, there are 4 TAs in the active portfolio with a total amount of $1.60 million. Of these, 1 is project preparatory and 3 are advisory.

[3] Prepared by Asian Development Bank staff.

Annex IV. Maldives—Statistical Issues

As of October 27, 2009

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Macroeconomic statistics have improved in recent years, with technical assistance from STA and the Asian Development Bank (AsDB). Remaining shortcomings affect the balance of payments, government finance, and national accounts statistics. The main official statistical publication is the *Statistical Yearbook of Maldives*, which contains data series up to 2004. APD receives a monthly electronic statistical report, covering a broad range of economic and financial statistics. It also receives, albeit with a lag, the *Quarterly Economic Bulletin* (*QEB*) and the *Annual Report*(*AR*) of the Maldives Monetary Authority (MMA).
Real sector: National accounts statistics are available only on an annual basis and with a considerable lag; while GDP estimates are made using both the production and expenditure approaches, these estimates are inconsistent. Furthermore, the base year for constant price estimates is 1995, so that recent changes in the structure of the economy are not reflected by the base period weights. The AsDB is assisting the authorities in setting up a framework for compiling more comprehensive national accounts. Recently, the CPI has been rebased to June 2004=100, with assistance from the AsDB. Weights are based on the household income and expenditure survey that was conducted between September 2002 and June 2003 and adjusted for price changes up to June 2004.
Fiscal sector: General government data are reported for publication in the *GFS Yearbook and the latest published data are for 2008.* Monthly data on revenue and expenditure are available, but the reporting system is new, and its reliability is as yet untested. In particular, the consistency of these data with below-the-line financing numbers provided by the monetary authorities is weak. Data on external debt are subject to reconciliation with creditors. Data on the operations of state enterprises are limited.
Monetary sector: APD receives a weekly electronic report on monetary statistics, covering the balance sheets of the MMA and the commercial banks. Current summary data are published in the MMA's *Monthly Statistics* publication as well as in its *QEB* and *AR,* but with a significant lag. There are inconsistencies between monetary and fiscal data regarding the financing of the fiscal deficit due to issues of timing and coverage. An April 2007 STA monetary and financial statistics mission completed the standardized report forms for the central bank and other depository corporations, and developed an integrated monetary

<table>
<tr><td colspan="2">database that meets the needs of the MMA, STA, and APD, which is expected to become operational shortly. It is expected that a new call report form to obtain balance-sheet data for other financial corporations will be introduced with the assistance of a follow-up mission.</td></tr>
<tr><td colspan="2">External sector: MMA compiles balance of payments data on an annual basis. There are problems of coverage and measurement in a range of areas. Travel credits (receipts) are still estimated on the basis of a small, outdated, survey of resorts/hotels. Coverage of foreign direct investment firms is limited, leading to underreporting. Estimates of distributed and reinvested earnings of direct investment enterprises in the tourism sector remain unsatisfactory, and information on private financial flows is incomplete. Data on the international investment position are incomplete as private sector data are not available. Quarterly data on external debt and debt service are available for the government and the monetary authority, and to some extent for the banking sector and state enterprises at the time of the annual consultation missions, but no data are reported for the nonfinancial private sector. A STA technical assistance mission in January 2007 proposed steps to improve data on direct investment, travel receipts, and a range of other specific items.

Official reserves assets are reported weekly with a (variable) one-week lag. Predetermined foreign currency outflows (mainly debt service payments) are known and reported to APD at the time of annual Article IV consultation missions, while other movements of foreign currency assets are not identified.</td></tr>
<tr><th colspan="2">II. Data Standards and Quality</th></tr>
<tr><td>Maldives does not participate in the General Data Dissemination System (GDDS).</td><td>No data ROSC available.</td></tr>
<tr><th colspan="2">III. Reporting to STA (Optional)</th></tr>
<tr><td colspan="2">The authorities report macroeconomic data to the Fund on a regular and generally timely basis for publication in the IFS, BOPSY, and GFSY.</td></tr>
</table>

Maldives: Table of Common Indicators Required for Surveillance
(As of November 17, 2009)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	10/29/2009	11/08/2009	W	W	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/29/2009	11/08/2009	W	W	M
Reserve/Base Money	10/29/2009	11/08/2009	W	W	M
Broad Money	8/31/2009	9/24/2009	M	M	M
Central Bank Balance Sheet	10/29/2009	11/08/2009	W	W	M
Consolidated Balance Sheet of the Banking System	10/29/2009	11/08/2009	W	W	M
Interest Rates[2]	8/31/2009	9/24/2009	M	M	M
Consumer Price Index	7/2009	10/16/2009	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2008	8/31/2009	A	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2008	8/31/2009	A	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2008	8/31/2009	A	M	M
External Current Account Balance	2008	8/31/2009	A	M	M
Exports and Imports of Goods and Services	8/31/2009	9/24/2009	M	M	M
GDP/GNP	2008	9/19/2009	A	M	M
Gross External Debt	2008	9/19/2009	A	M	M
International investment Position[6]	2008	8/27/09	A	A	A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 09/142
FOR IMMEDIATE RELEASE
December 30, 2009

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

IMF Executive Board Concludes Article IV Consultation with Maldives

On December 4, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Maldives.[1]

Background

The Maldivian economy rebounded strongly from the 2004 tsunami disaster on the back of high tourism-related investment and large increases in public spending. However, the global financial crisis hit Maldives hard through steep declines in tourism (tourist arrivals fell by 8¾ percent in the year to August 2009), exports of goods, and the availability of external financing. As a result, real GDP is expected to fall by about 4 percent in 2009.

Import prices, particularly for food and fuel, have been driving inflation. After picking up sharply to 8½ percent year-on-year (y/y) in 2008 due to soaring commodity prices, inflation has declined rapidly in the first half of 2009, to 3 percent y/y in August, but is expected to rebound somewhat in the latter part of the year.

The fiscal deficit rose to 13¾ percent of GDP in 2008, reflecting rapid increases in current expenditures, particularly in the wage bill, combined with a fall in tourism-related revenue in the second half of 2008, driven by the global downturn. In 2009, additional increases in salaries and wages have driven up spending, while revenues have weakened further as the global crisis unfolded. Without policy action, the fiscal deficit would have reached 33 percent of GDP in 2009.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

In 2008, the rapid fiscal expansion, soaring import prices, and lower earnings from tourism led Maldives' external current account deficit to widen to 51½ percent of GDP in 2008. In 2009, the reduced availability of foreign financing has led to continued reserve losses, prompting the MMA to ration foreign exchange. Combined with the domestic slowdown and lower import prices, these factors have resulted in a very sharp import contraction, more than offsetting the decline in tourism inflows. The current account is thus expected to narrow significantly in 2009, to about 30 percent of GDP.

The fixed exchange rate regime has provided a clear and effective nominal anchor. The real effective exchange rate has appreciated recently, but remains below historical averages, and its trajectory has actually remained below that of the indices for relevant competitors. Excess money supply from deficit monetization and the decline of capital inflows have resulted in reserve losses and the rationing of foreign exchange supplied by the Maldives Monetary Authority to the banking system. As a result, a parallel market has emerged with a small premium over the official peg, and gross international reserves stood at 2¼ months of imports at end-September, 2009. The introduction, in August 2009, of open market operations, and the cessation of deficit monetization, will help reduce excess liquidity and alleviate pressures on the exchange rate.

The banking system has been hit by the reduced availability of external financing and the domestic economic slowdown. Non-performing loans have increased significantly, as banks have a high exposure to the tourism sector. Banks have ample domestic liquidity and long net open positions in foreign exchange. However, they are still vulnerable to dollar liquidity shocks. The difficult economic and financing conditions, and the deteriorating portfolio, have led y/y private sector credit growth to shrink by 2 percent in August 2009, after several years of very high growth rates.

Executive Board Assessment

Executive Directors noted that the Maldivian economy has been severely hit by the global crisis through a fall in tourism inflows, external financing, and exports. Coming atop a period of unsustainable fiscal expansion—partly reflecting post-tsunami reconstruction efforts—these shocks exacerbated the fiscal and external imbalances, weakened the reserve position, and pushed the economy into recession. They also put considerable stress on the banking sector. While economic activity and fiscal revenues are expected to improve in the next few years, the external economic environment remains fragile. Against this background, Directors supported the authorities' program, aimed at restoring macroeconomic stability and medium-term sustainability through fiscal and monetary tightening, shoring up reserves, and strengthening the banking sector. They welcomed the significant steps recently taken by the new government.

Directors underscored that determined fiscal consolidation is critical to the success of the program. They supported the authorities' commitment to restore fiscal sustainability through a very significant adjustment. In light of already high public debt levels, it will be crucial to reduce the central government's deficit decisively—including by pressing ahead with the program's expenditure and revenue measures and saving most of any revenue over-performance. Directors welcomed the emphasis on adjustments in remuneration and

staffing levels, which are necessary to unwind part of the large wage increases in recent years and to streamline the civil service. They also welcomed the increase in electricity tariffs in line with a new cost-based formula. Directors supported the authorities' commitment to protecting social spending and improving the targeting of subsidies, including the replacement of across-the-board electricity subsidies with targeted relief for the poor. On the revenue side, they encouraged the authorities to move expeditiously to pass the needed tax reforms. Continued improvements in public financial management are also essential.

To complement fiscal consolidation and stem reserve losses, Directors stressed the need to tighten monetary policy. They welcomed the authorities' considerable progress in this area, including the cessation of deficit monetization, the conversion of the government's debt with the Maldives Monetary Authority into negotiable securities, and the introduction of open market operations to absorb excess rufiyaa liquidity.

Directors generally agreed that the fixed exchange rate regime has served as a nominal anchor for the Maldivian economy. They stressed that external sustainability and the sustainability of the current level of the peg are conditional on the implementation of the fiscal adjustment under the program and on continued progress on monetary tightening. Directors supported the authorities' commitment to building up foreign exchange reserves and phasing out the rationing of foreign exchange as conditions improve.

Directors called on the authorities to remain vigilant to developments in the banking system. They welcomed the authorities' resolve to improve financial sector regulation and supervision, including by passing the needed legislative reforms, and to strengthen the financial position of the banking system. Directors encouraged the authorities to enforce the implementation of recent regulatory changes on provisioning and asset classification, and to adopt regulations to limit banks' open foreign currency positions.

Directors encouraged the authorities to improve the quality and timeliness of data reporting to the Fund, with Fund technical assistance.

Directors stressed that the significant risks to the program—including those related to the implementation of the very large fiscal adjustment—heighten the importance of strong ownership, consensus building, and resolute policy implementation by the authorities. Close collaboration with the Fund, including through continued technical assistance, as well as strong support by the international community will also be important to ensure the success of the authorities' ambitious policy efforts. Directors emphasized the need to consider contingency measures to allow for prompt remedial action should any risks materialize.

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

Maldives: Selected Economic and Vulnerability Indicators, 2004-12

Population (in 1,000; 2008 est.)		310							
GDP per capita (in U.S. dollars; 2008 est.):		4,072							
Quota (in million SDRs):		8.2							

	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.	Prog.			
OUTPUT AND PRICES	(Annual percentage change)								
Real GDP	9.5	-4.6	18.0	7.2	5.8	-4.0	3.4	3.7	4.1
Inflation (end-of-period)	10.1	2.9	3.9	10.4	8.6	6.7	4.7	6.3	3.5
Inflation (period average)	6.3	2.5	3.6	7.6	11.9	5.5	4.5	6.3	3.5
GDP deflator	2.4	1.2	3.5	7.4	13.0	11.0	4.0	6.3	3.5
CENTRAL GOVERNMENT FINANCES	(In percent of GDP)								
Revenue and grants	34.2	47.7	52.1	55.8	49.0	36.3	37.0	43.4	44.2
Expenditure and net lending	36.0	59.0	59.3	60.8	62.8	65.0	54.8	47.5	47.9
Overall balance	-1.8	-11.3	-7.2	-4.9	-13.8	-28.8	-17.8	-4.2	-3.6
Overall balance excl. grants	-2.5	-19.8	-14.6	-12.7	-18.5	-33.6	-18.9	-5.2	-4.6
Financing	1.8	11.3	7.2	4.9	13.8	28.8	17.8	4.2	3.6
Foreign	4.1	2.4	4.5	4.6	3.8	12.7	4.2	2.0	2.6
Domestic	-2.3	8.8	2.7	0.4	10.0	16.1	13.6	2.2	1.1
Public and publicly guaranteed debt	55.2	64.9	62.9	66.4	68.6	91.6	96.0	87.9	82.5
Domestic	15.1	23.6	23.4	26.5	31.2	46.8	54.5	50.4	47.0
External (excl. IMF and currency swaps by MMA)	40.1	41.3	39.6	39.8	37.4	44.8	41.5	37.5	35.5
MONETARY ACCOUNTS	(Annual percentage change, unless otherwise indicated)								
Broad money	32.8	11.7	20.6	23.7	23.6	9.4	6.7	…	…
Domestic credit	32.6	63.2	37.6	45.8	43.4	5.7	7.5	…	…
Of which: To private sector	57.6	54.5	49.5	49.2	33.0	-4.1	-2.1	…	…
BALANCE OF PAYMENTS	(In percent of GDP, unless otherwise indicated)								
Current account	-15.8	-36.4	-33.0	-41.5	-51.4	-29.6	-23.4	-13.1	-11.1
Of which:									
Exports	23.3	21.6	24.6	21.6	26.2	16.1	17.7	17.7	17.8
Imports	-72.7	-87.4	-89.1	-91.5	-96.8	-58.2	-58.8	-55.9	-55.9
Nonfactor services, net	45.1	14.6	35.0	36.0	29.4	22.0	28.4	33.0	36.3
Capital and financial account (incl. e&o)	21.4	34.1	37.9	48.8	46.0	30.5	20.6	11.1	12.5
Of which:									
General government, net	3.2	2.5	4.2	3.4	5.3	8.4	-1.9	-1.2	0.6
Banks and other sectors, net	14.6	30.6	26.0	37.1	33.3	14.6	20.4	10.3	11.1
Overall balance	5.7	-2.3	4.9	7.3	-5.4	0.9	-2.8	-2.0	1.4
Gross international reserves									
(in millions of US$; e.o.p.) 1/	204	187	232	310	241	277	291	305	347
In months of GNFS imports	3.4	2.6	2.7	3.0	1.8	3.2	3.1	3.1	3.4
In percent of short-term debt at remaining maturity	585	261	168	121	80	81	88	118	143
External debt 2/	43	53	63	80	77	82	80	71	65
Medium- and long-term	42	48	53	63	60	67	68	60	56
Short-term	1	5	10	17	17	15	13	10	8
External debt service (in percent of domestic GNFS exports)	5	9	9	12	12	17	24	22	15
MEMORANDUM ITEMS									
GDP (in millions of rufyiaa)	9,939	9,596	11,717	13,493	16,137	17,192	18,480	20,354	21,935

Sources: Maldivian authorities, and IMF staff estimates and projections.
1/ MMA liabilities, include SDR allocation of SDR 7.4 million, equivalent to US$11.7 million, made available in Q3 2009, see http://www.imf.org/external/np/tre/sdr/proposal/2009/0709.htm. These are treated as long term liabilities of the MMA.
2/ Includes IMF but excludes domestic foreign-currency denominated debt.

Press Release No. 09/444
FOR IMMEDIATE RELEASE
December 4, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$79.3 Million Stand-By Arrangement and US$13.2 Million Arrangement Under the Exogenous Shocks Facility for Maldives

The Executive Board of the International Monetary Fund (IMF) today approved blended financing arrangements for Maldives amounting to a combined SDR 57.4 million (about US$92.5 million). The financing is designed to help smooth the country's adjustment to the fallout from the global crisis and support the authorities' strong policy program.

The blended arrangements for Maldives include a 36-month, SDR 49.2 million (about US$79.3 million) Stand-By Arrangement (600 percent of Maldives' quota), and a 24-month, SDR 8.2 million (about US$13.2 million) arrangement under the Exogenous Shocks Facility High Access Component (ESF-HAC, 100 percent of Maldives' quota). The ESF-HAC is an IMF facility designed to provide policy support and financial assistance on concessional terms to eligible low-income countries facing temporary exogenous shocks.

A combined disbursement of SDR 5.13 million (about US$8.3 million) will become available under the arrangements following the Board's decisions.

Following the Executive Board discussion, Mr Takatoshi Kato, Deputy Managing Director and Acting Chair, issued the following statement:

"The Maldivian economy was severely hit by the global crisis through significant declines in Maldives' tourism receipts, capital inflows, and goods exports. Coming after unsustainable public spending over the last few years—partly reflecting post-tsunami reconstruction efforts—the crisis led to a very large fiscal deficit, a sharply weakened balance of payments position, and reserve losses.

"The government's ambitious policy program, supported by the IMF, is aimed at addressing the impact of the global economic crisis and restoring macroeconomic stability and fiscal sustainability. At the core of the program is a very strong effort to bring down the fiscal deficit while protecting social spending. To that end, the authorities are taking immediate

action to cut spending, including unwinding part of the recent large wage increases, and are introducing new revenue measures to broaden the tax base. They have also taken steps to reform the civil service, improve the targeting of subsidies to the poor, and transfer enterprises and services to the private sector.

"The program aims to rebuild international reserves to prudent levels while preserving the current exchange rate peg to the U.S. dollar. Monetary policy will support the fiscal adjustment efforts through a tightening of domestic currency liquidity. The authorities have taken key steps in this regard: the monetization of the fiscal deficit has been halted; the government debt stock with the Maldives Monetary Authority has been converted into tradable securities; and open market operations have been introduced to absorb excess liquidity.

"The authorities are committed to strengthening the financial sector. These measures include restructuring the Bank of Maldives' portfolio; ensuring speedy action for the recovery of its collateral on defaulted debt; and, as necessary, securing a capital infusion. The authorities also plan to put in place a stronger legal framework for the operation, supervision, regulation, intervention, and liquidation of commercial banks, and have already introduced regulatory changes to enhance asset classification and loan loss provisioning.

"The authorities' program, while subject to considerable risks, is strong, comprehensive, and well-focused, and deserves strong support of the international community. If fully implemented, it will put the Maldivian economy back on a path of macroeconomic stability and set the conditions for sustained economic growth and poverty reduction," Mr Kato said.

ANNEX

Recent Economic Developments

The Maldivian economy is facing severe fiscal and external imbalances. A rapid fiscal expansion began after the 2004 tsunami, including steep wage bill increases. From mid-2008, the global crisis significantly exacerbated existing imbalances and severely weakened the country's balance of payments position. Tourism revenue has been badly affected by the global downturn, reducing fiscal and foreign exchange earnings and driving the economy into recession. Net capital inflows have also fallen sharply, as have goods exports. The loss in fiscal revenues, combined with the continued growth in public expenditures, led to a dramatic increase in the fiscal deficit in 2008-09, much of which has been monetized. Despite foreign exchange rationing by the Maldives Monetary Authority (MMA), international reserves had fallen to about 2¼ months of imports by end-September 2009.

Key Program Policies and Objectives

The authorities are undertaking a very significant adjustment program, aimed at addressing the severe impact of the global economic crisis and restoring macroeconomic stability and fiscal sustainability, thereby setting the conditions for renewed economic growth and poverty reduction. In particular, they plan to:

• Reduce the very large budget deficit by curtailing spending and implementing revenue measures, in order to restore economic stability and fiscal sustainability;

• Protect critical social spending and broaden the coverage of the pension system. The targeting of food, medicine and other subsidies to the poor will also be enhanced. For instance, across-the-board electricity subsidies have been eliminated and replaced by a cost-based electricity pricing formula combined with a subsidy mechanism for the poor;

• Reduce excess liquidity of the Maldivian rufiyaa and rebuild reserves to prudent levels; and

• Strengthen the financial system.

Maldives: Selected Economic and Vulnerability Indicators, 2004-12

Population (in 1,000; 2008 est.) 310
GDP per capita (in U.S. dollars; 2008 est.): 4,072
Quota (in million SDRs): 8.2

	2004	2005	2006	2007	2008	2009	2010	2011	2012
					Est.	Prog.			
OUTPUT AND PRICES	(Annual percentage change)								
Real GDP	9.5	-4.6	18.0	7.2	5.8	-4.0	3.4	3.7	4.1
Inflation (end-of-period)	10.1	2.9	3.9	10.4	8.6	6.7	4.7	6.3	3.5
Inflation (period average)	6.3	2.5	3.6	7.6	11.9	5.5	4.5	6.3	3.5
GDP deflator	2.4	1.2	3.5	7.4	13.0	11.0	4.0	6.3	3.5
CENTRAL GOVERNMENT FINANCES	(In percent of GDP)								
Revenue and grants	34.2	47.7	52.1	55.8	49.0	36.3	37.0	43.4	44.2
Expenditure and net lending	36.0	59.0	59.3	60.8	62.8	65.0	54.8	47.5	47.9
Overall balance	-1.8	-11.3	-7.2	-4.9	-13.8	-28.8	-17.8	-4.2	-3.6
Overall balance excl. grants	-2.5	-19.8	-14.6	-12.7	-18.5	-33.6	-18.9	-5.2	-4.6
Financing	1.8	11.3	7.2	4.9	13.8	28.8	17.8	4.2	3.6
Foreign	4.1	2.4	4.5	4.6	3.8	12.7	4.2	2.0	2.6
Domestic	-2.3	8.8	2.7	0.4	10.0	16.1	13.6	2.2	1.1
Public and publicly guaranteed debt	55.2	64.9	62.9	66.4	68.6	91.6	96.0	87.9	82.5
Domestic	15.1	23.6	23.4	26.5	31.2	46.8	54.5	50.4	47.0
External (excl. IMF and currency swaps by MMA)	40.1	41.3	39.6	39.8	37.4	44.8	41.5	37.5	35.5
MONETARY ACCOUNTS	(Annual percentage change, unless otherwise indicated)								
Broad money	32.8	11.7	20.6	23.7	23.6	9.4	6.7	…	…
Domestic credit	32.6	63.2	37.6	45.8	43.4	5.7	7.5	…	…
Of which: To private sector	57.6	54.5	49.5	49.2	33.0	-4.1	-2.1	…	…
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2/ Includes IMF but excludes domestic foreign-currency denominated debt.

Statement by Mr. Shaalan on Maldives
December 4, 2009

1. **Overview.** The administration of President Mohamad Nasheed that took office in November 2008 faced an urgent policy challenge as the economy was particularly hard hit by the global financial crisis. The crisis exacerbated the impact of the recent fiscal pressures by severely curtailing foreign exchange earnings and net capital flows, leading to a rapid drawdown in foreign exchange reserves and a sharp drop in government revenue by nearly one third relative to 2007. The post-Tsunami relief efforts and reconstruction projects had supported strong growth while contributing to enlarging the size of the public sector between 2004 to 2007. Public expenditure was also inflated to unsustainable levels in the run-up to the October 2008 elections, reflecting a rising wage bill partly due to the newly introduced civil service reform.

2. The ruling party's manifesto for 2008-2013 foresaw the need to "plan state expenditure in proportion to government income and reduce wasteful and excessive spending"[1]. The onset of the global financial crisis made such reforms all the more urgent as international reserves approached a critical level. While there was no time to adjust the 2009 budget before its scheduled submission to Parliament in mid-November, the government approached the Fund in its first few weeks in office to assess the situation and discuss policies that would return the fiscal and external positions to sustainable levels. Support from bilateral creditors and private investors was also sought for interim foreign exchange until multilateral creditor financing can be secured in support of an adjustment program.

3. **Request for Fund resources.** In close collaboration with the Fund, the authorities prepared an ambitious and comprehensive program to restore macroeconomic stability and growth. The access level of 600 percent of quota under the three-year Stand By Arrangement and 100 percent under the 2-year ESF is the highest level of "normal" access, amounting to SDR 57.4 million over 36 months. In order to soften the severe impact of the shock and smooth the adjustment path, the authorities had initially requested higher exceptional access, arguing that the tremendous size of the adjustment justified higher financing to ease the impact on domestic growth and to help bolster reserves to a comfortable level consistent with the Maldives' high vulnerability to external shocks. Moreover, higher access would lower risks to the program and support its successful implementation.

4. **International support**. To supplement financing from the IMF, the authorities have secured financing from the World Bank and AsDB for about $59 million. They have also approached the Government of India for a 2-3 year dollar-denominated bond of $100 million; in addition to the $100 million trade credit contracted earlier in 2009, and have been

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[1] *The Other Maldives, Manifesto of The Maldivian Democratic Party-Alliance 2008-2013*, p. 44.

discussing a swap agreement with the Government of Sri Lanka. A $40 million stake in the state telecommunications company also provided interim foreign exchange. The authorities intend to request additional concessional support from the international community at a conference to be organized by the World Bank. Such additional support would facilitate economic recovery and reserve buildup, ease the pressure on the private sector of increased domestic financing of the deficit, support public spending on capital projects, and facilitate repayment of short-term borrowing. Depending on the outcome of the donor meeting, and the pace of the global recovery and resumption of capital flows, the authorities may seek augmentation of access in conjunction with successful implementation of the fiscal adjustment measures.

5. **Tsunami legacy**. Although the country made a remarkable recovery to the Tsunami, the reconstruction efforts bloated the size of public sector and sharply increased debt as the government attended to the damage that the World Bank estimated at 65 percent of GDP. The reconstruction process was long drawn out as Tsunami-related aid was disbursed over several years, and about 85 percent of affected housing and physical infrastructure had been restored by end 2008.[2] Government expenditure increased from 36 percent of GDP in 2004 to 61 percent of GDP in 2007 as the number of permanent government employees increased by 24 percent, primarily due to public take-over of all private schools and expansion of health facilities. Similarly, the trade deficit nearly doubled following the Tsunami and the current account deficit rose from 16 percent in 2004 to 33 percent in 2006. Rising oil and food prices in 2007, as well as increased imports of construction materials, further pushed the current account deficit to over 40 percent of GDP in 2007 and over 50 percent of GDP in 2008, creating an untenable drain on foreign exchange reserves. As a result, total debt to GDP increased from 55 percent of GDP in 2004 to 91 percent of GDP in 2008.

6. **Civil service reforms**. A Civil Service Commission (CSC) was established in 2007 and a Civil Service Act adopted in March 2008. Consistent with a U.N.-supported study to modernize the civil service and rationalize the pay scale, the CSC recommended reforms to introduce job classifications, a 12 percent pay dispersion between grades, and equalize pay for similar work in various government offices. A new civil service salary structure was introduced in late 2008. Moreover, in the run-up to the October 2008 presidential elections, the previous administration promised pay increases to specific sectors of about 20 percent. To address equity concerns, the new administration agreed to extend the increases to all sector in conjunction with introduction of the new civil service pay structure to become effective on February 1, 2009. This came on top of a public sector wage increase in January 2008 that was necessitated by the erosion of real incomes due to higher commodity prices and weakening of the rufiyaa. Together, and in the absence of corrective measures, these

[2] *Maldives - 4 Years after the Tsunami: Progress and Remaining Gaps*. Department of National Planning, Ministry of Finance and Treasury.

policies would cause the wage bill to increase from 16.3 percent of GDP in 2007 to 29.1 percent of GDP in 2009, an unsustainable level.

7. The policy of the current government is to have a lean and efficient civil service and to reduce the number of public employees accordingly. Recognizing the detrimental impact of the recent civil service policies on fiscal imbalances, the President announced in August 2009 a partial reversal of the February salary increase and elimination of most allowances. The salary reductions were implemented starting in September 2009, yielding 4 percent of GDP on an annual basis. However, initial plans to roll back allowance payments could not be implemented. The Civil Service Commission ruled against elimination of allowances, insisting that further reductions in take home pay would only be considered once the salary cuts were reversed– this outcome delayed program negotiation. As an alternative measure to reduce the public wage bill, the President brought forward the retrenchment program, requiring elimination of 9,000 government positions through restructuring of government offices and a rapid transfer of government services to the private sector by mid-2010. This would effectively reduce the public wage bill from 29 percent of GDP in 2009 (before the salary reductions) to 17½ percent of GDP by 2011.

8. **Program objectives and macroframework**. The program aims to restore external balance and fiscal sustainability primarily through a sharp fiscal adjustment over two years, consistent with maintaining the current exchange rate peg. Growth is expected to resume in 2010 to around 4 percent as tourism receipts and tourism-related investments rebound, driven by the recovery in the global economy and resumption of capital flows. Government revenue is expected to partially recover to its 2007 level, and together with the sharp reduction in expenditures, the primary balance is targeted to turn positive by 2011 and the overall deficit is to fall to 1 percent of GDP by 2014. The current account deficit will narrow drastically in the coming years, as imports remain subdued, contained by the fiscal and monetary tightening, allowing gross international reserves to be maintained at 3-4 months of imports.

9. **Fiscal adjustment**. The programmed fiscal adjustment is sizeable—the fiscal measures under the program are expected to yield full year savings of 29 percent of GDP when fully implemented by 2012 (as outlined in the table on page 17). The fiscal adjustment falls equally on expenditure and revenue mobilization, but with more immediate effect on the expenditure side. Total government expenditure would have reached 67.6 percent of GDP in 2009 without corrective measures, and will by slashed by 12½ percentage points to under 55 percent of GDP in 2010. These savings will come from wage cuts (4 percent), staff redundancies (3 percent), electricity tariff increases (2½ percent), reduction in transport and office expenses (2 percent) and lower capital spending (1 percent). The full-year impact of the all expenditure measures amounts to 14 percent of 2009 GDP, when fully implemented. In addition to the expenditure cuts, revenue measures will yield another 3½ percent of GDP in 2010 from a transfer of the airport tax to the government together with an increase in its rate, switching the $8 per night fixed rate to an ad valorem hotel room tax, and introduction of a business profit tax to be passed by Parliament by end 2009. In the following two years,

2011-2012, the further fiscal consolidation will rely on the introduction of a general sales tax from 2011. The full year impact of all revenue measures amount to 15 percent of 2009 GDP, when fully implemented.

10. The magnitude of such fiscal adjustment is clearly unprecedented in Fund programs, and we must not underestimate the enormity of the challenge facing the new administration in pushing through these painful reforms. Altogether, fiscal measure amounting to 29¼ percent of GDP are expected over the course of the program. The sheer magnitude of the adjustment is likely to engender public outcry. Nevertheless, the authorities are fully determined to implement the agreed measures, emphasizing that the envisaged fiscal policies are consistent with the structural public sector reforms they intended to pursue from the outset (as noted above), even if the pace is considerably more challenging than had been originally envisaged.

11. **Monetary policy**. Several steps have been taken to alleviate the burden of fiscal financing on the conduct of monetary policy and to stem reserve losses. Most important is the government's decision to cease the monetization of the fiscal deficit and to convert the government debt stock held by the Maldives Monetary Authority (MMA) into tradable securities to reverse the impact of past monetization on liquidity. Open market operations were introduced in August 2009. Domestic financing through direct monetization is to be replaced by treasury bill auctions, scheduled to begin by December 2009.

12. **Exchange rate policy and competitiveness**. The significant fiscal and monetary tightening aims to support the current peg, whose level the staff and authorities consider to be appropriate and consistent with the envisaged fiscal consolidation. As well-argued in the staff report, a devaluation would not be appropriate in the current circumstances due to the small scope for expenditure-switching, large pass-through effect on domestic prices, and high confidence risks that could invite speculation in the context of low reserves. Moreover, as staff analysis clearly indicates in Box 2, the economy remains competitive at this exchange rate when compared to other tourism-dependent economies, and competitiveness could be further improved by addressing some structural weaknesses related to the business climate. Due to the mounting pressures on reserves which had reached a precariously low level, the authorities have been rationing foreign exchange to commercial banks, which has given rise to multiple-currency practices. However the authorities are committed to gradually eliminating this practice over the program period as reserves build up.

13. **Financial sector policies**. Significant progress has been achieved in financial regulation and supervision, and ongoing efforts aim to address remaining weaknesses. Benefiting from MCM and LEG advice, a banking law and reforms to the MMA Act have been presented to the parliament, and regulations were introduced in May 2009 to strengthen the prudential framework. The new regulations include tighter capital adequacy requirements, limits on loans to related persons and single borrowers, asset classification and provisioning, audit and disclosure requirements, and corporate governance. The authorities

are pressing ahead for recovery of collateral on defaulted loans for the Bank of Maldives, the largest commercial bank. Their intention is to secure capital infusion, preferably in the context of a strategic partner to take over the state share in the bank.

14. **Structural reforms**. As noted earlier, the authorities' policy for state reform aims to make the public sector leaner and more efficient, including by transferring services that can be more efficiently provided by the private sector and through the sale of public enterprises. The government's retrenchment plan will reduce the public work force by privatizing services. In addition to selling a stake in the telecommunication company, the Privatization Committee has been working on privatization of the airport and other enterprises. Significant strengthening of public financial management is underway, with FAD support, aimed at improving budget planning, control, monitoring, and implementation. A key challenge in the period ahead will be to prioritize the vast legislative agenda, which includes over 80 bills before Parliament. Public sector reforms and privatization are part of a larger effort to improve the business climate in order to foster a dynamic more diversified private sector and to strengthen the economy's resilience to shocks.

15. **Debt sustainability**. Maldives' total debt (public and private) increased rapidly since the 2004 Tsunami, reaching almost 110 percent of GDP in 2008 and resulting in a rating of moderate risk of debt distress. However, with one minor and temporary exception, all external debt indicators remain below the relevant LIC debt burden thresholds under the baseline scenario, as the fiscal adjustment embedded in the program will bring down significantly the debt to GDP ratio. Indeed, even a more gradual path of fiscal consolidation would be consistent with a sustained downward path in the public and external debt stocks.

16. Finally, the authorities would like to express their appreciation for the staff's valuable analysis and policy advice and for the Fund's helpful technical assistance, which have been instrumental in the formulation and implementation of their reform effort. They consider continued technical assistance of paramount importance to implementing this ambitious reform program. While they had sought a smoother path of adjustment and higher financing from the Fund, they look forward to continued close collaboration as they implement this arduous program in the months and years ahead.