INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/135

MALDIVES

May 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALDIVES

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with Maldives, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 13, 2016 consideration of the staff report that concluded the Article IV consultation with Maldives.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 13, 2016, following discussions that ended on January 17, 2016, with the officials of Maldives on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 7, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and International Development Association (IDA).
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Maldives.

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 16/246
FOR IMMEDIATE RELEASE
May 26, 2016

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

IMF Executive Board Concludes 2016 Article IV Consultation with Maldives

On May 13, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Maldives.

After outperforming its peers for several years, Maldives economy slowed sharply in 2015 to 1.5 percent from 6.5 percent the previous year, as tourism arrivals decelerated. The fiscal deficit narrowed following measures in the 2015 Budget and a sustained strong revenue performance, although public debt remains high and on a rising trajectory. The monetary policy stance was eased in 2015 and credit to the private sector began to pickup. Inflation remains contained and further pass through from lower oil prices is expected. The current account deficit widened to 8.8 percent of GDP in 2015, despite a positive terms of trade shock from the decline in oil prices.

Growth is expected to pick up but the outlook is clouded by the risks of less robust growth in Asia and uncertain returns from large-scale infrastructure scaling up. Staff expects real GDP growth to rise to 3.5 percent in 2016 supported by a modest recovery in tourism. A substantial infrastructure scale up is planned by the authorities comprising three mega projects—airport expansion, Hulhumalé island development and bridge, and port enlargement—which are aimed at supporting further development of the key tourism sector and improving resilience to climate change. The authorities plan a doubling of capital spending in the next three years and are raising external debt to finance these projects.

Executive Board Assessment[2]

Executive Directors commended Maldives's considerable progress in reaching middle income status on the back of rapid tourism development over the past two decades. Directors noted, however, that important challenges remain ahead. In particular, the planned infrastructure scale

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

up could be transformational for the economy, adding to growth and helping to build resilience to climate change, but it could also bring with it external financing risks if not implemented appropriately, as the projects require significant external financing that would add to already elevated public debt. Against this backdrop, Directors encouraged the authorities to pursue the development strategy while preserving fiscal and external sustainability.

Directors agreed that a durable fiscal adjustment is needed to ensure that public debt is placed on a sustainable trajectory. This should include prioritizing overall capital expenditures, leveraging the well administered tax system to generate higher revenues (including user fees for new infrastructure and broadening the tax base), and strengthening controls on current spending. Enhanced public financial management, with a particular focus on public investment management, would also be key for successful fiscal adjustment.

Directors viewed the stabilized exchange rate regime as appropriate. They generally noted, however, the staff's assessment that the external position is moderately weak while the real effective exchange rate appears moderately overvalued. In this regard, Directors concurred that a tighter fiscal policy stance would help improve the external position and support the exchange rate. They also noted that support from monetary and financial policies would be important to help stabilize the external position. In particular, small step increases in administered rates and the minimum reserve requirement may be called for if capital outflow pressures emerge. Directors welcomed the Maldives Monetary Authority's focus on further strengthening banking supervision beyond credit risk.

Directors commended Maldives' success in overcoming logistical challenges to provide near universal access to basic services across all the inhabited islands. Looking forward, they encourage the authorities to further build resilience to climate change, reduce the cost of public service delivery, invest in human capital, and promote economic diversification. Directors welcomed Maldives' early ratification of the Paris Agreement. They supported the authorities' initiatives to establish regional hubs and improve inter-island connectivity, and recommended establishing a more detailed national development strategic plan to aid coordination and bring about the expected growth dividends. Directors stressed that strict ring fencing of tax exemptions for special economic zones will be necessary to preserve the tax base.

Maldives: Selected Economic Indicators, 2012–20 (Baseline Scenario)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Est.	Proj/Prel.	Proj				
Output and prices	(Annual percentage change)								
Real GDP	2.5	4.7	6.5	1.5	3.5	3.9	4.6	4.7	4.8
Inflation (end-of-period) 1/	5.4	3.1	1.2	1.2	2.0	3.2	3.6	4.0	4.2
Inflation (period average) 1/	10.9	4.0	2.5	1.4	2.1	2.6	3.5	3.8	4.1
GDP deflator	5.5	6.0	3.0	0.4	1.3	2.5	2.8	3.0	3.2
Central government finances	(In percent of GDP, unless otherwise indicated)								
Revenue and grants	26.2	27.7	32.1	35.9	35.6	34.4	33.1	32.5	32.4
Expenditure and net lending	33.9	35.2	41.2	44.3	48.9	52.5	52.0	48.4	43.2
Overall balance	-7.7	-7.4	-9.1	-8.4	-13.3	-18.1	-18.9	-15.9	-10.9
Overall balance excl. grants	-8.6	-7.7	-9.4	-9.2	-13.7	-18.5	-19.2	-16.2	-11.1
Primary balance	-4.8	-4.9	-6.3	-5.9	-10.6	-14.7	-14.5	-10.7	-4.9
Current primary balance	1.5	-0.6	-0.3	2.2	1.8	1.3	0.5	0.5	0.7
Public and publicly guaranteed debt	63.9	64.8	66.6	73.1	83.1	96.5	109.0	117.5	120.8
Monetary accounts	(Annual percentage change, unless otherwise indicated)								
Broad money	6.4	16.8	14.7	13.6	11.1	9.2	10.1	9.9	10.3
Domestic credit	-2.4	3.9	4.7	16.0	11.7	9.0	8.6	8.9	8.5
Balance of payments	(In percent of GDP, unless otherwise indicated)								
Current account	-7.4	-4.3	-4.1	-8.8	-7.7	-14.7	-17.3	-14.1	-10.9
Of which:									
Exports	12.5	11.9	9.8	8.0	7.0	7.4	7.7	8.0	7.9
Imports	-62.6	-61.1	-64.1	-62.9	-60.4	-66.7	-67.6	-62.7	-58.5
Tourism receipts and nonfactor services, net	64.1	68.5	72.9	69.7	69.4	68.1	66.0	64.6	64.2
Income (net)	-11.1	-13.3	-12.1	-11.4	-11.9	-11.6	-11.6	-12.1	-12.5
Current transfers	-10.3	-10.3	-10.6	-11.4	-11.8	-11.8	-11.9	-11.9	-11.9
Capital and financial account (including e&o)	9.5	9.2	12.0	6.7	9.8	19.6	20.3	15.6	11.8
Of which:									
General government, net	1.7	0.7	-0.6	-0.2	6.2	10.7	10.9	5.9	2.3
Banks and other sectors, net	-5.0	-6.8	6.5	-0.6	-3.8	-1.9	-1.2	-0.9	-0.9
Overall balance	2.1	5.0	7.9	-1.3	2.1	5.0	3.0	1.5	0.9
Gross international reserves (in millions of US$; e.o.p.) 2/	305	368	605	564	633	805	919	978	1,017
In months of GNFS imports	1.7	1.8	2.6	2.5	2.7	3.1	3.2	3.4	3.4
Memorandum items:									
GDP (in millions of rufiyaa)	38,693	42,952	47,122	48,209	50,549	53,836	57,854	62,358	67,403
GDP (in millions of U.S. dollars)	2,517	2,789	3,060	3,130	3,282	3,496	3,757	4,049	4,377
Tourism bednights (000')	6,451	7,058	7,290	6,978	7,005	7,146	7,360	7,654	8,075
Tourist arrivals (000')	958	1,125	1,205	1,234	1,251	1,299	1,338	1,392	1,468
Tourism bednights (% change)	-1.2	9.4	3.3	-4.3	0.4	2.0	3.0	4.0	5.5
Tourist arrivals (% change)	2.9	17.4	7.1	2.4	1.4	3.9	3.0	4.0	5.5
Dollarization ratio (FC deposits in percent of broad money) 3/	49.2	50.2	53.8	52.4					

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

1/ CPI-Male definition.

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

3/ Data for 2015 Jan-Aug.

INTERNATIONAL MONETARY FUND

MALDIVES

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

April 6, 2016

KEY ISSUES

Context Maldives living standards have risen to middle income levels over the past two decades driven by tourism development. The country's geography—with a widely dispersed population across small far flung islands—creates fiscal challenges and the economy has faced persistent fiscal deficits over the past decade. The economy is highly exposed to climate change which further adds to fiscal costs.

Recent economic developments. The real economy outperformed its peers in the past few years but tourism slowed last year. The current account deficit widened despite a positive terms of trade shock but inflation is contained. Public debt is high and on a rising trajectory. The authorities are embarking on a substantial infrastructure scale up which could transform the economy but brings with it external financing risks.

Policy recommendations:

- **Fiscal policy.** Durable fiscal adjustment is needed to prevent growing fiscal and external imbalances. Staff supports priority public infrastructure spending where benefits clearly outweigh costs. But additional fiscal measures are needed to contain the overall increase in debt. This should include revenue raising measures and firmer control of current spending, alongside more prioritized capital expenditure. Strengthened public financial management is critical to support fiscal goals.

- **Monetary, financial and external policies.** The external position looks moderately weaker than implied by fundamentals and desirable policies and the exchange rate moderately overvalued. Alongside fiscal adjustment, support from monetary and financial policies would help stabilize the external position.

- **Building longer term resilience.** Building climate change resilience, improving public service delivery and economic diversification are key challenges. Encouraging voluntary resettlement to regional hubs and better connectivity would reduce the cost of service provision but will take many years. A detailed national development strategy would ensure that investment plans are well coordinated and bring about bigger growth dividends. Diversification into new sectors would be helpful, but care is needed to preserve the tax base.

Approved By
Kalpana Kochhar and Catherine Pattillo

Discussions took place in Malé during January 5–17, 2016. Staff representatives comprised Ms. A Stuart (head), J. De, J. A. Garcia (APD), K. Wijeweera (APD, and Resident Representatives Office), J. Ge (RES) and Ms. E. Kvintradze (Resident Representative, Sri Lanka and Maldives). Ms. W. Abdelati (OED) joined the discussions. Mr. Atolia (RES) provided research and support from HQ.
Research assistance: Ms. Q. Zhang.
Administrative assistance: Mr. S. George

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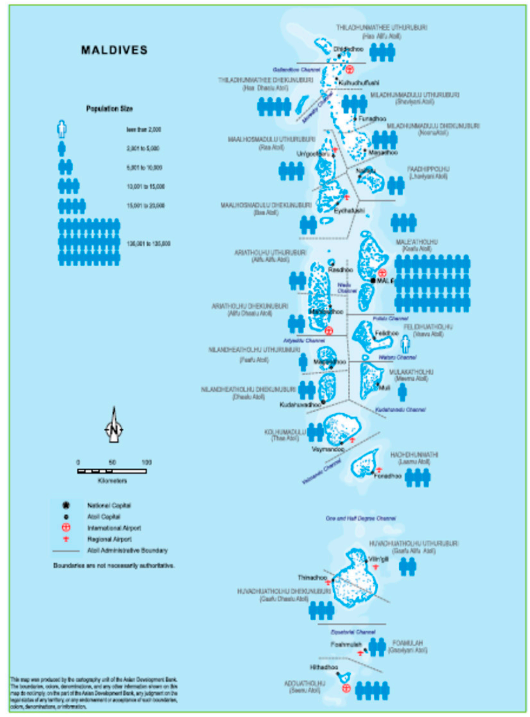
SETTING

An islands idyll facing difficult challenges…

1. Maldives living standards have risen to middle income levels over the past two decades driven by tourism development. Tourism directly or indirectly accounts for three quarters of activity with income per capita reaching $6792 in 2014. The economy is highly dollarized, has a de facto fixed exchange rate but an open capital account and a deep parallel foreign exchange market. The country's unique geography with 188 inhabited islands and spread over 90000 sq kms creates fiscal challenges—with high costs for the provision of public services across such far flung small islands. Despite this challenge, Maldives has successfully provided near universal access to basic services of electricity, clean water and sanitation (Table 7). But some gaps remain in health and education; and many youths have opted out of employment.

Maldives Settlement Distribution



Sources: ADB Map Department, based on data from National Bureau of Statistics (2014).

2. The islands are highly exposed to climate change. The economic costs from climate change could become very large by the end of the century, and Maldives would significantly benefit from a reduction in global emissions (Box 1). Domestic policies—encouraging voluntary resettlement onto fewer islands over the longer term, promoting renewable energy, improving waste management and environmentally-friendly tourism infrastructure—would also help adapt and build resilience to climate change.

3. An unprecedented scale up in public infrastructure is planned which could transform the economy but brings with it large financing risks. The public investment program is aimed at further developing tourism, easing constraints in the capital Malé, and includes elements of climate change adaptation. However, public debt levels are already very high following persistent fiscal problems; and while the investment program could boost growth in the long run, it will substantially add to fiscal and external risks in the near term.

4. Political tensions clouded developments last year. Maldives' new constitution was established in 2008, with multi-party elections. Relations between political parties are fractious which has led to bouts of political unrest over the past ten years. In 2015 tensions rose following the arrest of the former president; and a sequence of events leading to the imposition of a brief state of emergency in November.

Box 1. Climate Change Challenges and Adaptation Policies /1

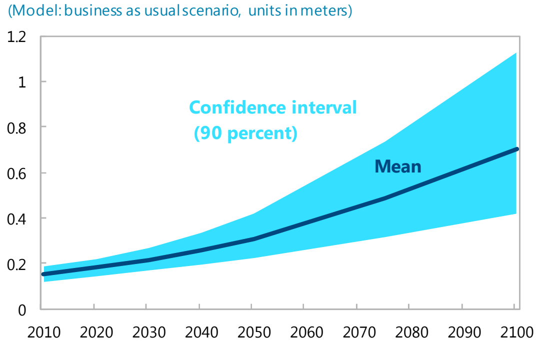
Maldives is highly exposed to climate change from a rising sea level, sea surges and flooding alternating with drought. The country comprises 25 low lying coral atolls with 1192 islands of which 188 are inhabited. 80 percent of the total land area is less than 1 meter above the mean sea level. Most of Maldives' islands are small, half of all settlements, including tourist resorts, and two thirds of key infrastructure are within 100 meters of the coastline—and are exposed to severe weather events. Drought and flooding are already occurring with greater frequency than in the past. High urban density in the capital Malé—home to a third of the population—adds to difficulties.

Climate change adaptation costs are high for public and private sectors, including:

- ***Developing renewable energy***. Maldives is reliant on fossil fuels for electricity generation and faces the highest costs in South Asia. Solar energy is being developed, but geography and population dispersion pose challenges.
- ***Promoting voluntary population resettlement.*** Consolidating onto fewer islands over the longer term is necessary to adapt to climate change and would help reduce the costs of service provision.
- ***Improving infrastructure resilience.*** Coastal protection of inhabited islands, resorts, airports and ports.
- ***Water security***. Rainwater is the main source of drinking water on many islands. Changes in annual rainfall patterns are leading to periods of drought and localized water stress, requiring desalination and strengthened water resource management policies, including by the tourism industry.
- ***Protection of biodiversity and better waste management.*** Critical to conserve coral reefs and reduce pollution.
- ***Health***. Higher risks from vector and water borne diseases have been identified as an emerging challenge.
- ***Tourism and fisheries industries***. Protection of the coral reefs, beaches and coastal infrastructure are essential for tourism. The fisheries industry will need to adapt to changes in sea temperature.

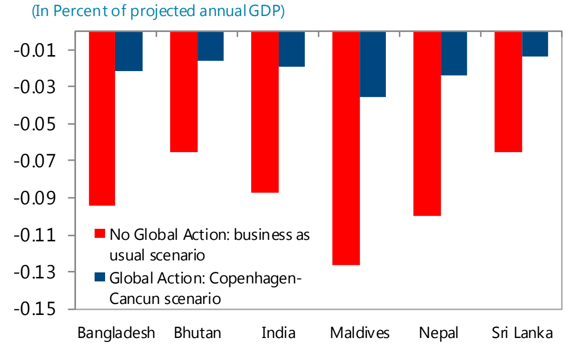
Maldives could face the highest economic burden in South Asia from climate change and has most to gain from global action. The Asian Development Bank/UKAID estimate that without global action to tackle climate change (business as usual scenario), the average economic costs in South Asia would accelerate. For Maldives the costs could be 2 percent of annual GDP in 2050 and 12 percent of annual GDP in 2100. By contrast, global action (the Copenhagen-Cancun scenario—keeping the mean temperature rise below 2 C) could limit the economic losses to Maldives to around 3.5 percent of annual GDP by 2100. Successful implementation of the Paris COP 21 agreement is therefore critical for Maldives. It will help mobilize grants and concessional financing in key adaptation areas. Research indicates that early investment in adaptation can help limit losses in later decades; and climate change policies are most effective when fully integrated in a sustainable development strategy.

Global Sea Level Rise in South Asia Without Global Action
(Model: business as usual scenario, units in meters)



Source: Asian Development Bank/ U.K. Aid.

Possible Mean Economic Costs for South Asia Under Different Scenarios
(In Percent of projected annual GDP)



Source: Asian Development Bank. U.K.AID

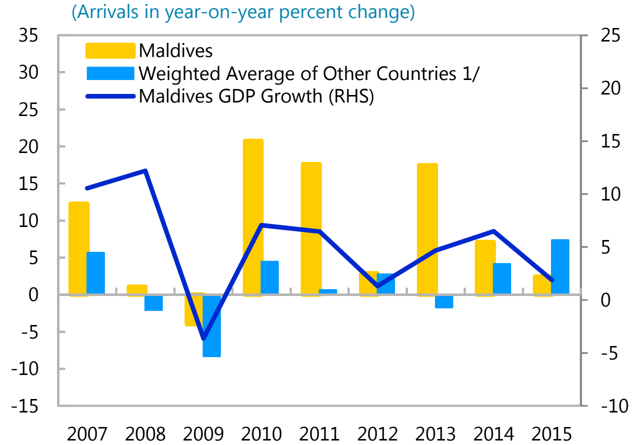
1/Sources Maldives Intended Nationally Determined Contribution to U.N. CCC; Assessing the Costs of Climate Change and Adaptation in South Asia, 2014 (Asian Development Bank and UK aid), and U.N. Development Assistance Framework (2016–2020).

RECENT DEVELOPMENTS

Growth has faltered and performance is mixed…

5. Maldives tourism has outperformed its peers in the past few years but this success faded in 2015. Growth slowed sharply from 6.5 percent in 2014 to around 2 percent (Figure 1). Tourist arrivals slowed following a collapse in arrivals from Russia, a slowing from China (after rapid market expansion) and a temporary downward blip as November's state of emergency led to some cancellations.

Tourism Outperformed Peers But Has Slowed
(Arrivals in year-on-year percent change)



1/ Countries include Mauritius, Seychelles, Bahamas and Barbados.
Sources: Authorities data and IMF staff estimates.

6. The current account deficit widened to 8 percent of GDP, despite lower oil prices. Preliminary estimates suggest that the positive terms of trade shock was outweighed by the tourism slowdown, a large increase in non-oil imports and higher capital outflows.[1] Gross official reserves fell back to $564mn at the end of 2015, although usable reserves showed an improvement, and the parallel market exchange rate premium increased to 6 percent in January 2016 from 3–4 percent in 2015. Inflation has remained contained (1.2 percent y on y in December) and further pass through from lower oil prices is expected (Figures 2 and 3).

7. Encouragingly, significantly better revenue performance contained the fiscal deficit. The 2014 fiscal deficit is estimated by staff to have reached 9.1 percent a significantly better outturn compared to 11.6 percent of GDP expected in the previous Article IV Consultation. In 2015 revenues were further buoyed by fiscal measures including the increase in the tourism goods and services tax (TGST) rate, higher business profits tax revenue (BPT) and import duties (Figure 4). Preliminary estimates suggest a small improvement in the overall deficit in 2015. Outstanding domestic arrears have also been reduced.

8. But public debt remains on a rising trajectory. Notwithstanding higher revenues, sustained deficits have placed public debt on a rising path to 73.1 percent of GDP in 2015, above the 60 percent limit in the Fiscal Responsibility Law—and higher infrastructure spending will drive up debt further (Figure 4). The international arbitration ruling over the authorities' cancellation of the airport operating concession adds a significant contingent fiscal liability.[2]

9. Monetary conditions are easy with credit growth turning around. The Minimum Reserve Requirement and administered rates on treasury bills and bonds were halved in October 2015 as the

[1] Revisions to BOP data are likely as the methodology improves with IMF technical assistance.
[2] In 2012 the authorities cancelled the airport concession contract with GMR and Malaysia Airports Berhad to upgrade and operate Malé airport. In June 2014 international arbitration ruled in favor of GMR. Maldives Airport Company Limited (MACL) paid $4mn in immediate costs. A final settlement has yet to be reached.

authorities sought to stimulate credit, reduce interest costs and lengthen maturities. With a structural excess liquidity position, banks have continued to invest in treasury bills notwithstanding lower rates and have begun to take up longer maturity treasury bills. After some years of weakness, private sector credit has turned up rising 13 percent in the year to December (Figure 5).

10. Financial soundness indicators are strengthening. Banks have met capital adequacy ratios and are compliant with prudential limits. Legacy non performing loans (NPLs) are being settled with the sale of tourism resorts and NPLs are down from the 2011 peak (Figure 6). However, a recent corruption case has highlighted the need to tighten banks' operational risk management.

OUTLOOK AND RISKS: HIGH STAKES

A. Unprecedented Infrastructure Scale Up

11. A big push on infrastructure investment is underway to further develop the tourism sector and create a regional hub around the airport. Three main projects are in the pipeline (Box 2), costing around 35 percent of GDP and doubling capital spending in the next three years (Debt Sustainability Analysis).

Box 2. Public Infrastructure Program

Three large projects are planned:

- **International airport development** (cost totaling around US$828mn) will open up Maldives to increased tourist traffic. The airport is unable to accommodate large jets and is operating at close to full capacity. The new runway, plus terminal development, would increase passenger capacity fivefold (to 7.5 mn). While, geographical, logistical and size constraints are likely to cap feasible maximum tourism capacity, there is still substantial scope for expansion. Tourism and ancillary services are likely to increase once the airport development is completed. But risks include engineering complexity, implementation capacity, and the availability of financing.
- **Phase II Hulhumalé development and bridge** (cost totaling around $400mn) will develop a new population center next to the international airport and Malé, to support population resettlement, ease overcrowding, and expand electricity generation at lower cost. Projects in the north and southern atolls aimed at developing hubs are in the early stages of development. Over the medium term, voluntary population resettlement, supported by employment opportunities, would help adapt to climate change and reduce the costs to government of service delivery.
- **Port relocation and development** would improve resilience to climate change, ease bottlenecks and reduce transport costs—but this is at an early stage of planning with financing yet to be identified.

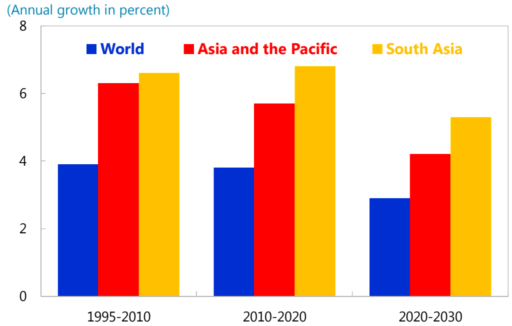
Staff's Position

12. On the positive side, the economic gains from investment scale up could be substantial:

- **International experience suggests the impact on growth could be sizeable.** More direct flights to small islands are also associated with a large increase in tourist arrivals (Appendix I). The airport development would remove a key growth inhibitor, potentially generating additional foreign investment.

- **There is ample room for Maldives' tourist industry to grow.** With accommodation at an average 70 percent occupancy rate, there is capacity to boost tourism in the short term and expand substantially in the long run with additional investment. Long term tourism forecasts point to robust growth in the Asia and Pacific region, with South Asia expected to be the most rapidly expanding region (see Chart).

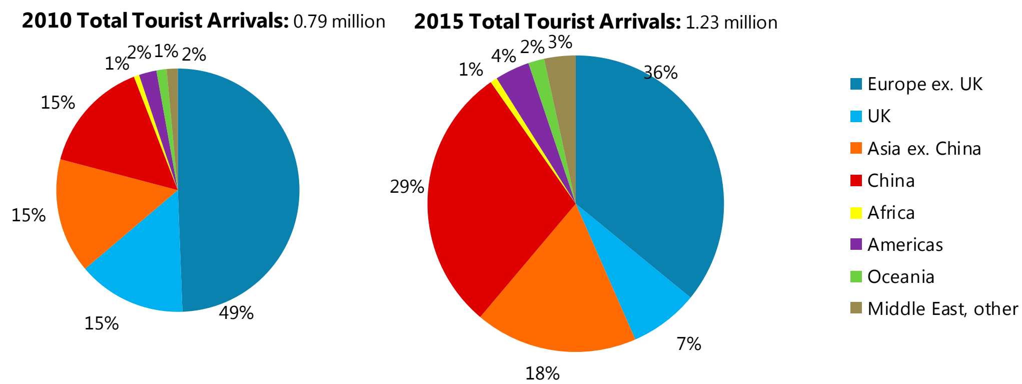
Tourism forecast to grow robustly in South Asia to 2030
(Annual growth in percent)



Sources: UNWTO.

- **Maldives is adept at attracting new markets for tourism.** Tourist composition has changed markedly since 2008 with a much higher share of tourists from emerging Asia.

Tourist arrivals... composition more Asia focused
2010 v.s. 2015 (In percent of total tourist arrivals)



Sources: MMA and IMF staff estimates.

- **Climate change adaptation.** The capital projects described in Box 2 may help diversify activity, ease congestion in Malé, and some may help build resilience to climate change.

13. However, on the negative side, external and fiscal vulnerabilities would increase. The bulk of infrastructure capital and labor will be imported, requiring foreign exchange cash flow (through external loans). If growth benefits are not substantial, debt may become unsustainable, leading to financing difficulties as the infrastructure loans amortize. Strengthened management of the capital budget is needed to help realize the growth benefits (see paragraphs 20, 27 and Box 3).

14. The transformation of tourism will pose additional challenges. Maldives business model would need to change from a niche luxury market to accommodate a wider range of luxury resorts, mid-market hotels and guesthouses. Domestic as well as international competition would intensify, demand would become more price elastic, and tourist spending per head would be lower than it is today. The challenges of generating demand to meet the expanded supply would likely be greater than at earlier stages of development.

Authorities' Views

15. The infrastructure scale up is necessary to ensure that Maldives remains an attractive tourism destination and address social and economic challenges. The airport and port are operating at close to full capacity and substantial investment is needed to accommodate growing demand. The development of Hulhumalé and the bridge is a key plank of the authorities' policies to relieve overcrowding in Malé, further develop the regional center and encourage voluntary population resettlement which will be necessary as the country adapts to climate change.

B. Outlook and Risks: A Challenging Global Environment

Staff's Position

16. Growth rises moderately in 2016 against an uncertain global backdrop, and infrastructure scale up adds a little to potential in the medium term.

- **Growth** picks up to 3.5 percent in 2016 supported by a modest recovery in tourism—a marketing initiative aimed at Asia plus new airline services should boost tourism arrivals; higher transport and electricity generation activity is also likely.

- **The current account deficit** remains close to current levels in 2016 as the highly import intensive infrastructure projects come on stream and offset the improvement from lower oil prices, and widens beyond 2016 with higher infrastructure spending. In the near term, infrastructure spending goes hand in hand with external loan disbursements, but financing pressures could build as loans mature.

17. The medium term outlook is clouded by uncertain returns from infrastructure scaling up, and less robust growth in Asia. Staff factor in a ½ percent of GDP per year increase in medium-term potential growth from tourism development—consistent with public investment efficiency in line with the average of less developed economies. More positive growth outcomes could be achieved with higher public investment efficiency (Appendix I). Growth peaks at 5 percent, somewhat lower than the 6.5 percent reached during the initial phase of tourism development.

	High Vulnerability, Risks to the Downside Dominate	Likelihood	Impact
Upside	**1.** Tourism demand recovers more strongly than expected.	**Medium**	**Medium**
	2. Decisive and durable fiscal consolidation effort puts policy back on track	**Low**	**High**
Downside	**1.** Political tensions escalate and dent tourism	**Medium**	**Medium**
	2. Structurally weak growth in China – medium term; a sharp slowdown in growth in China in 2015/16 – short term; Persistent dollar strength (short term)	**Medium** **Low** **High**	**High/ Medium**
	3. Policy slippage exacerbates the downside.	**High/ Medium**	**High**

18. The risks are largely on the downside (Appendix IV):

- ***A sharper than expected slowdown in China and persistent U.S. dollar appreciation.*** Chinese outbound tourism has broadly held up so far. But a slowdown would dent tourism arrivals. With tourist resorts pricing in U.S. dollars, a further U.S. dollar appreciation could also dampen growth.

- ***Policy mistakes could compound vulnerabilities.*** External debt-financed capital expenditure will add to already elevated debt levels. Other tax incentive proposals could erode the tax base (paragraph 42). A re-emergence of political tensions would exacerbate risks.

19. There is little policy space to respond to risks. Reserves are low and there is no fiscal space to absorb shocks (including climate change related shocks). Fiscal slippage would likely be accompanied by capital outflows, pressure on the parallel foreign exchange market premium, and an erosion of official reserves. In those circumstances an accelerated fiscal adjustment would be needed with measures to shore up revenues as well as sustained and durable expenditure restraint.

…however, with careful fiscal management, there is upside potential…

20. Imposing greater fiscal discipline at an early stage would lead to better outcomes. Careful planning of capital projects (see paragraph 27 and Box 3), revenue raising efforts, and durable expenditure control would raise investment returns, catalyze additional financing and avert the need for more abrupt adjustment at a later stage.

Authorities' Views

21. The authorities expect growth to bounce back to over 6 percent in 2016 and to remain stronger than projected by staff over the medium term. They expect sizeable domestic spillovers from public investment, in construction and tourism, which would also boost growth in the medium term. The infrastructure scale up is seen as necessary to address the bottlenecks in the economy and expand production capacity. On fiscal policy, non-tax revenues are expected to rise sharply and this would help cover capital spending; and spending plans would be adjusted if revenues are not forthcoming.

POLICIES FOR FISCAL SUSTAINABILITY

Staff's Position on the Budget

22. The 2016 Budget is expansionary. Public spending on wages, subsidies and social welfare has risen sharply in recent years. But in 2015 significant and encouraging progress was made addressing the deficit through revenue raising measures, a public employment freeze and streamlining of electricity subsidies. The deficit narrowed. Disappointingly, the 2016 Budget reverses this progress and Staff is not confident that the authorities' deficit targets can be met:

Preliminary Fiscal Projections 2015-2017: Authorities and Staff (in percent of GDP)/1

	2015		2016		2017	
	Auth	Staff	Auth	Staff	Auth	Staff
Total Revenue (excl grants)	34.5	35.1	42.6	35.1	39.5	34.0
Tax Revenue	25.0	25.3	27.3	26.7	27.6	26.2
Non-tax revenue	9.5	9.7	15.4	8.2	11.9	7.7
Total Expenditure & net lending[1/]	44.2	44.3	51.7	48.9	49.7	52.5
Current Expenditure	33.7	35.4	32.1	35.9	30.1	36.2
Capital Expenditure	10.5	8.1	19.6	12.2	19.5	15.8
Primary Balance (inc grants)	(6.9)	(6.6)	(6.3)	(11.1)	(7.6)	(15.1)
Overall Balance (excl grants)	(9.6)	(9.2)	(9.1)	(13.7)	(10.2)	(18.5)

/1 In addition to current and capital expenditure, staff's expenditure estimates include gradual clearance of outstanding domestic arrears.

- *Revenues*. The authorities project a substantial boost to non-tax revenues including from the setup of special economic zones (SEZs) and new resort leases. Staff's view is that such a large increase in non-tax revenues cannot be attained, as investors in the SEZs have yet to be identified and resort openings would need to accelerate sharply to bring in the revenues envisaged.

- *Expenditures*. Differences on overall expenditures are less—though staff projects less capital and more current spending than the authorities. Staff and the authorities agree that firm control over the public sector wage bill is needed but there are also strains on healthcare, and social security spending. The reversal of the decision to fully eliminate electricity subsidies will add to costs.

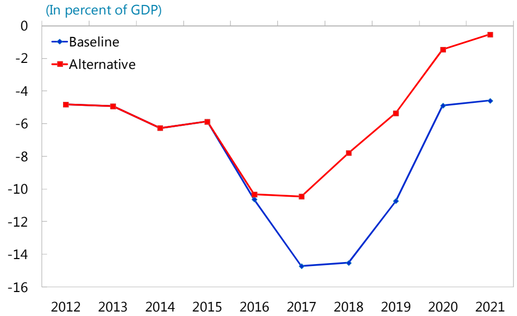
23. Without fiscal adjustment, debt is on an unsustainable path. Staff projects that public debt could reach 121 percent of GDP in 2020; and would continue rising, substantially above in the Fiscal Responsibility Law (FRL). The risk of external debt distress has deteriorated to a high risk rating. Recent debt contracts have been on semi-concessional terms even though Maldives remains PRGT eligible.

Staff's Fiscal Policy Recommendations

24. Durable fiscal adjustment is needed to prevent growing fiscal and external imbalances. The 2014 Article IV consultation emphasized that a sustained fiscal adjustment effort was needed with stronger expenditure restraint. The 2015 budget included measures which were a significant step forward, although they relied more on revenue raising efforts than on expenditure restraint. It was emphasized that careful planning of infrastructure investment would help ensure a bigger boost to growth. Staff supports priority public infrastructure spending where feasibility studies demonstrate viability (Box 3). But additional fiscal measures are needed to contain the increase in debt—now requiring both expenditure restraint and further revenue measures. Since the limits in the FRL are unlikely to be achieved in the near term, interim targets for the current primary balance could be used to anchor adjustment. Together with more strictly prioritized overall capital spending, this would help stabilize the debt ratio by 2020 and bring debt levels down thereafter. A medium term debt strategy—guided by the FRL—would help anchor the path. The growth impact should be contained as Maldives has low multipliers.

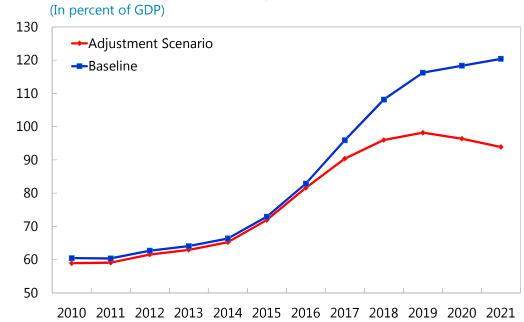
Baseline and Staff's Illustrative Scenario

Primary Balance
(In percent of GDP)



Source: MMA and IMF staff estimates.

Public Debt: Baseline vs. Adjustment Scenarios, 2010–2021
(In percent of GDP)



Sources: Maldives authorities; and IMF staff estimates.

25. Feasible measures could improve the current primary balance by 5.5 percentage points of GDP by 2020.

- **User fees should be charged for key infrastructure** including a bridge toll and increase in airport departure tax.

- **Other revenue raising measures.** Maldives has a well administered tax system that performs better than in neighboring and other comparator economies (see Appendix II). This can be leveraged to bolster revenues. Broadening the base of business profits tax (BPT) and increasing rates on other taxes should be feasible as the BPT rate is low compared to the Asia Pacific region and the tourism goods and services tax is not out of line with other competitor economies.

Fiscal Adjustments to the Primary Balance 2016–2020 1/
(In percent of GDP relative to the baseline scenario)

	2016	2017	2018	2019	2020	Fiscal Measures
Revenue	**0.0**	**1.2**	**3.7**	**3.8**	**3.9**	
Tax revenue	0.0	1.0	3.4	3.5	3.6	
Tourism GST	0.0	0.0	1.9	2.0	2.0	raise rate to 15 percent
Business Profits tax	0.0	0.9	1.4	1.4	1.4	broaden base and raise rate
Other (including excise)	0.0	0.4	0.4	0.4	0.4	Raise resort rent and loyalties; and/or excises
Expenditure (excl interest)	**-0.3**	**-3.1**	**-3.1**	**-1.6**	**0.4**	
Current expenditures	**-0.1**	**-0.4**	**-0.8**	**-1.4**	**-1.9**	
Wages and allowances	0.0	0.0	-0.1	-0.3	-0.5	Contain wage bill
Subsidies	-0.1	-0.2	-0.3	-0.5	-0.6	Cut electricity and food subsidies gradually
Healthcare	-0.1	-0.1	-0.2	-0.4	-0.5	Contain healthcare costs
Capital Expenditure	**-0.2**	**-2.7**	**-2.3**	**-0.3**	**2.3**	Drop low viabiity projects, smooth scale up
Total Savings	**0.3**	**4.3**	**6.7**	**5.4**	**3.4**	
Primary Balance						
Baseline	-10.6	-14.7	-14.5	-10.7	-4.9	
Alternative Scenario	-10.3	-10.4	-7.8	-5.4	-1.5	
Current Primary Balance						
Baseline	1.8	1.3	0.5	0.4	0.7	
Alternative Scenario	2.0	2.9	4.9	5.5	6.4	

Source: IMF staff estimates
1/ This table shows the difference between baseline and adjustment scenario deficit paths reflecting the direct and indirect impact of fiscal measures, including the impact on growth from fiscal consolidation.

- **Expenditure saving.** The authorities focus on the public sector wage bill is welcome. The public service review should be restarted but it will take time to plan and implement, while ensuring key functions are preserved. A baseline costs review of the healthcare system would identify emerging pressures and scope for savings. Plans to better target social welfare and food subsidies through means testing and to eliminate the electricity subsidy (the latter postponed) are welcome. SOE transparency and oversight should be strengthened to reduce rent seeking. Savings could also be made through greater use of renewable energy.

26. The Paris COP21 agreement opens new opportunities for financing for climate change adaptation. A more strategic approach, together with a medium term debt plan, would help

Maldives obtain better terms. Presenting the climate-change adaptation features and quantifying costs in each Budget would help demonstrate Maldives' development strategy and could mobilize resources available to small states following Paris COP 21.

27. Better public financial management is a prerequisite to support fiscal sustainability. The 2014 Public Expenditure and Financial Accountability assessment (PEFA) and recent technical assistance have confirmed that deep rooted expenditure control problems remain. Difficulties include unrealistic budgets with insufficient spending allocations, unenforced expenditure ceilings and reshuffling of spending between activities/ministries. Completion of the Public Accounting System would address some but not all of these problems. Staff's technical assistance has recommended wide-ranging reforms (Table 8), including to public investment management (Box 3). Strengthening budgetary institutions would improve investment outcomes. An economic management team, building on the Economic and Youth Council and including the MMA, could be established to steer investment priorities and instill discipline. Commitment by the Majlis to the aggregate spending envelope and composition of spending would also help.

Box 3. Public Investment Management Efficiency

Improvements in public investment management (PIM) can significantly enhance the productivity of investment. In many countries infrastructure scale-up initiatives have not generated a sustained growth impetus as inefficient processes undermined public investments, crowded out private investments and saddled countries with high debt ("Making Public Investment Efficient", IMF 2015).

Maldives' budgeting and planning process is weak. Capital expenditure proposals are not prioritized, instead a list of projects is aggregated from all levels of government, with parliament adding projects. Capital budgets are not aligned with implementation capacity and are undertaken with only partial funding identified. The practice of deferring capital projects within the year when fiscal revenue outturns disappoint is inefficient and inhibits planning; new projects are often launched and ongoing projects left uncompleted.

Maldives could strengthen all aspects of the PIM process. A rigorous vetting and selection process (with feasibility studies) would ensure project viability. Ceilings for capital expenditure should focus on finishing committed projects before proposing new spending. IMF technical assistance has been offered to follow up in these areas. A revised annual budgeting and implementation process similar to the one adopted by Chile has been proposed by staff—the process eliminates projects with no financial viability in the pre-investment phase; starts political debate over projects after the pre-investment phase; and has mandatory steps for each project decision: idea, pre-feasibility study, feasibility study, and design.

Authorities' Views

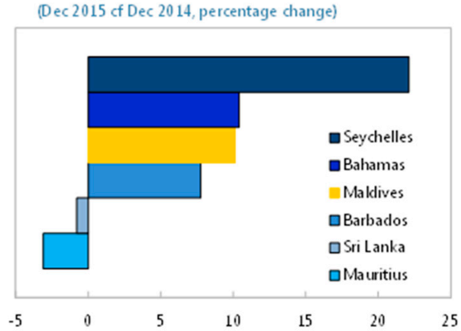
28. The authorities expect substantial growth gains from infrastructure scale-up—with the payoffs enabling debt reduction in the medium term. They do not see a need for higher tax rates, although they are open to considering base broadening and user fees for some infrastructure projects. They are optimistic that the increase in external debt is manageable and that non-tax revenues, expenditure restraint and a boost to growth will be sufficient to repay infrastructure project loans. If revenues disappoint they would defer some lower priority capital spending. On expenditures restraint, the public sector hiring restrictions will continue to be enforced and they will consider undertaking a public service review. The authorities are looking at better targeting subsidies and social welfare schemes, as well as streamlining healthcare expenditures. Technical assistance is supporting the strengthening of public financial management, including the capital budget, and the roll out of the public accounts system. Staff's proposal to quantify and present the climate adaptation policies in each Budget is welcome.

EXTERNAL SECTOR ASSESSMENT

Background

29. **The real exchange rate has appreciated by 30 percent since the 2011 devaluation with a 10 percent increase over the past year.** Since the April 2011 devaluation, Maldives has operated within a wide exchange rate band at 20 percent either side of Rf 12.85 per dollar but in practice the rate has stayed at the weakest end of the band, operating like a de facto peg to the U.S. dollar.[3] The real exchange rate has risen as the U.S. dollar has appreciated against the euro, with increase higher than for some of Maldives' competitors.

REER Appreciation since 2014
(Dec 2015 cf Dec 2014, percentage change)



Sources: IMF INS database and staff calculations.

Box 4. The Operation of Maldives Parallel Foreign Exchange Market

Maldives has a stabilized exchange rate; the capital account is very open but there is an active parallel foreign exchange market with a stable premium. With low reserves, the MMA is able to supply only a small fraction of foreign exchange demand to commercial banks. Excess demand leads to the existence of a parallel market. The tourist industry appears to be a key supplier and driver of the parallel market. The scale of the premium has been stable fluctuating from 2–15 percent since the GFC (2–6 percent in the past year) possibly reflecting the oligopolistic nature of the market. Flows are difficult to monitor as many transactions are conducted abroad and do not go through the domestic banking system.

The parallel market premium and shortage of foreign exchange at the official rate gives rise to exchange restrictions and multiple currency practices (MCP) subject to IMF approval under Article VIII Sections 2(a) and 3.[/1] Maldives is an Article XIV member but no longer maintains any measures under Article XIV. The official exchange rate used by MMA for government transactions may deviate by more than 2 percent from the prevailing market exchange rate and there is no mechanism to prevent such a spread which gives rise to a multiple currency practice. Although these measures are non-discriminatory, Fund approval is not recommended as they are unlikely to be temporary and would be eliminated only once official reserves levels are higher and the fiscal position has improved. Over the past two years the MMA has eased rationing by increasing the foreign exchange provided to commercial banks and adjusting amounts in line with seasonal patterns.

[1/]See Informational Annex.

[3] The de jure exchange rate regime is a pegged exchange rate within horizontal bands.

30. **Despite lower oil prices, the current account deficit is estimated to have widened in 2015.** The deficit will widen as infrastructure projects are implemented but this will be matched by external financing inflows and does not pose an immediate financing problem, although rollover risks will rise in the medium term.

Staff's Position

31. **The external sector position looks moderately weak.** The assessment is difficult given the large turnover in the parallel foreign exchange market, possible underestimation of tourism spending, and likely data revisions. But, available evidence points in one direction:

- Standard indicators (Box 5) point to a moderately weak external position and moderately overvalued real exchange rate. The loose fiscal stance explains most of the policy gap.
- Reserves are low relative to adequacy metrics. The parallel foreign exchange market premium also points to some overvaluation (Box 4).
- Infrastructure spending could add 7–10 pps of GDP a year to the current account deficit.
- Further U.S. dollar appreciation could hurt competitiveness.

32. **With a moderately weak external position and pressures likely to build, corrective action is needed.** Fiscal adjustment would help improve the external position and support the exchange rate going forward. A peg/stabilized regime is appropriate for Maldives given the small scale, high openness, dollarized nature of the economy, and large seasonal variation in revenues. The U.S dollar link was historically appropriate given a natural hedge of the tourism sector and U.S. dollar denominated imports and financing. With greater tourism from Asia, prospective financing from the region and the future possibility of greater exchange rate flexibility in China, consideration could be given in the medium term to reviewing the operation of the stabilized exchange rate.

Authorities' Views

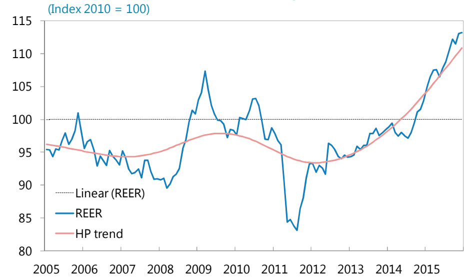
33. **The authorities are committed to the stabilized exchange rate regime in the current band and agree that improving the fiscal position is the best way to sustain it.** They are of the view that large capital spending will generate growth which will help contain the fiscal deficit going forward. The stabilized exchange rate regime and the U.S dollar link remains appropriate and no exchange rate adjustment is needed at present. The increase in the parallel market premium in January 2016 is likely to be seasonal and therefore temporary; it has not been passed on to consumer goods prices suggesting it is not too high. The premium is likely to fall back to 3 to 4 percent, but as it is structural in nature, it is not expected to be eliminated. The authorities agree that there is likely to be no change on Article VIII issues until official reserves levels have increased and the fiscal deficit narrowed.

Box 5. Maldives: External Sector Assessment: Quantified Approaches

Current account approach points to a moderately weak external position. The current account (CA) equation from the extended External Balance Assessment (EBA-lite) methodology points to a CA norm of -4.0 percent of GDP, and suggests that the 2015 CA is moderately weaker than the CA norm. [1/] Loose fiscal policy accounts for 1.7 percentage points of the policy gap. The CA gap for Maldives reflects a saving-investment imbalance with a weak savings culture and persistent fiscal deficits. However, there is uncertainty surrounding the CA estimate for 2015 which is preliminary and revisions are likely. Also, estimates of tourism spending in Maldives may be underestimated (see Maldives 2014 Article IV Consultation). These factors may explain the large residual of 2 percent of GDP. Looking ahead the current account is likely to remain weak relative to fundamentals and desirable policies as infrastructure spending will keep the deficit wide.

Maldives: EBA-lite CA analysis	
CA-Actual	-8.0%
CA-Norm	-4.0%
CA-Gap	-4.0%
CA-Fitted	-5.8%
Residual	-2.2%
Policy gap	-1.9%
Real Exchange Rate Gap	10.8%

Maldives: Real Effective Exchange Rate
(Index 2010 = 100)

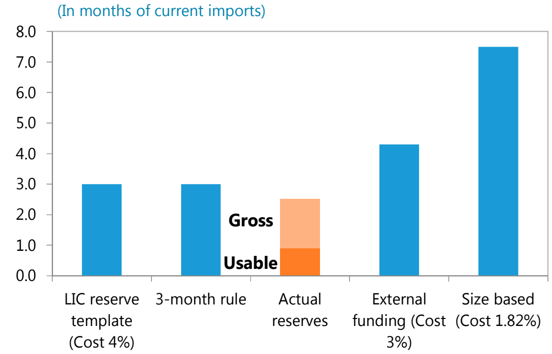


Sources: IMF *Information Notice System (INS)* data and staff calculations.

Real exchange rate methods point to a moderately overvalued exchange rate. Based on the EBA-lite CA methodology, staff assesses the REER gap to be around 11 percent. Simple trends—such as using a HP filter—also point to an overvaluation of similar magnitude.

Reserves remain low relative to adequacy metrics: Staff's reserve adequacy framework for low income countries suggests that the optimum level of usable reserves for Maldives is in the range 3–7.5 months of imports for a fixed exchange rate regime. The estimates depend on the assumptions made about the net cost of holding reserves, external funding costs and economic size. Actual reserves—both usable and gross—are below the adequate level of import cover suggested by the range of metrics.

Reserve Adequacy Assessment
(In months of current imports)



[1/] EBA-lite applies a modified EBA methodology to a larger country sample (149 countries, compared with 49 in the case of EBA).

SUPPORTING MONETARY AND FINANCIAL POLICIES.

Background

34. **Monetary policy was eased in 2015 to boost credit, reduce interest costs and lengthen maturities on sovereign bonds.** The MRR was halved to 10 percent and administered yields on treasury bills and bonds were cut to 3–4.6 percent. With excess liquidity, banks and the pension fund have continued to purchase treasury bills; and have taken up longer term bonds. Credit growth has begun to accelerate.

35. **Access to finance remains difficult and the authorities are seeking ways to cut costs.** Maldives ranks 116th on Doing Business indicators (World Bank) for access to finance by small and medium sized enterprises(SMEs), and financial inclusion is challenging with the high cost of providing services to remote islands (Appendix III). The authorities' initiatives include concessional and Islamic financing to SMEs; and mobile banking services. They have also announced a plan for sovereign guarantees for private sector loans in the tourism sector as a way to rejuvenate investment in tourism resorts mothballed since the global financial crisis.

Staff's Position

36. **The overall monetary stance appears relatively loose, especially given the expansionary fiscal policy setting and a wider current account deficit.** The 2014 Article IV consultation noted that the policy stance was eased during 2014 with measures that staff viewed as being aimed at facilitating government financing. Following further easing, the policy stance appears relatively loose. While previously administered rates were very high, they are now below the rates in neighboring countries. Though financing pressures are not currently evident, a tightening of yields in small steps may be needed if financing shortfalls emerge. The authorities should also stand ready to increase the MRR if the external imbalance looks to be widening, capital outflows increase and there is pressure on reserves. Open market operations could help mop up liquidity. Over the longer term, once the fiscal position improves, the MMA should move back to auctions and market based financing of government debt.

37. **Facilitating credit:**

- **Sovereign guarantees to the private sector.** The scheme is a costly way to promote credit and adds to contingent fiscal costs. Staff recommends dropping or strictly limiting it. If implemented, the following features would be important—ensure risk sharing with banks; provide guarantees only on new loans (to residents); and impose fees to build a provisions fund against a call on guarantees.

- **Other ways to improve access to finance.** Credit growth has been subdued until recently given public financing needs, high NPLs, and limited information on counterparty risk. Constraints could be eased: by fully establishing the credit information bureau to aid risk assessment; and by clarifying secured creditors' legal rights regarding collateral plus more timely enforcement of the bankruptcy law to help banks more easily recover losses and provide a better environment for the extension of loans.

- **Encouraging savings.** Developing mobile money through the non-bank (mobile phones) should help facilitate financial intermediation across the country. The World Bank FSAP development module may also identify ways to strengthen the savings culture.

38. There is scope for further supervisory strengthening. Compliance with prudential limits has improved and NPLs are almost fully covered. Nonetheless there are areas for strengthening and the MMA's is increasing its focus on operational, liquidity and market risks alongside credit risk; as well as building analytical capacity. Plans to relax single borrower limits for some infrastructure projects backed by collateral will need to be strictly controlled. Risks stemming from high exposures to the tourism sector, lending concentration and the rapid growth of construction credit deserve particular attention. Given the high footprint of foreign banks in Maldives, it is important that the authorities access the views of all home regulators. Reconsidering the types of licenses available to foreign exchange money changers could assist with prioritizing supervision over large players. Regular data collection, analysis and closer supervision of large fx operators would assist policy decisions. A safeguards assessment of the MMA was conducted in 2010; progress has been made on many recommendations (see Informational Annex), although the recommendation to enhance MMA's autonomy and accountability through legal reform remains outstanding.

Authorities' Views

39. The authorities view the monetary policy stance as appropriate. The significant reduction in the MRR in 2015 had helped to turn around a lackluster domestic credit market and credit expansion in the second half of the year is viewed as positive. The MMA is also mindful that credit growth should not accelerate too rapidly. The relaxation of the single borrower limit will only be in clearly circumscribed circumstances, and it will be closely monitored on a case by case basis to contain financial stability risks. More generally the MMA is bolstering its supervisory capacity and is focusing more attention on operational and other risks. The impact of the lower yields on treasury bills and the bond market is yet to be fully observed, but the banks have plentiful reserves and tap auctions have typically been adequately subscribed. The authorities noted that the sovereign guarantee scheme will be limited in aggregate size and they plan to take staff's views into account when designing the scheme.

BUILDING LONGER TERM RESILIENCE

Background

40. **Maldives' geography—critical for tourism—poses a climate change challenge and imposes high costs.** The costs of service provision across small and far flung islands is unavoidably high, and is compounded by the costs of building resilience to climate change and disaster relief management (see Box 1). Maldives is already investing in a number of areas to adapt to climate change—food and water security, infrastructure resilience, public health, coastal protection, fishing industry, waste management and renewable energy—but focus on these priorities is often diverted by poor planning and the need to deal with a weak fiscal position.

41. **The government is promoting long voluntary resettlement to regional hubs and improving transport connectivity.** This would enable higher quality service provision at lower cost in key areas such as health, education and water management and would help contain the cost of climate change adaptation. However, resettlement will take place only over many years as it requires changes in the social fabric and adequate provision of housing.

42. **The SEZs are part of the government's strategy to diversify into labor intensive sectors such as off port shipping services, IT and financial services.** The SEZs (with a 40 percent limit on tourism activity) will encourage mixed activity into labor intensive sectors such as off-port shipping services, IT and financial services and help diversification.

Staff's Position

43. **Careful planning and prioritizing infrastructure investment scale up would ensure that it adds more to growth.** It would generate better growth outcomes, raise foreign investment and unlock cheaper financing. Greater predictability in investment and spending would also reduce waste. The development of regional hubs and voluntary resettlement will also cut the cost of public service provision. But resettlement also brings with it the challenge of providing the relocated population with access to traditional ways of making a living or viable alternatives, and adequate housing.

44. **Establishing a detailed national development strategic plan would foster coordination of climate change resilience and other plans and create employment opportunities.** Such a plan would set current infrastructure plans in context and could identify scope for prioritization. It could include more systematic climate adaptation planning and be supplemented by reporting of the climate adaptation impact of the Budget, including a quantification of climate change costs. The strategy could include ways to better prepare and equip Maldivian youth for employment in the tourism and supporting service sectors.

45. **Ring-fencing SEZs.** Staff agrees that development of the SEZs could help diversify economic activity in labor-intensive sectors. But the SEZs will need to be strictly ring fenced so as not to substantially add to incentives and undermine the tax base. Keeping the tax system broad based, simple, transparent, stable and automated is important as it reduces scope for corruption and

bargaining. Safeguards are also needed to ensure that financial institutions setting up an SEZ face equivalent prudential, supervisory and reporting requirements as those onshore (including anti money laundering provisions).

46. Data gaps could inhibit policy making. Priority should be given to passage of the statistics law (planned for 2017) which provides data collection powers to the MMA, Maldives Internal Revenue Authority and the statistics office; and would improve private sector data. The same requirements should apply to entities operating in SEZs. Continued support through technical assistance in the areas of external statistics, national accounts and fiscal areas is a high priority.

Authorities' Views

47. Climate change adaptation measures features high on the government's medium term agenda. The government's voluntary resettlement policy should generate significant cost savings in terms of service delivery which will help improve fiscal position and create space for development activities. Other climate adaptation measures over the medium term include progressive reduction in thermal generated electricity—to raise renewable capacity—to provide 30 percent of daily peak load by 2018 and schemes for harvesting rain water for domestic purposes.

48. The authorities are also hopeful that the SEZ law will bring about much needed diversification of the economy. The scheme includes a generous tax incentive scheme which comprises of a blanket 10-year tax holiday (on land tax, GST and income tax) for all approved ventures. The authorities are hopeful of managing the tax expenditures and believe that the additional economic activity created will have long term favorable impact on the economy.

STAFF APPRAISAL

49. Maldives developed rapidly reaching middle income levels driven by tourism development. The real economy outperformed its peers in the past few years but tourism slowed last year. The current account deficit widened despite a positive terms of trade shock but inflation has remained contained and further pass through from lower oil prices is expected this year.

50. Substantial infrastructure scale up could transform the economy but brings with it external financing risks. Airport development has been shown to have significant growth effects in other small tourism economies and other projects will support the authorities' efforts to build resilience to climate change. However, after good progress in reducing the deficit, the 2016 Budget is expansionary driven by capital spending. Public debt will rise from already elevated levels, and prospective external borrowing indicates a high risk of debt distress.

51. Durable fiscal adjustment is needed to prevent growing fiscal and external imbalances. Capital expenditures should be prioritized and accommodated only where feasibility studies show the benefits clearly outweigh the costs. Additional restraint is needed to contain the increase in debt. Staff would recommend a fiscal adjustment of around 5.5 percentage points of GDP by 2020. User fees should be charged for key infrastructure. Maldives well administered tax system can be leveraged to generate higher revenues, through base broadening and higher tax rates. Firmer control of current spending is needed—including the wage bill and healthcare costs. Plans to better target subsidies should move forward. Stronger public financial management, including over capital budgets would raise the probability of successful fiscal adjustment.

52. The external position looks moderately weak. The current account deficit has widened, the real exchange rate appreciated last year following U.S. dollar appreciation and reserves remain low relative to adequate levels. Notwithstanding uncertainties, overall the external position looks moderately weaker than fundamentals and desirable policies; and the real exchange rate moderately overvalued. A tighter fiscal policy stance would improve the external position and support the exchange rate. A stabilized exchange rate regime continues to be appropriate for Maldives. The parallel market premium of greater than 2 percent, the rationing of foreign exchange and an official exchange rate used by MMA for government transactions that may deviate by more than 2 percent from the prevailing market rate, leads to multiple currency practices and exchange restrictions. Without a timetable for removal of these measures, Fund staff does not recommend their approval.

53. Support from monetary and financial policies would help stabilize the external position. The current monetary stance appears relatively loose, especially given expansionary fiscal policy. Small step increases in administered rates may be called for and the MRR may need to be raised if capital outflow pressures emerge. The MMA's focus on further strengthening supervision beyond credit risk should continue.

54. Building climate change resilience, improving public service delivery and economic diversification are key medium term challenges. Maldives could face substantial long run economic costs from climate change. Encouraging voluntary resettlement to regional hubs and better connectivity is an important part of the authorities' adaptation strategy. It would also reduce the cost of service provision but will take many years. Establishing a detailed national development strategic plan would help ensure that investment programs are well coordinated and bring about growth dividends. Diversification of economic activity in new sectors through SEZs is welcome but strict ring-fencing of SEZ tax exemptions is needed to preserve the tax base.

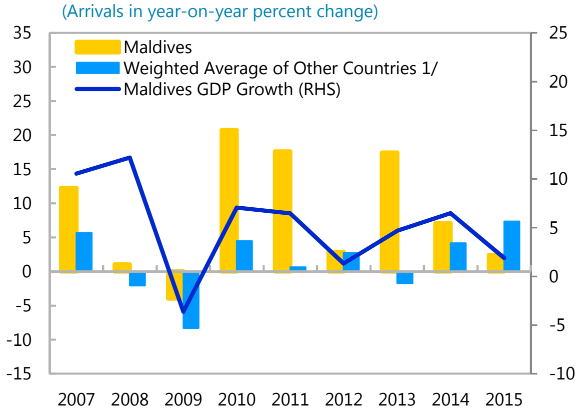
55. Work strengthening statistics is yielding good returns and should be continued. A statistics law would help greatly improve private sector data provision.

56. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Maldives: Comparison with Other Tourist Dependent Economies

Tourism has performed well compared to competitors but has slowed recently…

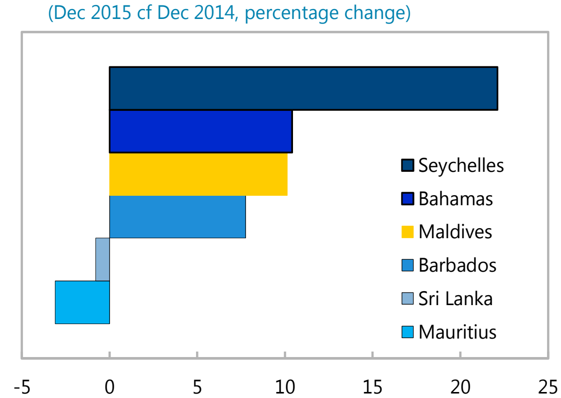
Tourism Outperformed Peers But Has Slowed
(Arrivals in year-on-year percent change)



1/ Countries include Mauritius, Seychelles, Bahamas and Barbados.
Sources: Authorities data and IMF staff estimates.

…and the real exchange rate has appreciated

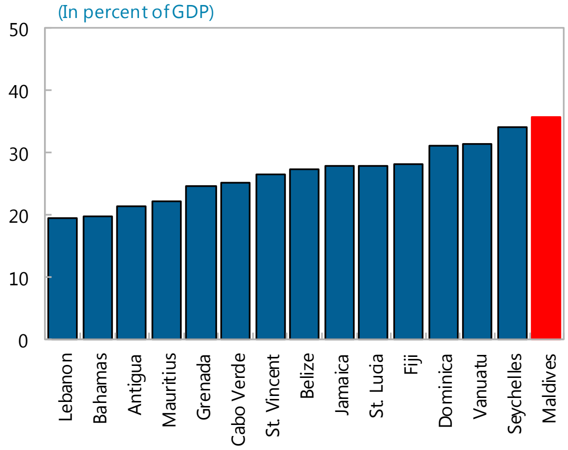
REER Appreciation since 2014
(Dec 2015 cf Dec 2014, percentage change)



Sources: IMF INS database and staff calculations.

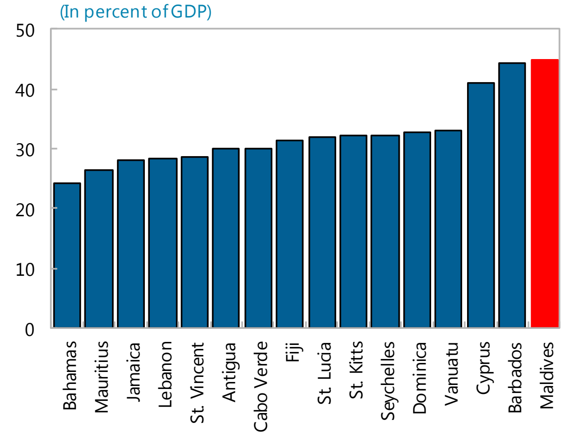
Fiscal Revenues are high compared to others…

Selected Tourism Dependent Economies: Revenue 2015
(In percent of GDP)



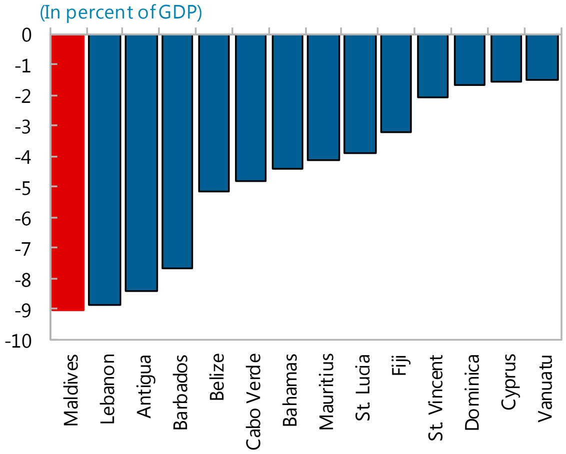
…but expenditures are high and increasing.

Selected Tourism Dependent Economies: Expenditure 2015
(In percent of GDP)



The overall fiscal deficit is large.

Selected Tourism Dependent Economies: Fiscal Deficit 2015
(In percent of GDP)



Tourism GST and corporate tax rates are moderate compared to peers.

Selected Tourism Dependent Economies: VAT Rates as of mid 2013
(In percent)

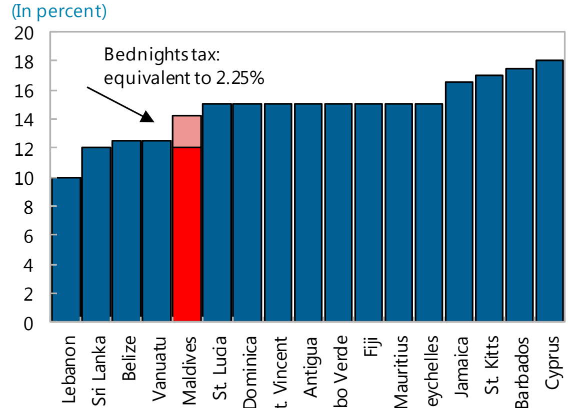
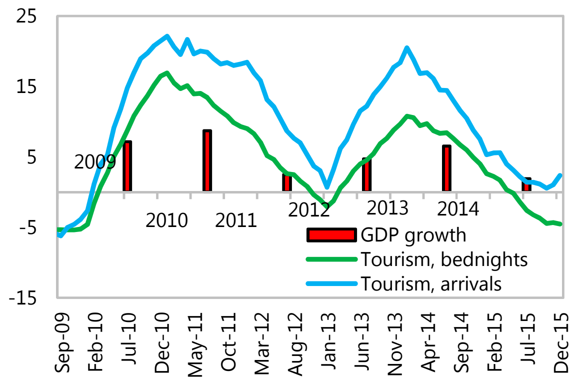


Figure 2. Maldives: Summary of Recent Developments

Growth in tourist arrivals has slowed…

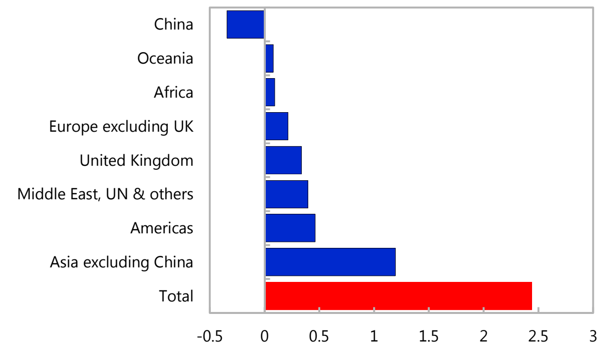
Tourism
(12-mo moving average growth, in percent)



Sources: Maldivian authorities; and IMF staff estimates.

…arrivals from Europe have slowed, and arrivals from China edged down following earlier strong growth.

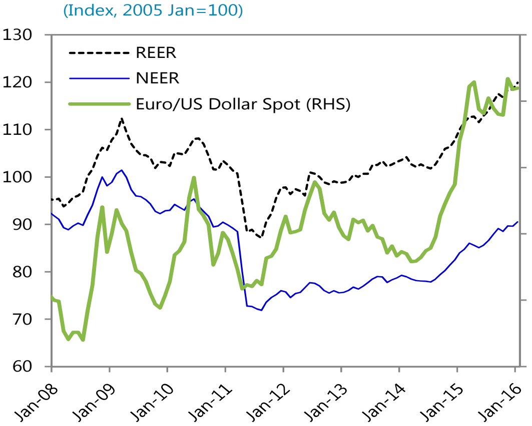
Tourist Arrivals Contributors to Growth
(2015 cf 2014 percentage change)



Sources: Maldives MMA and staff calculations.

Exchange rate appreciation (given the dollar link) may be affecting competitiveness…

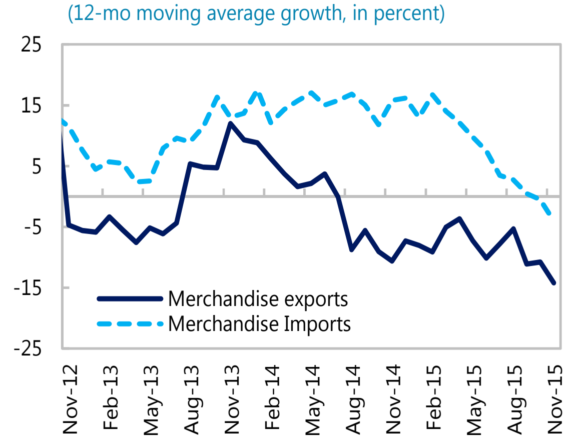
Nominal and Real Effective Exchange Rate, 2008–16
(Index, 2005 Jan=100)



Sources: IMF *International Finance System (IFS)* database and staff calculations.

…though lower oil prices have reduced the import bill.

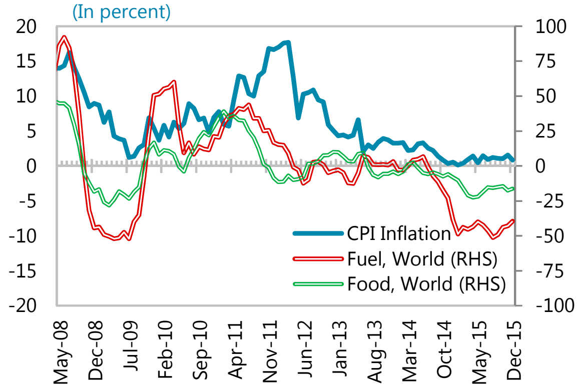
Merchandise Exports and Total Imports
(12-mo moving average growth, in percent)



Sources: Maldivian authorities; and IMF staff estimates.

Inflation is contained.

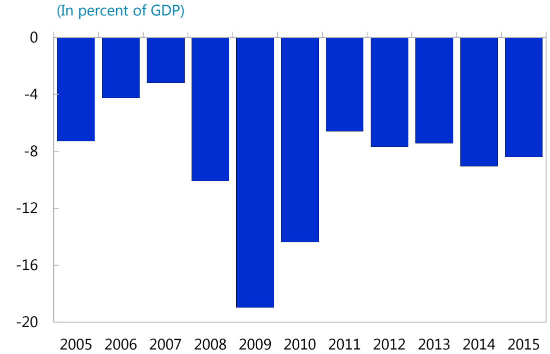
Inflation
(In percent)



Sources: Maldivian authorities; and IMF staff estimates.

The fiscal deficit is persistently high.

Overall Fiscal Deficit
(In percent of GDP)

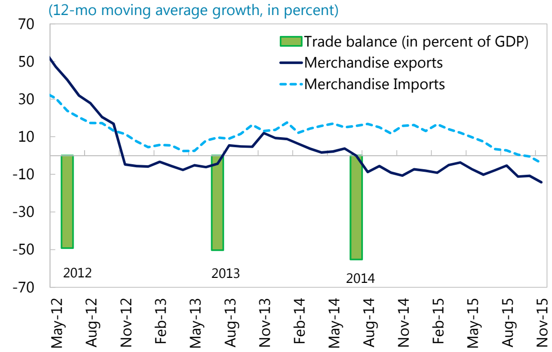


Source: MMA and IMF staff estimates.

Figure 3. Maldives: External Sector Developments

The goods balance widened a little despite lower oil prices.

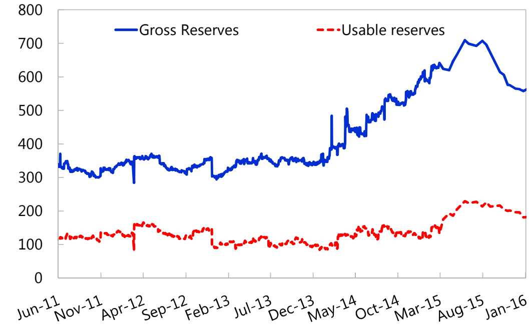
Merchandise Exports and Total Imports
(12-mo moving average growth, in percent)



Sources: Maldivian authorities; and IMF staff estimates.

Reserves improved through to mid-2015 then fell back.

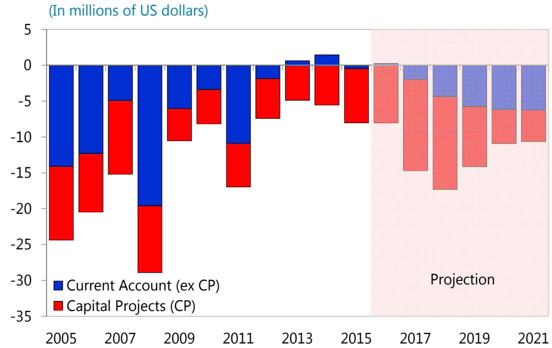
Reserves
(In millions of US dollars)



Sources: Authorities data.

The current account deficit widened and set to widen again as imports for capital projects expand….

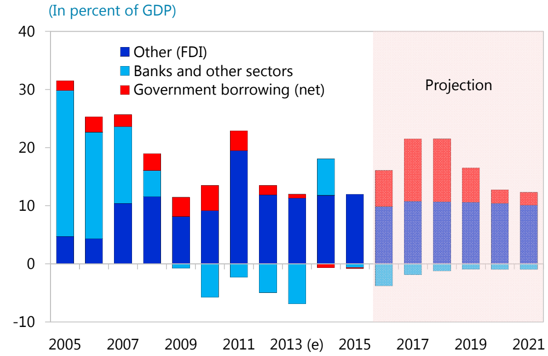
Current Account and Capital Projects
(In millions of US dollars)



Sources: Maldivian authorities; and IMF staff estimates.

…financed by a substantial increase in external borrowing

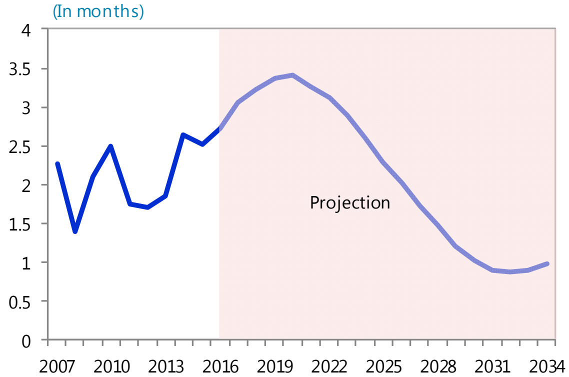
Capital and Financial Account
(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

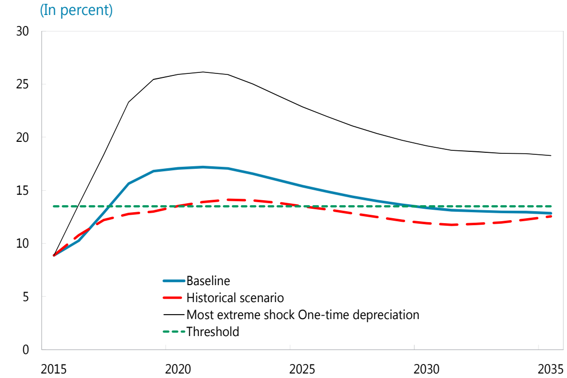
…placing pressure on reserves in the long run

Import Cover of Gross Reserves
(In months)



… and leading to a higher risk of debt distress

PV of Debt-to-GDP Ratio
(In percent)



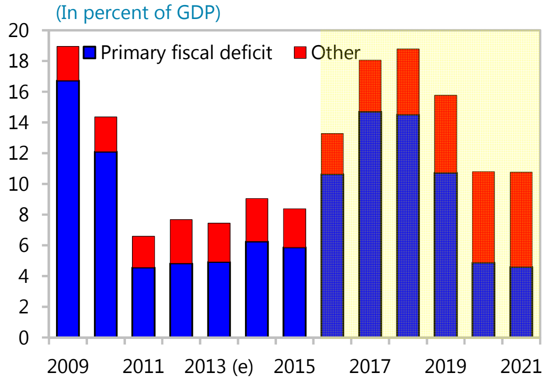
Source: Authorities data and IMF staff calculations and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 4. Maldives: Fiscal Developments

High primary deficits drive the weak fiscal position and the 2016 Budget includes very large capital spending…

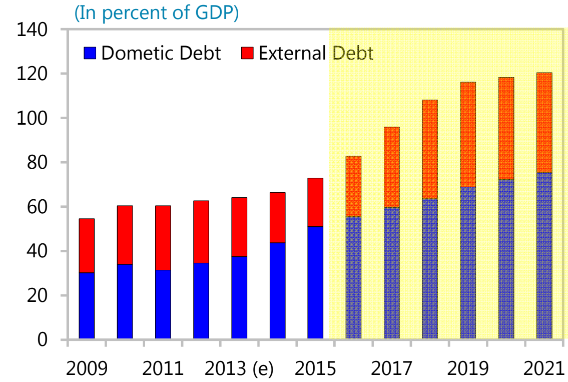
Overall Fiscal Deficit
(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

… which is adding to already elevated levels of public debt and pushes up external debt

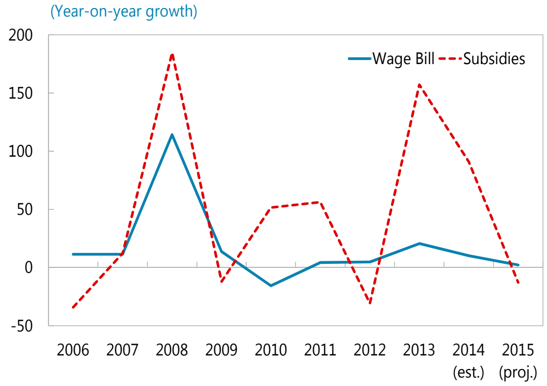
Public Debt
(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

The wage bill is ramped up erratically and is high.

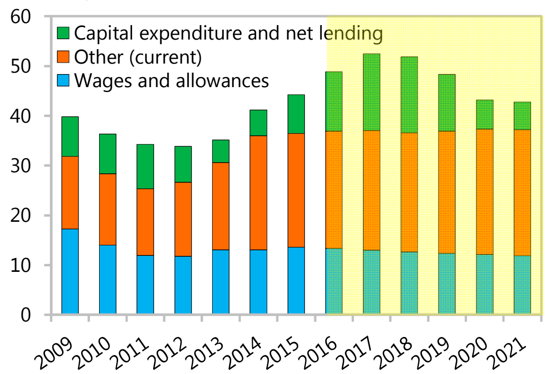
Government Expenditure on Wage and Subsidies
(Year-on-year growth)



Sources: Maldivian authorities; and IMF staff estimates.

The spending structure is rigid

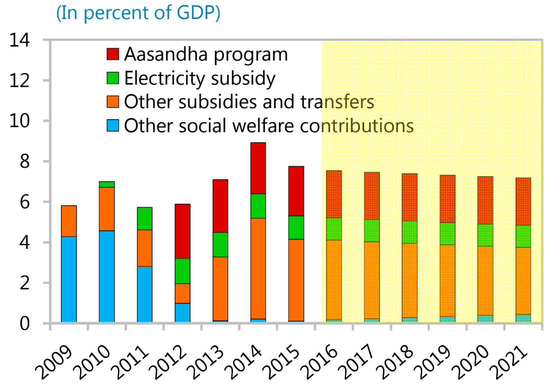
Central Government Expenditure
(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

Subsidies and transfers have expanded rapidly.

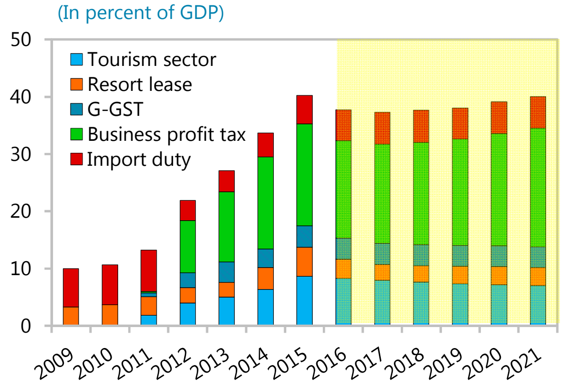
Social Welfare, Subsidies and Transfers
(In percent of GDP)



Sources: Maldivian authorities; and IMF staff estimates.

New and sustainable tax measures have helped raise the revenue ratio since 2009

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

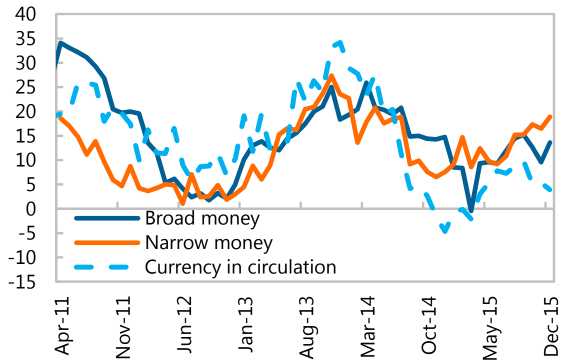


Sources: Maldivian authorities; and IMF staff estimates.

Figure 5. Maldives: Money and Credit Developments

Broad money growth has picked up

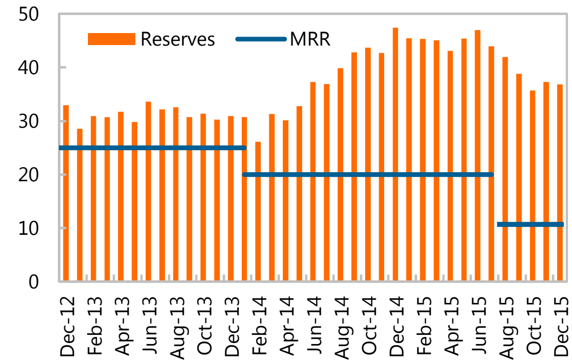
Monetary Variables
(Year-on-year growth, in percent)



Sources: Maldivian authorities; and IMF staff estimates

Banks have structurally substantial excess liquidity—to deal with unexpected liquidity shocks.

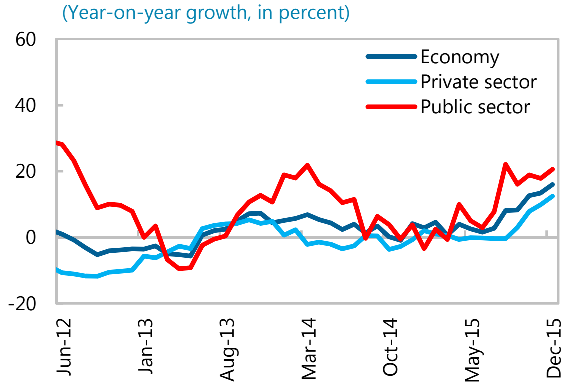
Commercial Banks' Reserves
(In percent of total deposits)



Sources: Maldivian authorities; and IMF staff estimates.

Private sector credit is turning around quite rapidly.

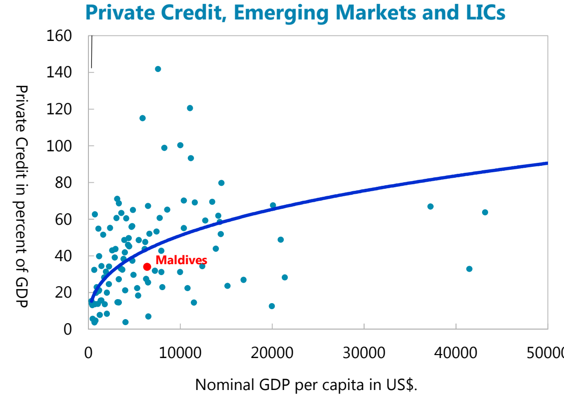
Credit
(Year-on-year growth, in percent)



Sources: Maldivian authorities; and IMF staff estimates.

Though private credit remains low compared to economies at similar income levels.

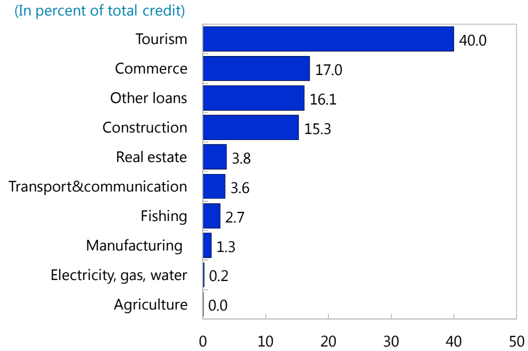
Private Credit, Emerging Markets and LICs



Sources: IMF *World Economic Outlook* and IFS database.

Lending is concentrated in tourism, commerce and construction..

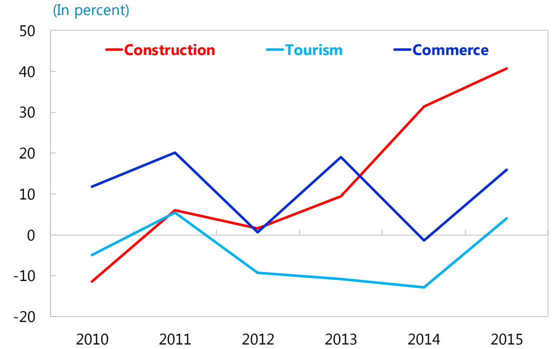
Sectoral Composition of Private Credit, 2015
(In percent of total credit)



Sources: Authorities data and IMF staff calculations.

... construction lending is growing rapidly from a small base which could pose a concentration risk

Selective Private Sector Credit Growth
(In percent)

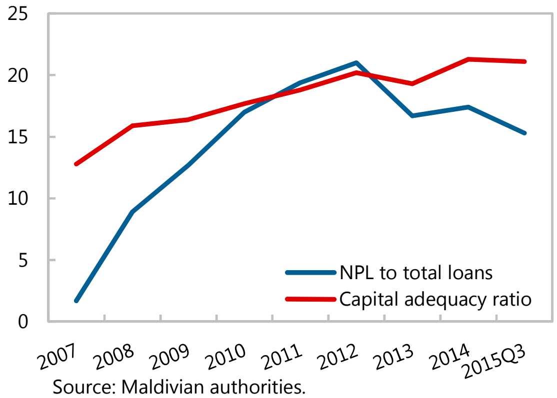


Sources: Authorities data and IMF staff calculations.

Figure 6. Maldives: Financial Soundness and Doing Business Indicators

System wide NPLs and capital adequacy have slowly improved…

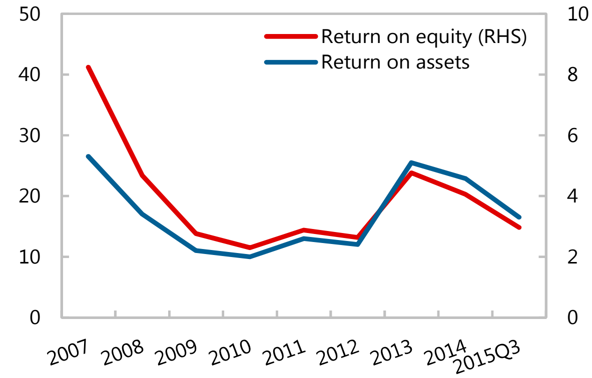
Commercial Banks' Capital and Credit Quality Indicators
(In percent)



Source: Maldivian authorities.

…profitability has improved since the GFC

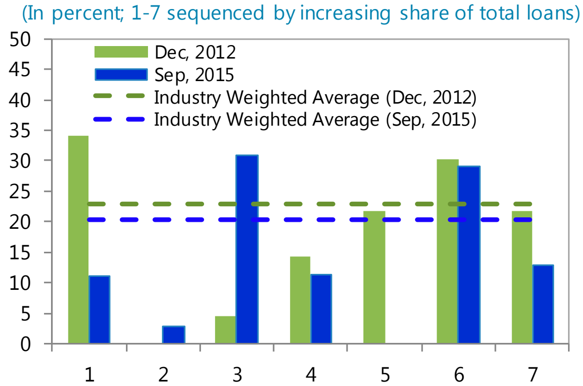
Commercial Banks' Profitability Indicators
(In percent)



Source: Maldivian authorities.

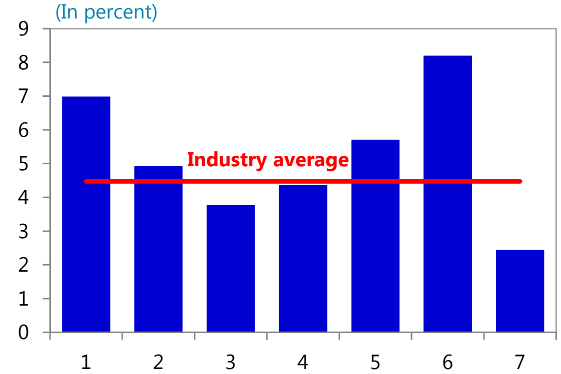
But NPLs remain very high in some banks…

Banks NPLs to Total Loans
(In percent; 1-7 sequenced by increasing share of total loans)



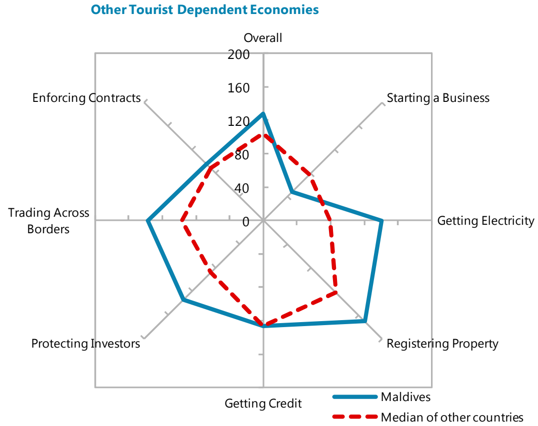
….and leverage ratios are also relatively high.

Leverage Ratio (Assets/Capital)
(In percent)



Doing business indicators remain weak…

2015 World Bank Doing Business Ranking Ciompared to Other Tourist Dependent Economies



Note: The other tourist-dependent countries include Antigua and Barbuda, Bahamas, Barbados, Belize, Cabo Verde, Cyprus, Dominica, Fiji, Grenada, Jamaica, Lebanon, Mauritius, Samoa, Seychelles, Sri Lanka, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Vanuatu.

… with little change this year

Comparison of 2015 and 2014 World Bank Doing Business Ranking

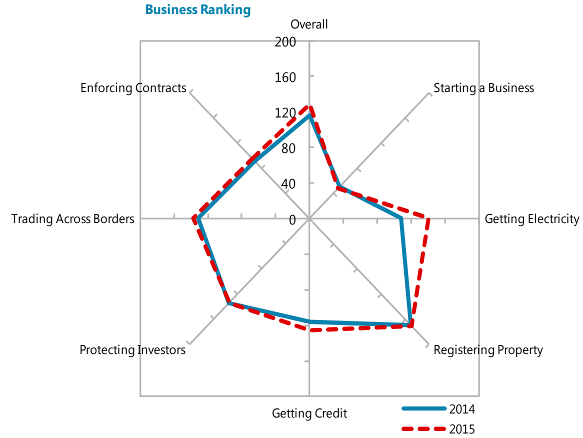


Table 1. Maldives: Selected Economic Indicators, 2012–20 (Baseline Scenario)

Population (in 1,000; 2014)	450
GDP per capita (in U.S. dollars; 2014 prel.):	6,792
Quota (in million SDRs):	10.0

	2012	2013	2014	2015	2016	2017	2018	2019	2020
		Est.	Prel.			Proj.			
Output and prices				(Annual percentage change)					
Real GDP	2.5	4.7	6.5	1.9	3.5	3.9	4.6	4.7	4.8
Inflation (end-of-period) 1/	5.4	3.1	1.2	1.9	2.0	3.2	3.6	4.0	4.2
Inflation (period average) 1/	10.9	4.0	2.5	1.4	2.1	2.6	3.5	3.8	4.1
GDP deflator	5.5	6.0	3.0	0.4	1.3	2.5	2.8	3.0	3.2
Central government finances				(In percent of GDP, unless otherwise indicated)					
Revenue and grants	26.2	27.7	32.1	35.9	35.6	34.4	33.1	32.5	32.4
Expenditure and net lending	33.9	35.2	41.2	44.3	48.9	52.5	52.0	48.4	43.2
Overall balance	-7.7	-7.4	-9.1	-8.4	-13.3	-18.1	-18.9	-15.9	-10.9
Overall balance excl. grants	-8.6	-7.7	-9.4	-9.2	-13.7	-18.5	-19.2	-16.2	-11.1
Primary balance	-4.8	-4.9	-6.3	-5.9	-10.6	-14.7	-14.5	-10.7	-4.9
Current primary balance	1.5	-0.6	-0.3	2.2	1.8	1.3	0.5	0.5	0.7
Public and publicly guaranteed debt	63.9	64.8	66.6	73.1	83.1	96.5	109.0	117.5	120.8
Monetary accounts				(Annual percentage change, unless otherwise indicated)					
Broad money	6.4	16.8	14.7	13.6	11.1	9.2	10.1	9.9	10.3
Domestic credit	-2.4	3.9	4.7	16.0	11.7	9.0	8.6	8.9	8.5
Balance of payments				(In percent of GDP, unless otherwise indicated)					
Current account	-7.4	-4.3	-4.1	-8.0	-7.7	-14.7	-17.3	-14.1	-10.9
Of which:									
Exports	12.5	11.9	9.8	8.0	7.0	7.4	7.7	8.0	7.9
Imports	-62.6	-61.1	-64.1	-62.9	-60.4	-66.7	-67.6	-62.7	-58.5
Tourism receipts and nonfactor services, net	64.1	68.5	72.9	69.7	69.4	68.1	66.0	64.6	64.2
Income (net)	-11.1	-13.3	-12.1	-11.4	-11.9	-11.6	-11.6	-12.1	-12.5
Current transfers	-10.3	-10.3	-10.6	-11.4	-11.8	-11.8	-11.9	-11.9	-11.9
Capital and financial account (including e&o)	9.5	9.2	12.0	6.7	9.8	19.6	20.3	15.6	11.8
Of which:									
General government, net	1.7	0.7	-0.6	-0.2	6.2	10.7	10.9	5.9	2.3
Banks and other sectors, net	-5.0	-6.8	6.5	-0.6	-3.8	-1.9	-1.2	-0.9	-0.9
Overall balance	2.1	5.0	7.9	-1.3	2.1	5.0	3.0	1.5	0.9
Gross international reserves (in millions of US$; e.o.p.) 2/	305	368	605	564	633	805	919	978	1,017
In months of GNFS imports	1.7	1.8	2.6	2.5	2.7	3.1	3.2	3.4	3.4
Memorandum items:									
GDP (in millions of rufiyaa)	38,693	42,952	47,122	48,209	50,549	53,836	57,854	62,358	67,403
GDP (in millions of U.S. dollars)	2,517	2,789	3,060	3,130	3,282	3,496	3,757	4,049	4,377
Tourism bednights (000')	6,451	7,058	7,290	6,978	7,005	7,146	7,360	7,654	8,075
Tourist arrivals (000')	958	1,125	1,205	1,234	1,251	1,299	1,338	1,392	1,468
Tourism bednights (% change)	-1.2	9.4	3.3	-4.3	0.4	2.0	3.0	4.0	5.5
Tourist arrivals (% change)	2.9	17.4	7.1	2.4	1.4	3.9	3.0	4.0	5.5
Dollarization ratio (FC deposits in percent of broad money) 3	49.2	50.2	53.8	52.4 3/					

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

1/ CPI-Male definition.

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

3/ Data for 2015 Jan-Aug.

Table 2a. Maldives: Central Government Finances, 2011–19 (Baseline Scenario)

(In millions of rufiyaa)

	2012	2013	2014	2015	2016	2016	2017	2018	2019	2020
			Est.		Auth.	Staff.		Proj.		
Total revenue and grants	10,138	11,901	15,127	17,298	22,760	17,971	18,523	19,150	20,271	21,815
Revenue (excluding privatization receipts)	9,771	11,783	14,962	16,927	21,539	17,756	18,321	18,968	20,088	21,633
Tax revenue	6,803	8,771	10,749	12,182	13,776	13,511	14,104	14,364	15,043	16,084
Import duties	1,369	1,576	1,975	2,393	2,377	2,721	3,000	3,238	3,383	3,722
Airport service charge	300	350	432	475	583	482	500	515	536	565
Business profit tax (BPT)	1,401	1,881	2,471	2,741	2,880	2,621	2,673	2,753	2,863	3,021
Goods and services tax (GST)	2,559	3,693	4,515	5,967	6,623	6,061	6,254	6,515	6,839	7,258
Of which: General GST	1,006	1,538	1,513	1,791	2,112	1,868	1,977	2,109	2,258	2,424
Tourism GST	1,554	2,155	3,002	4,176	4,511	4,193	4,277	4,405	4,582	4,834
Tourism tax ($6 green tax) 1/	805	862	805	54	654	647	660	680	707	746
Other	369	410	551	552	142	979	1,016	662	714	772
Nontax revenue	2,920	2,743	4,134	4,664	6,245	4,160	4,126	4,507	4,941	5,436
SOE profit transfers	633	476	782	640	596	839	893	960	1,035	1,119
Royalties, land, and resort rent	1,187	1,287	1,987	2,627	3,985	1,857	1,673	1,871	2,099	2,364
Other	1,100	981	1,365	1,397	1,664	1,465	1,560	1,676	1,807	1,953
Capital revenue	48	268	79	81	1,518	85	90	97	104	113
Grants	367	118	165	371	1,221	215	203	182	182	182
Expenditure and net lending	13,110	15,100	19,395	21,342	26,132	24,699	28,282	30,065	30,164	29,146
Current expenditure	10,316	13,143	16,408	17,083	16,227	18,183	19,472	21,200	23,062	25,226
Of which: Salaries and allowances	4,559	5,606	6,152	6,560	6,792	6,755	6,998	7,337	7,726	8,171
Transportation, communication, and utilities	1,035	1,226	1,345	1,857	1,681	1,947	2,074	2,229	2,402	2,597
Social welfare contributions	1,595	1,359	1,675	1,671	1,723	1,791	1,930	2,097	2,287	2,503
Repairs and maintenance	195	519	570	583	260	611	651	699	754	815
Subsidies and transfers	690	1,774	3,388	2,952	1,283	3,041	3,127	3,252	3,380	3,524
Interest	1,107	1,087	1,320	1,215	1,400	1,356	1,836	2,516	3,206	4,041
Other	1,134	1,571	1,958	2,244	3,088	2,682	2,856	3,069	3,308	3,576
Capital expenditure	2,884	2,093	2,585	3,912	9,904	6,176	8,480	9,048	7,299	4,133
Of which: Mega projects				209		2,473	4,777	5,345	3,596	430
Net lending	-90	-136	-149	-152	16	-159	-170	-183	-197	-213
Overall balance	-2,972	-3,199	-4,268	-4,044	-3,372	-6,728	-9,759	-10,915	-9,894	-7,330
Overall balance, excluding grants	-3,339	-3,317	-4,433	-4,416	-4,593	-6,943	-9,961	-11,097	-10,076	-7,513
Financing 2/	2,972	3,199	4,268	4,044	3,372	6,728	9,759	10,915	9,894	7,330
External	772	473	-299	-85	2,487	3,150	5,773	6,282	3,707	1,572
Domestic	2,200	2,727	4,567	4,129	886	3,578	3,986	4,633	6,186	5,759
MMA			228	0	…	0	0	0	0	0
Commerical banks			1,873	1,899	…	1,646	1,833	2,131	2,846	2,649
Other			2,466	2,230	…	1,932	2,152	2,502	3,341	3,110
Memorandum items:										
Current balance	-545	-1,360	-1,446	-156	…	-427	-1,151	-2,232	-2,974	-3,593
Primary balance	-1,865	-2,112	-2,948	-2,829	…	-5,372	-7,922	-8,399	-6,688	-3,290
Current primary balance	562	-273	-126	1,059	…	929	685	284	232	448

Table 2b. Maldives: Central Government Finances, 2011–19 (Baseline Scenario)

(In percent of GDP, unless otherwise specified)

	2012	2013	2014	2015	2016	2016	2017	2018	2019	2020
			Est.		Auth.	Staff.		Proj.		
Total revenue and grants	26.2	27.7	32.1	35.9	45.0	35.6	34.4	33.1	32.5	32.4
Revenue (excluding privatization receipts)	25.3	27.4	31.8	35.1	42.6	35.1	34.0	32.8	32.2	32.1
Tax revenue	17.6	20.4	22.8	25.3	27.3	26.7	26.2	24.8	24.1	23.9
Import duties	3.5	3.7	4.2	5.0	4.7	5.4	5.6	5.6	5.4	5.5
Airport service charge	0.8	0.8	0.9	1.0	1.2	1.0	0.9	0.9	0.9	0.8
Business profit tax (BPT)	3.6	4.4	5.2	5.7	5.7	5.2	5.0	4.8	4.6	4.5
Goods and services tax (GST)	6.6	8.6	9.6	12.4	13.1	12.0	11.6	11.3	11.0	10.8
Of which: General GST	2.6	3.6	3.2	3.7	4.2	3.7	3.7	3.6	3.6	3.6
Tourism GST	4.0	5.0	6.4	8.7	8.9	8.3	7.9	7.6	7.3	7.2
Tourism tax ($6 green tax) 1/	2.1	2.0	1.7	0.1	1.3	1.3	1.2	1.2	1.1	1.1
Other	1.0	1.0	1.2	1.1	0.3	1.9	1.9	1.1	1.1	1.1
Nontax revenue	7.5	6.4	8.8	9.7	12.4	8.2	7.7	7.8	7.9	8.1
SOE profit transfers	1.6	1.1	1.7	1.3	1.2	1.7	1.7	1.7	1.7	1.7
Royalties, land, and resort rent	3.1	3.0	4.2	5.4	7.9	3.7	3.1	3.2	3.4	3.5
Other	2.8	2.3	2.9	2.9	3.3	2.9	2.9	2.9	2.9	2.9
Capital revenue	0.1	0.6	0.2	0.2	3.0	0.2	0.2	0.2	0.2	0.2
Grants	0.9	0.3	0.4	0.8	2.4	0.4	0.4	0.3	0.3	0.3
Expenditure and net lending	33.9	35.2	41.2	44.3	51.7	48.9	52.5	52.0	48.4	43.2
Current expenditure	26.7	30.6	34.8	35.4	32.1	36.0	36.2	36.6	37.0	37.4
Of which: Salaries and allowances	11.8	13.1	13.1	13.6	13.4	13.4	13.0	12.7	12.4	12.1
Transportation, communication, and utilities	2.7	2.9	2.9	3.9	3.3	3.9	3.9	3.9	3.9	3.9
Social welfare contributions	4.1	3.2	3.6	3.5	3.4	3.5	3.6	3.6	3.7	3.7
Repairs and maintenance	0.5	1.2	1.2	1.2	0.5	1.2	1.2	1.2	1.2	1.2
Subsidies and transfers	1.8	4.1	7.2	6.1	2.5	6.0	5.8	5.6	5.4	5.2
Interest	2.9	2.5	2.8	2.5	2.8	2.7	3.4	4.3	5.1	6.0
Other	2.9	3.7	4.2	4.7	6.1	5.3	5.3	5.3	5.3	5.3
Capital expenditure	7.5	4.9	5.5	8.1	19.6	12.2	15.8	15.6	11.7	6.1
Of which: Mega projects				0.4	0.0	4.9	8.9	9.2	5.8	0.6
Net lending	-0.2	-0.3	-0.3	-0.3	0.0	-0.3	-0.3	-0.3	-0.3	-0.3
Overall balance	-7.7	-7.4	-9.1	-8.4	-6.7	-13.3	-18.1	-18.9	-15.9	-10.9
Overall balance, excluding grants	-8.6	-7.7	-9.4	-9.2	-9.1	-13.7	-18.5	-19.2	-16.2	-11.1
Financing 2/	7.7	7.4	9.1	8.4	6.7	13.3	18.1	18.9	15.9	10.9
External	2.0	1.1	-0.6	-0.2	4.9	6.2	10.7	10.9	5.9	2.3
Domestic	5.7	6.3	9.7	8.6	1.8	7.1	7.4	8.0	9.9	8.5
MMA			0.5	0.0	…	0.0	0.0	0.0	0.0	0.0
Commerical banks			4.0	3.9	…	3.3	3.4	3.7	4.6	3.9
Other			5.2	4.6	…	3.8	4.0	4.3	5.4	4.6
Memorandum items:										
Current balance	-1.4	-3.2	-3.1	-0.3	…	-0.8	-2.1	-3.9	-4.8	-5.3
Primary balance	-4.8	-4.9	-6.3	-5.9	…	-10.6	-14.7	-14.5	-10.7	-4.9
Current primary balance	1.5	-0.6	-0.3	2.2	…	1.8	1.3	0.5	0.5	0.7
Public and publicly guaranteed debt 3/	63.9	64.8	66.6	73.1	…	83.1	96.5	109.0	117.5	120.8
Domestic	34.6	37.5	43.7	50.9	…	55.7	59.7	63.6	68.9	72.3
External (excluding IMF and currency swaps by MM/	29.4	27.3	22.9	22.1	…	27.4	36.8	45.4	48.6	48.6
GDP (in millions of rufiyaa)	38,693	42,952	47,122	48,209	50,549	50,549	53,836	57,854	62,358	67,403

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

1/ The green tax will be effective late 2015, it replaces the bednights tax (eliminated November 2014).

2/ Includes unidentified financing.

3/ Arrears are not included.

Table 2c. Maldives: Statement of General Government Operations, 2012–18 (Baseline Scenario)

(In millions of rufiyaa)

	2012	2013	2014 Est.	2015 Proj.	2016	2017	2018
Revenue	10,090	11,632	15,048	17,218	17,887	18,433	19,053
Tax revenue	6,803	8,771	10,749	12,182	13,511	14,104	14,364
Taxes on income, profits, and capital gains	1,401	1,881	2,471	2,741	2,621	2,673	2,753
Payable by individuals	0	0	0	0	0	0	0
Payable by corporations and other enterprises	1,401	1,881	2,471	2,741	2,621	2,673	2,753
Taxes on goods and services	2,559	3,693	4,515	5,967	6,061	6,254	6,515
General GST	1,006	1,538	1,513	1,791	1,868	1,977	2,109
Tourism GST	1,554	2,155	3,002	4,176	4,193	4,277	4,405
Taxes on international trade and transactions	1,369	1,576	1,975	2,393	2,721	3,000	3,238
Taxes not elsewhere classified	1,474	1,622	1,788	1,081	2,108	2,177	1,858
Airport service charges	300	350	432	475	482	500	515
Tourism ($8 bed tax) 1/	805	862	805	54	647	660	680
Other	369	410	551	552	979	1,016	662
Grants	367	118	165	371	215	203	182
Other revenue	2,920	2,743	4,134	4,664	4,160	4,126	4,507
Administrative fees and charges	1,028	930	1,332	1,363	1,429	1,522	1,636
Interest income	72	51	33	34	36	38	41
Resort lease rent 2/	1,031	1,106	1,815	2,452	1,679	1,490	1,681
SOEs dividend payments	633	476	782	640	839	893	960
Other	155	180	172	175	178	183	189
Total expenditure	13,152	14,967	18,914	20,914	24,274	27,862	30,150
Expense	10,316	13,143	16,408	17,083	18,183	19,472	21,200
Compensation of employees	4,559	5,606	6,152	6,560	6,755	6,998	7,337
Goods and services	2,549	3,716	4,885	5,555	6,153	6,516	6,964
Interest	1,107	1,087	1,320	1,215	1,356	1,836	2,516
Subsidies	226	884	1,137	980	1,001	1,027	1,062
Social benefits	1,843	1,825	2,887	2,745	2,890	3,064	3,288
Miscellaneous other expense	32	25	27	27	29	31	33
Net acquisition of nonfinancial assets	2,836	1,825	2,506	3,831	6,091	8,390	8,951
Domestically financed	1,704	648	1,707	2,477	2,473	2,468	2,461
Capital expenditure (domestically financed)	1,752	916	1,786	2,558	2,558	2,558	2,558
Capital revenue	-48	-268	-79	-81	-85	-90	-97
Externally financed	1,132	1,177	799	1,354	3,618	5,922	6,490
Capital expenditure (foreign financed)	1,132	1,177	799	1,354	3,618	5,922	6,490
Gross operating balance	-226	-1,510	-1,360	135	-296	-1,039	-2,147
Net lending/borrowing (overall balance)	-3,062	-3,335	-3,866	-3,696	-6,387	-9,428	-11,097
Net financial transactions	-3,062	-3,335	-3,866	-3,696	-6,387	-9,428	-11,097
Net acquisition of financial assets	90	136	149	152	159	170	183
Domestic	90	136	149	152	159	170	183
Currency and deposits	0	0	0	0	0	0	0
MMA	0	0	0	0	0	0	0
Commercial banks	0	0	0	0	0	0	0
Debt securities	0	0	0	0	0	0	0
Loans	90	136	149	152	159	170	183
Account payable	0	0	0	0	0	0	0
Equity and investment fund shares	0	0	0	0	0	0	0
Foreign	0	0	0	0	0	0	0
Currency and deposits	0	0	0	0	0	0	0
Loans	0	0	0	0	0	0	0
Equity and investment fund shares	0	0	0	0	0	0	0
Net incurrence of liabilities	3,368	6,529	7,073	8,083	8,083	8,083	8,083
Domestic	3,498	7,009	7,372	8,168	8,168	8,168	8,168
Currency and deposits	0	0	0	0	0	0	0
Debt securities	3,498	7,009	7,372	8,168	8,168	8,168	8,168
Treasury bills	4,132	7,326	7,689	8,485	8,485	8,485	8,485
Commercial banks	0	0	0	0	0	0	0
Non banks	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	0
Treasury bonds (ways and means account)	-634	-317	-317	-317	-317	-317	-317
Loans	0	0	0	0	0	0	0
MMA loans to the C.G.	0	0	0	0	0	0	0
Commercial banks to the C.G.	0	0	0	0	0	0	0
Equity and investment fund shares	0	0	0	0	0	0	0
Foreign	-130	-480	-299	-85	-85	-85	-85
Currency and deposits	0	0	0	0	0	0	0
Debt securities	-770	-770	0	0	0	0	0
SBI dollar bonds	-770	-770	0	0	0	0	0
Loans	640	290	-299	-85	-85	-85	-85
Domestic Commercial banks to the C.G.	0	0	0	0	0	0	0
Foreign	640	290	-299	-85	-85	-85	-85
o/w arrears	0	0	0	0	0	0	0
Equity and investment fund shares	0	0	0	0	0	0	0
Statistical discrepancy	*-215*	*-3,058*	*-3,059*	*-4,235*	*-1,536*	*1,515*	*3,197*
Memorandum items:							
Primary balance	-1,955	-2,248	-2,545	-2,481	-5,031	-7,592	-8,582
Overall balance excluding grants	-2,695	-3,217	-3,701	-3,325	-6,172	-9,226	-10,915
Net privatization proceeds	0	0	0	0	0	0	0
Public and publicly guaranteed debt	24,254	27,514	31,248	35,137	41,870	51,639	62,565
Domestic	13,375	16,101	20,586	24,556	28,141	32,136	36,780
External (excluding IMF and currency swaps by MMA)	10,879	11,414	10,662	10,580	13,730	19,502	25,785
GDP at market prices	38,693	42,952	47,122	48,209	50,549	53,836	57,854

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

Table 3. Maldives: Monetary Accounts, 2007–20 (Baseline Scenario)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
		Est.			Proj.				
	(In millions of rufiyaa, e.o.p.)								
Net foreign assets	5,141	8,813	12,552	12,219	13,084	16,191	18,319	19,605	20,544
Maldives Monetary Authority, net	4,241	5,308	9,110	8,225	8,570	11,226	12,967	13,881	14,486
Assets	4,690	5,685	9,476	9,403	9,748	12,404	14,145	15,059	15,664
Liabilities	-448	-377	-366	-1,178	-1,178	-1,178	-1,178	-1,178	-1,178
Commercial banks, net	900	3,505	3,442	3,993	4,515	4,965	5,352	5,724	6,058
Net domestic assets	15,138	14,863	14,612	18,634	21,207	21,244	22,914	25,729	29,437
Domestic credit	23,908	24,850	26,008	30,168	33,707	36,744	39,914	43,479	47,187
Public sector	9,242	10,212	10,606	12,864	15,448	18,063	20,717	23,402	26,138
Central government (net)	7,664	8,638	9,273	11,371	13,879	16,394	18,970	21,586	24,246
Public enterprises	1,578	1,574	1,333	1,493	1,569	1,669	1,747	1,816	1,892
Private sector	14,505	14,638	15,114	17,001	18,259	18,681	19,197	20,076	21,049
Other items (net)	-8,770	-10,096	-11,396	-11,534	-12,500	-15,500	-17,000	-17,750	-17,750
Broad money	20,280	23,677	27,164	30,853	34,292	37,434	41,234	45,333	49,981
Narrow money	8,429	10,416	11,202	13,317	14,801	16,158	17,798	19,567	21,573
Currency	2,117	2,802	2,683	2,756	2,756	2,756	2,756	2,756	2,756
Public enterprise and local government deposits	1	2	1	1	0	0	0	0	0
Demand deposits	6,311	7,612	8,518	10,560	12,045	13,402	15,042	16,811	18,817
Quasi-money	11,851	13,261	15,963	17,536	19,490	21,276	23,436	25,766	28,407
	(Annual percentage change, unless otherwise indicated)								
Broad money	6.4	16.8	14.7	13.6	11.1	9.2	10.1	9.9	10.3
Narrow money	3.0	23.6	7.5	18.9	11.1	9.2	10.1	9.9	10.3
Domestic credit, net	-2.4	3.9	4.7	16.0	11.7	9.0	8.6	8.9	8.5
Central government	13.8	12.7	7.4	22.6	22.1	18.1	15.7	13.8	12.3
Public enterprises	-6.1	-0.2	-15.3	12.0	5.1	6.3	4.7	4.0	4.2
Private sector	-9.8	0.9	3.3	12.5	7.4	2.3	2.8	4.6	4.8
	(In percent of GDP)								
Broad money	52.4	55.1	57.6	64.0	67.8	69.5	71.3	72.7	74.2
Narrow money	21.8	24.2	23.8	27.6	29.3	30.0	30.8	31.4	32.0
Domestic credit, net	61.8	57.9	55.2	62.6	66.7	68.3	69.0	69.7	70.0
Central government	19.8	20.1	19.7	23.6	27.5	30.5	32.8	34.6	36.0
Public enterprises	4.1	3.7	2.8	3.1	3.1	3.1	3.0	2.9	2.8
Private sector	37.5	34.1	32.1	35.3	36.1	34.7	33.2	32.2	31.2
	(In millions of U.S. dollars)								
Gross foreign assets of MMA	305	368	605	564	633	805	919	978	1,017
Usable reserves	99	93	120	194	232	326	389	421	443
Commercial banks NFA	59	228	224	259	293	322	348	372	393
Commercial banks forex open position, net	155	221	280	280	n.a.	n.a.	n.a.	n.a.	n.a.
Memorandum items:									
Velocity	1.9	1.8	1.7	1.6	1.5	1.4	1.4	1.4	1.3
Money multiplier	2.4	2.5	2.2	3.0	3.0	3.0	3.0	3.0	3.0
Reserve money (in millions of rufiyaa, e.o.p.)	8,368	9,629	12,502	10,274	11,419	12,466	13,731	15,096	16,644

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

Table 4. Maldives: Balance of Payments, 2011–20 (Baseline Scenario)
(In millions of U.S. dollars, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Est.			Proj.			
Current account	-393	-187	-119	-125	-251	-253	-512	-649	-571	-476
Balance of goods and nonfactor services	157	352	537	570	464	523	307	232	399	596
Trade balance	-1,370	-1,261	-1,372	-1,660	-1,719	-1,754	-2,074	-2,249	-2,216	-2,213
Exports (f.o.b.)	346	314	331	301	252	230	260	290	322	347
Domestic exports	127	162	167	145	153	156	166	180	193	208
Re-exports	219	153	164	156	98	74	94	110	130	139
Imports (f.o.b.)	-1,717	-1,576	-1,703	-1,961	-1,971	-1,984	-2,333	-2,539	-2,538	-2,560
Tourism-related	-251	-253	-302	-372	-380	-392	-408	-428	-454	-489
Other	-1,466	-1,322	-1,401	-1,589	-1,590	-1,592	-1,926	-2,111	-2,084	-2,071
Of which: Construction	-130	-129	-126	-167	-249	-270	-454	-498	-346	-214
Nonfactor services, net	1,528	1,613	1,909	2,230	2,183	2,277	2,381	2,480	2,615	2,808
Of which: Travel receipts	1,940	1,958	2,337	2,696	2,580	2,745	2,855	2,998	3,180	3,421
Income, net	-308	-280	-370	-370	-357	-390	-406	-434	-488	-549
Current transfers, net	-242	-259	-286	-325	-358	-387	-414	-447	-483	-523
Receipts	18	20	4	4	24	14	13	12	12	12
Payments	-260	-279	-290	-329	-382	-401	-427	-459	-494	-534
Capital and financial account	478	215	142	534	349	403	685	763	631	516
Of which: 1/										
Foreign direct investment, net	424	228	361	372	333	328	381	406	433	460
Other investment, net	26	-83	-174	173	-26	79	309	362	203	61
Monetary authorities 2/	-4	0	-4	-6	-2	0	0	0	0	0
General government	79	42	19	-19	-6	205	375	408	241	102
Of which: Disbursements of loans	137	111	76	45	44	266	443	490	330	190
Of which: Mega projects					14	161	310	347	234	28
Amortization	-58	-69	-58	-65	-49	-62	-68	-82	-89	-88
Banks	99	179	-153	20	-41	-170	-137	-124	-123	-130
Other sectors 3/	95	61	-36	179	23	45	71	78	85	89
Errors and omissions	-71	24	116	-166	-138	-80	0	0	0	0
Overall balance	14	53	139	243	-40	70	173	114	60	39
Gross international reserves (increase: -)	-14	-53	-139	-237	41	-69	-172	-113	-59	-39
Use of Fund credit, net	0	0	0	-6	-1	-1	-1	-1	0	0
Financing gap 4/	0	0	0	0	0	0	0	0	0	0
Memorandum items:										
Gross international reserves (stock; e.o.p.) 2/	335	305	368	605	564	633	805	919	978	1,017
In months of GNFS imports	1.7	1.7	1.8	2.6	2.5	2.7	3.1	3.2	3.4	3.4
In percent of short-term debt at remaining maturity	109	120	161	192	186	210	263	275	265	250
Usable reserves (stock; e.o.p.) 2/	137	99	93	120	194	232	326	389	421	443
In percent of short-term debt at remaining maturity	44	39	40	46	64	77	107	116	114	109
Current account (in percent of GDP)	-16.9	-7.4	-4.3	-4.1	-8.0	-7.7	-14.7	-17.3	-14.1	-10.9
GNFS balance (in percent of GDP)	6.8	14.0	19.3	18.6	14.8	15.9	8.8	6.2	9.9	13.6
Exports (volume, percent change)	56.3	-7.6	6.1	-7.9	-7.9	-4.1	12.7	11.7	10.5	7.2
Imports (volume, percent change)	18.9	-7.5	9.4	18.8	24.0	15.0	11.2	5.7	-2.5	-0.7
Tourism: bednights (percent change)	9.1	-1.2	9.4	3.3	-4.3	0.4	2.0	3.0	4.0	5.5
Tourism: travel receipts (percent change)	13.3	0.9	19.3	15.4	-4.3	6.4	4.0	5.0	6.0	7.6
External debt (in percent of GDP) 4/	43.5	35.2	31.8	33.4	31.3	35.7	45.4	55.0	59.3	60.2
Medium- and long-term	38.2	32.6	29.8	29.7	28.1	33.0	42.6	52.1	56.1	56.7
Short-term	5.3	2.7	1.9	3.7	3.2	2.7	2.8	2.9	3.2	3.5
Debt service (in percent of domestic GNFS exports)	9.6	8.9	7.4	6.3	7.5	7.5	7.5	7.3	7.8	8.3
Exchange rate (rufiyaa per U.S. dollar; average)	15.4	…	…	…	…	…	…	…	…	…
GDP (in millions of U.S. dollars)	2,321	2,517	2,789	3,060	3,130	3,282	3,496	3,757	4,049	4,377

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

Table 5. Maldives: Selected Economic and Vulnerability Indicators, 2011–19 (Staff's Recommended Adjustment Scenario) 1/

Population (in 1,000; 2014)	450								
GDP per capita (in U.S. dollars; 2014 prel.):	6,792								
Quota (in million SDRs):	10.0								

	2012	2013 Est.	2014 Prel.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.	2020 Proj.
Output and prices			(Annual percentage change)						
Real GDP	2.5	4.7	6.5	1.9	3.5	3.9	4.6	5.5	5.5
Inflation (end-of-period) 1/	5.4	3.1	1.2	1.9	2.0	3.2	3.6	4.0	4.2
Inflation (period average) 1/	10.9	4.0	2.5	1.4	2.1	2.6	3.5	3.8	4.1
GDP deflator	5.5	6.0	3.0	0.4	1.3	2.5	2.8	3.0	3.2
Central government finances									
Revenue and grants	26.2	27.7	32.1	35.9	35.6	35.6	36.8	36.3	36.2
Expenditure and net lending	33.9	35.1	41.1	44.4	48.5	49.4	48.6	46.1	42.5
Overall balance	-7.7	-7.4	-9.0	-8.5	-13.0	-13.8	-11.9	-9.8	-6.3
Overall balance excl. grants	-8.6	-7.7	-9.3	-9.2	-13.4	-14.2	-12.2	-10.1	-6.5
Primary balance	-4.8	-4.9	-6.3	-5.9	-10.3	-10.4	-7.8	-5.4	-1.5
Current primary balance	1.5	-0.6	-0.3	2.2	1.8	1.3	0.5	0.5	0.7
Public and publicly guaranteed debt	62.8	63.7	65.5	72.1	81.9	91.0	96.9	99.5	99.0
Monetary accounts			(Annual percentage change, unless otherwise indicated)						
Broad money	6.4	16.8	14.7	13.6	11.1	9.2	10.1	10.8	11.1
Domestic credit	-2.4	3.9	4.7	16.0	11.9	9.0	8.7	6.8	10.2
Balance of payments			(In percent of GDP, unless otherwise indicated)						
Current account	-7.4	-4.3	-4.1	-8.0	-7.7	-11.7	-14.6	-11.5	-9.7
Of which:									
Exports	12.5	11.9	9.8	8.0	7.0	7.4	7.7	7.9	7.8
Imports	-62.6	-61.1	-64.1	-62.9	-60.4	-63.8	-65.0	-61.3	-59.5
Tourism receipts and nonfactor services, net	64.1	68.5	72.9	69.7	69.4	68.1	66.0	66.0	66.6
Income (net)	-11.1	-13.3	-12.1	-11.4	-11.9	-11.6	-11.5	-12.1	-12.6
Current transfers	-10.3	-10.3	-10.6	-11.4	-11.8	-11.8	-11.9	-11.9	-11.9
Capital and financial account (including e&o)	9.5	9.2	12.0	6.7	9.7	16.8	17.7	15.0	13.6
Of which:									
General government, net	1.7	0.7	-0.6	-0.2	6.1	7.9	8.3	5.3	4.2
Banks and other sectors, net	-5.0	-6.8	6.5	-0.6	-3.8	-1.9	-1.2	-0.9	-0.9
Overall balance	2.1	5.0	7.9	-1.3	2.0	5.1	3.1	3.5	4.0
Gross international reserves (in millions of US$; e.o.p.) 2/	305	368	605	564	630	807	924	1,067	1,243
In months of GNFS imports	1.7	1.8	2.6	2.5	2.7	3.2	3.3	3.7	4.0
Memorandum items:									
GDP (in millions of rufiyaa)	38,693	42,952	47,122	48,209	50,549	53,836	57,854	62,870	68,455
GDP (in millions of U.S. dollars)	2,517	2,789	3,060	3,130	3,282	3,496	3,757	4,082	4,445
Tourism bednights (000')	6,451	7,058	7,290	6,978	7,005	7,146	7,360	7,838	8,426
Tourist arrivals (000')	958	1,125	1,205	1,234	1,251	1,299	1,338	1,425	1,532
Tourism bednights (% change)	-1.2	9.4	3.3	-4.3	0.4	2.0	3.0	6.5	7.5
Tourist arrivals (% change)	2.9	17.4	7.1	2.4	1.4	3.9	3.0	6.5	7.5
Dollarization ratio (FC deposits in percent of broad money) 3/	49.2	50.2	53.8	52.4 3/					

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

1/ CPI-Male definition.

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

3/ Data for 2015 Jan-Aug.

Table 6. Maldives: Selected Financial Soundness Indicators
(In percent, unless otherwise specified)

	2007	2008	2009	2010	2011	2012	2013	2014	2015Q1	2015Q2	2015Q3
Capital											
Regulatory capital to risk-weighted assets	15.4	21.0	24.7	28.9	30.3	35.8	34.0	44.5	44.5	44.3	42.0
Tier 1 capital to risk-weighted assets	24.8	15.4	20.82	24.8	26.3	30.1	30.0	34.5	42.1	39.6	36.1
Capital to total assets	12.8	15.9	16.4	17.7	18.8	20.2	19.3	21.3	20.7	20.9	21.1
Asset quality											
Nonperforming loans (gross) to total loans (gross)	1.7	8.9	12.7	17	19.4	21	16.7	17.4	15.9	20.1	15.3
Nonperforming loans (net of provisioning) to regulatory capital	-1.7	31.8	33	34.9	35.2	16.5	2.4	11.1	7.5	0.4	3.5
Loan loss provisions to nonperforming loans	118.4	24.2	34.4	39.8	41.5	77.1	95.0	76.7	88.9	75.8	89.8
Earnings and profitability											
Return on assets	5.3	3.4	2.2	2.0	2.6	2.4	5.1	4.6	2.2	3.1	3.3
Return on equity	41.2	23.4	13.8	11.5	14.4	13.2	23.8	20.3	10.1	14.4	14.8
Liquidity											
Ratio of net loans to total deposits	130.6	141.9	112.6	97.6	86.3	70.7	62.6	61.9	58.6	54.7	59.8
Liquid assets to total assets	11.4	9.6	20.7	25.9	27.9	28.3	34.1	43.4	40.2	40	45.2
Assets of Banks (rufiyaa billions)	18.3	22.7	25.1	25.9	28.7	27.6	32.7	37.0	38.7	39.8	40.2
Deposits of banks (rufiyaa billions)	10.2	12.2	14.3	15.5	18.3	19.2	22.6	26.8	27.9	28.0	29.1

Source: Maldives Monetary Authority.

Table 7. Maldives: Millennium Development Goals

Goals	1990	1995	2000	2005	2010	2013
Goal 1: Eradicate extreme poverty and hunger						
Employment to population ratio, 15+, total (%) (modeled ILO estimate)	45	46	49	54	58	59
Employment to population ratio, ages 15-24, total (%) (modeled ILO estimate)	32	29	30	39	40	40
GDP per person employed (constant 1990 PPP $)	..	..	..	..	..	..
Income share held by lowest 20%	..	..	1	7	..	..
Malnutrition prevalence, weight for age (% of children under 5)	..	39	26	..	..	..
Poverty gap at $1.90 a day (PPP) (%)	..	..	13	0	..	..
Poverty headcount ratio at $1.90 a day (PPP) (% of population)	..	..	26	1	..	..
Vulnerable employment, total (% of total employment)	46	54	50	30	..	..
Goal 2: Achieve universal primary education						
Literacy rate, youth female (% of females ages 15-24)	98	98	98	99	..	..
Literacy rate, youth male (% of males ages 15-24)	98	98	98	99	..	..
Persistence to last grade of primary, total (% of cohort)	..	..	..	..	..	83
Primary completion rate, total (% of relevant age group)	..	122	184	144	..	..
Adjusted net enrollment rate, primary (% of primary school age children)	..	96	99	98	..	..
Goal 3: Promote gender equality and empower women						
Proportion of seats held by women in national parliaments (%)	6	6	6	12	7	6
Ratio of female to male primary enrollment (%)	100	97	100	98	..	..
Ratio of female to male secondary enrollment (%)	..	106	108	113	..	..
Ratio of female to male tertiary enrollment (%)	..	..	..	159	..	..
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	16	32	41	30	41	...
Goal 4: Reduce child mortality						
Immunization, measles (% of children ages 12-23 months)	96	96	99	97	97	99
Mortality rate, infant (per 1,000 live births)	68	53	35	19	11	8
Mortality rate, under-5 (per 1,000 live births)	94	70	44	23	13	10
Goal 5: Improve maternal health						
Adolescent fertility rate (births per 1,000 women ages 15-19)	136	79	38	17	11	8
Births attended by skilled health staff (% of total)	..	90	70	84	98	..
Contraceptive prevalence (% of women ages 15-49)	29	..	42	39	..	..
Maternal mortality ratio (modeled estimate, per 100,000 live births)	430	210	110	57	38	31
Pregnant women receiving prenatal care (%)	..	..	81	95	..	..
Unmet need for contraception (% of married women ages 15-49)	..	..	..	..	..	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases						
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	..	..	..	..	..	..
Condom use, population ages 15-24, female (% of females ages 15-24)	..	..	..	..	..	..
Condom use, population ages 15-24, male (% of males ages 15-24)	..	..	..	..	..	..
Incidence of tuberculosis (per 100,000 people)	150	118	60	51	38	40
Prevalence of HIV, female (% ages 15-24)	0.1	0.1	0.1	0.1	..	..
Prevalence of HIV, male (% ages 15-24)	0.1	0.1	0.1	0.1	..	..
Prevalence of HIV, total (% of population ages 15-49)	0.1	0.1	0.1	0.1	..	..
Tuberculosis case detection rate (%, all forms)	47	80	80	80	76	83
Goal 7: Ensure environmental sustainability						
CO2 emissions (kg per PPP $ of GDP)	..	..	0	0	0	0
CO2 emissions (metric tons per capita)	1	1	2	2	3	3
Forest area (% of land area)	3	3	3	3	3	3
Improved sanitation facilities (% of population with access)	68	70	79	89	97	98
Improved water source (% of population with access)	93	94	95	97	98	99
Marine protected areas (% of territorial waters)	..	..	..	..	..	..
Goal 8: Develop a global partnership for development						
Net ODA received per capita (current US$)	97	236	70	255	340	66
Debt service (PPG and IMF only, % of exports of goods, services and primary income)	4	3	4	7	3	3
Internet users (per 100 people)	0	0	2.2	6.9	27	44
Mobile cellular subscriptions (per 100 people)	0	0	3	68	152	181
Telephone lines (per 100 people)	3	6	9	11	..	7
Other						
Fertility rate, total (births per woman)	6	5	3	3	2	2
GNI per capita, Atlas method (current US$)	..	..	..	3420	5960	6730
GNI, Atlas method (current US$) (billions)	..	..	..	1	2	2
Gross capital formation (% of GDP)	..	31	26	40	..	..
Life expectancy at birth, total (years)	61	65	69	74	77	78
Literacy rate, adult total (% of people ages 15 and above)	96	96	96	98	..	..
Population, total	223179	254070	280384	304968	332575	351111
Trade (% of GDP)	168	170	161	136	159	219

Source: World Development Indicators
Note: Figures in blue refer to periods other than those specified.

Table 8. Public Financial Management Reform Plan (2015–2018)

Goal	Actions
Clear responsibilities between agencies should be established to enable successful reform.	• Convene high level discussion among public financial management agencies to establish agreement on the reform plan, monitoring, priorities and responsibilities. • Develop capacity for analysis of budget, fiscal framework and audit reports.
Strengthened Budget formulation policies and procedures and establish more realistic Budgets.	• Improve policies for setting expenditure ceilings, including identifying multi-year expenditure commitments. Gain commitment to realistic expenditure ceilings at line ministry and agency level at the beginning of the budget process. • Strengthen information provision for line ministries and agencies on actual, priority and committed expenditures. • Closer coordination between recurrent and capital budgets including unified expenditure plans together with financing plans for capital expenditures.
Better cash management.	• Review baseline expenditures as an input for cash management. • Improve reporting and monitoring of budget execution, including commitments. All line ministries to implement commitment control. • Develop policy on payment of arrears and preventing their recurrence • Strengthen capacity and coordination to improve cash flow forecasting
A medium term fiscal framework should be put in place once macro-fiscal analysis and forecasting capacity is developed.	• Develop a medium term fiscal plan in line with the fiscal Responsibility Law. • Strengthen capacity and develop the analytical information for a medium term framework including projecting credible aggregate fiscal parameters. Develop a simple medium term model. • Improve information flow on fiscal policy within and among ministries and agencies.
A medium term debt strategy should be established once the information base has improved.	• Update the debt strategy in line with the Fiscal Responsibility Law and ensure it is based on clear risk minimization policies. • Gather reliable data, including on guarantees, arrears and domestic securities. Improve procedures for recording information on external grants. • Make debt data available to the public • Increase capacity for debt sustainability analysis. • Publish interim targets for debt and the current primary and primary balance to move back towards the targets under the Fiscal Responsibility Law. • Expand primary domestic debt market through the provision of longer term instruments and develop a secondary market.
Better accounting, fiscal reporting, internal and external audit and monitoring across local government agencies and SOEs.	• Document the accounting and reporting frameworks and introduce streamlined reporting requirements and formats. • Use the Chart of Accounts in consultation with key data users • Roll out the remainder of the Public Accounting System. • Fuller reporting including of major deviations in budget and financial statement • For both internal and external audit, review legislation, clarify responsibilities and develop capacity. Make external audits timelier.

Commitment at the political level by the Majlis (Maldives' parliament) to the spending envelope and the composition of spending in addition to the budget aggregate would be important.

The Reform Plan was developed by the IMF and World Bank following the 2014 PEFA.

Appendix I. The Benefits and Costs of Scaling Up Using a Debt Investment Growth Model

International evidence shows that the benefits of airport development could be substantial. The airport expansion in particular could have a substantial growth impact, expanding capacity, leading to lower airfares and boosting tourism demand:

- Airport development. Punta Cana has become a key Caribbean tourist destination as its airport became the most important in the Dominican Republic: raising numbers from 850 thousand tourists (35 percent of all arrivals in the country) in 2000 to nearly 3 million (65 percent of arrivals) in 2014 (an increase of almost 240 percent).
- Culiuc (2014) suggests that the presence of direct flights to small islands is associated with a large increase in tourist arrivals. While estimates are sensitive to estimation methodology and control variables, increases range between 20–80 percent. Acevedo et al (2015) finds that increasing the number of flights to tourist destinations is the most effective way to boost tourist arrivals.

But there are fiscal as well as growth implications from infrastructure scaling up. Research in the October 2014 WEO, *Is it Time for an Infrastructure Push? The Macroeconomic Effects of Public Investment,* showed there are historically wide variations in the macroeconomic outcomes of public investment for emerging markets and less developed economies—with inefficient investment often leading to larger fiscal deficits without substantially improving the quality of public assets**.**

A debt investment growth (DIG) model traces the possible growth and fiscal impacts for Maldives (see Selected Issue).[1,2] The DIG model takes into account the highly open nature of Maldives' economy, high import intensity, and the size and pace of investment plans. Since the benefits are mainly to the tourism sector, and supporting FDI will be needed in resorts and transportation to fully exploit the enhanced infrastructure, there is greater than usual uncertainty about the economic impact. This is captured by using alternative rates of return for public capital.

- **The baseline demonstrates potential for higher growth.** With the return on public capital in line with the average drawing on evidence from less developed economies, the model suggests a temporary by sustained increase in real growth rates of ½–¾ percentage points can be attained (Figure A (right panel), blue lines). But higher growth rates can be achieved with greater efficiency of public investment.

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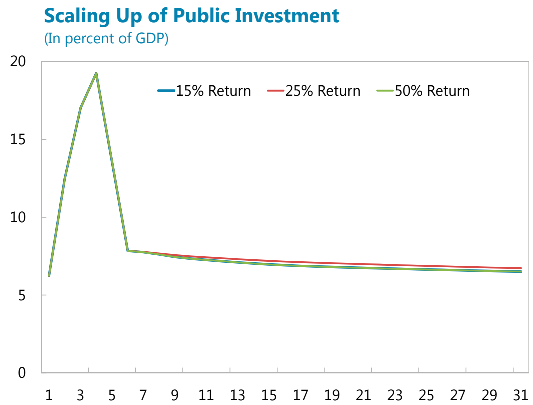
[1] Buffie, E., Berg, A., Pattilo, C., Portillo, R. and L.-F. Zanna, 2012, "Public Investment, Growth, and Debt Sustainability: Putting Together the Pieces," IMF Working Paper, WP/12/144.

[2] For model details see Selected Issues Paper "Scaling up public expenditure on infrastructure" (forthcoming)

Chart 1. Macroeconomic Impact

(i) baseline 25 percent return (blue lines); (ii) 50 percent return (green lines) (iii) 15 percent return (red lines)



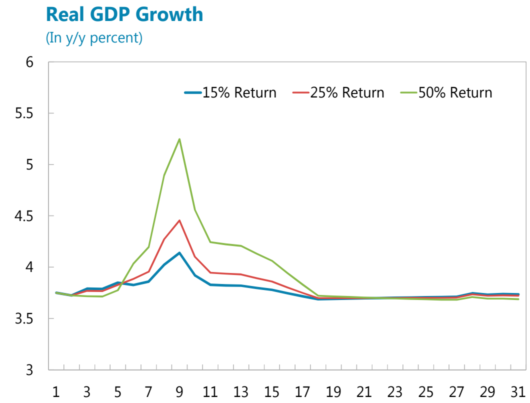
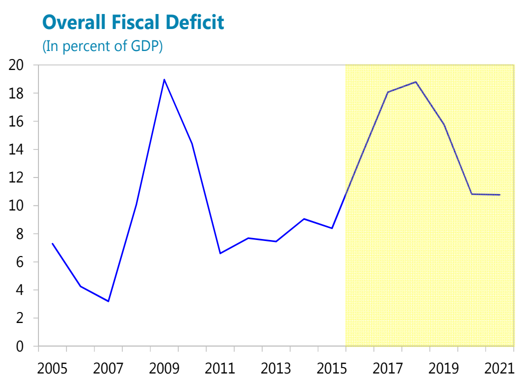
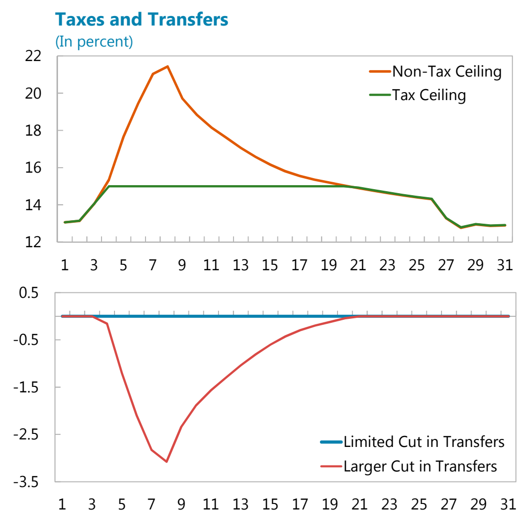


Chart 2. Public finance impact



Sources: Maldivian authorities; and IMF staff estimates.



- **The impact on public finances is also large.** An increase in tax rates of more than 6 percentage points to 19 percent would be necessary to finance the scaling up and limit the impact on the deficit in the absence of further adjustments, even allowing for a substantial amount of concessional debt. A more balanced fiscal response with a smaller increase in taxation could be achieved with other, complementary adjustments in the budget, such as in public transfers—to limit the increase in taxes to 15 percent would require a temporary cut in transfers of 2.5 percent of GDP. The authorities' current plans are more heavily weighted to external debt than would be suggested in this model.

- **Sound project implementation is crucial to boost private sector confidence and to reap all the potential benefits.** Increasing the return on public investment from 25 to 50 percent, could increase output growth by an additional 0.6 percentage points for 3–4 years after completion, and by around 0.3 percentage points for 6–7 years. Private investment and capital, as well as private consumption, would all increase substantially over the medium-to-long term. Poor project management that results in lower public investment efficiency would not add much to growth but would drive the debt level higher.

Appendix II. Maldives: Tax System – Keep it Simple, Keep it Fair

Maldives tax system and revenue performance compare favorably to South Asian economies and Caribbean islands. Maldives tax system is relatively new with a small number of broad based taxes that enables efficient tax administration and strong revenue collections. The tax system being newly established operates efficiently and productively and has not been distorted with tax incentives which other comparators find to be the main cause for their tax base erosions and weakening revenue performances. As the tax system matures, it is important to maintain its strengths as a simple, fair and effective framework and avoid introducing tax incentives. Experience shows that tax incentives carry a significant risk to the long-term revenue generation capacity.

Maldives Special Economic Zones Act 2014 (SEZ) sets unlimited discretionary space for tax incentivizing of investment, which carries significant risks to the current simple, effective and efficient tax system. SEZs are specifically designated geographical areas with special regulations and financial incentives aiming at attracting investment and job-creation. Maldives plans to set up free trade, offshore financial services, industrial, export processing, and ports SEZs. Incentives include wide-ranging exemptions from import duty, BPT, GST, and withholding taxes, and concessions in bringing in expatriate workers and land taxes. There are many shortcomings to SEZ framework, particularly:

- **Unlimited room for discretion.** Respective roles and margins of discretion are not clearly defined. Some incentives are automatically available ("guaranteed"), while more generous ones are subject to negotiation. The act does not define roles, accountability, reporting, and oversight frameworks for issuing, negotiating, and evaluating incentives.
- **Unlimited room for tax incentivizing.** The act does not define nature of tax incentives and its limits. Potentially extremely broad tax exemptions, holidays, rate reductions, and various forms of deductions could be obtained affecting BPT and GST legal frameworks.

Discretionary tax incentivizing under SEZ may undermine health, stability and efficiency of the overall tax system. SEZ sets open windows for interaction between various Special Interest Groups (SIGs) and government opening unlimited space for using tax incentivizing. Similar to Caribbean countries and Sri Lanka, this will invite competition among potential investors, business community, individuals to seek tax regime customizations which will be made available only for these groups, protecting them from any unwanted competition. More importantly, this will make tax system prone to annual injections of new tax incentives, eroding the tax base and reducing the revenue potential. As a result of these efforts, current efficient and effective tax system will become increasingly complex, unpredictable, and unstable. More tax incentives are granted under SEZ, more government would need to scramble to find alternative revenue sources, increase tax rates, and bring on new taxes to compensate for the tax base erosion and revenue reduction from incentivizing.

Consideration should be given to tightening SEZ legislation with a view to limiting discretionary space and protecting integrity of the existing tax system. In particular: i) define roles, responsibilities, accountability and reporting framework for various agencies involved in tax incentivizing decisions; ii) use alternative incentive mechanisms than the tax legislation; iii) establish gatekeeper role for ministry of finance and treasury for any tax incentivizing decisions with a view of protecting integrity of the tax system; iv) quantify and report all tax incentives as part of budget submission; and v) establish and enforce quantitative ceilings for tax incentives, if such being considered.

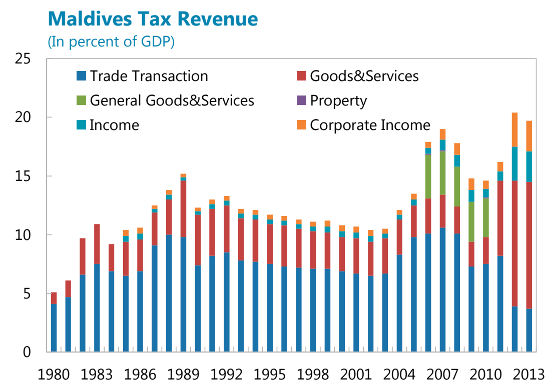
Lessons: Pros and Cons for Tax Incentives

Pros	Cons
+ FDI injecting expertise and resources	- Erode tax base resulting in a direct loss of revenue
+ Development for non-traditional exports and industries	- Do not matter for investment if overall economic factors are conducive
	- Business investment decisions are not based on tax burden, but predictability, stability and transparency of the tax system
	- Distort allocation of resources
	- Enable corruption by opening space for discretion and non-transparent decision making
	- Complicate tax system, make administration costly, and lead to rates increase on a narrower base
	- Once precedent is created it spreads to the system

Source: IMF FAD TA (2015)

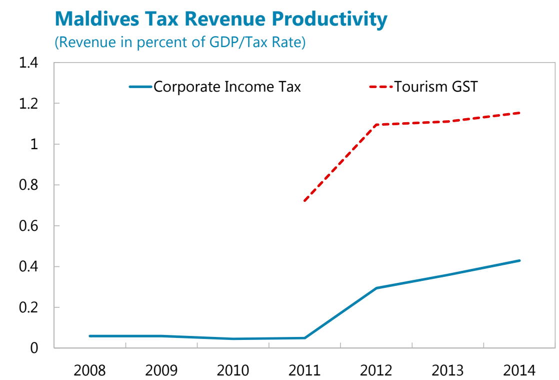
Chart 1. Maldives: Tax Productivity

The tax base has broadened with recent policy measures.



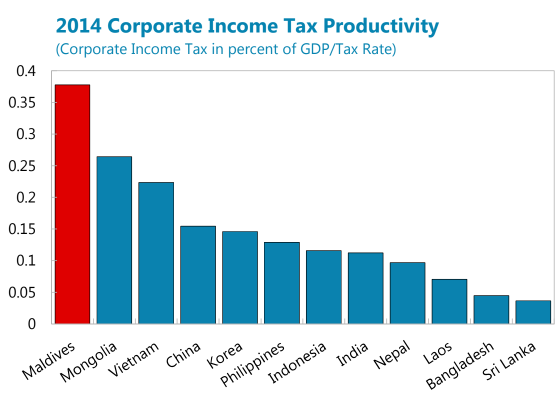
Sources: IMF data.

Maldives tax revenue is productive.



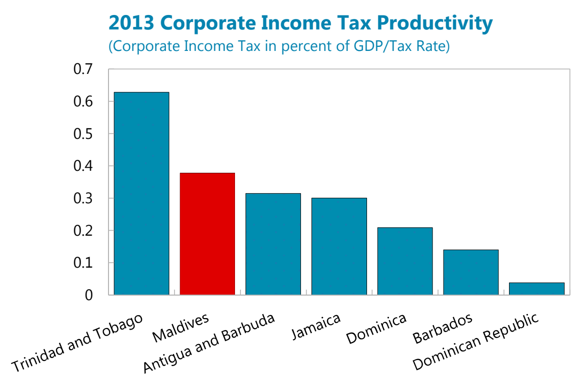
Sources: IMF data and staff calculations.

Higher than other economies in the region.



Sources: IMF *World Economic Outlook*, FAD database and staff calculations.

And compares well to other regions such as the Caribbean.

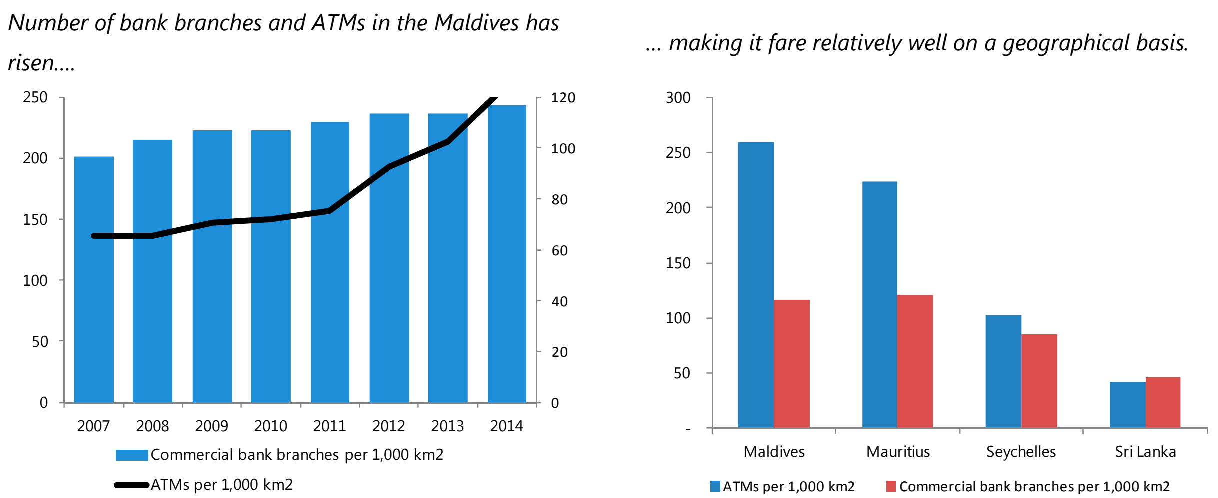


Sources: IMF *World Economic Outlook*, FAD database and staff calculation.
Note: some of the country data is from early years such as 2009 and 2010.

Appendix III. Financial Inclusion in the Maldives

Financial Inclusions (FI)—access to formal financial services by households and firms—is especially challenging for Maldives, given the high transaction and sunk costs of providing these services to the sparsely populated and remote islands.[1] Despite these challenges, Maldives compares relatively favorably on two measures of FI: the number of bank branches and the number of ATMs, if measured in terms of area (Chart 1). Additionally, it also scores relatively well on FI amongst some developing economies in Asia according to a study done by the Asian Development Bank.[2] However, because of the high population density in the capital and larger islands, these indicators are pulled down when measured on a per 100,000 adults basis highlighting the problem that FI on the small remote islands is still very low.

Chart 1. Geographical Coverage in the Maldives



Improving financial access by marginalized groups would help them raise income (reducing its volatility), and build assets, promoting growth and improving resilience to economic shocks. As part of their efforts to increase FI, the Maldives authorities are scaling up their support to SMEs including through concessional and Islamic financing, reviving small scale industries, encouraging female labor force participation and prioritizing government contracts to SMEs. The Bank of Maldives has also increased its FI efforts by providing a range of services via dhoni banking units to the remote islands. They have also announced that plans are under way to provide banking services to all islands by 2017. In addition, the FIRST Initiative has also launched a project—Enabling a Non-Bank Mobile Money Solution—that addresses financial inclusion targeting the population in the outer islands where financial infrastructure is largely absent.[3]

[1] FI is measured in three dimensions – access, usage, and quality of financial services and products. A total of 24 key categories endorsed by G20 leaders measure the three dimensions of financial inclusion. See http://www.gpfi.org/featured/g20-basic-set-financial-inclusion-indicators. Given that the authorities only submit data to the Financial Access Survey and not to FINDEX, only data on access is currently available (the authorities plan to report to FINDEX in 2016).

[2] Financial Inclusion, Poverty, and Income Inequality in Developing Asia, ADB Working Paper No. 426. http://www.adb.org/sites/default/files/publication/153143/ewp-426.pdf

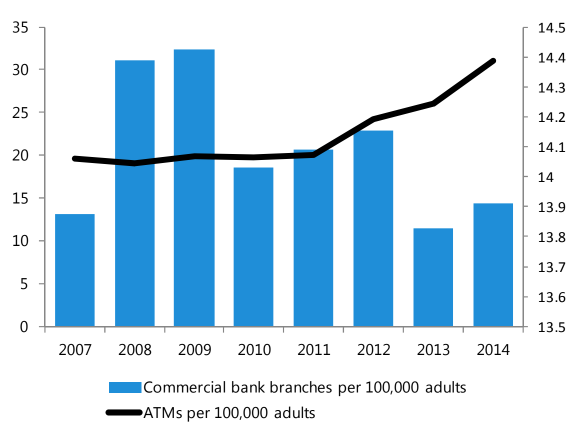
[3] FIRST was created in 2002, with the primary mandate of promoting the implementation of the Financial Sector Assessment Program and is currently supported by five donors: the Department for International Development of the United Kingdom, Germany's Federal

Challenges persist and credit remains expensive and exclusive due to: (i) limited information about counterparty risk (the coverage of the credit registry is limited); (ii) a lack of accurate information on collateral (given the absence of an electronic collateral registry) and complexities in the legal framework. Credit diversification is therefore limited and businesses not in the perceived profitable sectors have difficulties in obtaining credit. Furthermore, harnessing up to date technology such as mobile and internet banking would help the population in remote atolls to have access to basic financial services and reduce transaction costs. Internet banking is available from the major banks but mobile banking is still in its nascent stage and the widespread scope of telecom connectivity is still underutilized.

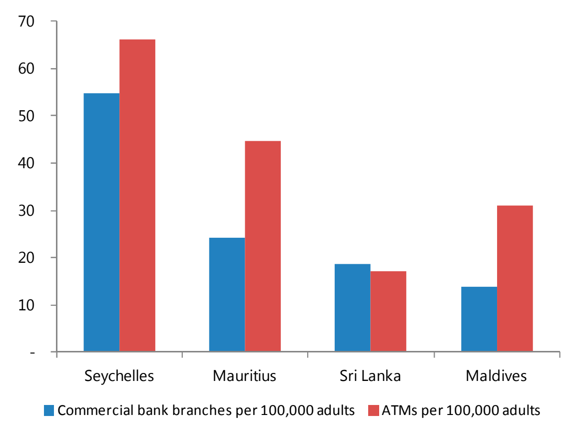
Measures to improve inclusion include: revamping the credit registry and pushing for technology like mobile banking to combat geographical constraints in parallel to schemes to promote the ease of credit to women and youth via SME development. Strengthening financial literacy programs, conducting surveys to understand the needs of minority groups and their constraints, making use of existing networks like the postal system for financial awareness would also help.

Chart 2. Demographic Coverage in the Maldives

But a recent drop in the number of bank branches ….



…ranks it lower on a demographics basis.



Ministry of Economic Cooperation and Development, the Ministry of Finance of Luxembourg, the Ministry of Foreign Affairs of the Netherlands, and the State Secretariat for Economic Affairs of Switzerland, as well as the World Bank Group and the IMF.

Appendix IV. Maldives: Risk Assessment Matrix

Likelihood	Impact	Policy Response
	Upside	
	1. Tourism demand rebounds more strongly than expected. Maldives has proved adept at attracting tourists from different destinations in the past. Redevelopment of the airport if successful could significantly raise capacity and there is scope for catalytic investment.	• Higher tourism growth would provide short term breathing space to implement fiscal measures. • Decisive and durable fiscal measures together with strengthened public financial management would reduce both fiscal and external pressures. A successful completion of infrastructure project would add to potential growth at least temporarily.
Low	**High**	
	2. Decisive and durable fiscal consolidation efforts put policy back on track. Public financial management improvements are implemented and the ramp up in capital expenditures is strictly prioritized and offsetting consolidation measures are put in place in line with staff's illustrative scenario.	
	Downside	
Medium	**Medium**	
	1. Political tensions escalate and dent tourism. Security advisories usually only apply to the capital Malé with the airport and tourist resorts remaining open for travel. However, some tourist cancellations followed November's state of emergency and heightened tensions could prompt a further decline in arrivals.	• The baseline projections show that debt is on an unsustainable path and will add to external pressures in the medium term. The authorities' investment plans need to be prioritized, sequenced and carefully managed to avoid debt distress. Public financial management needs to be substantially strengthened. Financial supervision can be further strengthened. • Domestic and external shocks would add to an already highly vulnerable outlook, cause the fiscal position to deteriorate, would place pressure on the parallel market premium, and erode the level of MMA official reserves. • In the event that risks materialize, fiscal adjustment would need to be accelerated and investment plans abated. Tough and durable expenditure control would need to be in place. • Financial stability risks need to be closely monitored, In the events of strains in a bank a range of resolution measures would need to be considered and should include independent external assessment.
China Medium Low **US dollar high**	**High/Medium**	
	2. Global risks—structurally weak growth in China (medium term), a sharp slowdown in growth in China in 2015/16 and persistent US dollar strength (short term). Tourism activity has been driven increasingly by arrivals from new markets such as China. A slowdown which affects Chinese middle class, outbound travel and spills over to other Asian economies would have a significantly negative impact on Maldives tourism arrivals. A further U.S. dollar appreciation against the euro could also dampen growth. The real effective exchange rate has risen as the US dollar appreciated and Maldives may be losing some competitiveness compared to other tourist destinations. As a high end destination with around 60 percent of resorts in the 5 star and plus category, Maldives tourist demand is likely to be relatively price and income inelastic—though the new and growing middle-market is likely to be more price sensitive. But over time a further sharp U.S. dollar appreciation against the euro would likely have some dampening effect on demand	
High/ Medium	**High**	
	3. Policy slippages. Stronger public financial management and investment management needs to be in place to help manage fiscal vulnerabilities. The large public investment program is substantially adding to downside risks.	

The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

INTERNATIONAL MONETARY FUND

MALDIVES

April 6, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of February 29, 2016)

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

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

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	7.69	100.00
Holdings	3.66	47.54

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
ESF Arrangements	1.74	8.22

Latest Financial Arrangements:

Type	**Arrangement Date**	**Expiration Date**	**Amount Approved (SDR million)**	**Amount Drawn (SDR Million)**
Stand-By	12/04/2009	12/3/2012	49.20	8.20
ESF	12/04/2009	12/3/2011	8.20	2.05

Projected Payments to Fund[1]

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2016	**2017**	**2018**	**2019**	**2020**
Principal	0.41	0.41	0.41	0.41	0.1
Charges/Interest	0.00	0.01	0.00	0.00	0.00
Total	**0.41**	**0.42**	**0.41**	**0.41**	**0.11**

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

Exchange Arrangements

Since April 2011, the rufiyaa has floated in a band of 20 percent on either side of Rf 12.85 per dollar. In practice, however, the rufiyaa has been virtually fixed at the band's weaker end of Rf 15.42 per dollar. The de jure exchange rate arrangement is a pegged exchange rate within horizontal bands and the de facto exchange rate arrangement is classified as a stabilized exchange rate arrangement. Maldives continues to avail itself of the transitional provisions of Article XIV but no longer maintains any measures under this provision, and has not yet accepted the obligations of Article VIII, Sections 2, 3, and 4. It maintains an exchange restriction subject to IMF approval under Article VIII, Section 2(a) of the IMF's Articles of Agreement arising from a shortage of foreign exchange at the official rate which leads to the MMA rationing its supply of foreign exchange to commercial banks. This results in a channeling of foreign exchange transactions for current international transactions to the parallel market where transactions take place at an exchange rate that deviates by more than 2 percent from the prevailing market exchange rate. The greater than 2 percent spread gives rise to multiple currency practice subject to IMF approval under Article VIII, Section 3 and also to an exchange restriction, given the additional cost involved for obtaining foreign exchange. The extent of rationing has been eased over the past two years by increasing the amounts provided to commercial banks and adjusting amounts in line with seasonal patterns. The official exchange rate used by the MMA for government transactions is calculated based on the mid-point of the weighted average of the buying and selling rates of foreign exchange transactions conducted by commercial banks one day earlier. The lack of a mechanism to prevent the spread between this official exchange rate used by the MMA for government transactions and the prevailing market exchange rate from deviating by more than 2 percent gives rise to a multiple currency practice subject to IMF approval under Article VIII, Section 3.

Last Article IV Consultation

The 2014 Article IV consultation was concluded by the Executive Board on February 11 2015.

Technical Assistance

FAD: FAD main areas of engagement are in Public Expenditure and Financial Accountability (PEFA) assessment and providing TA for cash management. A joint IMF/WB-led PEFA assessment was carried out in February 2014 to gauge progress made since the last PFM Action Plan for 2009-2011, identify remaining weaknesses and future direction. As a follow-up to the PEFA, the FAD team together with the World Bank developed a Public Financial Management Reform Plan (PFMRP) for the GoM in June 2014. This was a broad PFM reform and consolidation plan aimed at improving the overall policy-making, coordination, implementation and monitoring framework in PFM. Altogether 3 missions on cash management have been carried out since FY14 by the Cambodia-based Regional PFM Advisor. These missions focused on developing a cash management manual for the GoM and related activities. To consolidate this work and to broaden it to expenditure and commitment controls, the August 2015 mission reviewed progress. The mission developed an updated action plan to make the cash management unit functional, start using the cash flow forecasting model and the implementation of a commitment control system. On request from the authorities, in September 2014 FAD carried out a review of Chart of Accounts (CoA) at the ministry of finance and proposed structure for a revised CoA and an action plan to achieve same. The mission was coordinated with an overlapping STA mission to review the mapping of the government COA to GFSM 2014.

LEG: In October 2003 provided technical 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). A follow-up mission in February 2011 focused on payments law. LEG conducted an AML/CFT assessment in October 2010 and conducted a desk-based review of the draft AML/CFT law in May 2012. In 2014 and 2015 LEG provided advice on the Special Economic Zones Law, offshore banking legislation and deposit insurance.

MCM: Two missions visited in 2006 on monetary operations, financial market development, and banking issues. In 2007, a series of mission were provided on debt management, monetary policy and financial supervision. In 2008, three missions visited on monetary operations and liquidity management, monetary policy and financial supervision issues. In November 2008 and March/May/August 2009, a series of mission were provided on research capacity building, bank supervision, monetary policy and the MMA act. Two missions visited Malé to advise on monetary operations, liquidity management, and the development of a crisis management framework. In December 2010, MCM conducted a TA mission on crisis preparedness and management, bank restructuring, and monetary operations. In May and September 2011, MCM consecutively conducted missions on the development of debt markets, and on on-site banking supervision. In February 2012, MCM undertook a TA mission on assessing the foreign exchange operations framework. In 2014, MCM conducted a series of TA missions on banking supervision in early February and late May. Also, together with APD another joint mission on developing foreign exchange market was carried out. MCM also provided advice on deposit insurance schemes. In 2015 MCM fielded two missions to Malé in the areas of banking supervision (March) and foreign exchange reserve management (September). A mission is confirmed for late March 2016 to advise on foreign exchange and monetary policy operations

***STA*:** In May 2007, STA conducted a mission on money and banking statistics. In February and April 2011, STA offered TA on multiple topics covering improvements in balance of payments statistics, government financial statistics (GFS), monetary and financial statistics (MFS) and national accounts. In June and September 2011, STA conducted TA missions on improving price statistics and on the General Data Dissemination System (GDDS). In February, May, and October 2012 STA continued providing TA on improving price statistics. Similarly, in April 2012, a TA mission on improving national accounts covered constructing GDP from the expenditure side and compiling quarterly national accounts. Further advice on improving GDP and developing quarterly GDP was provided in November 2012, January and July, 2014, and April 2015, the latter jointly with APD . Subsequently, Maldives attended a workshop for the ICP-SNA project covering both national accounts and price statistics. Between March 2013 and January 2016, STA field eight TA missions on balance of payments statistics, in the context of a project funded by the Government of Japan. Another TA mission on balance of payments statistics is scheduled for March 2015.

Safeguards Assessment

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

IMF–WORLD BANK JOINT MANAGEMENT ACTION PLAN

(As of February 2016)

The World Bank Group Systematic Country Diagnostic (2015) for Maldives identified three specific priority areas to promote growth, reduce poverty, and increase shared prosperity in a sustainable manner. The priorities are as follows: enhancing opportunities in tourism and fisheries for the local population; enabling opportunities for the creation of new sources of inclusive growth; and enhancing the efficiency and efficacy of public resource management and reduce macro-fiscal risk. The Country Partnership Framework (CPF) FY16-19, which relies heavily on the SCD analysis, and is expected to be presented to the Board in April 2016, proposes a selective program of engagement that aims to enable more inclusive and sustainable growth through better use of the country's assets including human capital, natural assets and financial resources. Under the proposed CPF program, support is oriented towards enhancing the economic participation of Maldivians to improve the inclusiveness of growth and deepening successful interventions in the following sectors: education, public finance management, environment and natural resource management and renewable energy. Youth, gender, governance and climate resilience are cross-cutting themes that are recognized as essential for social inclusion and sustainable management of resources.

The World Bank is supporting a Public Financial Management Systems strengthening project for FY 15-20, with the objective to enhance budget credibility, transparency, and financial reporting of central government finances. It is focusing on strengthening the PFM environment (including enhancing the medium-term fiscal framework and strengthening debt and cash management) and strengthening budget execution. A separate Bank funded project supports the office of the Auditor General in updating the audit law, conducting performance audit pilots and training the staff on auditing the consolidated financial statements of the country using international audit standards.

The teams have been holding, and will continue to hold, joint missions and regular briefing meetings on macroeconomic developments. Public financial management is a key area of collaboration for these operations.

The Bank is taking the lead on a number of initiatives aimed at improving targeting of universal subsidies and reforming social protection:

- **Health:** Bank technical support currently focuses on helping achieving operational savings for Aasandha, though substantial capacity building of the implementing agency, NSPA, would be needed to plan, implement and monitor the much needed reforms.
- **Poverty:** the Bank – through the Statistical Capacity Building Project and Poverty Technical Assistance – has been assisting in the design of a new Household Income and Expenditure survey, which is planned to start field operations in March 2016. Upon the

completion of the survey which is expected by November 2016, the poverty team will assist in the estimation of a new, official national poverty line for Maldives.

- **Proxy Means Testing:** Bank support has helped NSPA develop a targeting mechanism based on both means and proxy means test (PMT) methods to target the electricity subsidy and other social safety net programs; the PMT formula will be updated once new HIES data is available

The Appendix details the macro-critical activities that the Bank and IMF will work on over the coming year.

Appendix I. Maldives IMF-World Bank Joint Management Action Plan		
Title	**Products/Activity**	**Expected Dates**
Bank Work Program in the next 12 months	**A. Strategy and Analytical Work** Poverty and Shared Prosperity in Maldives Youth & Gender Assessment in the Maldives Governance Support **B. Lending** Environmental Management Project Statistical Capacity Building Enhancing Education Development Project Public Financial Management Systems Strengthening Project Accelerating Sustainable Private Investments in Renewable Energy (ASPIRE) Project Climate Change Trust Fund II Capacity Development Support for Auditor General's Office Trust Fund (IDF) Sustainable Fisheries Resources Development Project Entrepreneurship and jobs in Maldives **C. Technical Assistance** Mobile Money and Financial Sector Support/ Enabling a nonbank Mobile Money Solution Maldives Medium Term Debt Strategy TA to Universal Health Insurance Technical Assistance on Renewable Energy Resource Mapping and Geospatial Planning Maldives #C001 Enabling a Non-Bank Mobile Money Solution.	**Delivery date** FY 16 FY 16 FY 16 **Approval date** June 2008 Nov 2012 April 2013 June 2014 June 2014 March 2015 October 2012 Sept 2016 February 2017 **Delivery date** FY 16 FY 16 FY 17 FY 18 FY 18
Joint products	**Agreement on joint products** Joint Bank-Fund Debt Sustainability Analysis	April 2016

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of August, 2015)

The ADB country operations business plan (COBP), 2015–2017 was approved in February 2015, and was based on the interim CPS, 2014–2015. Appendix 1 provides an updated results framework under the new business plan. To anchor the COBP -- particularly the program in its first year, an abridged interim CPS –consistent with CPS 2014-15 was prepared for 2016. A full CPS spanning 2016–2020, is to be prepared in 2016. This will inform successive COBP's.

The Maldives is eligible for resources from the Asian Development Fund. Indicative resources available during 2016−2018 amount to $25.36 million. The final country allocations for 2017 and 2018 will be subject to available Asian Development Fund grants and concessional ordinary capital resources and the outcome of the country performance assessments. The Maldives was eligible for a 100 percent grant share of country allocations in 2015. The proportion of grants for the country allocations in 2016–2018 will be determined by future annual debt distress classifications. As per the Midterm Review of Strategy 2020, ADB will make efforts, wherever possible, to secure co-financing resources for projects to be developed during the COBP period.

The indicative assistance pipeline (both for lending and non-lending products) for 2016–2018 and the ongoing non-lending program is given below:

Indicative Assistance Pipeline – Lending Products 2016-2018

Project/Program Name	Sector	Poverty Targeting	Strategic Agendas and Drivers of Change	Division	Year of PPTA/PDA	Cost ($ million) Total	ADB OCR	ADF Loans	ADF Grants	ADB Total	Gov't	Co-finance
2016 Firm												
Kulhudhuffushi Harbor Expansion Project	TRA	TI-G	IEG, ESG, PSD, RCI	SATC	2014	TBD	0.0	0.0	9.69	9.69	TBD	TBD
2017												
None[a]												
2018												
L. Gan-Fonadhoo Community Connectivity Project[b]	TRA	TI-G	IEG	SAER	2015	TBD	0.0	0.0	15.67	15.67	TBD	TBD
Total							**0.0**	**0.0**	**25.36**	**25.36**		

ADB = Asian Development Bank; ADF = Asian Development Fund; ESG = environmentally sustainable growth; Gov't = government; IEG = inclusive economic growth; OCR = ordinary capital resources; PDA = project design advance; PPTA = project preparatory technical assistance; PSD = private sector development; RCI = regional integration; SAER = Environment, Natural Resources, and Agriculture Division, South Asia Department; SATC = Transport and Communications Division, South Asia Department; TBD = to be determined; TI-G = targeted intervention—geographic dimensions of inclusive growth; TRA = transport.

[a] In the COBP, 2015–2017, the L.Gan-Fonadhoo Major Cross-Roads Project was standby for 2017 (the project preparatory TA will be in 2015). The project is now moved to 2018.

[b] The original title of this project was the L.Gan-Fonadhoo Major Cross-Roads Project.

Source: Asian Development Bank.

Indicative Assistance Pipeline – Non-Lending Products 2016-2018

Assistance Name	Sector	Division	Assistance Type	Sources of Funding: ADB Source	ADB Amount ($'000)	Others Source	Others Amount ($'000)	Total ($'000)
2016								
Capacity Development for Kulhudhuffushi Harbor Expansion Project	TRA	SATC	CDTA	TASF	1,000.00		0.00	1,000.00
2017								
Township Development Project	WUS	SAER	PPTA	TASF	1,000.00		0.00	1,000.00
2018								
L. Gan–Fonadhoo Community Connectivity Project	TRA	SAER	CDTA	TASF	1,000.00		0.00	1,000.00
Total					**3,000.00**			**3,000.00**

ADB = Asian Development Bank; CDTA = capacity development technical assistance; PPTA = project preparatory technical assistance; SAER = Environment, Natural Resources, and Agriculture Division, South Asia Department; SATC = Transport and Communications Division, South Asia Department; TASF = Technical Assistance Special Fund; TBD = to be determined; TRA = transport, WUS = water and other urban infrastructure and services.
Source: Asian Development Bank.

Non lending Product and Services 2015

Assistance Name	Sector	Division	Assistance Type	Sources of Funding: ADB Source	ADB Amount ($'000)	Others Source	Others Amount ($'000)	Total ($'000)
Firm								
Strengthening Capacity for Operations Management (Supplementary)	PSM	SARC	CDTA	TASF	500.00		0.00	500.00
Capacity Development of Maldives Energy Authority (Supplementary)	PSM	SAEN	CDTA		0.00	SCF	400.00	400.00
L. Gan-Fonadhoo Community Connectivity Project	PSM	SAER	PPTA	TASF	600.00		0.00	600.00
Standby								
Supporting Project Development and Information Management[a]	PSM	SARC	CDTA	TASF	0.00	TBD	400.00	400.00
Total					**1,100.00**		**800.00**	**1,900.00**

ADB = Asian Development Bank; CDTA = project preparatory technical assistance; JFPR = Japan Fund for Poverty Reduction; PPTA = project preparatory technical assistance; PSM = public sector management; SAEN = Energy Division, South Asia Department; SAER = Environment, Natural Resources, and Agriculture Division, South Asia Department; SARC= Regional Cooperation and Country Coordination Division, South Asia Department; SCF = Strategic Climate Fund; TASF = Technical Assistance Special Fund; TBD = to be determined.
[a] Previously titled Improving Business Climate; on standby, resources to be sought from the JFPR.
Source: Asian Development Bank estimates.

Lending program.

For 2016, funds for the Kulhudhuffushi Harbor Expansion Project was reduced from $12.68 million to $9.69 million; this is the result of the revised allocation of Asian Development Fund resources for the Maldives for 2015 and 2016 (the project uses the resources set aside for 2015 and 2016). The L. Gan-Fonadhoo Major Cross-Roads Project, proposed as standby in 2017 in the previous COBP, is to be moved to 2018 as a firm project with a change in the name to L. Gan-Fonadhoo Community Connectivity Project.

Non-lending program.

The Improving Business Climate capacity development technical assistance (TA), factored in for 2015 in the previous COBP, will be renamed Supporting Project Development and Information Management, and will seek resources ($400,000) from the Japan Fund for Poverty Reduction. It is kept on standby pending a funding decision on the proposal to be made to the Japan Fund for Poverty Reduction, as well as a request from the government for specific TA components. For 2017, a project preparatory TA is proposed for the Township Development Project (for $1,000,000), as suggested by the government and as part of its plans for the development of urban areas. The funds are to be used for a project design advance, as needed. Finally, for 2018, a capacity development TA is proposed to be attached to the L. Gan-Fonadhoo Community Connectivity Project (for $1,000,000).

Non-sovereign operations.

There are ongoing constraints in actively pursuing private sector investments and non-sovereign operations in the Maldives. Two critical ones are (i) the lack of effective convertibility of the rufiyaa, and (ii) the country's weak sovereign rating. To this should be added the generally weak capacity of the private sector in key areas such as financial management and accounting, and constraints regarding the availability of a skilled workforce. Given the government's strong push for economic transformation, which includes support for private sector investments, ADB will—during 2016–2018—consider scoping out specific areas where it can support the private sector, which will subsequently support inclusive economic growth. Where feasible, ADB will discuss with the government support for possible areas of non-sovereign operations that could be considered in the future.

Appendix II. ADB Updated Interim Country Partnership Strategy Results Framework

Country Development Goals[a]				Changes from CPS or Last COBP
1. Budget deficit as percentage of GDP reduced to 3.0% by 2015 (2013 baseline: 4.2%) 2. Foreign debt–GDP ratio reduced to 23.5% by 2015 (2013 baseline: 29.4%) 3. Recurrent expenditure reduced to 65% of budget by 2015 (2013 baseline: 75.7%) 4. Revenue as percentage of GDP increased to 38% by 2015 (2013 baseline: 28%)				Indicators for the development goals and baselines updated based on the March 2015 statistics report of the Maldives Monetary Authority and in consultation with government
Sector Selected for ADB Support				
Government Sector Objectives	**Sector Outcomes that ADB Contributes to and Indicators**	**ADB Areas of Intervention**	**ADB Indicative Resource Allocation in the Next Pipeline and Strategic Priorities**	**Changes from CPS or Last COBP**
Transport (Core area 1: infrastructure)				
Enhanced movement of people and goods, including at regional level	Increased and more efficient intra- and interisland movement of people and goods **Indicators** Number of passengers from the atolls to Malé increases to 1,572 people/day in 2015 (2012 baseline: 1,209) Current value: NA Inbound container throughput of general cargo increases to 47,053 tons in 2015 (2013 baseline: 42,089 tons)[b] Current value: NA Average dwell time of cargo vessels nationally decreases by 10% by 2015 (2013 baseline [estimate]: average 6.3 days)[c] Current value: NA	Infrastructure development in water transport Capacity development Promotion of private sector participation	$9.69 million (38% of total investments in the COBP, 2016–2018) of which: ESG = 100% GEM = 0% PSD = 100%[d] RCI = 100%[d]	Changes in the sector outcomes and project composition in consultation with the government; changes in the resource allocation based on revised ADF and OCR concessional allocations for the Maldives for $25.36 million for 2015–2018

ADB = Asian Development Bank, ADF = Asian Development Fund, COBP = country operations business plan, CPS = country partnership strategy, ESG = environmentally sustainable growth, GDP = gross domestic product, GEM = gender equity and mainstreaming, NA = not available, OCR = ordinary capital resources, PSD = private sector development, RCI = regional integration.

Note: This CPS refers to the Interim CPS, 2016, which focuses on one sector (transport, i.e., the Kulhudhuffushi Harbor Expansion Project). The results framework for the renewable energy project, Preparing Outer Islands for Sustainable Energy, has already been reflected in the Interim CPS, 2014–2015. In the full CPS, 2016–2020 to be prepared in 2015 and 2016, the complete results frameworks for the project portfolios in the Maldives country programming (from beyond 2016) will be reflected.

[a] The country development goals here are updated from the COBP, 2015–2017; this section will be further updated for the full CPS.

[b] The target and baseline for general cargo are from Government of the Maldives. 2013. *Maldives Maritime Transport Master Plan*. Malé.

[c] This baseline indicator is meant as a proxy measure derived from the work done for the Maldives Maritime Transport Master Plan, using survey results for Malé North Harbor (which has less-efficient cargo handling than Malé South Harbor).

[d] PSD and RCI impacts will be assessed during the project preparatory technical assistance.

Source: Asian Development Bank.

STATISTICAL ISSUES

(As of March 2016)

I. Assessment of Data Adequacy for Surveillance
General: Macroeconomic statistics have improved in recent years, with technical assistance from STA and the Asian Development Bank (AsDB). While data are broadly adequate for surveillance (Category B) there are nonetheless significant data gaps that complicate policy making and aspects of surveillance. Remaining shortcomings affect the balance of payments, government finance, and national accounts statistics.
Real sector: National accounts statistics are available on an annual basis and with a considerable lag, though the authorities have also begun to publish quarterly GDP data. While GDP estimates are made using both the production and expenditure approaches, these estimates are inconsistent. Furthermore, the base year for constant price estimates is 2003, so that recent changes in the structure of the economy are not reflected by the base period weights. The AsDB has assisted the authorities in setting up a framework for compiling more comprehensive national accounts and STA has provided substantial assistance for improving the annual production and expenditure GDP measures, and for developing quarterly GDP series. The CPI was rebased to June 2012=100, with assistance from STA. Weights are based on the 2012 household income and expenditure survey.
Fiscal sector: General government data are reported for publication in the *GFS Yearbook* and the latest published data are for 2011. 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.
Financial sector: APD receives an electronic report on monetary statistics every two weeks, covering the balance sheets of the MMA and the commercial banks. Current summary data are published in the MMA's *Monthly Statistics* publication as well as in its *QEB* and *AR*. There are inconsistencies between monetary and fiscal data regarding the financing of the fiscal deficit due to issues of timing and coverage. The MMA uses the standardized report forms (SRFs) to report data for the central bank and other financial corporations on a regular basis. An integrated monetary database that meets the needs of the MMA, STA, and APD and is operational.
External sector: The MMA compiles balance of payments data on an annual basis. Coverage has improved substantially but is still limited in some areas and recent recommendations provided by technical assistance missions have yet to be implemented. Travel credits (receipts) and other services items are estimated on the basis of tourism GST receipts and the use of the withholding tax on services provided by nonresidents which has improved the coverage of other services

(debits) although it does not capture all cross-border services. The survey run by the Ministry of Tourism should be used to validate the estimates related to the travel credits. The MMA conducted the first survey on inward foreign direct investment (FDI) in June 2013 and a second in 2015; a new regulation should address the problem of a low response rate. The FDI source data are now sufficiently detailed to enable Maldives` participation in the next IMF`s Coordinated Direct Investment Survey (CDIS). Other private financial flows are estimated on the basis of the CPIS and BIS data, but coverage needs to improve. A revised and more complete international investment position dataset consistent with the financial account will be disseminated in April 2016. 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 and the external debt data are not reported to QEDs. STA technical assistance missions have been working to improve external sector data and the International Investment Position.

Notwithstanding recent improvements in the balance of payments statistics, the reliability of the data is uncertain—in part as it is inherently difficult to capture full data with many transactions occurring outside the country and no international counterparty data on tourism services to validate revenue estimates.

Official reserves assets are reported every two weeks with a (variable) one-week lag. Predetermined foreign currency outflows (mainly debt service payments) are known and reported to APD at the time of annual Article IV consultation missions, while other movements of foreign currency assets are not identified.

II. Data Standards and Quality

Maldives has participated in the General Data Dissemination System (GDDS) since October 14, 2011.	No data ROSC available.

III. Reporting to STA (Optional)

The authorities report macroeconomic data to the IMF on a regular and generally timely basis for publication in the *IFS*, *BOPSY*, *and GFSY*.

Maldives: Table of Common Indicators Required for Surveillance
(As of April 6, 2016)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	03/31/2016	04/06/2016	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	03/31/2016	04/06/2016	D	D	D
Reserve/Base Money	03/24/2016	03/31/2016	W	W	M
Broad Money	03/24/2016	03/31/2016	W	W	M
Central Bank Balance Sheet	03/24/2016	03/31/2016	W	W	M
Consolidated Balance Sheet of the Banking System	03/24/2016	03/31/2016	W	W	M
Interest Rates[2]	04/05/2016	04/06/2016	W	W	M
Consumer Price Index	01/31/2016	03/07/2016	W	W	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2014	11/30/2015	A	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2014	11/30/2015	A	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2014	11/30/2015	A	M	M
External Current Account Balance	2014	10/28/2015	A	M	M
Exports and Imports of Goods and Services	11/30/2015	03/07/2016	M	M	M
GDP/GNP	2014	10/30/2015	A	M	M
Gross External Debt	2014	10/30/2015	A	M	M

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

INTERNATIONAL MONETARY FUND

MALDIVES

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITYANALYSIS

April 8, 2016

Approved By
Kalpana Kochhar,
Catherine Pattillo (IMF),
and Satu Kahkonen (IDA)

Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)

This Debt Sustainability Analysis (DSA) updates the March 2015 DSA. Maldives' external risk rating has been elevated to a high risk of debt distress, based on an assessment of public external debt in the context of large prospective increases in capital spending. The assessment of the overall risk of debt distress is also high and is reinforced by significant vulnerabilities related to domestic debt. The 2016 Budget, included in the baseline, projects a substantial increase in capital spending financed wholly by external debt (with no offsetting fiscal measures) which will add to both debt and foreign currency risk and would markedly change the composition of Maldives debt. The execution rate of the capital projects is highly uncertain—and under-execution is likely—but after factoring this in debt still rises sharply (and there could be cost overruns). The authorities' 2016 Budget entails a large increase in external debt which would breach the PV of external debt to GDP threshold.[1]

Fiscal policy mistakes and shocks to tourism exports or foreign direct investment are key risks that could trigger debt distress. To stabilize and then reduce public debt ratios, staff proposes greater prioritization of capital expenditures, additional fiscal revenue and expenditure measures and public financial management reforms. Adjustment measures – as illustrated by the staff's illustrative scenario (Figures 4 and 5)—are needed to reduce the probability of debt distress while accommodating an increase in capital expenditure.

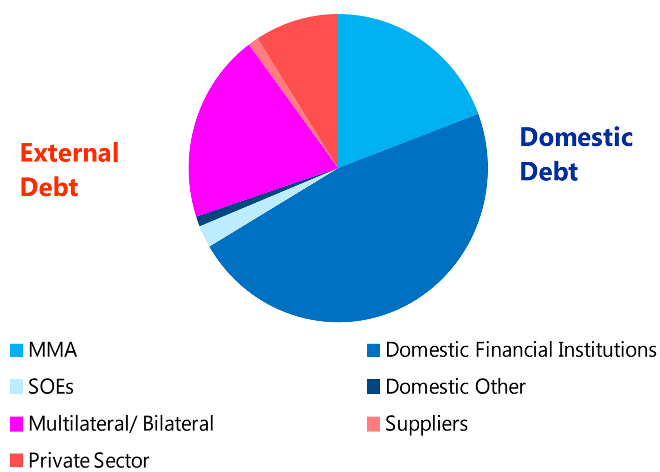
[1] Maldives continues to be classified as a medium performer in terms of policies and institutions by the World Bank's Country Policy and Institutional Assessment (CPIA), averaging 3.25 over 2012–14.

RECENT DEBT DEVELOPMENTS

Total public debt has risen rapidly since the 2004 tsunami and is above the 60 percent limit in the Fiscal Responsibility Law as of end-2015 at around 73.1 percent of GDP (Table 3).[2,3] The increase initially reflected additional expenditure needs in the aftermath of the tsunami but more recently additional recurrent spending on wages, social welfare, and subsidies and capital spending on infrastructure scale up. Under the baseline scenario, public debt would remain on a rising path over the medium term.

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

Public Debt Holdings by Sector
(Percent distribution)



The economy has relied heavily on the issuance of treasury bills and monetization as well as external borrowing to finance deficits. Domestic arrears are likely to have declined significantly in 2015 (aided by better revenue performance) and the DSA baseline assumes these are cleared over a period of three years.

The external debt ratio has declined since the global financial crisis. Between 2010 and 2015, net repayments of external public and publicly guaranteed external debt and private external debt reduced the external debt (Table 1 and 3). With an open capital account and little reporting, private sector external debt data are subject to large errors and there are likely to be further revisions to debt estimates.

Taken together private external debt and total public debt are estimated at about $ 2.6 bn (82.3 percent of GDP) in 2015.

[2] The fiscal year for Maldives is January to December.

[3] Public debt is defined as the debt of the non-financial public sector comprising central government, including loans on-lent to State Owned Enterprises. It does not include publicly guaranteed debt and domestic arrears. The Ministry of Finance and Treasury (MoFT) is currently undertaking a process to gather and record all data and information regarding government guarantees. Once the process is completed, guaranteed debt might be included in the analysis.

Box 1. PRGT Eligibility for the Maldives

The PRGT eligibility framework reviewed on a two-year cycle was last reviewed in June 2015. Maldives continues to be PRGT eligible to date. The criteria for PRGT eligibility – income and market access criterion – are closely linked with the PRGT's key objectives that access should be reserved for members with low per capita income levels who do not have durable and substantial access to international financial markets. Even though Maldives meets the income criterion by a large margin, its short term macroeconomic vulnerabilities particularly a risk of income decline and loss of market access from elevated debt kept it from graduating from PRGT eligibility. Broad alignment with IDA practices was also an important element in defining its PRGT-eligibility as it still remains an IDA-only country based on the small island economy exception, receiving most of its assistance from IDA on grant terms.

With medium term risks like the planned investment scale up, the slowdown in China (its largest tourism market) and the possible costs from climate change, concessional financing will continue to be a key source of external financing in the Maldives given the existing level of very high debt.

MACROECONOMIC ASSUMPTIONS

The baseline scenario is built on current policies, including staff's assessment of the Authorities' 2016 Budget. The budget projects unrealistically low current expenditures which does not match staff's assessment of commitments and an unprecedentedly large rise in capital spending. Managing these projects could strain implementation capacity if they are wholly financed through debt with no offsetting fiscal measures making debt unsustainable even with financing on semi concessional terms. The actual execution of these projects is highly uncertain, depending on the availability of financing (many projects are not yet under contract). Staff's baseline does not include estimates for revenues from the Special Economic Zones (SEZs). It also does not include any compensation amount from the arbitration ruling over the airport concession.[4]

Key assumptions: Overall, the baseline macroeconomic assumptions are a little weaker in the next few years than in the previous DSA but are stronger in the medium term when the growth impact of the airport and other infrastructure development comes through.[5]

- *Real GDP growth*. Growth remains subdued in 2016 and 2017 and averages 4.4 percent over 2021–35 which is a slower pace than the average of the past ten years (around 6.5 percent) that included the initial rapid development of the tourism sector. Staff factor in a ½ percent of GDP per year increase in medium-term potential growth from the tourism development—this assessment is consistent with public investment efficiency being in line with the average of less developed economies, more positive growth outcomes could be achieved with higher public investment efficiency

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

[5] The baseline scenario in the DSA assumes that the stabilized exchange rate regime holds although reserve cover dwindles by 2034.

- *Inflation*. GDP deflator inflation remains low over the next two years reflecting lower oil prices and generally weaker global commodity prices partly offset by higher import duties and then rises to around 3.2 percent—close to its long run average.

- *The current account*. The non interest current account deficit balloons from 2016 reflecting higher imports for infrastructure projects. The deficit narrows once the large projects are completed but the deficit is higher than before at 7.5 percent of GDP on average over 2020–2035. Over the longer term financing pressure from maturing infrastructure loan result in reserves levels dwindling to be negligible in terms of import cover by the end of the forecast.

Text Table 1. Change in Macro Assumptions

	Average			
	(2014 - 2020)		(2021 - 2034)	
	Previous	**Current**	**Previous**	**Current**
GDP Deflator	3.0	2.3	3.5	3.2
Non interest current account deficit	4.3	9.7	4.1	7.5
Primary deficit	3.6	9.7	2.4	4.7
Real GDP growth (in percent)	4.6	4.3	4.5	4.4
Growth of exports of G&S (in percent)	8.5	5.4	7.9	7.5
Growth of imports of G&S (in percent)	8.1	6.1	8.2	7.4

- *The fiscal deficit*. The primary deficit (under the baseline), widens substantially from 2015 to 2016 due to capital projects and social welfare spending and once capital projects are completed the primary deficit remains well above that which would stabilize debt.

- *Financing*. In the recent past, the bulk of the deficit financing has been met from domestic sources, in particular through the domestic banking system and the pension fund. Interest rates had risen sharply in the primary market for T-bills in 2012 and 2013. But, from mid-2014 the government replaced the auction system with a 'tap system' (of administered interest rates) and has successively lowered the rate recently halving them to a range of 3.5–4.6 percent across maturities. This temporarily stabilized interest cost on domestic debt. So far demand for T-bills has been sustained by the banking sector. However, as debt rises, lower yields may not be sustained and with global interest rates expected to rise, staff assume that Maldives yields are high and rise over the forecast horizon. External infrastructure loans are assumed to be on semi-concessional terms.

- *New debt*. The new infrastructure projects are included in the 2016 Budget. The DSA assumes external disbursements totaling US$ 1.1 billion which includes the infrastructure projects (see Box 2) and undisbursed loans signed in 2015. The loans contracted in 2015 are semi-concessional loans (a positive grant element below 35 percent) and may affect future financing for the Maldives for two reasons. First, Maldives receives grant funding from IDA and is therefore subject to a continuous criterion under IDA's non-concessional borrowing policy

(NCBP).[6] In the absence of an IMF program and its associated borrowing limits, IDA still has its NCBP in place and therefore a breach will entail requesting a waiver to the policy. Waivers are considered based on country- and loan-specific criteria. Second, financing from other multilateral institutions including IDA and the ADB are affected by the outcome of the debt sustainability assessment given that these institutions use the results of the DSA to determine eligibility requirements for future financing.[7]

- *Sovereign guarantees to the private sector.* Since the guarantee scheme has not yet been approved, staff has not included any amounts for potential guarantees under the scheme in the DSA.

- *Non debt creating financial flows.* With limited lending opportunities, Maldives banks have paid down debt and increased assets abroad. These outflows are expected to continue.

Box 2. Scaling up and new borrowing

The planned infrastructure scale up in the 2016 Budget is unprecedented for Maldives. This includes Ibrahim Nasir International Airport development (cost estimate: US$828 million), a road bridge connecting the airport to the capital (cost estimate: US$189 million), continued investment in new housing developments along with the relocation and expansion of the port. Of these mega projects, the authorities have signed an agreement for US$ 373 million with China's Exim Bank (runway and fuel farm) and have also received commitments for some of the other costs related to the airport development. An implementation agreement with China's Exim Bank for the road bridge project has also been signed. In addition, the authorities have signed three other external loans in 2015 – US$ 80 million with Saudi Funds (housing development), US$ 6 million with Abu Dhabi (waste management) and US$ 50 million with OPEC Fund (water and sewerage project). While not fully concessional, with low interest rates (2 to 5 percent) and longer maturities (close to 20 years or more) these loans are semi-concessional with grant elements close to 30 percent. It is expected that the authorities will continue to negotiate terms similar to these and therefore this has been assumed for future disbursements included in the DSA. The total external disbursements are estimated to be US$ 1.1 billion (including the undisbursed loans signed in 2015) and are front loaded until 2019 to meet the timeline set for the completion of the mega projects pipeline.

STAFF'S ILLUSTRATIVE SCENARIO

To stabilize debt and place the fiscal position on a sounder footing staff are proposing the following measures.

- **Capital projects.** Greater prioritization saving around 2.5 pps of GDP compared to the baseline

- **Revenue raising**. Staff suggested charging user fees for key infrastructure including a bridge toll (commercial and leisure) and an increase in airport departure tax. Broadening the base of business profits tax and increasing rates on some taxes should be feasible as the business profits tax rate is

[6] For more information, please visit http://www.worldbank.org/ida/non-concessional-borrowing.html

[7] Maldives is a group A (ADF only) country in the ADB and an IDA eligible country under the small island exception. The proportion of grant financing for both these institutions is contingent on the country's risk of debt distress. This is determined by the outcome of a forward-looking Debt Sustainability Analysis. For more information, please visit http://www.adb.org/site/adf/faqs and http://www.worldbank.org/ida/financing.html.

low compared to the Asia Pacific region and the tourism goods and services tax is not out of line with other competitor economies.

- **Expenditure saving.** The authorities focus on the public sector wage bill is welcome. Staff suggested that the public service review should be restarted taking time to plan and implement it, while ensuring key functions are preserved. A baseline costs review of healthcare would help identify emerging pressures and scope for savings. Plans to better target social welfare and food subsidies through means testing and to eliminate the electricity subsidy (the latter currently delayed) are welcome. SOE transparency and oversight should be strengthened. Savings in other areas could also be made, including through greater use of renewable energy.
- **Public financial management.** These measures would be accompanied by strengthened public financial management, development of a debt strategy and public investment framework.
- **Growth dividend.** In Staff's view improving the efficiency of public investment and stabilizing debt would help to generate longer term growth dividends. In the medium term growth could be around 0.5 pps per year higher than in the baseline, falling back to 0.3pps by 2030–2034.

EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

External debt sustainability. The main cause for concern in the Maldives is the PV of debt-to-GDP ratio. Under the baseline scenario, the nominal PPG external debt rises to 56.9 percent of GDP in 2035 while the PV of PPG external debt to GDP is just under the threshold around 2020 necessitating further analysis under the probability approach. Under the probability approach (Figure 3), the threshold for the PV of external PPG debt-to-GDP ratio is breached in the baseline mainly driven by capital spending.[8] Furthermore, the external debt path is not only vulnerable to all the standard shocks in the DSA but especially to a one time depreciation shock and an exports shock. Taking this into consideration, staff is of the view that the debt distress in Maldives has deteriorated from a moderate to a high risk of debt distress.[9]

Public debt sustainability. Public debt ratios continue to rise. Under the baseline, the PV of public debt rises from 66.6 percent of GDP in 2014 to 161.1 percent of GDP in 2035. Domestic debt is also highly vulnerable to shocks to the primary balance, to growth and data in line with historical averages.

ASSESSMENT

Without fiscal adjustment and careful management of the infrastructure investment program, current policies would lead to large domestic and external financing requirements and adjustment would be needed. Such high financing needs are unlikely to be met on a sustained basis and problems could magnify as repayments of infrastructure loans become due in the medium term.

[8] The probability approach methodology focuses on the evolution of the probability of debt distress over time, rather than on the evolution of debt burden indicators. This approach provides complementary, country specific information to help decide cases where a country's risk rating is on the border between two categories – in this case, a ±5 percent range is nearly breached for the present value of debt to GDP ratio in the baseline scenario.

[9] Note given a strong revenue performance (with revenue well above developing country levels) and a large tourism sector (gross exports of goods and services over 100 percent of GDP), the thresholds for revenues and exports are not breached.

This may lead to financing problems, the need for abrupt fiscal consolidation and pressure on the exchange rate. The DSA therefore points to the need for additional fiscal consolidation measures in the near term together with greater prioritization of overall capital expenditures and improved public financial management.

Fiscal measures are needed to stabilize the debt ratio and place it on a downward path and this should entail tighter expenditure control and public financial management reforms.

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

CONCLUSION

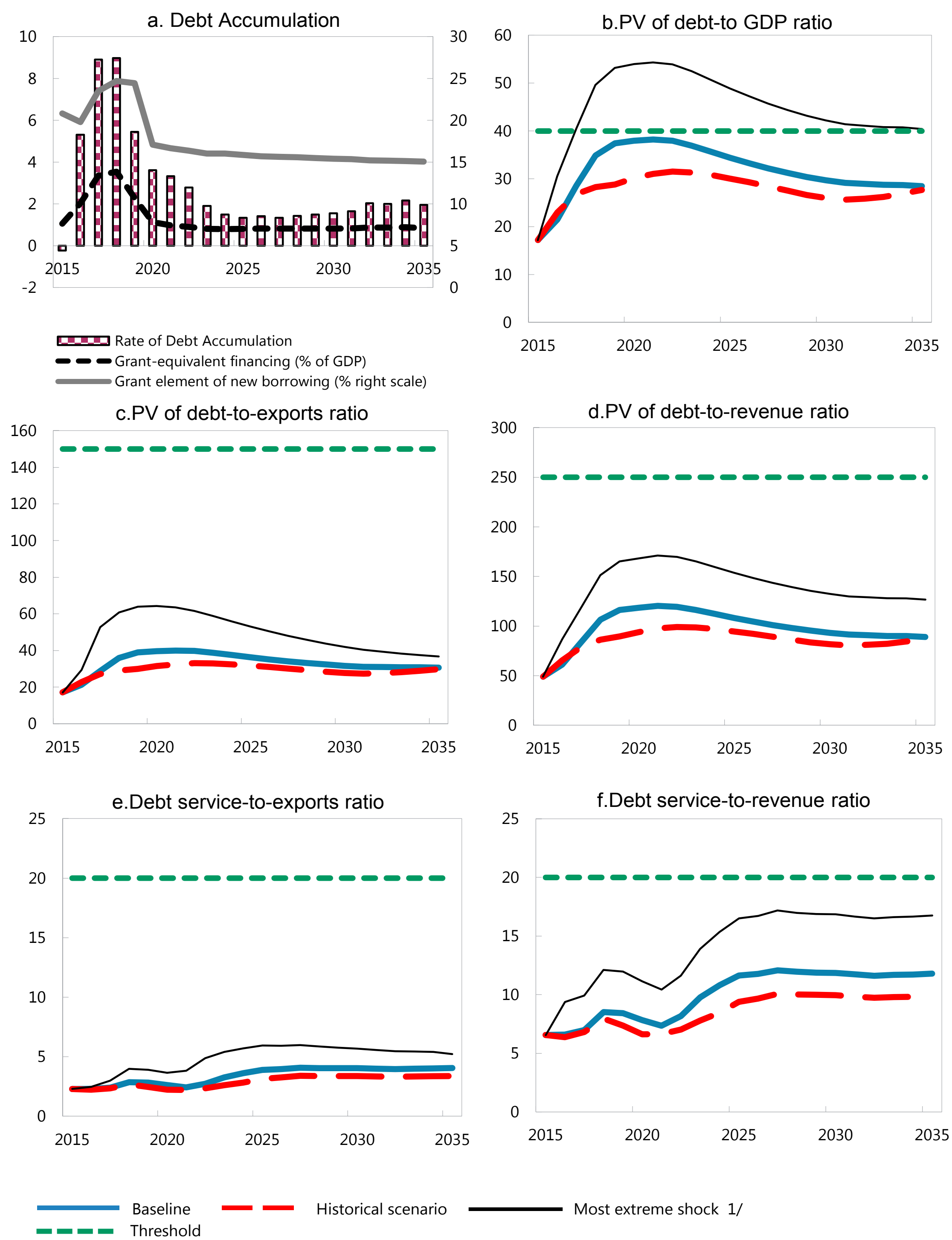
Risk rating. Maldives' debt distress has deteriorated and it currently faces a high risk of external debt distress. The assessment of the overall risk of debt distress is also high risk and is reinforced by significant vulnerabilities related to domestic debt.

To lower the risks staff, suggest policy measures described in the staff's illustrative scenario above. A more careful scale up of overall capital expenditure together with offsetting fiscal measures, can help boost the growth impact of infrastructure spending (this is also supported by an alternative model looking at public investment debt and growth dynamics), and would help limit the rise in both public and external debt.

Authorities' Views

The authorities are of the view that the substantial increase in external borrowing is needed to finance infrastructure investment. This is required to ensure that Maldives remains an attractive tourism destination and to address climate change challenges. The authorities are seeking long term loans on the best terms available. They are mindful of the risks and are seeking to contain current expenditures, while undertaking the scale up. Over the longer run, the authorities believe that the infrastructure investment will add substantially more to growth than suggested by staff and that the payoffs should be sufficient to enable debt reduction. They concur with staff that the Paris COP21 agreement opens up new opportunities to finance climate change adaptation on concessional terms and they plan a strategic approach to such investments going forward. They noted the change in the external risk rating from moderate to high risk of debt distress and disagreed with the change, given the conservative assumption of growth used by the IMF. They expect that the infrastructure scale up would enable a shift in the production frontier to a higher growth path.

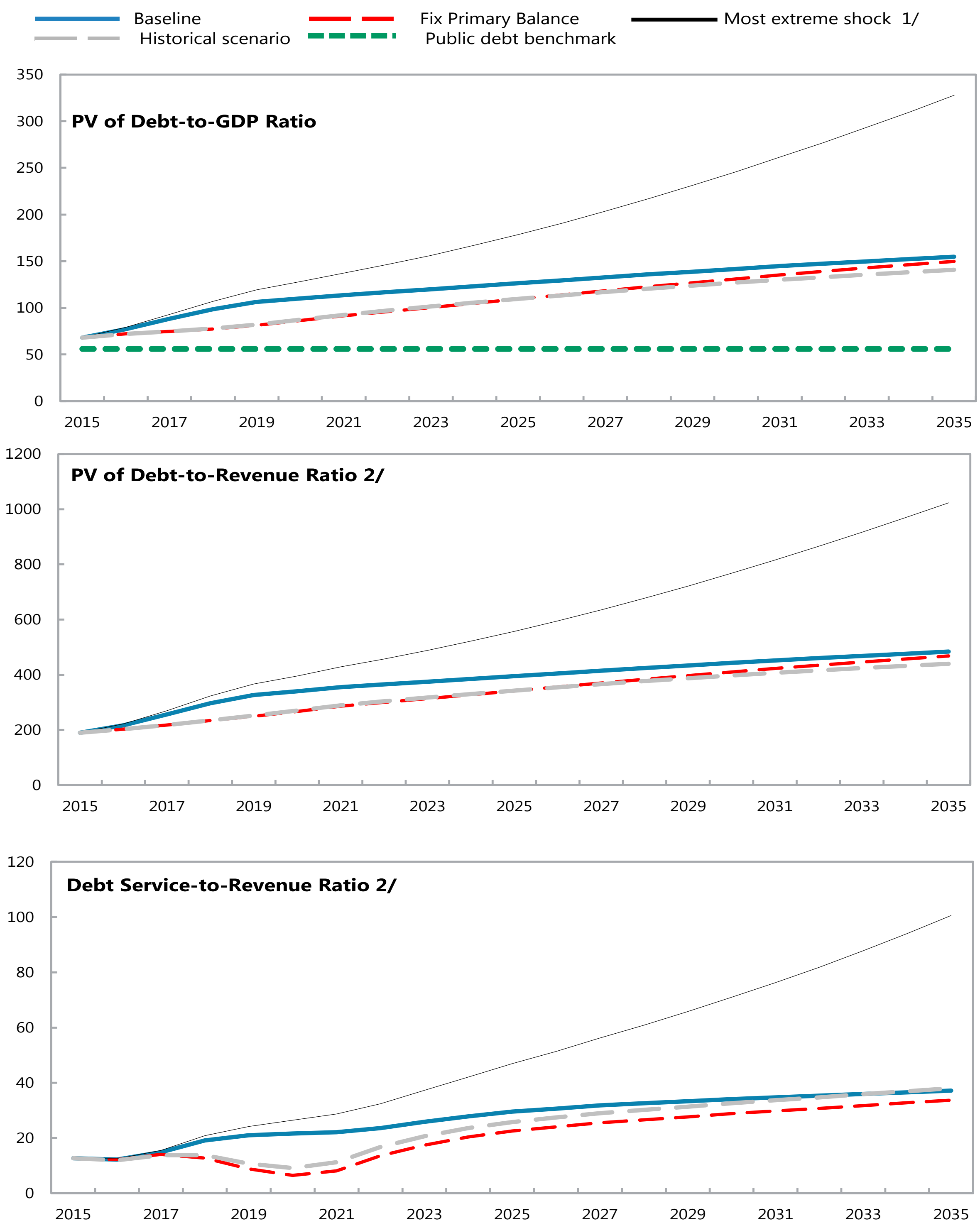
Figure 1. Maldives Baseline Scenario: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2015–2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Maldives Baseline Scenario: Indicators of Public Debt Under Alternative Scenarios, 2015–2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.

2/ Revenues are defined inclusive of grants.

Table 1. Maldives: External Debt Sustainability Framework, Baseline Scenario, 2010–35 1/

(In percent of GDP, unless otherwise indicated)

	Actual					Historical 6/	Standard 6/	Projections									
						Average	Deviation							2015-2020			2021-2035
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	Average	2025	2035	Average
External debt (nominal) 1/	**46.1**	**43.5**	**35.2**	**31.8**	**33.4**			**31.3**	**35.7**	**45.4**	**55.0**	**59.3**	**60.2**		**58.1**	**56.9**	
of which: public and publicly guaranteed (PPG)	27.8	30.4	29.4	27.3	22.9			22.1	27.4	36.8	45.4	48.6	48.6		41.9	34.8	
Change in external debt	-3.2	-2.6	-8.2	-3.5	1.6			-2.0	4.4	9.7	9.5	4.3	0.9		-0.9	0.2	
Identified net debt-creating flows	-4.9	-1.3	-5.0	-12.1	-10.9			-3.2	-3.3	2.5	4.6	1.0	-2.2		-1.4	-1.9	
Non-interest current account deficit	**6.6**	**15.6**	**6.5**	**3.6**	**3.2**	**10.3**	**8.6**	**6.8**	**6.7**	**13.5**	**15.8**	**12.5**	**9.1**		**7.9**	**5.9**	7.4
Deficit in balance of goods and services	-13.8	-6.8	-14.0	-19.3	-18.6			-14.8	-15.9	-8.8	-6.2	-9.9	-13.6		-14.2	-14.6	
Exports	86.6	105.8	99.2	105.0	108.7			100.6	100.9	99.1	97.3	96.1	95.7		94.8	92.9	
Imports	72.8	99.0	85.3	85.8	90.1			85.8	85.0	90.3	91.2	86.3	82.1		80.6	78.3	
Net current transfers (negative = inflow)	8.6	10.4	10.3	10.3	10.6	9.8	0.9	11.4	11.8	11.8	11.9	11.9	11.9		12.0	12.0	12.0
of which: official	-0.5	-2.0	-0.9	-0.3	-1.3			-1.0	-0.6	-0.4	-0.3	-0.3	-0.3		-0.2	-0.1	
Other current account flows (negative = net inflow)	11.8	11.9	10.2	12.6	11.3			10.2	10.9	10.4	10.1	10.4	10.8		10.1	8.5	
Net FDI (negative = inflow)	**-9.3**	**-18.2**	**-9.1**	**-12.9**	**-12.1**	**-11.1**	**3.7**	**-10.6**	**-10.0**	**-10.9**	**-10.8**	**-10.7**	**-10.5**		**-9.0**	**-7.8**	-8.5
Endogenous debt dynamics 2/	**-2.1**	**1.4**	**-2.4**	**-2.8**	**-2.0**			**0.6**	**-0.1**	**-0.1**	**-0.5**	**-0.7**	**-0.9**		**-0.3**	**0.0**	
Contribution from nominal interest rate	1.6	1.3	0.9	0.6	0.8			1.2	1.0	1.2	1.5	1.6	1.8		2.0	2.3	
Contribution from real GDP growth	-3.3	-4.0	-1.0	-1.5	-1.9			-0.6	-1.1	-1.3	-1.9	-2.4	-2.6		-2.4	-2.3	
Contribution from price and exchange rate changes	-0.4	4.1	-2.4	-1.9	-0.9			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**1.7**	**-1.4**	**-3.2**	**8.7**	**12.5**			**1.2**	**7.7**	**7.3**	**5.0**	**3.3**	**3.2**		**0.5**	**2.1**	
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	...	...	28.3			26.4	29.8	37.2	44.5	48.1	49.6		50.6	50.6	
In percent of exports	...	...	...	...	26.0			26.2	29.5	37.5	45.7	50.0	51.9		53.4	54.5	
PV of PPG external debt	**...**	**...**	**...**	**...**	**17.8**			**17.2**	**21.5**	**28.5**	**34.9**	**37.4**	**38.0**		**34.4**	**28.4**	
In percent of exports	**...**	**...**	**...**	**...**	**16.4**			**17.1**	**21.3**	**28.8**	**35.8**	**38.9**	**39.7**		**36.3**	**30.6**	
In percent of government revenues	**...**	**...**	**...**	**...**	**56.2**			**49.0**	**61.1**	**83.8**	**106.4**	**116.2**	**118.3**		**108.1**	**89.1**	
Debt service-to-exports ratio (in percent)	**10.7**	**8.8**	**8.4**	**6.9**	**6.0**			**7.7**	**7.1**	**7.0**	**6.8**	**7.0**	**6.9**		**9.0**	**10.3**	
PPG debt service-to-exports ratio (in percent)	**2.9**	**3.1**	**3.0**	**2.7**	**2.5**			**2.3**	**2.3**	**2.4**	**2.9**	**2.8**	**2.6**		**3.9**	**4.1**	
PPG debt service-to-revenue ratio (in percent)	**11.8**	**12.6**	**11.8**	**10.4**	**8.6**			**6.6**	**6.6**	**7.0**	**8.5**	**8.4**	**7.8**		**11.6**	**11.8**	
Total gross financing need (Millions of U.S. dollars)	353.0	319.0	267.1	10.9	-17.8			236.0	226.7	422.7	537.6	449.7	358.9		749.6	1836.0	
Non-interest current account deficit that stabilizes debt ratio	9.8	18.2	14.7	7.1	1.6			8.9	2.3	3.8	6.3	8.1	8.2		8.9	5.7	
Key macroeconomic assumptions																	
Real GDP growth (in percent)	7.2	8.7	2.5	4.7	6.5	5.3	5.7	1.9	3.5	3.9	4.6	4.7	4.8	3.9	4.4	4.5	4.4
GDP deflator in US dollar terms (change in percent)	0.9	-8.1	5.8	5.8	3.0	3.2	5.5	0.4	1.3	2.5	2.8	3.0	3.2	2.2	3.2	3.2	3.2
Effective interest rate (percent) 5/	3.4	2.9	2.3	2.0	2.9	2.7	0.5	3.6	3.3	3.5	3.4	3.2	3.2	3.4	3.7	4.4	4.0
Growth of exports of G&S (US dollar terms, in percent)	17.3	22.0	1.8	17.3	13.6	9.7	12.0	-5.4	5.2	4.6	5.5	6.4	7.6	4.0	7.4	7.6	7.5
Growth of imports of G&S (US dollar terms, in percent)	13.6	35.9	-6.6	11.5	15.2	9.7	21.4	-2.7	3.9	13.2	8.5	2.0	2.8	4.6	7.3	7.4	7.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	20.8	19.8	23.5	24.7	24.5	17.1	21.7	15.9	15.1	15.6
Government revenues (excluding grants, in percent of GDP)	21.5	25.6	25.3	27.4	31.8			35.1	35.1	34.0	32.8	32.2	32.1		31.8	31.9	31.8
Aid flows (in Millions of US dollars) 7/	69.9	87.6	52.0	-12.6	-51.5			25.1	21.8	20.7	20.1	21.0	21.9		23.6	29.9	
of which: Grants	12.1	47.5	23.9	7.6	10.7			24.1	14.0	13.2	11.8	11.8	11.8		11.8	11.8	
of which: Concessional loans	57.8	40.1	28.1	-20.2	-62.2			1.0	7.8	7.6	8.2	9.1	10.1		11.7	18.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...	...	...			1.1	2.0	3.4	3.5	2.3	1.1		0.8	0.8	0.8
Grant-equivalent financing (in percent of external financing) 8/	...	...	...	...	...			48.9	23.8	25.7	26.5	27.1	21.4		19.7	16.5	18.6
Memorandum items:																	
Nominal GDP (Millions of US dollars)	2323.4	2321.1	2517.4	2789.1	3059.9			3130.4	3282.4	3495.8	3756.7	4049.2	4376.8		6394.7	13357.4	
Nominal dollar GDP growth	8.1	-0.1	8.5	10.8	9.7			2.3	4.9	6.5	7.5	7.8	8.1	6.2	7.7	7.8	7.7
PV of PPG external debt (in Millions of US dollars)					545.7			538.7	704.9	997.3	1311.1	1515.8	1662.2		2198.3	3797.7	
(PVt-PVt-1)/GDPt-1 (in percent)								-0.2	5.3	8.9	9.0	5.4	3.6	5.3	1.3	2.0	1.9
Gross workers' remittances (Millions of US dollars)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of PPG external debt (in percent of GDP + remittances)			...	...	17.8			17.2	21.5	28.5	34.9	37.4	38.0		34.4	28.4	
PV of PPG external debt (in percent of exports + remittances)			...	...	16.4			17.1	21.3	28.8	35.8	38.9	39.7		36.3	30.6	
Debt service of PPG external debt (in percent of exports + remittances)			...	...	2.5			2.3	2.3	2.4	2.9	2.8	2.6		3.9	4.1	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/2014 Balance of Payments is a preliminary estimate and includes errors and omissions, change in assets and valuation effects and over the projection period banks pay down debt abroad/ increase asset position abroad

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

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

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

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

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

Table 2. Maldives: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35

(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to GDP ratio								
Baseline	17	21	29	35	37	38	**34**	28
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	17	23	27	28	29	30	**30**	28
A2. New public sector loans on less favorable terms in 2015-2035 2	17	23	33	42	46	47	**46**	47
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	17	22	31	38	41	41	**37**	31
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	17	27	45	51	53	53	**44**	30
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	17	22	31	38	41	41	**37**	31
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	17	23	32	38	41	41	**36**	29
B5. Combination of B1-B4 using one-half standard deviation shocks	17	22	33	39	42	42	**38**	30
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	17	31	41	50	53	54	**49**	40
PV of debt-to-exports ratio								
Baseline	17	21	29	36	39	40	**36**	31
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	17	23	27	29	30	31	**32**	30
A2. New public sector loans on less favorable terms in 2015-2035 2	17	23	33	43	48	49	**49**	50
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	17	21	29	36	39	40	**36**	31
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	17	29	53	61	64	64	**53**	37
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	17	21	29	36	39	40	**36**	31
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	17	23	32	39	42	43	**38**	31
B5. Combination of B1-B4 using one-half standard deviation shocks	17	22	32	39	42	43	**39**	32
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	17	21	29	36	39	40	**36**	31
PV of debt-to-revenue ratio								
Baseline	49	61	84	106	116	118	**108**	89
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	49	65	79	86	89	94	**94**	87
A2. New public sector loans on less favorable terms in 2015-2035 2	49	66	96	127	142	147	**146**	146
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	49	64	91	115	126	128	**117**	97
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	49	78	133	156	165	166	**137**	93
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	49	63	91	116	126	129	**118**	97
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	49	65	94	116	126	128	**114**	90
B5. Combination of B1-B4 using one-half standard deviation shocks	49	64	96	120	130	132	**119**	95
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	49	87	119	151	165	168	**154**	127

Table 2. Maldives: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35 (continued)

(In percent)

Debt service-to-exports ratio								
Baseline	2	2	2	3	3	3	**4**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	2	2	2	3	2	2	**3**	3
A2. New public sector loans on less favorable terms in 2015-2035 2	2	2	2	3	3	3	**5**	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	2	2	2	3	3	3	**4**	4
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	2	2	3	4	4	4	**6**	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	2	2	2	3	3	3	**4**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	2	2	2	3	3	3	**4**	4
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	2	3	3	3	**4**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	2	2	2	3	3	3	**4**	4
Debt service-to-revenue ratio								
Baseline	7	7	7	9	8	8	**12**	12
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	7	6	7	8	7	7	**9**	10
A2. New public sector loans on less favorable terms in 2015-2035 2	7	7	7	8	9	10	**15**	19
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	7	7	8	9	9	8	**13**	13
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	7	7	8	10	10	9	**15**	13
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	7	7	8	9	9	9	**13**	13
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	7	7	7	9	9	8	**12**	12
B5. Combination of B1-B4 using one-half standard deviation shocks	7	7	7	9	9	9	**13**	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	7	9	10	12	12	11	**17**	17
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	17	17	17	17	17	17	**17**	17

Sources: Country authorities; and staff estimates and projections.

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

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. Maldives: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012–35

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate				Projections					
	2012	2013	2014	Average 5/	Standard Deviation 5/	2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	63.9	64.8	66.6			73.1	83.1	96.5	109.0	117.5	120.8		133.9	161.1	
of which: foreign-currency denominated	30.7	27.9	22.9			22.1	27.4	36.8	45.4	48.6	48.6		41.9	34.8	
Change in public sector debt	2.2	0.9	1.8			6.5	10.0	13.4	12.5	8.6	3.3		2.7	2.4	
Identified debt-creating flows	2.9	1.2	3.3			6.9	9.9	13.1	12.2	8.0	2.1		2.3	2.3	
Primary deficit	4.8	4.9	6.3	7.0	4.5	5.5	10.8	14.7	14.4	10.7	5.3	10.2	4.8	4.6	4.7
Revenue and grants	26.2	27.7	32.1			35.9	35.6	34.4	33.1	32.5	32.4		32.0	32.0	
of which: grants	0.9	0.3	0.4			0.8	0.4	0.4	0.3	0.3	0.3		0.2	0.1	
Primary (noninterest) expenditure	31.0	32.6	38.4			41.4	46.4	49.1	47.5	43.2	37.6		36.8	36.6	
Automatic debt dynamics	-1.9	-3.7	-2.9			1.3	-0.9	-1.6	-2.3	-2.7	-3.2		-2.5	-2.3	
Contribution from interest rate/growth differential	-0.6	-2.5	-2.5			1.1	-1.0	-1.5	-2.0	-2.3	-2.7		-2.0	-1.9	
of which: contribution from average real interest rate	0.9	0.3	1.4			2.3	1.5	1.6	2.2	2.6	2.7		3.5	4.9	
of which: contribution from real GDP growth	-1.5	-2.9	-3.9			-1.2	-2.5	-3.1	-4.2	-4.8	-5.4		-5.5	-6.8	
Contribution from real exchange rate depreciation	-1.2	-1.2	-0.4			0.3	0.1	-0.1	-0.3	-0.4	-0.5		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-0.7	-0.3	-1.6			-0.4	0.1	0.3	0.3	0.6	1.2		0.4	0.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	61.5			68.1	77.1	88.2	98.5	106.4	110.2		126.4	154.8	
of which: foreign-currency denominated	...	...	17.8			17.2	21.5	28.5	34.9	37.4	38.0		34.4	28.4	
of which: external	...	...	17.8			17.2	21.5	28.5	34.9	37.4	38.0		34.4	28.4	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	39.9	41.7	45.9			52.9	63.8	72.1	76.3	76.5	76.0		95.5	131.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	191.6			189.9	217.0	256.4	297.5	327.2	340.6		395.0	483.8	
PV of public sector debt-to-revenue ratio (in percent)	...	...	193.8			194.1	219.6	259.2	300.4	330.2	343.5		397.3	485.1	
of which: external 3/	...	...	56.2			49.0	61.1	83.8	106.4	116.2	118.3		108.1	89.1	
Debt service-to-revenue and grants ratio (in percent) 4/	20.8	18.2	16.0			12.7	12.2	14.9	19.1	21.0	21.6		29.5	37.2	
Debt service-to-revenue ratio (in percent) 4/	21.6	18.4	16.1			12.9	12.4	15.0	19.3	21.2	21.8		29.7	37.3	
Primary deficit that stabilizes the debt-to-GDP ratio	2.6	4.1	4.5			-1.0	0.8	1.3	1.9	2.1	2.0		2.1	2.2	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	2.5	4.7	6.5	5.9	8.2	1.9	3.5	3.9	4.6	4.7	4.8	3.9	4.4	4.5	4.4
Average nominal interest rate on forex debt (in percent)	1.4	1.2	1.6	2.0	0.8	2.7	2.2	2.7	2.7	2.5	2.5	2.6	2.8	3.3	2.9
Average nominal interest rate on domestic debt (in percent)	9.1	7.3	7.1	6.1	2.3	5.2	4.2	5.2	6.3	7.0	7.0	5.8	7.1	7.1	7.1
Average real interest rate (in percent)	1.4	0.5	2.4	0.2	1.9	3.6	2.1	2.0	2.4	2.5	2.4	2.5	2.8	3.2	2.9
Average real interest rate on foreign-currency debt (in percent)	-1.6	-1.4	-1.3	-2.0	0.8	-1.4	-1.7	-1.9	-1.9	-1.9	-1.9	-1.8	-1.9	-1.9	-1.9
Average real interest rate on domestic debt (in percent)	3.4	1.2	4.0	0.2	4.1	4.8	2.9	2.7	3.5	3.8	3.7	3.6	3.8	3.8	3.8
Exchange rate (LC per US dollar)	15.4	15.4	15.4	13.8	1.3	15.4	15.4	15.4	15.4	15.4	15.4	15.4	15.4	15.4	15.4
Nominal depreciation of local currency (percentage change in LC per dollar)	-0.3	0.2	0.0	2.0	6.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exchange rate (US dollar per LC)	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nominal appreciation (increase in US dollar value of local currency, in percer	0.3	-0.2	0.0	-1.7	5.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real exchange rate depreciation (in percent, + indicates depreciation)	-3.9	-4.1	-1.6	-1.7	5.3	1.1	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	5.5	6.0	3.0	6.0	3.3	0.4	1.3	2.5	2.8	3.0	3.2	2.2	3.2	3.2	3.2
Growth of real primary spending (deflated by GDP deflator, in percent)	-1.4	10.1	25.2	3.5	8.3	10.1	15.9	10.0	1.2	-4.8	-8.7	3.9	4.2	4.5	4.2
Grant element of new external borrowing (in percent)	...	...	...	...	...	20.8	19.8	23.5	24.7	24.5	17.1	21.7	15.9	15.1	...

Sources: Country authorities; and staff estimates and projections.

1/ Public debt is defined as the debt of the non-financial public sector comprising central government, including loans on-lent to State Owned Enterprises. It does not include publicly guaranteed debt and domestic arrears. The Ministry of Finance and Treasury (MoFT) is currently undertaking a process to gather and record all data and information regarding government guarantees. Once the process is completed, guaranteed debt might be included in the analysis.

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 4. Maldives: Sensitivity Analysis for Key Indicators of Public Debt, Baseline Scenario, 2015–35

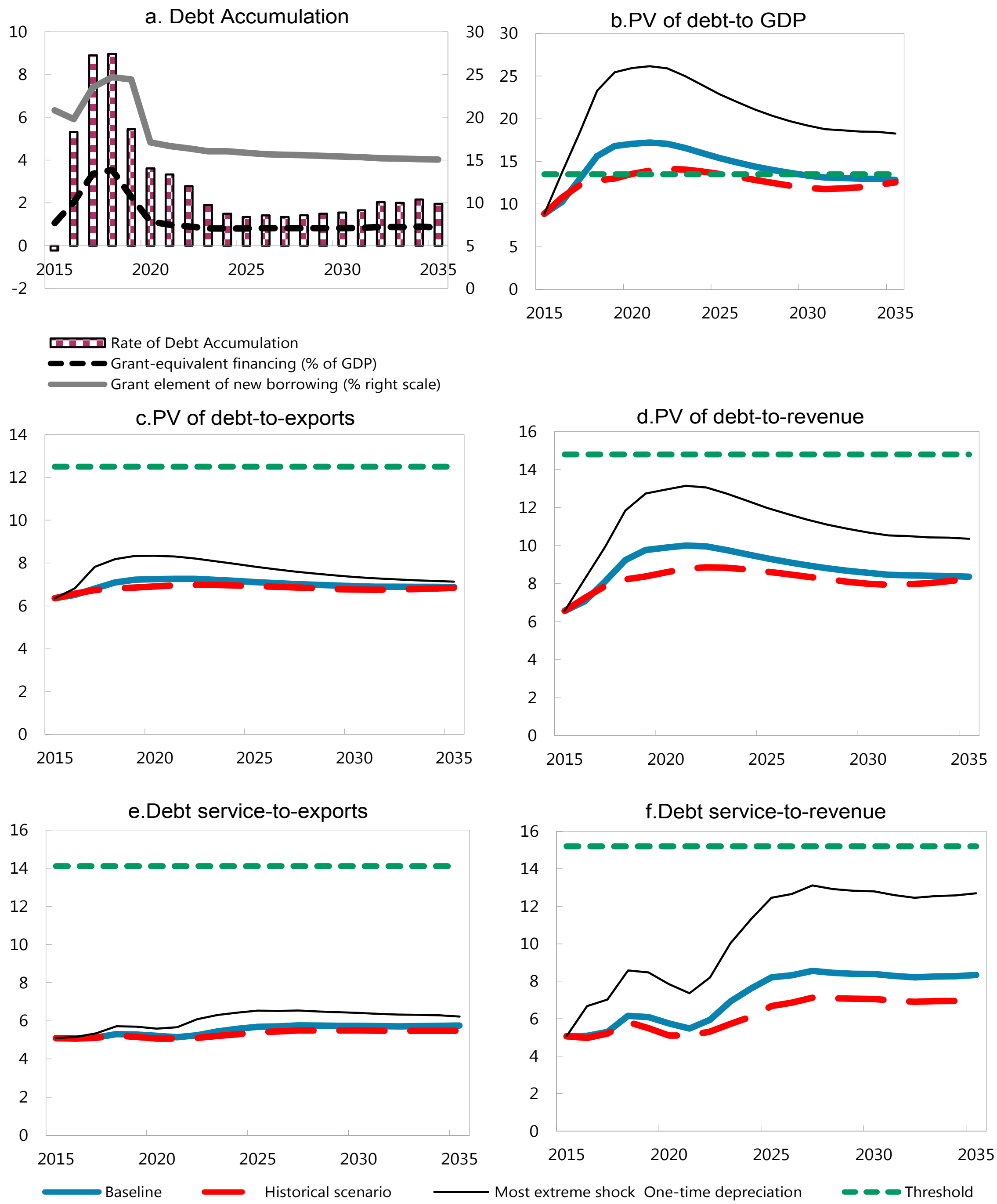
	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	68	77	88	98	106	110	126	155
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	68	72	75	78	82	87	110	141
A2. Primary balance is unchanged from 2015	68	72	75	77	81	86	109	150
A3. Permanently lower GDP growth 1/	68	79	93	107	119	128	179	328
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	68	84	106	121	133	141	174	229
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	68	78	86	96	104	108	125	153
B3. Combination of B1-B2 using one half standard deviation shocks	68	77	84	96	106	111	134	172
B4. One-time 30 percent real depreciation in 2016	68	84	94	103	110	114	132	163
B5. 10 percent of GDP increase in other debt-creating flows in 2016	68	86	97	107	115	118	133	159
PV of Debt-to-Revenue Ratio 2/								
Baseline	190	217	256	298	327	341	395	484
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	190	203	218	235	253	270	343	440
A2. Primary balance is unchanged from 2015	190	203	218	234	250	267	342	469
A3. Permanently lower GDP growth 1/	190	222	270	323	367	396	558	1024
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	190	235	306	364	409	434	542	715
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	190	219	249	290	320	334	389	480
B3. Combination of B1-B2 using one half standard deviation shocks	190	216	245	291	326	344	418	539
B4. One-time 30 percent real depreciation in 2016	190	236	272	310	339	353	412	508
B5. 10 percent of GDP increase in other debt-creating flows in 2016	190	243	283	324	353	365	416	499
Debt Service-to-Revenue Ratio 2/								
Baseline	13	12	15	19	21	22	30	37
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	13	12	14	14	11	9	26	38
A2. Primary balance is unchanged from 2015	13	12	14	13	9	6	23	34
A3. Permanently lower GDP growth 1/	13	12	15	21	24	26	47	101
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	13	13	17	24	29	32	47	67
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	13	12	15	19	18	21	29	36
B3. Combination of B1-B2 using one half standard deviation shocks	13	12	15	17	16	21	32	44
B4. One-time 30 percent real depreciation in 2016	13	14	18	23	26	27	38	51
B5. 10 percent of GDP increase in other debt-creating flows in 2016	13	12	16	28	25	26	32	40

Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

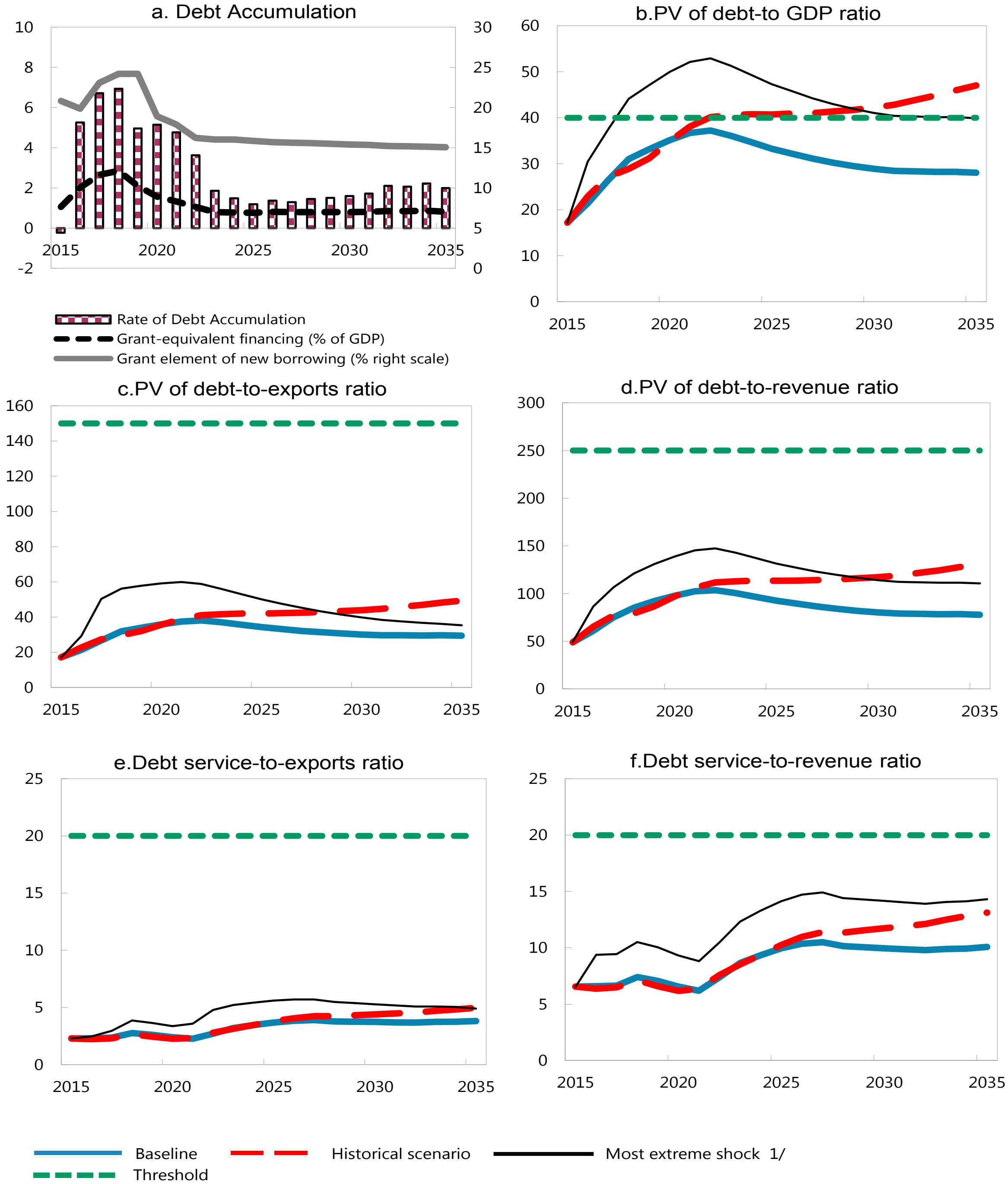
Figure 3. Probability of Debt Distress of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2015–2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

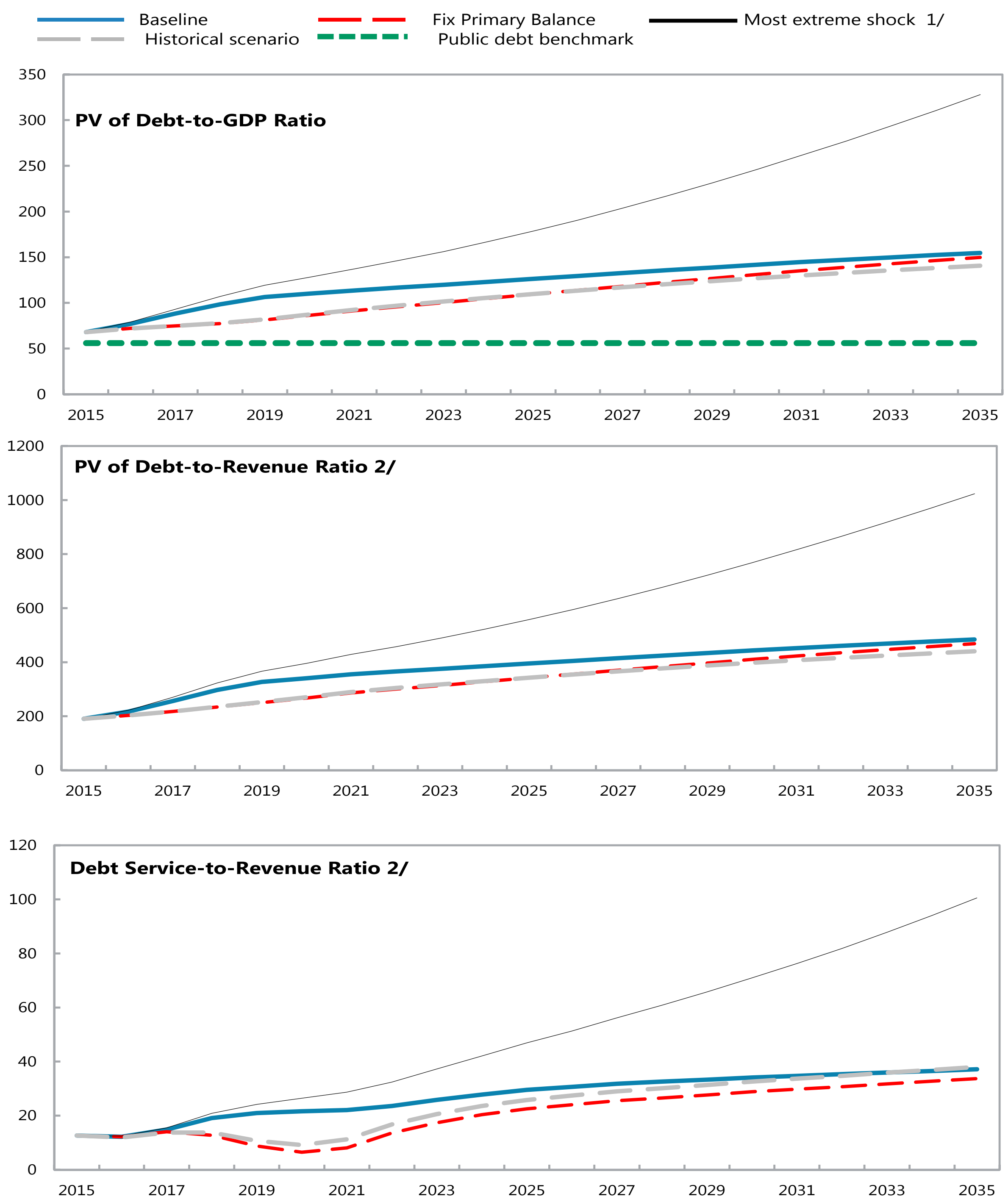
Figure 4. Staff's Illustrative Scenario: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2015–2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 5. Staff's Illustrative Scenario: Indicators of Public Debt Under Alternative Scenarios, 2015–2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.

2/ Revenues are defined inclusive of grants.

MALDIVES

May 10, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared by | Asia and Pacific Department

1. This supplement reports on information that has become available since the Staff Report was issued to the Executive Board on April 7. It does not alter staff's broad assessment of policy issues and recommendations contained in the report.

2. Published data for 2015 are slightly softer than staff's projections but latest monthly indicators continue to point to a pick up in activity this year.

- **GDP.** The preliminary estimate for GDP growth in 2015 is a little weaker than projected by staff at 1.5 percent compared to 1.9 percent. Tourism activity contracted a little more than expected; and other sectors were subdued apart from transport and construction. However, the latest monthly indicators are positive—tourism arrivals picked up by 4.3 percent in January-March 2016 compared to the same period last year, with higher arrivals from Europe (perhaps reflecting re-established airline routes) making up for a continued decline in arrivals from Asia.

- **Inflation.** Inflation has remained contained, rising by 1.4 percent year on year in March and continues to benefit from the pass through of lower oil prices, plus declining communications costs.

- **Current account and reserves.** The 2015 current account deficit widened to 8.8 percent of GDP compared to staff's projection of 8 percent of GDP. Against a backdrop of steady imports since the start of the year and some increase in tourism exports, gross and usable reserves rose to $685 million and $225 million respectively in early May (2.9 and 1 months of import cover). However, the parallel market premium has remained higher, hovering between 6 and 7 percent.

- **The fiscal position.** Based on the latest available information, staff assesses the 2015 fiscal position to be broadly in line with projections (overall deficit 8.4 percent of GDP)—a slightly weaker outturn for revenues is offset by modestly lower current spending. However, the estimates are still preliminary and data, especially on expenditures and grants will be verified further ahead of November's Budget.

3. **Climate change.** Maldives was one of the fifteen countries who were first to ratify the Paris Agreement on April 22.

Statement by Mr. Hazem Beblawi, Executive Director and Ms. Wafa Fahmi Abdelati, Senior Advisor to Executive Director
May 13, 2016

The Maldives economy has shown remarkable dynamism over the past two decades that has brought living standards to middle income levels. The economy has shown resilience following the 2004 tsunami and slowdown in global growth, but remains highly dependent on tourist receipts. To maintain robust growth, the authorities have identified critical infrastructure upgrades that will entail a spike in foreign financing but are expected to propel the country's growth potential. The authorities appreciate the constructive dialogue with staff on the potential implications of up-scaling infrastructure investment and, to some extent, agree with the assessment and recommendations.

Large external imbalances that were identified a decade ago—a current account deficit exceeding 35 percent of GDP—have significantly diminished reflecting the dynamic growth in tourism as well as the overhaul of external sector statistics with Fund Technical Assistance (TA). Tourism activity has outperformed its peers in recent years, except in 2015 when the rapid market expansion from China, Russia, and Ukraine slowed. As a small island economy, Maldives will continue to depend on imports, but strong tourism growth and foreign direct investment averaging over 10 percent of GDP have helped sustain reserves, limit pressure on the exchange rate peg, and contain external debt.

Like other small states, especially ones with a widely dispersed population, government expenditures in the Maldives are much higher than in countries at comparable income levels. Current expenditure reached 35 percent of GDP in recent years, following sharp increases in the wage bill, subsidies, and health care costs. Following the modernization of the tax authority and tax system since 2011, Maldives outperforms its neighbors in terms of tax collection and the efficiency or productivity of its taxes, as highlighted by staff.

The authorities' 2016 budget targets a narrowing of the fiscal deficit by 1¾ percent to 6.7 percent of GDP after accounting for a 240 percent increase in capital expenditure to nearly 20 percent of GDP in 2016 to be financed by higher tax and non tax revenues as well as grants. The sharp increase is meant to signal the intention to upscale infrastructure spending, but the pace of implementation will depend on the availability of revenue or financing on favorable terms. The authorities aim to delay some projects if tax collection disappoints or if the expected non tax revenue from resort leases or grants does not materialize. Setting aside the near term spike in spending on megaprojects, the authorities believe they will be able to contain the growth in the fiscal deficit to GDP in future years by containing the growth in the wage bill and in health costs, and by significantly boosting GDP growth. The authorities will continue to consider additional fiscal measures, including a bridge toll or a higher airport departure tax, broadening the base of the business profits tax; and expenditure savings through better targeting of subsidies, improved oversight of SOE finances, and potential for greater use of renewable energy.

Spending on the three megaprojects that aim to raise the economy's overall growth is estimated to amount to 30 percent of GDP over the next three years. The first of these projects is the expansion of the airport which is currently running at close to full capacity and whose upgrade is essential to sustain strong growth in tourism. The second project aims to support population resettlement to a large island near the capital and an airport that would reduce the cost of service delivery to the outer islands, help adapt to climate change, and improve job opportunities. The third project aims to relocate and expand port facilities to ease bottlenecks and improve resilience to climate change. These three high-priority projects will be mostly foreign-financed, at reasonable market cost, and subject to detailed feasibility studies. The initial viability assessments anticipate a sizeable growth impact and ample room for Maldives' tourist industry to grow.

The authorities understand staff's debt sustainability concerns but believe staff's assessment—that the investment upscale-up will only add ½ percent to GDP growth—does not adequately capture growth prospects. First, the authorities expect continued market expansion for tourism and expect the economy to benefit from the gradual recovery of growth in Europe and expansion of Asian markets, aided by the opening of many new hotels now under construction, and the extension of airport capacities. The low price elasticity of demand in the Maldives could allow strong tourism growth despite dollar appreciation, with a positive impact on construction, communications, and fishing. They question the rationale for the staff's downgrading of growth in the next few years compared to the previous DSA and anticipate growth to return to 6 percent levels. Second, staff's assumption that public investment efficiency would be in line with the average of less developed countries seems too conservative, especially when Maldives' tax system operates more efficiently than its peers (as highlighted in Appendix II and the SIP). Fund TA is supporting the further strengthening of public financial management, including of the capital budget to ensure maximum investment benefits. The authorities will be receiving IMF TA in June to conduct a public investment management assessment and to provide advice on prioritizing future investment projects within a well-defined budget envelope. Third, while the authorities understand that the DSA is based on current announced policies, Maldives has a strong track record of implementing staff recommendations, particularly in terms of tax reforms. Although a fully fleshed-out medium-term budget framework is not yet in place with time-bound measures and explicit contingency plans, they informed staff that they would consider broadening the tax base and that expenditures will be deferred if revenues disappoint or the fiscal position worsens.

In this regard, and since other island economies plan to upscale infrastructure investment to boost growth, the authorities have asked that the Fund review the DSA framework to take account of the special circumstances for small states that are necessarily reliant on large borrowing to harness the economic gains from the investment scale-up. The authorities believe that the growth dynamics should be better reflected in the DSA; they also believe that the assessment that Maldives' debt distress has not only deteriorated but it currently faces high risk of external debt distress is a byproduct of the overly conservative growth projection and is unduly alarming.

The authorities are committed to the stabilized exchange rate regime within the currency band and agree with staff that continued improvement in the fiscal position is the best way to support it. The exchange rate has stabilized since the 2011 devaluation; the capital account is very open; and the economy highly dollarized. Like other countries pegged to the dollar, the real exchange rate has appreciated by 30 percent since 2011. There is an active parallel market, which is structural in nature due to the size of dollar-denominated tourist transactions, with a relatively stable premium. The operation of the exchange system will remain under review, taking into account market developments. Regarding the Article VIII issues, the authorities believe the deviations from the official rate would remain until the fiscal deficit narrows and official reserves strengthen.

The MMA eased monetary policy by significantly reducing the marginal reserve requirement in 2015 which helped reduce borrowing cost, boost private credit, and lengthen maturities on sovereign bonds. Despite this easing, the overall expansion in monetary aggregates remained contained in 2015, reflecting lower net foreign assets and sluggish growth of private sector credit in the first half of the year. Credit picked up in the second half of the year after a long spell of stagnation. Enhancing financial inclusion is a national priority and the authorities would welcome Fund support, including providing information on successful experiences elsewhere. They are moving toward mobile banking services through the use of *Dhoni Banking Units* to reach the outer islands. An announced sovereign guarantee scheme for private sector loans in tourism aims to rejuvenate investment in some projects that were stalled during the global financial crisis. In designing the scheme, the authorities plan to limit its size and its contingent cost. More generally, the MMA continues to reinforce its supervisory capacity and activities, within a risk-based approach.

The authorities' national development plan for climate adaptation was shared with staff. It highlights the challenges and policies considered important to mitigate the impact of climate change. The authorities agree that there is scope for a more strategic approach that would set in context current infrastructure plans and include more systematic climate adaptation planning, including reporting on the budgetary impact. The authorities agree with staff's suggestion to quantify and present the climate adaptation policies in each budget. It is hoped that adding such detail would help access possible financing. They would welcome specific examples of how this has been done by others. They also see merit in a more coordinated planning of the different investment projects and monitoring of their implementation.

The development of special economic zones could help diversify economic activity in labor intensive sectors. The authorities take note of staff's concerns regarding excessive tax incentives and the potential for tax erosion or tax evasion, which could be mitigated by adequate reporting procedures. Safeguards will be considered when viable projects are under consideration.

The Maldives authorities welcome the opportunity to have an open and candid exchange of views with staff on their current challenges and policies. They appreciate the Fund's valuable TA and look forward to a continued fruitful engagement with the Fund. They also welcome the Fund's increased focus on issues of relevance to small states under the leadership of DMD Zhu.