Maldives

Despite slippage in tourist arrivals, growth strengthened in 2018 on higher construction and services underpinned by greater government expenditure. The current account deficit remained large, and inflation trended sharply lower as food subsidies resumed. With slower growth in tourism markets, the outlook is for growth to moderate and the current account deficit to stay large. A rapid buildup of government debt calls for careful management to keep the economy on a sustainable growth track.

Economic performance

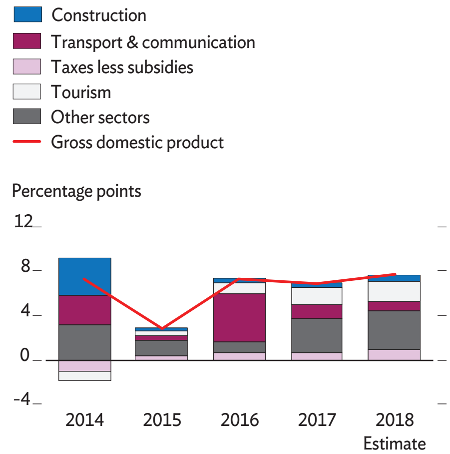
Expansion in tourism, construction, and supporting services boosted growth from 6.9% in 2017 to an estimated 7.6% in 2018, despite bouts of political unrest that ended in September with the election of a new president and government administration (Figure 3.18.1).

Growth in tourist arrivals slowed from 8.0% in 2017 to 6.8% in 2018, reaching almost 1.5 million. Fewer scheduled flights from Asian markets were offset by new flights and higher frequencies from Europe, bringing growth in arrivals from Europe to 12.4%, with that market accounting for 84.5% of the increase in arrivals and maintaining the largest market share at 48.9%. Arrivals from Asia, the second largest market, fell by 1.0%, to a 39.2% market share, as arrivals from the People's Republic of China declined by 7.6%, continuing a persistent trend as the market share of this single largest national market fell from 30.2% in 2014 to 19.1% in 2018. Meanwhile, the share of all other Asian countries increased only moderately over this period, from 17.0% to 20.1%.

Despite slower growth in tourist arrivals, travel receipts grew by 10.3% as the average stay lengthened to 6.4 days (Figure 3.18.2). Moreover, growth in collections of goods and services taxes on tourists accelerated to 11.4%, reflecting strong growth in income not only for the government but also for resorts.

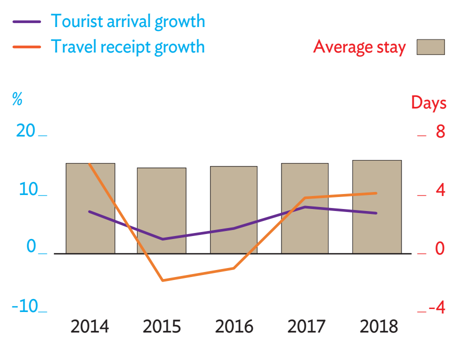
Construction growth remained robust in 2018, underpinned by credit growth and rising demand from infrastructure projects both public and private. The Public Sector Investment Program (PSIP) increased, with spending 20.3% higher than in 2017. Similarly, strong growth continued in bank loans to the private sector for construction and real estate, albeit

3.18.1 Supply-side contributions to growth



Source: Maldives Monetary Authority. 2019. Monthly Statistics. February. http://www.mma.gov.mv.

3.18.2 Tourism indicators



Source: Maldives Monetary Authority. 2019. Monthly Statistics. February. http://www.mma.gov.mv.

This chapter was written by Masato Nakane of the South Asia Department, ADB, Manila; and Abdulla Ali, Anthony Baluga, and Macrina Mallari, consultants, South Asia Department, ADB, Manila.

slowing from 34.1% in 2017 to 22.1% as the government offered competing loans with more favorable terms. Notably, growth in imports of construction materials markedly accelerated from 24.2% in 2017 to 37.7%.

Fish exports contracted by 10.2% on weak demand and lower global prices for skipjack and yellowfin tuna, the main export species. Growth remained strong in other sectors such as financial services, transportation and communications, and wholesale and retail trade.

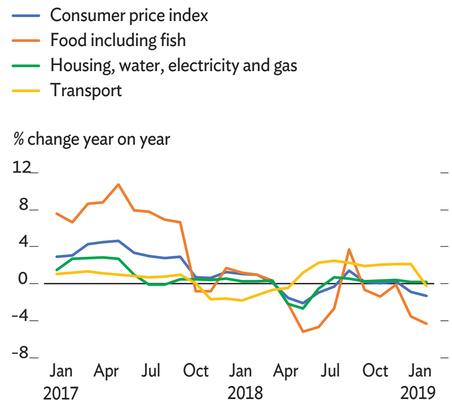
Average inflation fell from 2.8% to 0.1% deflation in 2018 (Figure 3.18.3). This reflected government efforts starting in the second quarter of 2017 to reduce food prices, which had ballooned earlier after subsidies on staples were removed. The measures included imposing price cuts and controls on major staples, cutting import duties on fuel to counter higher global prices, and setting lower prices for electricity and transportation. In April 2018, the government harmonized utility rates across the country to the lower urban rate and fully reversed its earlier policy to remove subsidies, which essentially restored 2016 food prices.

With inflationary pressure low, the Maldives Monetary Authority has maintained the accommodative policy in force since it lowered the indicative monetary policy rate in 2014 and again in 2015. In 2018, credit to the private sector increased by 11.2%, mainly through large loans for tourism, construction, and real estate.

Spending reprioritization helped to bring the budget deficit down to 3.0% of GDP in 2017 from 9.9% in 2016 (Figure 3.18.4). Fiscal policy for 2018 turned expansive with reacceleration of the PSIP, which raised capital expenditure by 16.0%, and with a new pay structure for civil servants that swelled recurrent spending by 14.8%. Total expenditure thus rose from 30.1% of GDP in 2017 to 31.3%. Revenue rose by 5.3% to equal 25.8% of GDP, though this reflected a weaker tax performance than in 2017 as collections of goods and services tax slumped and capital revenue declined. Accordingly, the estimated budget deficit climbed from 3.0% of GDP in 2017 to 5.5% in 2018, with financial data indicating a rather higher deficit in 2018 at 9.3% of GDP.

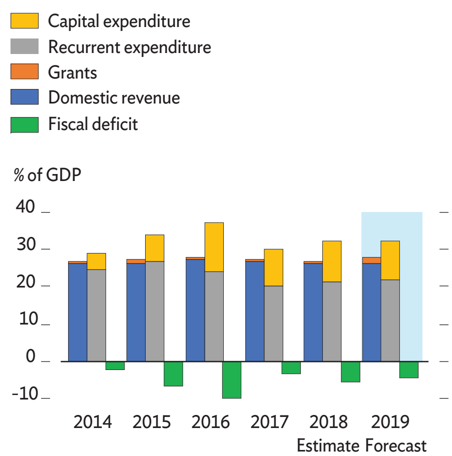
Government external debt, including Rf10.5 billion in state loan guarantees, nearly doubled to Rf30.8 billion in 2018, or the equivalent of 37.4% of GDP (Figure 3.18.5). State-owned enterprises' use of guarantees was the main factor pushing debt higher. Government external debt increased, by 21.9% of GDP, mainly from the private placement in May 2018 of a $100 million sovereign bond with a 5-year maturity and a 5.5% coupon, and a $130 million increase in commercial buyers credits. Government domestic debt, including a notional amount of domestic guaranteed debt, rose by 1.7% in 2018 to Rf28.7 billion but became a smaller percentage of GDP at 34.7%,

3.18.3 Inflation



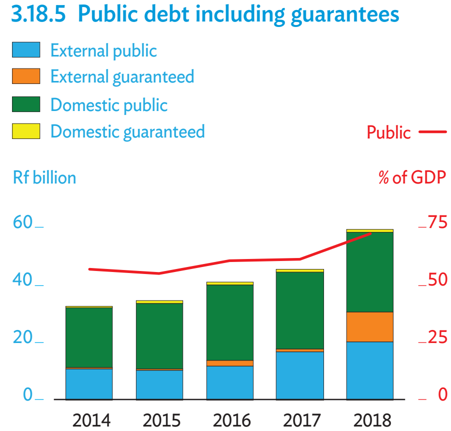
Source: Maldives Monetary Authority. 2019. Monthly Statistics. February. http://www.mma.gov.mv.

3.18.4 Fiscal indicators



Source: Maldives Monetary Authority. 2019. Monthly Statistics. February. http://www.mma.gov.mv.

3.18.5 Public debt including guarantees



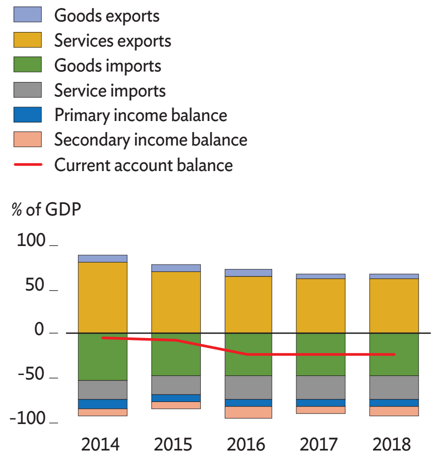
Source: Ministry of Finance, http://www.finance.gov.mv/.

down by 2.9 percentage points from 2017. At the end of 2018, total public debt including state guarantees was estimated at Rf59.5 billion, rising sharply to the equivalent of 72.1% of GDP from 61.0% a year earlier.

Provisional estimates indicate an 19.0% increase in the trade deficit and an almost 10% rise in foreign workers' outbound remittances, which pushed the 2018 current account deficit from 22.1% of GDP in 2017 to 23.7%, despite higher receipts from tourism. Imports rose by 25.6% on increased demand for construction goods, machinery, and electrical equipment, while exports rose by only 0.1%, with fuel reexports offsetting the drop in fish exports (Figure 3.18.6). The current account deficit was amply financed by large net financial inflows of direct and portfolio investment, including the $100 million government bond placement, and a marked increase in inflows of other investment liabilities facilitated by state guarantees.

A $100 million currency swap facility between the Maldives Monetary Authority and the Reserve Bank of India helped gross international reserves climb from $586.1 million in 2017 to $757.8 million. Usable reserves—gross international reserves less commercial banks' foreign currency deposits—amounted to $280.9 million, or cover for only about 1 month of imports (Figure 3.18.7).

3.18.6 Balance of payments



Source: Maldives Monetary Authority. 2019. Monthly Statistics. February. http://www.mma.gov.mv.

Economic prospects

Tourism and construction will continue to underpin growth in 2019 and 2020. The new government plans an aggressive approach to developing tourism that targets 2.5 million arrivals in 2023, or 1.0 million more than in 2018. An augmented promotional budget of $10 million for 2019 will fund intensified marketing campaigns to further enhance Maldives' exposure in foreign markets. To extend tourism beyond several selected atolls to the whole country, the government plans to develop tourist destinations on each atoll and to prioritize the development of guesthouses.

The outlook for construction is positive. The new government has pledged to continue the infrastructure projects initiated by the previous administration and to start new capital projects throughout the country. Although the PSIP allocation in the approved budget for 2019 is 2.0% lower than a year ago, the budget targets larger PSIP financing in succeeding years. Toward increasing private sector participation in infrastructure projects, the government plans to set up the Government Fund Management Corporation, which will extend funding to facilitate national development projects initiated by private firms.

Fiscal policy is slated to be slightly less expansionary in 2019 as the government aims to increase revenue by about 10% on higher tax collections and hold expenditure

3.18.1 Selected economic indicators (%)

	2019	2020
GDP growth	6.5	6.3
Inflation	1.0	1.5
Current account balance (share of GDP)	–21.8	–22.0

Source: ADB estimates.

5.8% above revenue in 2018. The share of capital spending in total expenditure is programmed to ease from 33.8% in 2018 to 32.2% with lower PSIP allocations, while the recurrent expenditure share will increase by 1.5 percentage points to 67.8%. The deficit is set to narrow to 4.4% of GDP in 2019, though it could reach 5.5% with higher capital investment and pressure to deliver on election pledges such as lower domestic airfares, lower electricity prices, and tuition-free higher education in Maldives to the first degree earned.

Fisheries will get much-needed policy attention intended to increase output and earnings by developing fish products with high value added for premium markets and expanding the capacity of Maldives Industrial Fisheries Company, a state-owned processer and exporter of fish products. The government intends to explore the potential of mariculture, aquaculture, and reef fishing.

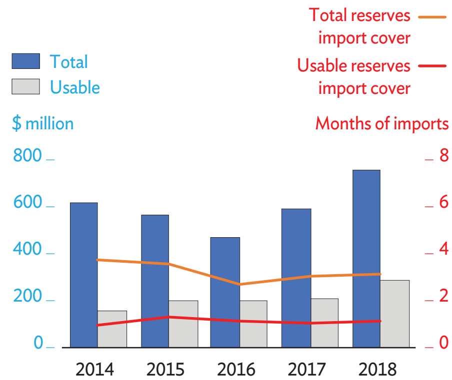
Despite good prospects domestically, signs of a global economic slowdown in the next 2 years, especially in Maldives' main tourist markets in Europe and the People's Republic of China, will weigh on tourism and the economy. GDP growth is thus projected to moderate to 6.5% in 2019 and further to 6.3% in 2020.

Forecasts of subdued global prices for oil and food should keep average inflation low. Also holding down price pressures will be government policies to contain the prices of basic commodities and several newly announced policies, notably removing duty on farming and fishing equipment, tuition free education, lower airfares and electricity prices, and harmonizing staple food prices across the country by April 2019. On balance, inflation is forecast at 1.0% in 2019, rising to 1.5% in 2020.

The high trade deficit will shrink slightly as large imports required to supply construction ease a bit on the projected marginal cut in the infrastructure program, and as investments to lift fishing capacity enable fish exports to recover. Sustained growth in tourism will maintain the service surplus. On balance, the current account deficit is expected to narrow to 21.8% of GDP in 2019 before widening again slightly to 22.0% in 2020 as capital expenditure picks up.

Threats to the outlook include the government's continuing unstable finances and the country's high ratio of debt to GDP and low foreign exchange reserves.

3.18.7 Gross international reserves



Source: Maldives Monetary Authority. 2019. Monthly Statistics. February. http://www.mma.gov.mv.

Policy challenge—managing the buildup of public debt

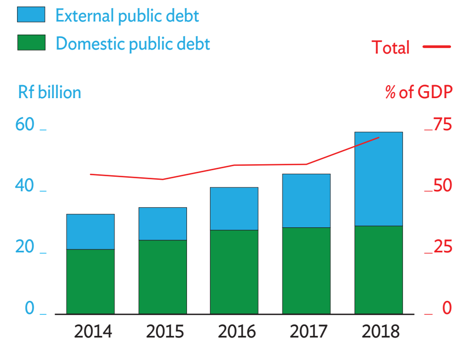
Maldives has increased its borrowing over the past few years to support a massive program to scale up infrastructure, and this has fueled a rapid buildup in public debt. Moreover, debt will mount further in the years ahead as large undisbursed balances in contracted debt materialize and from leaders' commitments to fund new projects. Moreover, the introduction of a sovereign guarantee scheme in 2017 has bound the government to additional debt obligations. Under the scheme, state-owned enterprises and private parties are both eligible for sovereign guarantees on projects that the government chooses to support, though so far only one private party has received a guarantee.

In 2018, public debt including government-guaranteed debt increased markedly by 30.4% to Rf59.5 billion, equal to 72.1% of GDP (Figure 3.18.8). According to an International Monetary Fund Article IV mission statement in 2019, Maldives is at high risk of debt distress. A challenge to the country is to balance infrastructure development with long-term debt sustainability in light of limited repayment capacity. To remain eligible for grants under the International Development Association, Maldives must comply with its Non-Concessional Borrowing Policy (NCBP). However, non-concessional loans to Maldives signed from 2015 to 2017 prompted the NCBP committee to find it in breach of this policy because a number of the loans did not meet the 35% minimum required for the grant component. This prompted a change starting in 2018 for allocations to Maldives to be half grant, half International Development Association credit.

The new government intends to borrow on more concessional terms in the future and has recently secured $1 billion in concessional financing from the Government of India, of which $50 million is grants, $150 million is concessional budgetary assistance, and $800 million is a line of credit with the Export-Import Bank of India. Moreover, the government plans to refinance high-cost debt with more concessional financing and is currently looking for options to do so. It has expressed its intention to renegotiate unfavorable loan and project agreements signed in recent years, and it is strengthening the process it uses to issue sovereign guarantees. To create a sufficient reserve buffer toward paying off external debt, the government will continue building up its Sovereign Development Fund. Meanwhile, it is requesting a waiver on the NCBP change in its funding allocation as it seeks to comply with the NCBP going forward.

Fiscal consolidation and proper debt management of government and government-guaranteed debt are critical to long-term fiscal and debt sustainability. This requires Maldives to prioritize capital expenditure in line with its National Development Strategy, improve public finance management, and reform state-owned enterprises. Further, the government needs to be mindful of the implications of it pledges and find ways to restrain the fiscal deficit in the near term. External pressures would be lower under more manageable fiscal deficits in the near term than are projected in the baseline scenario of the fiscal framework.

3.18.8 Public debt including guarantees



Source: Ministry of Finance, http://www.finance.gov.mv/.