Maldives

Growth picked up in 2013 owing to a strong recovery in tourism, mainly a further large influx of visitors from Asia. The country still has to grapple with hefty fiscal and external imbalances despite some improvement. With strengthening in global economic conditions, the outlook is for higher growth. Policy nevertheless needs to focus on durable reductions to the fiscal deficit.

Economic performance

After a deep downdraft in 2012, GDP growth picked up to an estimated 3.7% in 2013, buoyed by a strong rebound in tourism and associated sectors such as transport and communication (Figure 3.18.1). Tourism, the mainstay of this island economy, expanded by an estimated 5.5% and accounted for about 40% of growth. Transport performed robustly, expanding by 5.1%, as did communication at 7.6%. Together, the three sectors provided three-quarters of GDP growth. Industry, which is dominated by construction, has stalled in the past 2 years on weak investment, as hotel occupancy has not recovered to rates enjoyed before the financial crisis.

Tourist arrivals grew by 17.4%, nearly reaching the government’s target of 1.2 million, led by a strong influx of visitors from Asia, particularly the People’s Republic of China (PRC), which now provides nearly 30% of total arrivals (Figure 3.18.2). Asia has been a rapidly growing source of visitors, increasing its share to 45.0% of arrivals from barely a third only 4 years ago. Visitors from Europe, which made up just less than half of total arrivals, grew by a mere 1.8%, reflecting the prolonged economic slump in Europe.

Other sectors such as wholesale and retail trade, social services, and real estate posted good growth. Agriculture and fisheries also grew but contributed barely 2% to GDP growth. Agriculture remains constrained by the lack of cultivable land, while fisheries, the main employer in the atolls, struggles with depleted fish stocks. That said, after 6 years of steady decline, the catch rebounded substantially by 16.8%.

Inflation in Malé, the capital, eased markedly from averaging 10.9% in 2012 to 4.0% in 2013, the lowest since 2006 (Figure 3.18.3). Price increases for fish were much lower in 2013 as the catch improved. Prices for furnishings, household equipment, miscellaneous goods, and communications services fell sharply after double-digit growth in 2012. Controlled prices of certain food items, electricity, and fuel were largely unchanged.

The government estimates the budget deficit to have narrowed to 4.7% of GDP in 2013 on higher revenues and lower spending (Figure 3.18.4). Revenue grew by 15.8% on large increases in tax.
revenue from the goods and services tax on tourism and the business profit tax. Total expenditure is reported up by only 2.2%, with current expenditure advancing by 10.3% and capital expenditure falling by 26.1%, holding total spending to just 37.9% of GDP, well below the 40.8% average over the past 5 years. Although the estimated deficit is a marked improvement from 9.2% of GDP in 2012 and double-digit deficits in previous years, the actual deficit will likely be higher, as financial data suggested a cash deficit of 13.4% of GDP.

Because of chronic fiscal deficits, government domestic debt has soared to reach 47.8% of GDP in 2013 (Figure 3.18.5). Moreover, rising demand for financing is pushing interest rates significantly higher, as Treasury bill rates of all maturities were over 10% by December 2013. Meanwhile, bank lending rates to the country’s large nonfinancial public corporations have also sharply escalated (Figure 3.18.6). Worsening financing difficulties have driven the government to rely heavily on the Maldives Monetary Authority, with claims (mostly holdings of government securities) mounting to 18% of GDP in 2013. Moreover, the government appears to have accumulated payment arrears that are estimated to be nearly 4% of GDP in 2012. Government data show domestic and external public debt together estimated at 72% of GDP at the end of 2013; the International Monetary Fund, meanwhile, estimates a much higher total equal to 96% of GDP.

The current account deficit is estimated to have narrowed to 20.5% of GDP in 2013 from 23.0% a year earlier, on higher tourism receipts, improved exports (mainly re-exports of jet fuel), and sizably reduced net income outflows to pay interest (Figure 3.18.7). Though the deficit narrowed, it remains high, reflecting the country’s heavy reliance on imports (82.8% of GDP), particularly for food and petroleum products. Financial inflows, errors and omissions, and the overall balance remain unrecorded, reflecting weak data. Nevertheless, financing was sufficient to increase gross international reserves by $35.8 million to $340.3 million, which is still low, equivalent to only 1.7 months of projected imports of goods and services.

### Economic prospects

Tourism remains the major driver of the economy. Favorable global economic prospects—particularly in the euro area and the PRC—are expected to increase tourist arrivals and have a positive spillover into the rest of the economy. Following the election of the new President in November 2013, after nearly 2 years of political turmoil, greater stability is expected to prevail, bolstering a favorable outlook. The new government is expected to take steps to advance economic activity, including implementing plans to ensure that the Maldives maintains its high-end position in the world tourism market. Economic growth is projected to pick up moderately to 4.5% in 2014 and further to 5.4% in 2015.

The budget deficit is likely to expand. Although some measures were introduced to improve fundamentals, such as increasing the tourism goods and services tax from 8% to 12% effective July 2013 and broadening the base for the general goods and services tax,
actions fell short of identifying specific policies to effect needed cuts in expenditure. The budget for 2014 envisions a 22.6% expansion in spending and a reduction in the deficit to 3.2% of GDP. Budget revenues are seen increasing by 30%, or by a full 5% of GDP, which would be an extraordinary accomplishment.

In an expanding economy that must continue to rely heavily on imports, inflation is expected to increase slightly to 5.0% in 2014 but may ease a bit in 2015 as global prices subside. The current account deficit is projected to widen over the next 2 years to 22.1% of GDP, as increased tourism pushes imports and other payments higher.

Risks to the outlook center on large, simultaneous current account and fiscal deficits, high government debt and an exchange rate that is fixed in practice—circumstances that are increasingly difficult to sustain. Adverse shocks to income in tourist source countries or spikes in global oil prices continue as downside risks.

Policy challenge—reining in fiscal and external imbalances

The most pressing macroeconomic priority for the Maldives is containing its substantial fiscal and external imbalances. The government has very high expenditures, averaging 40.6% of GDP over the past 5 years and reflecting mainly expansion in current expenditure (Figure 3.18.8). Current expenditures comprise over two-thirds of total expenditure, with around one-third of it for salaries, wages, and allowances. Another 22% of expenditures fund subsidies, transfers, and social welfare. Heavy subsidies for food and fuel, two of the country’s main imports, contribute increasingly to the widening of current account and fiscal deficits alike.

High fiscal deficits and rising public debt increasingly challenge financing the budget. The government relies mainly on domestic sources, even at escalating interest rates, to finance its deficit. The principal sources of finance are bank loans and the issuance of Treasury bills to banks, state-owned enterprises, and the private sector. Most recently, the government has resorted to heavy debt monetization at the Maldives Monetary Authority and further accumulation of payment arrears.

Fiscal consolidation is therefore an urgent priority. Slimming a civil service that employs 11% of the population and costs about 14% of GDP is an important task, though past efforts have had little impact. A redesign of subsidy and transfer mechanisms to improve targeting and minimize leakage would help ease the burden. Better targeting of health insurance and pension systems in particular would advance government efforts to rein in excessive expenditure. A review of forecasting methods, particularly for allocating expenditures among ministries or agencies, would be key to taming large variations in these accounts. Looking more to the midterm, developing a stronger and more diverse economic base beyond tourism will be important to address the country’s heavy reliance on imports and persistently large current account deficits.