MALDIVES DEVELOPMENT UPDATE

APRIL 2022

NAVIGATING CHOPPY SEAS

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Preface

The Maldives Development Update (MDU) has two main goals. First, it takes the pulse of the Maldivian economy by providing key developments over the past 12 months. Placing these in a global context, and based on these recent developments, it analyzes the outlook over the medium term. Second, the MDU provides a more in-depth investigation of selected economic and policy issues. It has a wide audience including policymakers, policy analysts from think tanks or non-governmental organizations, and business and financial sector professionals interested in Maldives' economic development.

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The report was prepared based on published data available on or before March 31, 2022. Data sources included the World Bank, International Monetary Fund, Ministry of Finance, Maldives Monetary Authority, Maldives Bureau of Statistics, Ministry of Tourism, and press reports.

Previous report editions:

- April 2021: Maldives Development Update: A Digital Dawn
  https://openknowledge.worldbank.org/handle/10986/35832
- June 2020: Maldives Development Update: In Stormy Seas
  https://openknowledge.worldbank.org/handle/10986/33904

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Abbreviations

CPI	Consumer Price Index
FRA	Fiscal Responsibility Act
GDP	Gross Domestic Product
IDR	Issuer Default Rating
MDU	Maldives Development Update
MMA	Maldives Monetary Authority
MoF	Ministry of Finance
MPI	Multidimensional Poverty Index
MRR	Minimum Reserve Requirement
NDA	Net Domestic Assets
NFA	Net Foreign Assets
ODF	Overnight Deposit Facility
OLF	Overnight Lombard Facility
OMO	Open Market Operations
PPG	Public and Publicly Guaranteed
PSIP	Public Sector Investment Program
RBI	Reserve Bank of India
STO	State Trading Organization
y-o-y	year on year

Table of Contents

LIST OF FIGURES

LIST OF TABLES

LIST OF BOXES

Executive Summary

Driven by a rebound in tourism, Maldives' economy recovered sharply in 2021, and poverty is expected to return to pre-pandemic levels by 2023. In 2020, the outbreak of COVID-19 hit international travel and tourism severely and, thus, caused a 33.5 percent contraction in Maldives' GDP. However, following a successful nationwide government vaccination campaign, tourism has begun to recover strongly in the second half of 2021, with arrivals reaching 1.3 million in 2021 or about 78 percent of pre-pandemic levels. As a result, GDP growth is estimated to have bounced back by 31 percent in 2021. All sectors, except for construction which remains sluggish, showed a significant rebound, particularly in the second quarter of 2021 due to the low base effect. The poverty rate, which rose sharply to 11 percent in 2020 due to the COVID-19 pandemic, is estimated to have fallen to 4 percent in 2021.

With the economic recovery and higher international commodity prices, headline inflation rose slightly to 0.5 percent in 2021, following deflation in 2020. Despite some monetary tightening, inflationary pressures are likely to remain elevated amid rising global crude oil prices and higher public expenditures due to implementation of the minimum wage and public sector pay harmonization policies. The latter will increase incomes for those with the highest propensity to consume.

External imbalances improved along with the economic recovery and rebound in tourism. Although the merchandise trade deficit increased to US$2.2 billion in 2021 from US$1.5 billion in 2020, the current account deficit is estimated to have narrowed to US$1.1 billion (21.7 percent of GDP) from US$1.3 billion (35.5 percent of GDP) in 2020. This was mainly due to the strong recovery in service exports, following the rebound in tourism. As the economy and foreign exchange earnings grew in the second half of 2021, foreign reserves also rebounded and stabilized at above US$800 million for most of the latter part of the year.

While vulnerabilities remain, the fiscal and debt position has likely improved in 2021 due to strong revenue growth. With total revenues and grants increasing by 25.7 percent compared to 2020 – or only 16.7 percent below 2019 levels – and slower expenditure growth, the fiscal deficit is estimated to have narrowed to 17.7 percent of GDP from 23.5 percent in 2020. Furthermore, the GDP share of public and publicly guaranteed (PPG) debt is estimated to have moderated to 129 percent compared to 146 percent in 2020. The fiscal deficit is projected to narrow further due to stronger revenue collections, but, with rigid expenditures, remain in double digits as a share of GDP in the medium-term. Despite a narrowing of the fiscal deficit, PPG debt as a share of GDP is projected to remain high.

Although the economy is expected to grow strongly in the medium-term, the ongoing Russia-Ukraine war could impact Maldives' tourism recovery and growth in the near term. The impact of the Russia-Ukraine war will depend on the period of interruption and whether tourists from other countries can compensate for the loss. However, given that international travel is expected to further normalize and after accounting for the likely reduction of Russian and Ukrainian tourists,[1] Maldives is projected to receive 1.57 million tourists in 2022 (about 94 percent of pre-pandemic levels). With this level of tourists and a sustained recovery in other major sectors, projected real GDP growth for 2022 has been revised downwards to 7.6 percent from 8.4 percent in the initial baseline scenario.[2] Real GDP is, however, expected to grow by 10.2 percent in 2023 supported by: (i) greater capacity in the tourism sector due to the completion of the Velana International Airport expansion and development of new resorts; (ii) a return of Chinese tourists after their border is reopened, boosting total arrivals to 1.9 million; and (iii) continued strong capital expenditures and election-related spending. Thus, by 2023, both the tourism sector and real GDP are projected to fully recover to pre-pandemic levels.

A slower recovery in tourism, continued heightened oil prices, and the emergence of new and concerning COVID-19 variants pose substantial risks to the outlook. The Russian-Ukrainian War has already led to a spike in commodity prices and, as a result, Maldives is likely to face a higher current account deficit, elevated inflation, and an

[1] Assuming no arrivals from Russia and Ukraine in March, a gradual normalization in April and May, and a return to baseline in June.

[2] The baseline scenario was prepared prior to the onset of the Russia-Ukraine war.

additional fiscal burden. With a return to pre-pandemic levels of consumption and capital goods imports, more expensive fuel imports and a recovery in remittance outflows, the current account deficit is likely to expand in the next few years and then narrow from 2024 with the completion of some mega infrastructure projects. Inflation is expected to pick up in 2022 and moderate over the medium term as global oil prices normalize. An additional fiscal burden is expected in 2022 due to an increase in fuel subsidies by about 0.4 to 0.7 percent of GDP and revenue losses from lower-than-expected tourist numbers. Further increases in global energy prices may cause additional fiscal stress. Although there is some upside potential for increasing arrivals from traditional tourism markets, such as China and Western Europe, and new markets, such as Saudi Arabia, tourism could still be adversely impacted by a persistent reduction in Russian and Ukrainian tourists and new waves of COVID-19 infections.

Long-standing structural weaknesses need to be addressed. Maldives is highly vulnerable to external and macroeconomic shocks due to its dependence on tourism and limited sectoral diversification. To promote faster growth, the government has rightly scaled up infrastructure investments since 2016. This has helped boost construction activity, productivity, and medium-term growth prospects. Investments in physical and social infrastructure have also helped reduce poverty, with only 1.7 percent of the population estimated to be living below the poverty line (5.5 PPP USD/person/day) in 2019. However, financing of these large investments through external non-concessional sources and sovereign guarantees has contributed to growing fiscal and debt vulnerabilities. These vulnerabilities are unlikely to diminish given significant public investments are expected to continue due to government's desire to complete these projects before the 2023 presidential elections.

Measures to improve fiscal sustainability and reduce debt vulnerabilities remain priorities. Despite the elimination of immediate rollover risks associated with the US$250 million Eurobond due in June 2022, debt refinancing risks are looming in the medium term due to large bullet payments in 2026. The robust recovery in tourism should help replenish the Sovereign Development Fund to service and repay existing debt. More prudent fiscal and investment planning is important to bring down the high level of debt and replenish fiscal buffers against future external shocks and improve market confidence in Maldives' fiscal strength, which would eventually lead to lower costs of financing for critical investments. This requires prioritizing capital spending into select critical areas that can enhance growth and facilitate economic transformation. Attracting private capital into key investments through an improved investment climate and regulatory framework is also critical to pursuing continued development while reducing the fiscal burden. Finally, a gradual rationalization of fuel subsidies and further development of clean energy would help reduce sizable energy-related costs and support more sustainable fiscal and external balances.

A. Recent Economic Developments

1. Context

Tourism has been the backbone of Maldives' development success.

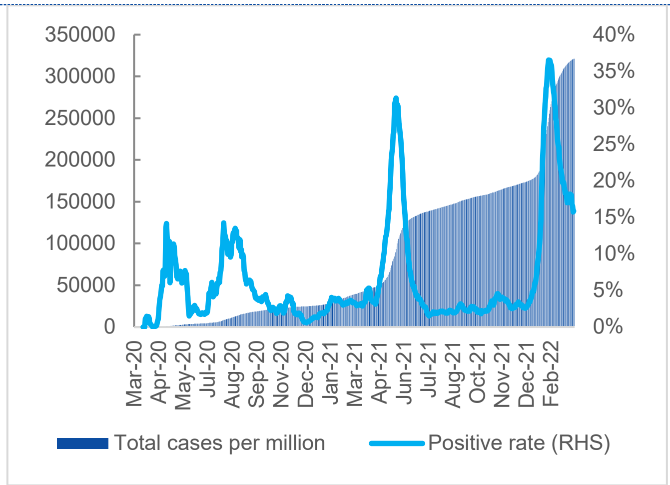
The unique concept of "one island, one resort", meaning only one resort occupying one island, has helped the country develop a reputation for luxury tourism and attracted large amounts of foreign direct investment. As a result, the successful development of high-end tourism has been the key driver of economic growth in Maldives. Tourism accounted for nearly a third of GDP, almost half of budget revenues, and greater than 80 percent of total exports before the COVID-19 pandemic. Annual real GDP growth averaged 5.7 percent from 2000 to 2019 and real GDP per capita rose from US$5,539 in 1995 to US$10,208 in 2019.[3] The sustained and robust growth has significantly reduced poverty, helped move the country to the upper-middle-income country category, and narrowed the development gap.

The COVID-19 pandemic was an unprecedented negative shock to the Maldivian economy.

Maldives was severely affected by several COVID-19 waves in the past two years. After the outbreak of the pandemic in March 2020, Maldives closed its borders for three months to contain the spread of COVID-19. The tourism sector was the first and hardest hit due to the sudden stop of incoming tourists. Only 555,494 tourists visited in 2020, one-third of the level in 2019. As a result, real GDP contracted by 33.5 percent in 2020 relative to 2019, and real GDP per capita fell to US$6,820 from US$10,208 in 2019. The COVID-19 shock also caused a significant impact on Maldives' fiscal position. In response to the significant reduction in revenues in 2020, government reduced the planned expenditures for 2020, but the level of spending remained high, driven in part by greater health, social assistance, and economic support needs for those affected by the pandemic. As a result, the fiscal deficit increased sharply from 6.7 percent of GDP in 2019 to 23.5 percent in 2020. Public and publicly guaranteed debt rose from 78.8 percent of GDP at end-2019 to 146.1 percent at end-2020.

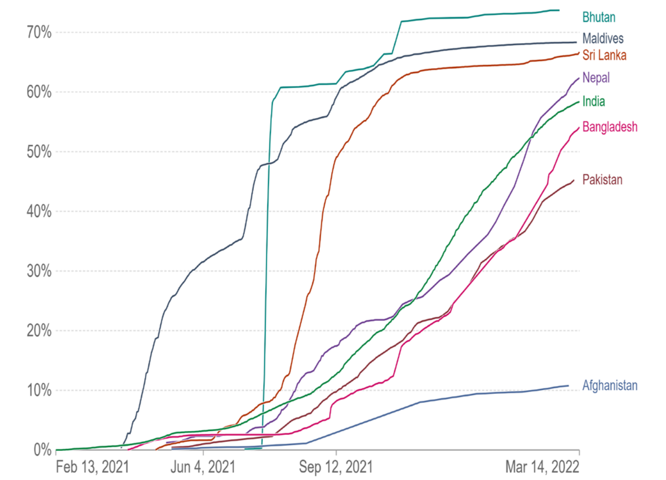
[3] World Development Indicators, 2020.

Figure 1: Cumulative cases and positive rate
Cumulative cases per million/percent



Source: Our World in Data.

Figure 2: Share of population fully vaccinated
Percent of population



Source: Our World in Data

Medium-term growth prospects are promising given a robust recovery in tourism since mid-2021.

Following a nationwide vaccination campaign that commenced in February 2021, over two-thirds of the population had received two vaccine doses by mid-March 2022, which compares well to other countries in South Asia (Figure 2). Despite high rates of COVID-19 infections during the Delta and Omicron waves (Figure 1), tourism began to recover strongly in the second half of 2021 due to the successful vaccination campaign and steady normalization in global travel. As a result, tourist arrivals reached 1.3 million in 2021, equivalent to 78 percent of 2019 numbers, which outperformed government's initial expectations. Further normalization of global travel, completed and ongoing investments to enhance tourism capacity, and growth-enhancing capital spending augur well for the medium-term outlook.

2. Real sector and inflation

Real GDP is estimated to have grown by 31 percent[4] in 2021 due to a strong rebound in tourism.

According to official estimates, after real GDP fell by 11.1 percent (y-o-y) in Q1 2021, the economy rebounded strongly from a low base in Q2 and Q3 by 71.6 and 76.5 percent (y-o-y), respectively. Almost all sectors have recovered fast since Q2[5], with tourism largely driving the overall recovery in output (Figure 3). In addition, transportation and communication, wholesale and retail trade, and entertainment, recreation, and other services also contributed to the recovery. While no updated estimates of GDP by expenditure are available for 2021, the recovery in tourism and other sectors has likely resulted in an increase in household consumption.

Industry is estimated to have declined by 1.6 percent overall in 2021, largely driven by a contraction of construction activities in early 2021.

Construction activities were hit hard by the pandemic due to shortages of raw materials amid the global supply disruptions and COVID-19 mitigation measures. Following the contraction of 33.8 percent (y-o-y) in 2020, the sector contracted by 41.3 percent in Q1 2021. As a result, public capital spending has slowed since Q4 2020, and further declined by 9.2 and 25.2 percent (y-o-y) in Q1 and Q2 2021, respectively. This was followed by a steady rebound in Q3 2021, as construction activities grew by 6.4 and 13.2 percent (y-o-y) in Q2 and Q3 2021, respectively.

Visitors from emerging markets drove the tourism

Although tourist numbers declined in Q2 2021, during the COVID-19 Delta wave, arrivals started catching up to pre-pandemic levels after June 2021. In fact, by the end of 2021, monthly arrivals had almost recovered to 2019 levels (Figure 4). In the end, Maldives received over 1.3

[4] As of March 16, 2021, GDP estimate for Q4 2021 had not been published by the National Bureau of Statistics. Hence, the annual real GDP growth are staff estimates based on statistics for the first three quarters.
[5] Except for fishery and electricity and water, which contracted by 34.3 percent and 0.2 percent (y-o-y), respectively, in Q3 2021.

recovery in the second half of 2021.

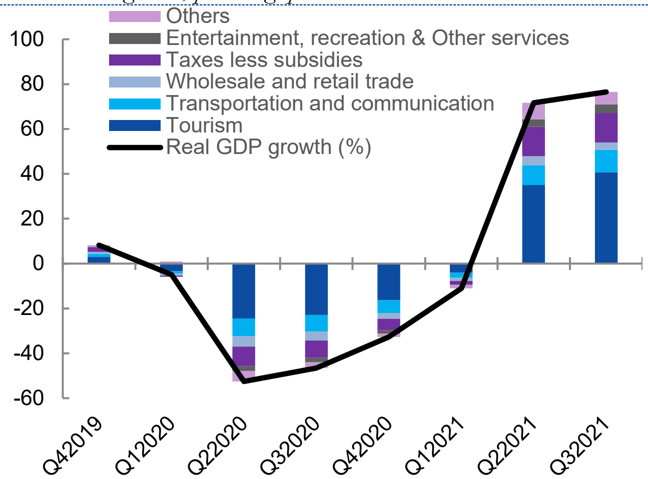
million tourists in 2021, which was only 22.4 percent below 2019 levels. The fast-growing number of tourists from emerging markets, such as India and Russia, has partially compensated for the absence of tourists from traditional markets such as China and Western Europe (Figure 5). The recovery in tourism outperformed government's expectations in 2021 and led to a faster-than-expected economic rebound.

Despite a slowing of tourist arrivals in early 2022, due to the spread of the COVID-19 Omicron variant, tourism continued to recover strongly.

Arrivals in January and February 2022 were well above 2021 levels for those months but remained below 2019 levels compared to the end of 2021 when arrivals had caught up with 2019 levels (Figure 4). Of these arrivals in 2022 (up to end-February), Russians accounted for 15 percent of the total, ranking first in terms of market share, and Ukrainians accounted for another 3 percent. Since Russia, Ukraine and other Eastern European countries became crucial markets during the pandemic, the Russia-Ukraine war could adversely affect the recovery of tourism in Maldives.[6] However, the recovery in early 2022 of arrivals from Western European countries, such as the United Kingdom, Germany, Italy and France, and a growing number of arrivals from new markets, such as Saudi Arabia,[7] is compensating somewhat for the decline in tourists from Russia and Ukraine (Figure 5 and Figure 6).

Figure 3: Real GDP growth (%) and sector contribution

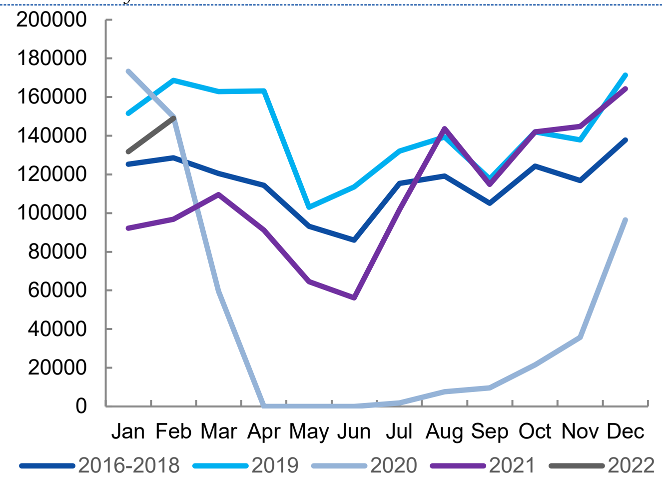
Contribution to growth, percentage points



Source: National Bureau of Statistics Maldives (NBS), staff calculations.

Figure 4: Tourist arrivals

Total number of tourist arrivals



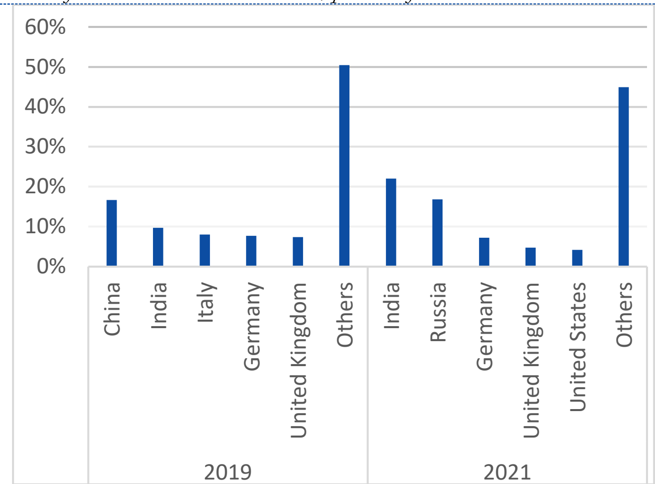
Source: Ministry of Tourism, staff calculations.

Note: 2016-2018 is a simple average across three years.

[6] A scenario assessment of the likely impact of the Russia-Ukraine War on Maldives' tourism and GDP growth in 2022 is provided in the outlook section (see Box 1).

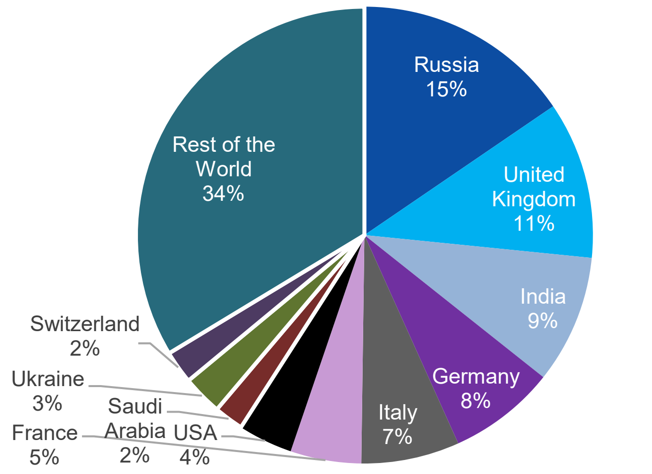
[7] Tourist arrivals from Saudi Arabia represent 2.4 percent of total arrivals in 2022, with almost 10,000 arrivals. This is a significant growth from 158 arrivals in 2021 and 7,400 arrivals in 2020 for the same period.

Figure 5: Top five tourist markets
Share of tourists in 2019 and 2020, percent of total



Source: Ministry of Tourism, staff calculations.

Figure 6: Share of tourists
Share of tourists in January and February 2022, percent of total



Source: Ministry of Tourism, staff calculations.

Headline inflation rose slightly in 2021 along with the economic recovery and higher global commodity prices.

Annual inflation picked up to 0.5 percent in 2021 from the deflation of 1.4 percent in 2020, mainly driven by three components: (i) transport; (ii) food and alcoholic beverages; and (iii) housing, water, electricity, gas and other fuels. Price levels also increased faster in the atolls (1 percent) than in Malé (0.2 percent) (Figure 7).

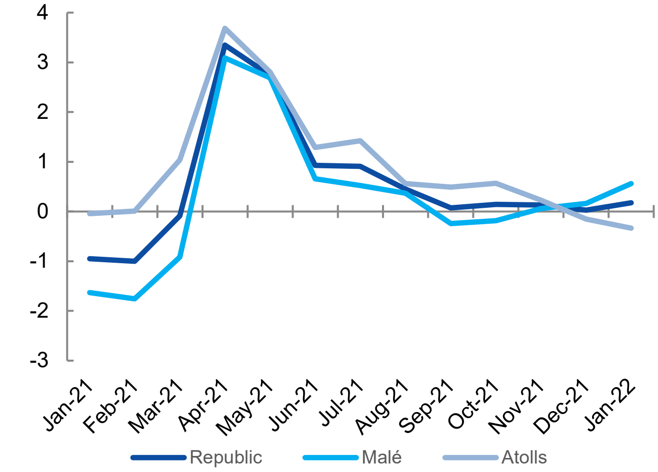
An upsurge in commodity prices in international markets, which led to several domestic fuel price hikes in 2021, contributed to inflation.

The average consumer price index (CPI) for housing, water, electricity, gas, and other fuels – which accounts for almost a quarter of the total CPI basket of goods and services – increased by 11.4 and 11.8 percent (y-o-y) in April and May, respectively (Figure 8). This occurred as the State Trading Organization (STO) raised the price of petrol and diesel at the end-February in response to a rise in global prices.[8] However, utility price inflation was largely kept under control due to the fuel subsidies that government provides to STO.[9] In addition, the fall in information and communications prices by 8.7 percent in 2021, as telecommunications providers gave discounts, also helped in managing inflationary pressures.

[8] The rise in international oil prices at end-February 2021 was due to an agreement Saudi Arabia signed with OPEC countries stating that it would reduce daily oil exports and help limit international supply (https://timesofaddu.com/2021/02/21/sto-raises-price-of-petrol-and-diesel/).

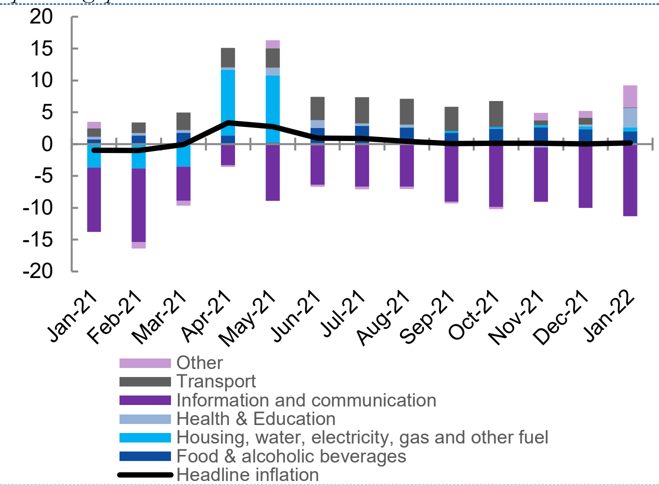
[9] The government provides diesel subsidies via STO to electricity providers. STO provides diesel to electricity providers at a fixed price of MVR 7.60 (US$0.50) per liter. If the market price of diesel exceeds the fixed price, then the difference is compensated as a subsidy to STO. The government also provides electricity subsidies to consumers based on a formula. See Maldives Utility Regulatory Authority (https://www.ura.gov.mv/en/tariff/) for further details.

Figure 7: CPI
Year-on-year growth, percent



Source: NBS, staff calculations.

Figure 8: Contributions to CPI growth
percentage points



Source: NBS, staff calculations.

3. Poverty

Maldives is an upper-middle-income country with low absolute levels of poverty and inequality, yet disparities in inequality persist.

The poverty rate in 2019, at the international poverty line of 5.5 PPP US$/person/day, was 1.7 percent (Figure 9). Most of the poor lived in the atolls, where the poverty rate climbs to 3.2 percent. Inequality is a greater challenge though. The Gini index[10] for the atolls and Malé are relatively similar at 24.2 and 25.2 respectively, indicating a similar spread of inequality among the wealthy and the poor in each area. The inequality between Malé and the atolls, however, is larger given the disparity in inequality worsens significantly when we combine Malé and the atolls, indicated by a significantly higher Gini index of 29.3 for the Maldives as a whole (Figure 10).

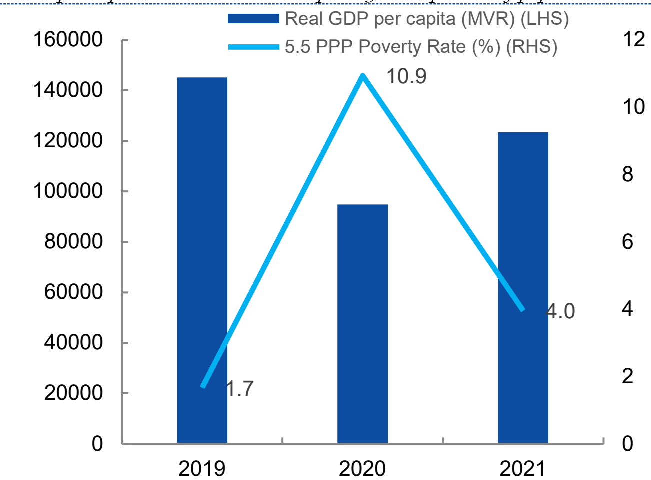
Different factors in Malé and the atolls drive poverty and inequality.

The Multidimensional Poverty Index (MPI) helps to outline the disparity between Malé and the atolls in non-monetary poverty metrics.[11] Whereas Malé's multi-dimensional poverty is driven largely by over-congestion and lack of access to healthcare, multi-dimensional poverty in the atolls is driven by low years of schooling and lack of access to safe drinking water, sewer systems and healthcare.

[10] The Gini index is measured between 0 and 100, with higher values indicating greater inequality.
[11] Maldives published its first MPI in 2020, based on the DHS (Demographic & Health Survey) 2017.

Figure 9: Poverty rate and GDP per capita

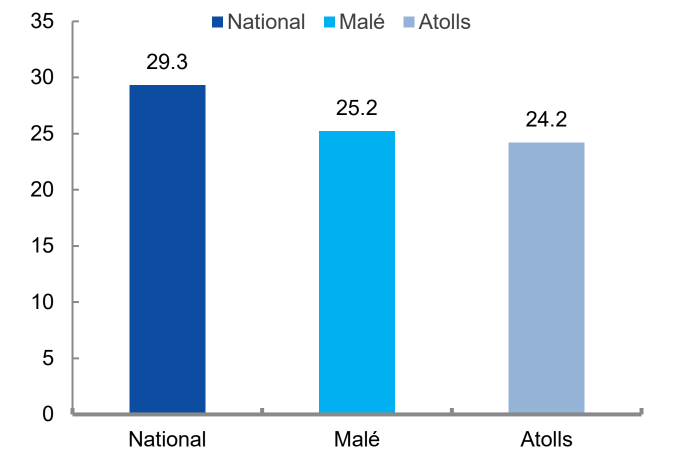
GDP per capita, MVR/estimated poverty rate, percent of population



Source: World Bank staff estimates based on NBS HIES (2019).

Figure 10: Gini index

Points



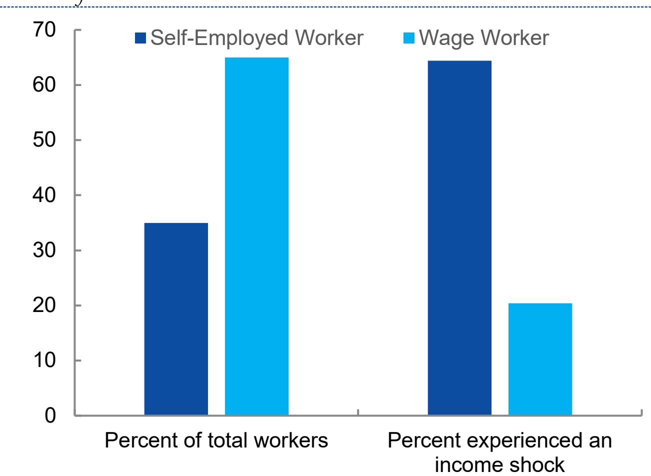
Source: World Bank staff estimates based on NBS HIES (2019).

In real per capita terms, the average household in the poorest 10 percent of the population did see a rise in income from MVR 21,019 (US$1,365) in 2016 to MVR 28,770 (US$1,868) in 2019.

This increase was primarily driven by a greater contribution of wage income, as well as a larger contribution of private transfers. Given the economic enclaves in Maldives, larger private transfers may indicate inbound remittances from family members working on the resort or industrial islands. These have led to a better quality of life in atolls, indicated by a wider base of assets and better human development outcomes, such as a higher percentage of individuals accessing tertiary levels of education.

Figure 11: Type of worker and income shocks

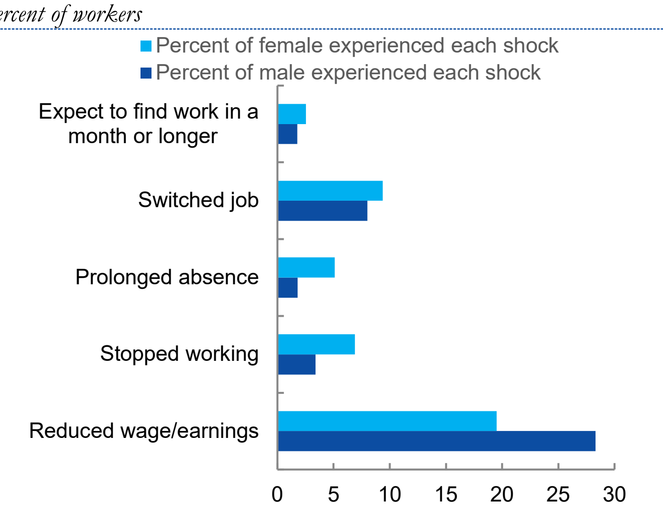
Percent of workers



Source: Staff estimates based on the World Bank South Asia Region COVID-19 phone survey and MBS COVID-19 Assessment phone survey.

Figure 12: Shocks by gender

Percent of workers



Source: Staff estimates based on the World Bank South Asia Region COVID-19 phone survey and MBS COVID-19 Assessment phone survey.

The COVID-19 pandemic increased the risks to welfare gains, especially for women.

The World Bank projects that the poverty rate may have risen sharply to 11 percent in 2020, before falling to 4 percent in 2021 (Figure 9). This fall was mainly due to a sharp recovery in tourism and other services, which effectively account for about 75 percent of all employment in the economy. In addition to these projections, phone surveys were conducted in early 2021 to understand the incidence of income shocks on adults. Individuals who are self-employed in any sector are three times as likely to face an income shock than those who are wage-employed, especially in sectors like fisheries and manufacturing (Figure 11). While the overall probability of an income shock is higher for men than for women, women are more likely to face long-term shocks such as prolonged absence or a complete stop in work (Figure 12).

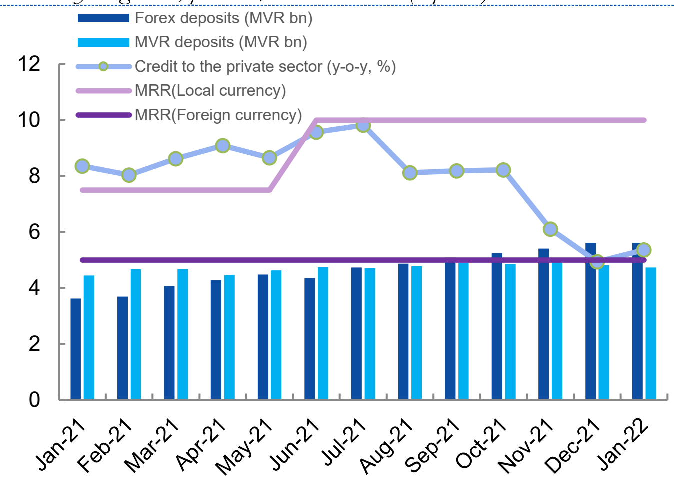
4. Monetary policy and financial sector

Rising inflation prompted the Maldives Monetary Authority (MMA) to tighten monetary policy and increase the minimum reserve requirement.

In June 2021, MMA increased the minimum reserve requirement (MRR) from 7.5 to 10 percent of average local currency deposits to mitigate the inflationary pressures that appeared in April and May (3.3 and 2.7 percent respectively), while the MRR for foreign currency deposits was kept unchanged at 5 percent. In response to this tightening, private sector credit growth decelerated, and both foreign and local currency deposits have increased slightly (Figure 13). Loans and advances to the private sector were mostly directed to the tourism, construction and housing sectors, accounting for 80 percent of the total. Of this, tourism accounted for about 40percent, with construction and housing accounting for 21 and 20 percent, respectively.

Figure 13: Private sector credit growth & MRR

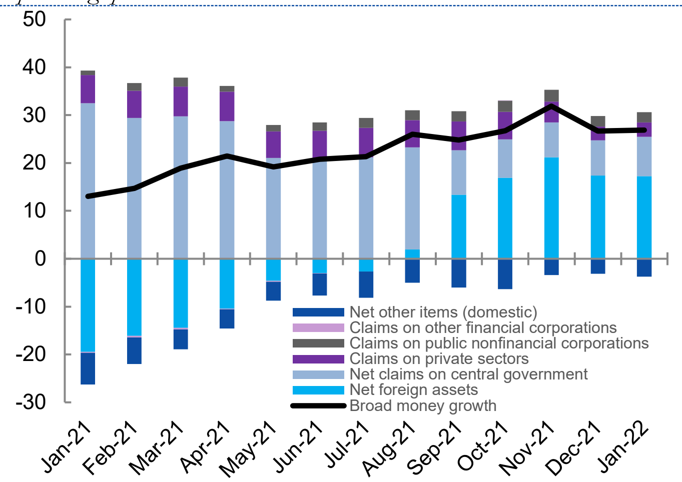
Year-on-year growth, percent / MVR billions (deposits)



Source: MMA, World Bank staff calculations.

Figure 14: Contributions to broad money growth

percentage points



Source: MMA, staff calculations.

Credit growth to the central government and growth in net foreign assets in late 2021 were the main drivers of the rapid growth in broad money in 2021.

Broad money (M2 or money supply) grew by 22.5 percent on average (y-o-y) per month in 2021, accelerating to 27 percent by the end of 2021 (Figure 14). This acceleration largely reflected a sizeable increase in net foreign assets (NFA), while net domestic assets (NDA) of the banking system also demonstrated significant growth. NFA grew by 131 percent on average (y-o-y) from August to December 2021, driven by the rise in NFA of commercial banks and MMA. The rise in NFA of commercial banks was due to an increase in foreign currency deposits, while the rise in NFA of MMA was mainly due to the significant drop in foreign liabilities after the repayment of the US$250 million currency swap to the Reserve Bank of India (RBI) in December 2021. In addition to the growth in NFA, the increase in net claims on central government drove the increase in NDA, contributing to broad money growth and reflecting an annual expansion in government securities. Though not as significant, credit to the private sector and public non-financial corporations also contributed to the growth in broad money, despite credit to the private sector decelerating in the latter half of 2021.

Efforts to bridge the financing gap helped drive an expansion in government securities.

In April 2020, Parliament approved the temporary suspension of elements of the Fiscal Responsibility Act (FRA) to help bridge the financing gap. As a result, a one-year expansion on the cap of MMA advances to MVR 4.4 billion (USD 286 million) was allowed, permitting government to overdraw from public banks to cover expenses. The temporary suspension was then further extended twice in 2021 until the end of 2023, but the overdraft limit was reduced to MVR 2.5 billion (USD 162 million). Parliament also approved the securitization of MVR 2.5

billion of the amount overdrawn into a 50-year bond (coupon of 2.5 percent) issued by the government to MMA.

Maldives continues to maintain a *de facto* stabilized exchange rate arrangement, using the US dollar as the exchange rate anchor.

MMA is responsible for the formulation and implementation of monetary policy. Under the current monetary policy framework, the exchange rate peg to the US dollar is used as the nominal anchor for achieving price stability. Since Maldives is a small open economy with a high dependence on imports, the domestic price levels are greatly influenced by changes in global market prices and exchange rates. Therefore, to maintain price stability through the exchange rate, the MMA strives to maintain the exchange rate peg within a set horizontal band, where the exchange rate is allowed to fluctuate within the bounds of MVR10.28 to MVR15.42. Furthermore, the MMA continues to manage excess liquidity in the banking system to support the exchange rate stability and maintain the domestic money supply consistent with economic activities.[12]

5. External sector

The current account deficit is estimated to have narrowed from US$1.3 billion (35.5 percent of GDP) in 2020 to US$1.1 billion (21.7 percent of GDP) in 2021.

Total exports of goods and services surged by 96.9 percent in 2021, faster than the 58.9 percent growth in total imports. Travel receipts, which account for almost 90 percent of services exports, rose by US$1.7 billion to US$3.1 billion in 2021 (a 124 percent increase after the sharp decline in 2020), which was about the same as 2019 levels. Meanwhile, merchandise imports rose by only US$685 million in 2021 or 40 percent above 2020 levels. At the same time, net outflows from investment income have likely increased only slightly due to marginally higher investment income returns. Remittance outflows are, however, yet to recover given sectors that employ foreign workers, such as construction and other service activities, are taking longer to rebound.

The merchandise trade deficit grew from US$1.5 billion in 2020 to US$2.2 billion in 2021 as imports rose by more than exports (Figure 15 and Figure 16).

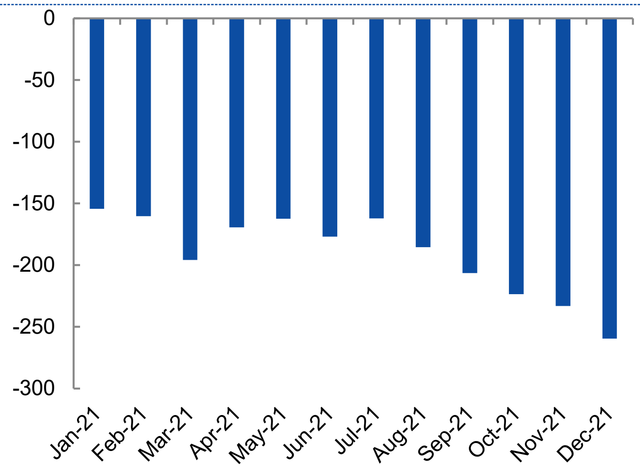
Goods imports[13] rebounded by an estimated 40 percent, in nominal terms, in 2021. The recovery was broad-based, led by greater petroleum, construction-related, and food product imports (Figure 17). Petrol imports increased by 86.3 percent in 2021, while diesel rose by 73.8 percent as global crude oil prices hiked and domestic demand bounced back. Construction-related imports, especially machinery, mechanical appliances and parts, rose by 44.6 percent as construction activity recovered in the latter part of 2021. Food imports grew in line with more tourists arriving as COVID-19 related restrictions eased and activity in food and accommodation establishments picked up. Goods exports,[14] on the other hand, contracted by 17.8 percent in 2021, mainly driven by the mixed quarterly performance of re-exports and fish exports (Figure 18). In the end, fish and fish product exports contracted by 9.9 percent in 2021, as processed fish exports decreased significantly by 35.2 percent and fresh and frozen fish exports contracted by 9 percent. As a result, fish and fish product exports declined to 49.5 percent of total exports in 2021 from 54.7 percent in 2020.

[12] To achieve the monetary policy objectives, the MMA uses the following instruments: Minimum Reserve Requirements (MRR), Open Market Operations (OMOs), standing facilities that include the Overnight Deposit Facility (ODF) and Overnight Lombard Facility (OLF), and foreign currency swaps.

[13] Measured on a cost, insurance, and freight basis (cif). Monthly import data is measured on a cif basis, whereas the annual balance of payments data uses imports measured on a free on board (fob) basis.

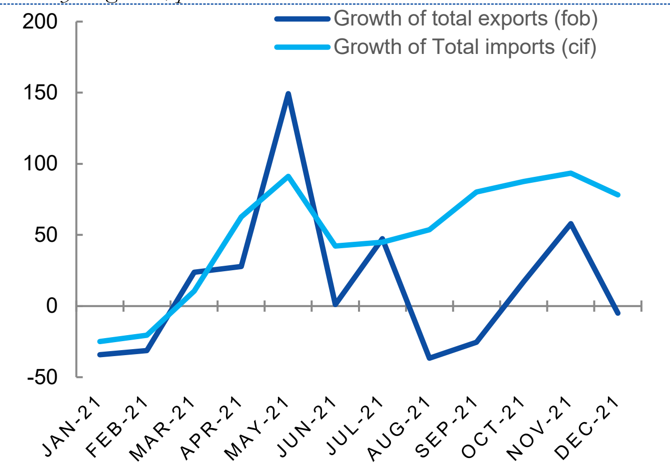
[14] Measured on fob basis.

Figure 15: Merchandise trade balance
US$ millions



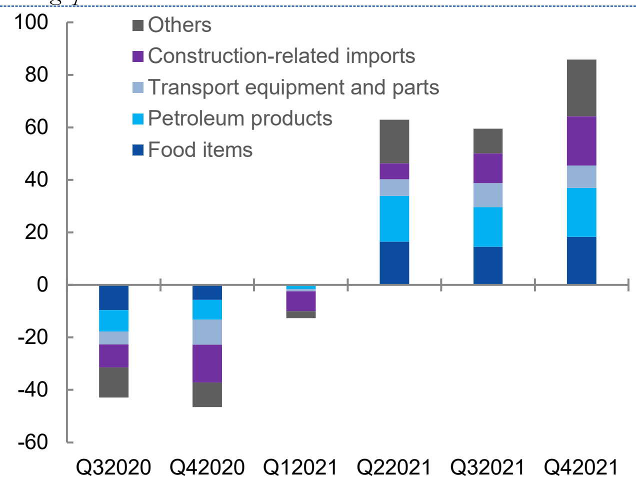
Source: MMA monthly statistics, staff calculations.

Figure 16: Growth of merchandise imports and exports
Year-on-year growth, percent



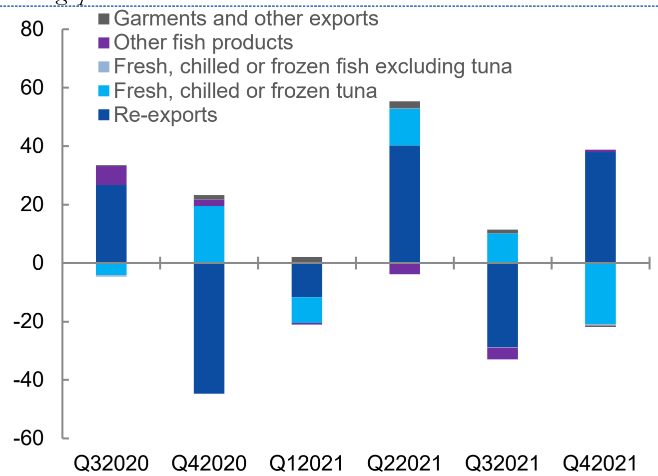
Source: MMA monthly statistics, staff calculations.

Figure 17: Contribution to import growth
percentage points



Source: MMA monthly statistics, staff calculations.
Note: Construction-related imports refer to wood, cement, metal & aggregates; machinery, mechanical appliances & parts; electrical, electronic machinery, equipment, and parts.

Figure 18: Contribution to export growth
percentage points



Source: MMA monthly statistics, staff calculations.
Note: Construction-related imports refer to wood, cement, metal & aggregates; machinery, mechanical appliances & parts; electrical, electronic machinery, equipment, and parts.

Official international reserves recovered and stabilized at above US$800 million for most of 2021.

During the pandemic, Maldives drew on an additional US$150 million from a previously signed US$400 million currency swap agreement with the RBI, which helped the country ensure sufficient reserves for macroeconomic management during the COVID-19 crisis. As the economy and foreign exchange earnings grew in the second half of 2021, foreign reserves also rebounded and reached over US$1 billion in September 2021. With reserves stabilizing at above US$800 million, the authorities paid back US$250 million at the end of 2021 which had been initially activated under the currency swap facility with the RBI.

6. Fiscal Policy

Strong revenue growth improved the fiscal position in 2021.

Given the robust recovery in tourism-linked revenue, preliminary estimates suggest that the fiscal deficit narrowed to 17.7 percent of GDP in 2021 from 23.5 percent in 2020, with a similar narrowing of the primary deficit (Figure 19). In nominal terms, this is a fall in the fiscal deficit to MVR 13 billion (US$846 million) or 5 percent lower than the deficit in 2020.

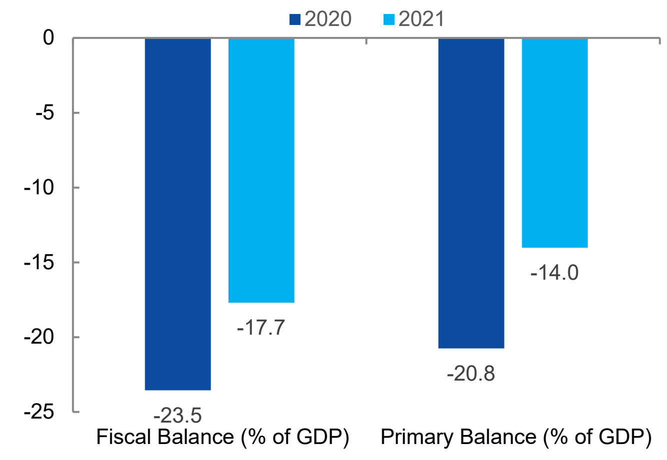
Tourism-linked revenue collections rose significantly as tourism recovered.

Overall revenue and grants are estimated to have grown 25.7 percent in 2021, of which tourism-related revenue[15] – which generates almost half of all revenues – is estimated to have grown 72.6 percent following a contraction of 50.3 percent in 2020. This revenue was predominantly driven by tourism goods and services tax (Figure 21), which is estimated to have grown 100 percent in 2021. Other key revenue contributors such as import duties, airport service charges, green taxes, and non-tax revenues also grew strongly in 2021. Furthermore, collections linked to tourism such as rent from resorts and airport development fees contributed the most to non-tax revenue growth in 2021. After the government deferred payments of the resort lease in 2020 for a year, resort rents are estimated to have grown by 153 percent in 2021.

Expenditure remained elevated, but capital expenditure only picked up in the latter part of 2021 along with the recovery in construction.

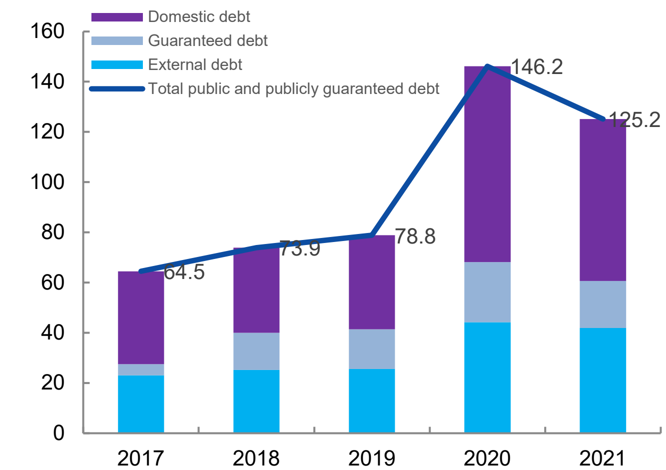
According to preliminary official estimates[16], total expenditures were 13 percent higher than in 2020. While total recurrent spending for the year is estimated to have increased by 19.6 percent compared to 2020, capital expenditures are estimated to have fallen by approximately 2.8 percent due to negative growth in the first and second quarters of 2021, following a slowdown in infrastructure investment, especially under the Public Sector Investment Program (PSIP), from Q4 2020. Capital spending, including development-related projects, only picked up again in Q3 2021 (by 9.2 percent y-o-y) when importing capital goods and inputs became easier. Fuel subsidies to state-owned enterprises were elevated due to higher global energy prices from about Q2 2021, and, as a result, grants, contributions and subsidies contributed most to overall expenditure growth in Q2 and Q3 2021, by 9.1 and 5.8 percentage points, respectively (Figure 22).

Figure 19: Fiscal and primary deficit
percent of GDP



Source: Ministry of Finance, staff calculations

Figure 20: Total public and publicly guaranteed debt
percent of GDP



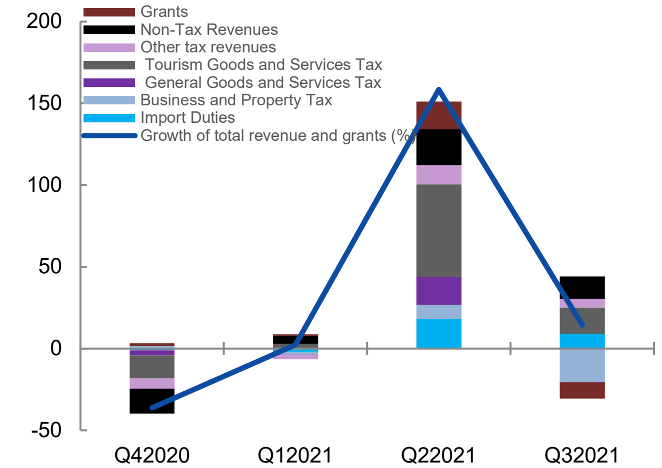
Source: Ministry of Finance debt statistics, staff calculations
Note: 2021 denominator using World Bank estimates.

The total PPG debt-to-GDP ratio declined considerably in 2021 due to the fast economic recovery.

Public debt, including guaranteed debt, was US$6.1 billion at end-2021, or 125 percent of estimated GDP, compared to 146.1 percent of GDP in 2020 (Figure 20). In terms of composition, domestic debt is estimated to have declined to 64 percent of GDP from 78 percent in 2020, while foreign debt and guaranteed debt accounted for 42 and 19 percent of GDP, respectively.

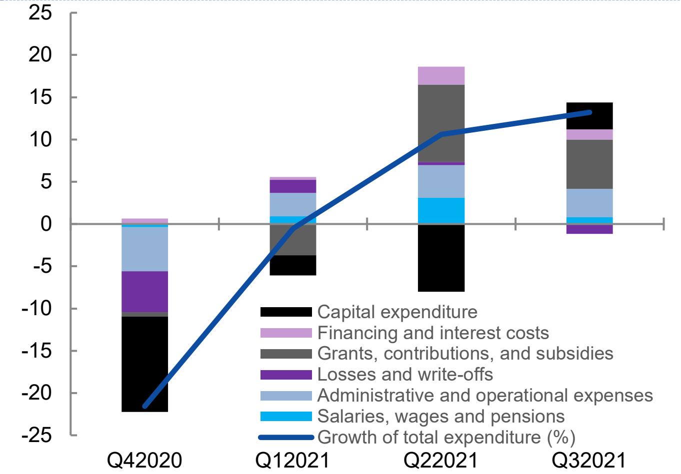
[15] Tourism related revenues include import duties, tourism goods and services tax, airport service charge, green tax, airport development fees, and rents from resorts.
[16] As of March 18, 2022. The expenditure estimates are subject to further revisions in the final budget statistics.

Figure 21: Contribution to revenue growth
percentage points



Source: Ministry of Finance, staff calculations
2021 values are World Bank estimates

Figure 22: Contribution to expenditure growth
percentage points



Source: Ministry of Finance, staff calculations
2021 values are World Bank estimates

While immediate rollover risks have been significantly reduced by Sukuk issuance in 2021, refinancing risks are still heightened in the medium term.

In total, government issued Sukuk worth US$500 million in 2021, with five-year maturities and a single bullet payment. The first issuance was in March 2021 with a face value of US$200 million, and the subscription was later reopened in April and in September for an additional US$100 million and US$200 million, respectively. Part of the proceeds was used to repay about 77 percent of the US$250 million Eurobond (coupon of 7 percent). While the Sukuk helped reduce immediate rollover risks, it came at an elevated cost with a coupon of 9.875 percent and a yield of 10.5 percent. Separately, the maturity of a privately placed US$100 million bond (coupon of 5.5 percent), initially due in 2023, has been extended to 2026. As a result, bullet payments for both the privately placed bond and Sukuk are now due in 2026, totaling US$600 million.

The fast economic recovery and improved refinancing outlook were reflected in an improved sovereign credit rating.

In October 2021, Fitch upgraded the Maldives' Long-Term Foreign-Currency Issuer Default Rating (IDR) to 'B-' from 'CCC' and with a stable outlook. A stronger-than-expected recovery in the tourism sector and an improved, yet still challenging, refinancing outlook for the sovereign's external debt over the next few years were cited as factors behind the upgrade.

Reforms to improve debt transparency and fiscal sustainability continue.

The Ministry of Finance (MoF) announced in June 2021 that it is working towards drafting a debt law, which will strengthen the current legal framework governing debt management functions. To better monitor potential fiscal risks, MoF now publishes and submits to Parliament a yearly fiscal risk statement that identifies sources of explicit and implicit risks (quantifying them where possible) and formulates mitigation measures for such risks.[17] A key driver of Maldives' debt vulnerabilities in recent years has been the increase in guaranteed debt to finance an expansion in the PSIP. To manage these vulnerabilities and ensure greater transparency on the status and financing of these projects, government is now publishing and updating information on public investment projects (including those under sovereign guarantees) on an official website. Finally, to enhance revenue mobilization, several new measures will be implemented in 2022, including the introduction of revised departure taxes and an increased Airport Development Fee.

[17] Publishing a fiscal risk statement helps government take more proactive measures to manage fiscal risks and reduce their probability of materializing. The statement systematically analyzes fiscal risks related to macroeconomic assumptions and public debt, including a discussion of possible scenarios and specific fiscal risks (e.g. natural disasters, state-owned enterprises, financial sector), and lays out mitigation measures for such risks.

B. Outlook and Risks

7. Medium-term outlook

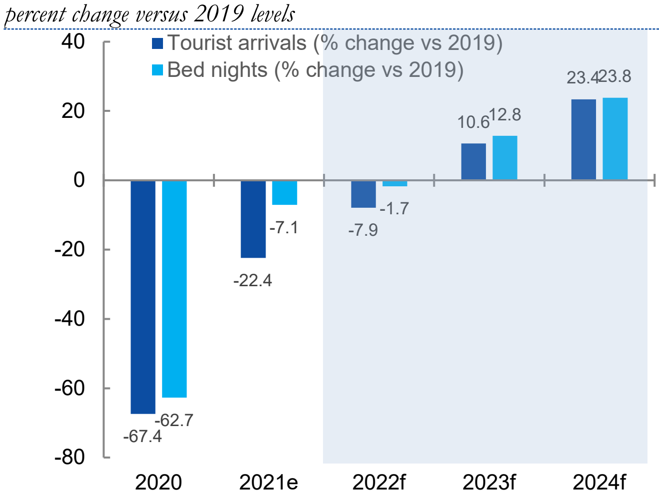
Although the economy is expected to grow strongly in the medium-term, the ongoing Russia-Ukraine war could impact Maldives' tourism recovery and growth in the near term.

The impact of the Russia-Ukraine war will depend on the period of interruption and whether tourists from other countries can compensate for the loss (Box 1). However, given the recent government measure to lift the pandemic state of health emergency from March 13, 2022[18], international travel is expected to further normalize. As a result, Maldives is projected to receive 1.57 million tourists in 2022 (about 94 percent of pre-pandemic 2019 levels) even after accounting for the likely reduction of Russian and Ukrainian tourists. Assuming 1.57 million tourists and the continued recovery in other major sectors, the projected real GDP growth for 2022 has been revised downwards to 7.6 percent from 8.4 percent in the baseline scenario (see Box 1).[19] Real GDP is, however, expected to grow by 10.2 percent in 2023 supported by: (i) greater capacity in the tourism sector due to the completion of the Velana International Airport expansion and development of new resorts; (ii) a return of Chinese tourists after their border is reopened, boosting total arrivals to 1.9 million; and (iii) continued strong capital expenditures and election-related spending. Both the tourism sector and real GDP are projected to fully recover to pre-pandemic levels by 2023 (Figure 23 and Figure 24).

[18] This includes: (1) no PCR test is required for anyone coming from abroad or travel between islands; (2) no quarantine is needed for fully vaccinated individuals; (3) mask use has been made optional (only except for at healthcare facilities and in islands with over 20% positivity rate); and (4) case updates will only be published once weekly (not daily anymore).

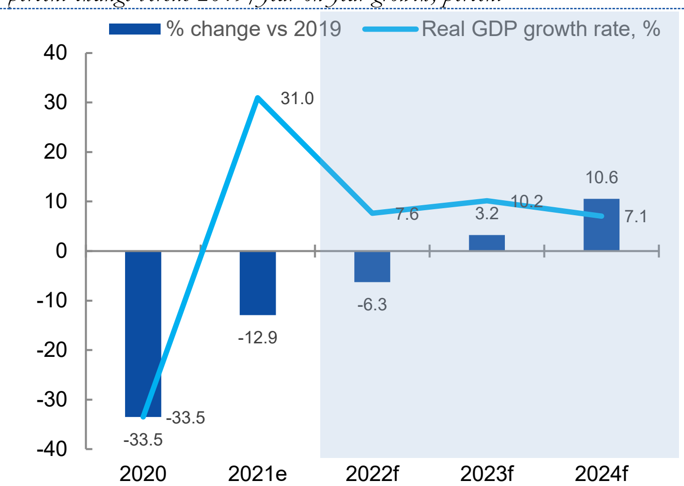
[19] The baseline scenario was prepared prior to the onset of the Russia-Ukraine war.

Figure 23: Change in projected tourists/bed nights
percent change versus 2019 levels



Source: Ministry of Tourism, staff calculations

Figure 24: Real GDP growth and projected change
percent change versus 2019/year-on-year growth, percent



Source: Ministry of Finance debt statistics, staff calculations
Note: 2021 denominator using World Bank estimates.

Box 1: Likely impact of Russia-Ukraine war on Maldives' tourism and GDP growth in 2022

Russian and Ukrainian tourists accounted for a fifth of tourists in 2021, a significant jump from pre-pandemic levels. During the COVID-19 pandemic, tourist arrivals from traditional markets like the European Union and China declined, which was partly compensated by a growing number of tourists from other emerging markets, including Russia and Ukraine. Rising from 4.9 and 0.8 percent in 2019, Russians and Ukrainians accounted for 16.8 and 2.7 percent of the 1.3 million arrivals in 2021, respectively. India accounted for a further 22.1 percent of these arrivals.

Although the Russia-Ukraine War could negatively impact Maldives' tourism recovery and growth prospects, other markets might make up for the loss. With the ongoing war in Ukraine, closure of Russia's airspace to over 30 destinations, and grounding of international operations of Russia's largest airline, Aeroflot, on March 8, 2022, a prolonged absence of travelers from these two markets can be expected (Figure 25 and Figure 26). However, the impact on Maldives' tourism sector will depend on the period of interruption and whether tourists from other countries can compensate for the loss. There are reasons to be optimistic about some compensation. While Russian tourists still accounted for 13.5 percent of all arrivals in February 2022, their share had been decreasing before the war due to increased arrivals from other European markets (such as the United Kingdom, Germany and Italy) and a surge in arrivals from new markets such as the Middle East.

Figure 25: Daily tourist arrivals from Russia
number of tourist arrivals

Source: Ministry of Tourism, staff calculations

Figure 26: Daily tourist arrivals from Ukraine
number of tourist arrivals

Source: Ministry of Tourism, staff calculations

Three scenarios are presented to assess the impact on tourism and growth:

- *Small impact scenario:* assumes no arrivals from Russia and Ukraine in March, a gradual normalization in April and May, and a return to baseline in June.
- *Medium impact scenario:* assumes no tourists from these two countries for two months until the end of April, a gradual normalization in May and June, and a return to baseline in July.
- *Large impact scenario:* assumes no tourists from these two countries for four months until the end of June, a gradual normalization in July and August, and a return to baseline in September.

Since there is crucial upside potential from a possible opening of Chinese borders in 2022, a further analysis of the same scenarios (an *upside* scenario) is conducted that assumes a return of Chinese tourists from November onwards. In addition, several points are worth noting:

a) The baseline, estimated before the war started, was tourist arrivals of **1.61 million** and real GDP growth of **8.4 percent** in 2022.

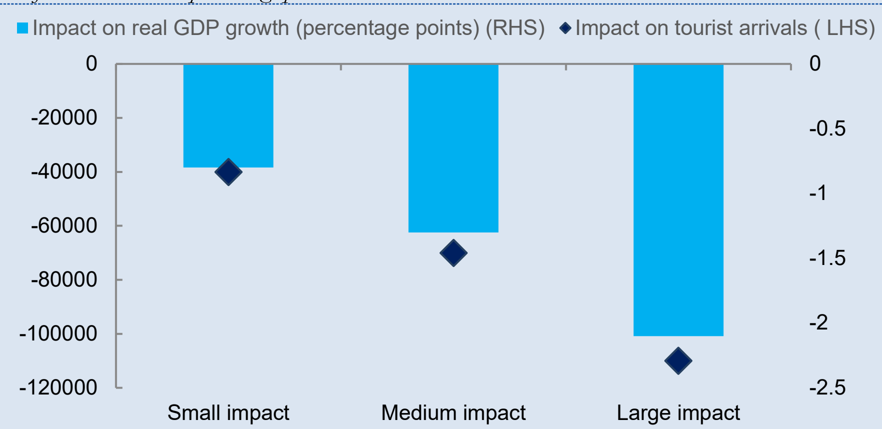
b) Tourism GDP per bed night has been remarkably stable over the last few years, so a direct value-added per bed night of MVR 1,900 is assumed.

c) While the number of tourist arrivals in each scenario is changed, the number of bed nights per tourist is kept constant at 6.7.

d) Tourism accounts for nearly a third of GDP in Maldives, so the direct impact on tourism GDP is first considered. Spillovers to other sectors that are highly correlated with tourist bed nights are then added. However, the results are mostly driven by the direct impact and the contribution from spillovers is limited.

The impact on tourist arrivals and GDP in 2022 is likely to be sizeable, but manageable. Tourism arrivals drop to 1.5 and 1.57 million for the large impact and small impact scenarios, respectively. As a result, under these two scenarios, real GDP growth drops to 6.3 and 7.6 percent (Table 1). Figure 27 gives a sense of the decline in real GDP growth and tourist arrivals across the three scenarios.

Figure 27: Possible impact of war on tourist arrivals and real GDP growth in 2022
number of tourist arrivals/percentage points



Source: Ministry of Tourism, staff calculations

An opening of China in late 2022 could partially compensate for the negative shock. If China opens its border from November and tourism to Maldives resumes to levels seen before the COVID-19 pandemic, tourist arrivals could go up to 1.59 million in the small impact scenario, which would help maintain growth in 2022 at 8.1 percent (closer to baseline). In the large impact scenario, an opening of the Chinese border in November could boost growth by 0.4 percentage points (Table 1).

Table 1: Scenario analysis of the 2022 growth impact of the Russia-Ukraine war

	Preliminary forecasts as of March 8, 2022, assuming no impact	Scenario 1: Large impact	Scenario 1: Large impact and upside	Scenario 2: Medium impact	Scenario 2: Medium impact and upside	Scenario 3: Small impact	Scenario 3: Small impact and upside
Tourist Arrivals (mn)	1.61	1.5	1.52	1.54	1.57	1.57	1.59
Average stay (days)	6.7	6.7	6.7	6.7	6.7	6.7	6.7
Real Tourism GDP (MVR mn)	20,443	19,120	19,403	19,664	19,947	19,964	20,247
Real GDP growth rate	**8.4**	**6.3**	**6.7**	**7.1**	**7.6**	**7.6**	**8.1**
Tourism-linked revenue (USD mn)	**810**	**755**	**765**	**775**	**790**	**790**	**800**
Revenue loss (USD mn)		**55**	**45**	**35**	**20**	**20**	**10**

Source: World Bank staff estimates

The impact on growth could also be somewhat larger, as Russian tourists spend more than others. Simple regression analysis suggests that tourism GDP per bed night increases with the share of Russian tourists. As a robustness check, it is assumed that Russian tourists spend on average 50 percent more than other tourists. This lowers growth further in the large impact scenario by 0.2 percentage points to about 6.1 percent.

While the impact of the war on tourist arrivals and GDP seems manageable, it will have other consequences. The war has already led to a spike in commodity prices and, as a result, Maldives is likely to face a higher current account deficit, inflationary pressures, and an additional fiscal burden given the likely increase in fuel and electricity subsidies. These channels may aggravate existing external and fiscal vulnerabilities.

Inflation is expected to pick up in 2022 and moderate over the medium term as global oil prices normalize.

Global crude oil prices are likely to rise significantly and average US$95.1 per barrel in 2022, and then fall to US$85.4 and US$80.4 per barrel in 2023 and 2024, respectively.[20] This will lead to a corresponding increase in retail fuel prices in 2022. STO has already hiked prices of petrol and diesel three times this year to the current MVR 14.6 (US$0.94) and MVR 14.8 (US$0.96) per liter, respectively – this compares to a petrol and diesel price of MVR 11.2 (US$0.72) and MVR 11.8 (US$0.77) per liter in October 2021. While the pass-through of global oil prices to consumer fuel prices in Maldives is only partial, due to government subsidies, these price movements are expected to lead to some increase in inflation over 2022-2024. In addition, with price controls on purchases of staple foods and food subsidies in place, food price inflation pass-through will also be limited. Overall, inflation is estimated to rise to 3.5 percent in 2022, but moderate to 1.3 and 1.2 percent with the decline in global energy prices.

Despite the recovery in tourism, the current account deficit is likely to expand in the next few years before narrowing from 2024 with the completion of some mega infrastructure projects (Table 2).

The trade deficit is expected to widen over 2022-2023 as consumption imports return to pre-pandemic levels and renewed construction activities – such as resort development and government's PSIP projects (e.g. airport expansion; bridge, road and port developments; housing, water and sewerage system projects) – demand more capital goods imports. The value of fuel imports is also expected to rise, as discussed, and remittance outflows are expected to recover to 2019 levels given the increased demand from tourism and construction for foreign labor.

Although the fiscal deficit is expected to

Government revenue is expected to continue to grow due to robust performance in tourism. Notably, starting from 2022, new revenue mobilization measures, particularly the introduction

[20] World Bank Commodity Price Data

remain well above pre-pandemic levels, it will gradually decline over the medium term as revenues pick up (Table 2).

of new departure taxes and an increased Airport Development Fee, have been implemented. At the same time, however, current expenditures are expected to increase over the medium term, compared to pre-pandemic levels, due to additional costs from implementing the minimum wage (2022) and public sector pay harmonization policies (2023-2024).[21]

Table 2: Macro outlook (annual percentage change, unless indicated otherwise)

	2019	2020	2021e	2022f	2023f	2024f
Real GDP Growth, at constant market prices	6.9	-33.5	31.0	7.6	10.2	7.1
Inflation (Consumer Price Index)	0.2	-1.4	0.5	3.5	1.3	1.2
Current Account Balance (% of GDP)	-26.6	-35.5	-21.7	-23.2	-23.9	-21.3
Fiscal Balance (% of GDP)	-6.7	-23.5	-17.7	-16.0	-13.9	-12.8
Debt (% of GDP)	78.8	146.1	128.8	130.9	129.6	129.2

Source: World Bank estimates as of March 18, 2022.

An additional fiscal burden is expected in 2022 due to increased fuel and electricity subsidies, following the spike in global crude oil prices, and revenue losses from lower-than-expected tourist numbers.

Initial estimates suggest that fuel and electricity subsidies could increase by about 0.4 to 0.7 percent of GDP, given a rise in oil prices by 35 to 60 percent over the average price in 2021.[22] At the same time, given the projected fall in tourist arrivals, tourism-related revenues could fall by about US$20 million or 0.4 percent of GDP (Table 1).

Even though a narrowing of the fiscal deficit is expected, public debt will remain significantly high, and refinancing risks will continue.

Although PPG debt has fallen from a high of 146 percent of GDP in 2020, it is expected to remain at around 130 percent of GDP in the medium term (Table 2). Despite the elimination of immediate rollover risks associated with the US$250 million Eurobond due in June 2022, substantial debt refinancing needs are looming in the medium-term from large bullet payments that are due in 2026. Thus, despite improving fiscal prospects, prudent debt management remains critical to improving fiscal sustainability and lowering the cost of growth-enhancing investments, especially with large debt service obligations coming due.

8. Risks and priorities

Although there is some potential upside, downside risks persist.

The baseline projection accounts for the estimated impacts of the Russia-Ukraine war on tourism and oil prices under the current trend, but further increases in global energy prices may cause an additional fiscal burden. Tourism could be adversely impacted by a persistent reduction in Russian and Ukrainian tourists and new waves of COVID-19 infections. High dependence on tourism and limited sectoral diversification remains a key structural challenge as the country is highly vulnerable to external and macroeconomic shocks. However, medium-term growth prospects are promising given a continued robust recovery in tourism and sustained

[21] Ministry of Finance (2021). According to the Medium-term Fiscal Strategy 2022-2024, the introduction of a "minimum wage policy" and "government employees pay harmonization policy" will incur additional expenditures on personal emoluments over the medium term. The Ministry of Finance estimates that an additional MVR 383 million would be needed in 2022 for personal emoluments of government employees when the minimum wage policy is implemented. An additional MVR 1,200 million would be required to implement the pay harmonization policy.

[22] The average oil price in 2021 was US$70.4/bbl. A 35 percent rise is the current forecast for 2022 (World Bank Commodity Price Data), whereas the 60 percent rise is roughly what was observed during the 2007/08 crisis.

improvements in infrastructure. There is also some upside potential for increasing arrivals from traditional tourism markets such as China and Western Europe.

Additional long-standing structural weaknesses remain that need to be addressed.

To promote faster growth, the government has rightly scaled up infrastructure investments since 2016. This has helped boost construction activity, productivity growth, and medium-term growth prospects. Investments in physical and social infrastructure have also helped reduce poverty, with only 1.7 percent of the population estimated to be living below the poverty line (5.5 PPP USD/person/day) in 2019. However, financing of these large investments through external non-concessional sources and sovereign guarantees has contributed to growing fiscal and debt vulnerabilities, which are unlikely to diminish given significant public investments are expected to continue due to government's desire to complete these projects before the 2023 presidential elections.

Measures to improve fiscal sustainability and reduce debt vulnerabilities remain priorities.

As discussed, the 5-year Sukuk issuance in 2021 helped eliminate immediate rollover risks, but debt refinancing risks still loom in the medium term. The robust recovery in tourism should help replenish the Sovereign Development Fund to service and repay existing debt. More prudent fiscal and investment planning is important to bring down the high level of debt and replenish fiscal buffers against future external shocks and to improve market confidence in Maldives' fiscal strength, which would eventually lead to lower costs of financing for critical investments. This requires prioritizing capital spending into select critical areas that can enhance growth and facilitate economic transformation. Attracting private capital into key investments through an improved investment climate and regulatory framework is also critical to pursuing continued development while reducing the fiscal burden. Finally, a gradual rationalization of fuel subsidies and further development of clean energy would help reduce sizable energy-related costs and support more sustainable fiscal and external balances.