Maldives Partnership Forum 2019

Investing in a Resilient & Sustainable Maldives

12 – 13 March 2019, Maldives

National Macroeconomic Outlook

Executive Summary

The Maldivian economy grew strongly in the recent past, with real GDP growth averaging 7.3% over the past three years. This robust performance is expected to be sustained with growth forecasts indicating an average growth of 7.0% over the period 2019 – 2021. The tourism sector, contributing almost 25% to real output, is expected to be the main driver of the economy, followed by the booming construction sector. Inflation has remained low in the recent past and is expected to remain below 2% over the next few years despite the high level of economic activity.

On the fiscal front, the government budget recorded an overall deficit equivalent to 4.7% of GDP. Currently, measures are being taken to ensure that the government's aim of achieving a balanced budget within the next 5 years is achieved. Tax revenues are consistently increasing, while reforms are underway to address increases in recurrent expenditure.

Currently, the exchange rate regime of the Maldives is a currency peg within a horizontal band, where the Maldivian Rufiyaa is pegged to the US dollar within a horizontal band of ± 20%, i.e. between 10.28 Rufiyaa and 15.42 Rufiyaa per US dollar. To ensure exchange rate stability, the Maldives Monetary Authority (MMA) monitors the developments in the foreign exchange market and carries out foreign exchange intervention.

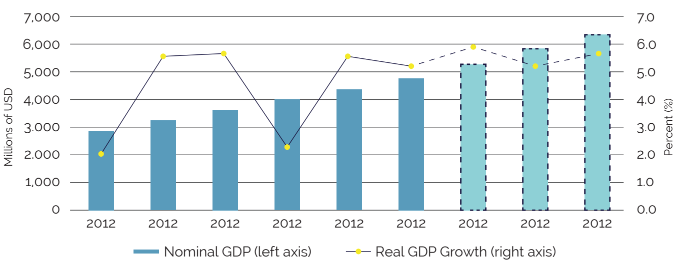
With regard to monetary sector developments, the monetary base increased by 10% in January 2019 compared to the corresponding period of 2018. As for the money supply, it increased annually by 1% to record MVR 33.2 billion in January 2019. The MMA will continue its current accommodative monetary policy stance as long as the exchange rate remains within the target band.

Recent Developments & the Medium Term Outlook

Real Economy

The Maldivian economy gained momentum during 2018, with the most recent estimates indicating a real GDP growth of 7.6%, up from 6.9% in 2017. This growth was mainly driven by the strong performances of the tourism and construction industries, and was higher than the initial forecast of 6.0% for the year. Real GDP is expected to grow at 6.8% and 7.3% in 2019 and 2020 respectively.

Figure 1: Nominal GDP and real GDP growth; 2012 - 2020

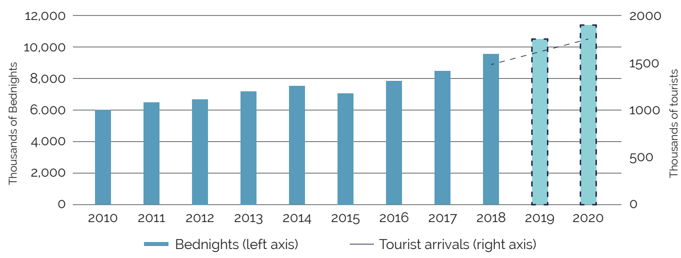


Tourism sector

Tourism is the single largest contributor to the Maldivian economy, with a share of around 24% of real output. Tourist arrivals reached a record 1.48 million in 2018, which is a 6.8% growth compared to the previous year. China accounted for the largest proportion of tourists with a share of 19.1% in 2018. Germany, the UK and Italy were the other leading markets, representing 7.9%, 7.7% and 7.1% respectively. Forecasts indicate that between 2019 and 2021, tourist arrivals to the country would increase by an average of 7.3%.

Meanwhile, tourist bednights, which is the main determinant of tourism related revenues for the government, registered 9.47 million during 2018, which is a 10.2% growth compared to 2017. This translates into an average duration of stay of 6.4 days, which is the highest level reached during the past 5 years. With regard to capacity utilization, the occupancy rate stood at an average of 62.1% over 2018, which is a marginal increase over the previous year.

Figure 2: Tourist arrivals and bednights; 2010 - 2020

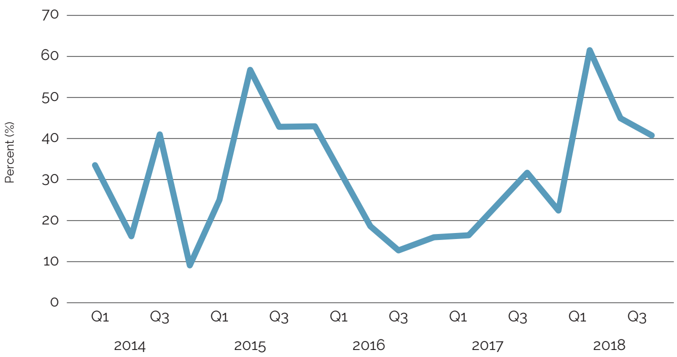


On the supply side, 829 tourism establishments were in operation across the country at the end of 2018, of which 136 were resorts and 534 were guesthouses. This translates into a total of 43,660 beds, which is a growth of 7.6% compared to a year earlier.

Construction sector

The construction sector of the Maldives accounts for a share of about 6% of real GDP. Driven by large infrastructure projects and private sector investments in real estate, the sector has experienced robust growth over the past few years. According to the most recent quarterly GDP estimates, the sector grew by 19.7% over the first three quarters of 2018 compared to the corresponding period of the previous year, and is estimated to have grown 17.3% over the entire year. This strong growth is expected to persist into the medium term, on account of increased credit to the construction sector and the infrastructure, residential and resort development projects in the pipeline.

Figure 3: Construction sector growth; 2014 - 2018



Fisheries sector

Despite having a share of around 4% in the economy, the primary fisheries sector provides a livelihood to many families in the Maldives, especially in outer islands. The growth of the fisheries sector registered 11.0% in 2017, supported by a 42.2% increase in fish purchases by fish processing companies. Although fish purchases during the first three quarters of 2018 declined marginally by 0.4%, the sector expanded by 10.6% according to the most recent quarterly GDP estimates.

Inflation

The average inflation in the Maldives in 2018 was at -0.1%. The main reasons for this deflationary episode are the base effects associated with the following two governmental policy changes:

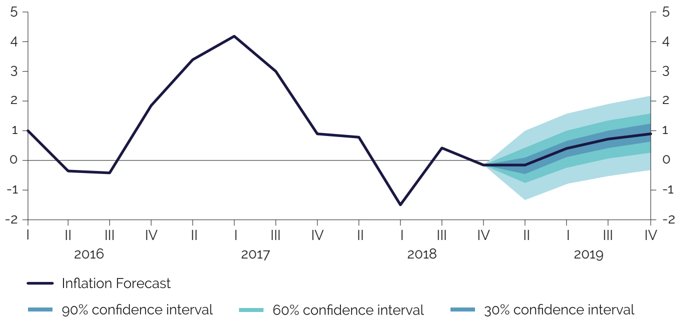
1. The reversal of the subsidy policy for staple goods; the government decreased the ceiling of administered prices for staples, effective from April 2018, after increasing the ceiling in October 2016.
2. Harmonizing the tariff rates on utilities (water and electricity) in the Maldives; to be in line with the tariff rates in Male' as well as other regions/atolls, decreasing the prices of utilities faced by all consumers in these regions.

These two government policies exerted downward pressure on the CPI basket, evident from the year-on-year declining growth rates of items associated with these policy changes (staples, electricity).

Looking ahead, inflation is forecasted to average at 0.5% in the year 2019. This acceleration of inflation from 2018 is a result of the complete dissipation of the base effects related to governmental policy changes. In addition, the inflation trajectory is then forecasted to marginally increase the rest of the year, indicating the overall inflationary episode for the year.

However, any unforeseen governmental policy changes which may exert or ease inflationary pressure is a risk factor to this outlook. In addition, shocks to global commodity prices such as oil prices would also have an impact on inflation since almost all commodities are imported to the Maldives.

Figure 4: Headline Inflation Projections; 2016 – 2019, (year-on-year percentage change in prices)



Public Finance

Government revenue

Government revenue and grants have been increasing rapidly over the past few years, averaging at 13.0% over the period 2014 – 2018. Looking at the year 2018, government revenue and grants totaled MVR 21,322.7 million, which is an increase of 5.3 per cent (MVR 1,064.1 million) compared to the previous year. This was mainly driven by an increase in tax receipts, which increased by 4.2 per cent (MVR 620.69 million). The increase in tax revenue was in turn driven by a significant increase in tourism goods and services tax receipts, reflecting the strong performance of tourism sector during the year. Meanwhile, non-tax revenue also increased by MVR 451.3 million (9.8 per cent) in 2018, primarily due to an increase in the collection of the airport development fee.

Government expenditure

Total government expenditure has also been increasing consistently over the years, on account of increases in both recurrent and capital spending. For the year 2018, total expenditure registered MVR 25,837.1 million, which is an increase of 14.8 per cent (MVR 3,339.5 million) compared to 2017.

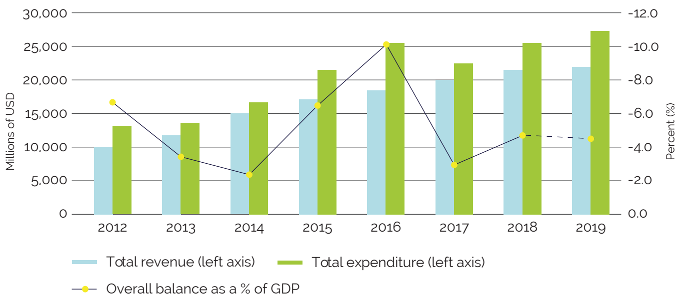
Current expenditure, which accounted for 66.2% of total expenditure, increased by 14.4% in 2018 and registered MVR17,113.6 million. This was mainly the result of significant increases in administrative and operational expenses, salaries and wages, contributions and subsidies payments. Meanwhile, capital expenditure totaled MVR 8,723.5 million in 2018, up by 15.7% compared to the previous year. The decline in capital expenditure was primarily due to the fall in spending on development projects and investment outlays.

Fiscal balance and public debt

On account of unrealized revenues and increases in expenditure, the government budget recorded an overall deficit of MVR4,514.4 million for the year 2018. The primary balance, which is the overall balance less interest expenditure, recorded a deficit of MVR2,936.4million. As a result, public debt rose to MVR48,577 million (58.9 per cent of GDP) at the end of 2018, which is an increase of 12.3% compared to a year earlier.

Looking ahead, measures are being taken to ensure that the government's aim of achieving a balanced budget within the next 5 years is achieved. These measures include tax reform, private sector development initiatives to expand the tax base and subsidy reform.

Figure 5: Government revenue, expenditure and fiscal balance; 2012 - 2019



Monetary and Financial Sector

Monetary policy and exchange rate policy

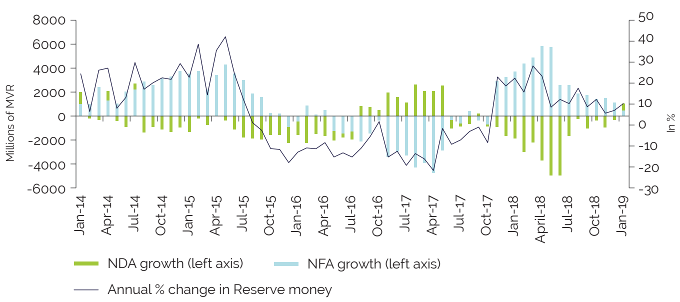
The key objective of the monetary policy of the MMA is attaining price stability and maintaining an adequate level of external reserves. The latter is essential for conducting foreign exchange interventions to stabilize the exchange rate peg with the US dollar within the horizontal band.

Currently, the exchange rate regime of the Maldives is a currency peg within a horizontal band, where the Maldivian Rufiyaa is pegged to the US dollar within a horizontal band of ± 20%, i.e. between 10.28 Rufiyaa and 15.42 Rufiyaa per US dollar. To ensure exchange rate stability, the MMA monitors the developments in the foreign exchange market and carries out foreign exchange intervention.

Monetary sector developments

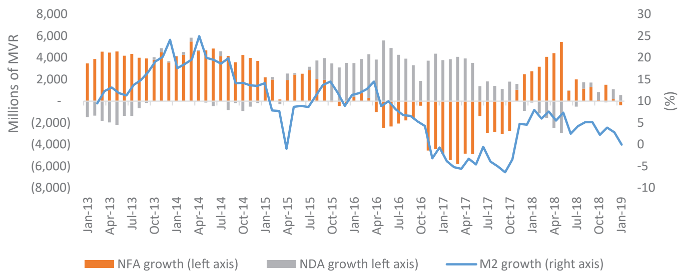
The monetary base (also referred to as the reserve money or M0) stood at MVR11.6 billion at the end of January 2019. In annual terms, monetary base increased by 10% in January 2019 compared to the corresponding period of 2018. The annual growth in monetary base reflects both the increase in NFA and NDA of the MMA, which increased by 5% and 44% respectively. The annual rise in NFA of the MMA mainly reflects the accumulation of the foreign assets of the MMA, facilitated by the improvements in the usable reserves of the MMA as well as the increase in the foreign currency balances of the commercial held at the MMA. As for the annual increase in the NDA of the MMA, this was mainly due to the fall in the domestic liabilities of the MMA owing to the declining ODF placements of the commercial banks. It should be noted that the contribution of the NDA towards monetary base of the MMA became positive for the first time in January 2019 after 15 months (Figure 6). As shown in Figure 6, the NDA recorded annual declines consecutively from October 2017 until December 2018, and thus hampered the monetary base growth.

Figure 6: Reserve money and its sources



As for the money supply, which is measured by M2, it increased annually by 1% to record MVR 33.2 billion in January 2019. This modest growth in M2 was solely due to the expansion in the NDA in the banking sector as NFA registered an annual decline during the review period. As such, NDA recorded an annual growth of 3% while NFA fell by 3% in January 2019. The expansion in NDA is mainly attributed with the increase in private sector credit growth as well as the increase in commercial banks' investments in government securities. It should be noted that NFA of the banking sector declined because of the fall in the NFA of commercial banks despite the annual increase observed for NFA of the MMA.

Figure 7: Money supply and its sources

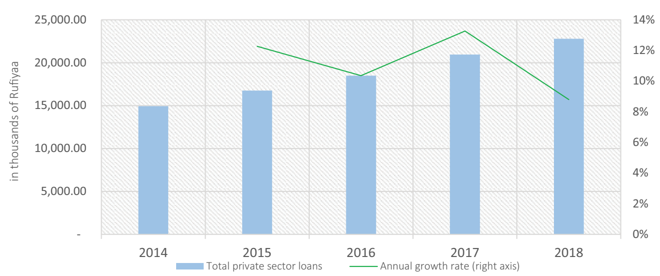


The MMA will continue its foreign exchange interventions and management of local currency liquidity aiming to achieve exchange rate stability in order to maintain overall inflation or prices within a reasonable level. The authority will continue its current accommodative monetary policy stance as long as the exchange rate remains within the target band. As for the policy rates, the authority intends to maintain the current interest rate corridor for an extended period of time. The MMA will continue monitoring developments in prices and economic activity, as well as the developments in the domestic foreign exchange market. Accordingly, the authority will make necessary policy adjustments to maintain the momentum towards achieving the price stability.

Financial sector performance

The banking sector continued to show strong growth in 2018 as profitability and asset quality of the banking sector improved compared to 2017 and capital adequacy ratios remained strong. Total risk-based capital ratio recorded 44.24%, on account of the large share of low-risk assets in the banks' portfolio.

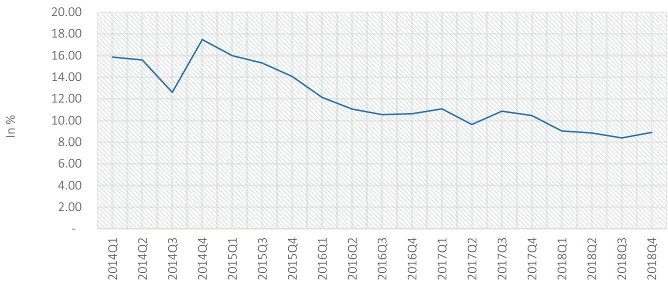
Figure 8: Private sector loans; 2014 - 2018



The total loan portfolio of the banking sector expanded by 6.62% in 2018 from the previous year while the share of non-performing loans (NPLs) in total loans decreased from 9.66% in 2017 to 8.90% in 2018. As shown in figure 7, the banking sector loans to private sector continue to expand but at a slower pace.

In terms of asset composition, net loans and advances accounted for 49.23% and liquid assets accounted for 49.25% of the net asset portfolio.

Figure 9: Non-performing loans of the banking sector; 2014 - 2018



Considering other financial institutions, non-bank financing sector continued to show stable growth. The capital adequacy ratio remained strong, with total risk-based capital ratio recorded 36.19% during 2018. Asset quality improved compared to the previous year, with the loan portfolio expanded by 9.15% and the proportion of non-performing loans (NPLs) in total loans declined from 1.77% in 2017 to 1.68% in 2018.

The insurance sector grew steadily in the year 2018 as indicated by the key variables which are used to measure the growth of the industry—insurance penetration and density. In annual terms, the insurance penetration increased marginally to 1.06% in 2018 after registering 1.02% in 2017 . Meanwhile, insurance density increased to USD111.02 in 2018 from USD101.23 in 2017. The growth in both indicators show the increase in the gross written premium, which increased annually by 13% in 2018.

External Sector

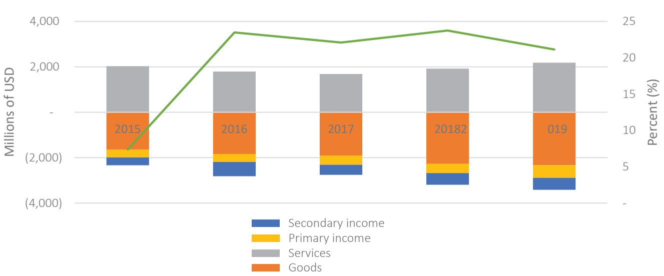
Balance of payments and gross international reserves

Current account

Current account deficit is an important indicator of the country, given the high dependence on merchandise imports and the tourism sector. According to the estimates made by MMA in October 2018, the current account deficit stood at US$1,270.2 million in 2018 (equivalent to 24% of GDP) when compared to a deficit of US$1,072.8 million in 2017 (equivalent of 22% of GDP). This increase in the current account deficit reflected the growth in merchandise imports despite a considerable rise in travel receipts during the year.

For 2019, the current account deficit is expected to improve marginally to US$1,235.6 million (equivalent of 21% of GDP). This is mainly on account of higher expected growth in travel receipts (the largest inflow component in the current account) compared with the growth in merchandise imports.

Figure 10: Composition of Current Account; 2015-2019



Financial account

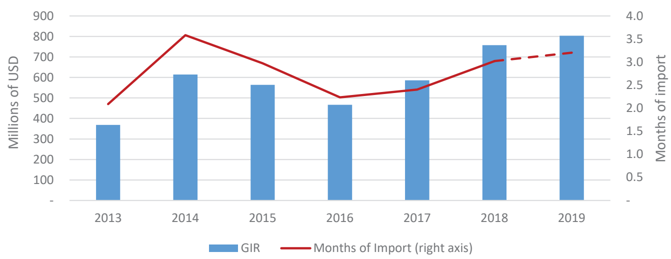
The financial account, which is a depiction of how the current account deficit is essentially financed, shows a net borrowing of US$1,321.2 million in the year 2018. One of the biggest inflows of financial account in the year 2018 was in the form of foreign direct investments flows and private sector loans from abroad. In 2019, the financial account is expected to stand at a net borrowing of US$1,247.7 million, largely on account of FDI inflows that are expected to be around US$564.6 million, including reinvested earnings. In addition to this, the current account is expected to be financed by the government borrowing (portfolio debt and loans) and the private sector borrowing from abroad.

Gross international reserves (GIR)

By the end of December 2018, the gross international reserves (GIR) stood at USD757.8 million and the usable reserves (UR) stood at USD280.9 million. While the GIR increased by 29% in comparison to 2017, the UR also witnessed a growth of 36% when compared to the same period. The increase in the GIR was mainly due to the increase in usable reserves along with a significant increase in commercial banks' foreign currency deposits at MMA which was associated with the escalation in excess reserves of the banks. The increase in usable reserves stemmed from an 11% growth in revenue received from MIRA along with the reduced outflow payments in comparison to 2017. By the end of 2018, the stock of reserves was sufficient to maintain 3.1 months of imports.

The gross international reserves are estimated to be at USD803.4 million by the end of 2019, while the usable reserves are projected to be at USD292.5 million. In terms of UR, this is an increase of USD11.6 million compared to December 2018. This increase mainly stems from the anticipated increase in total inflows for 2019 owing to the expected increase in the financing flows compared to 2018. The main downward driver in 2019 is the expected repayment of the swap facility availed in December 2018 and the increase in MMA FX intervention compared to 2018.

Figure 11: Gross international reserves; 2013 - 2019



[1] Figures for 2018 are derived from unaudited returns submitted to MMA.

[2] Figures for 2017 are revised to include revised population and GDP data (Source: Monthly statistics, January 2019) and audited figures.