Maldives

The economy grew fast in 2011 owing to continued strong growth in mainly Asia-sourced tourism, but still has to grapple with hefty fiscal and external imbalances. A devaluation of the local currency in April 2011 should help, over the longer term, counter dollar shortages, though it has pushed inflation higher. The resignation in February 2012 of the president—succeeded by the vice president, from the opposition—was met with unrest and has raised uncertainty for the outlook. The impact on tourism, however, is expected to be limited.

Economic performance

The economy grew by 7.5% in 2011, supported by continued buoyant growth in tourism and related sectors such as construction, transport, and communications (Figure 3.18.1). Tourism, accounting for about 30% of GDP, saw a second year of strong recovery with arrivals up by 17.6% (Figure 3.18.2). An influx of visitors from the Peoples' Republic of China (up by 67%) and elsewhere in Asia (up 13%) again drove the expansion, while growth of European tourists slowed to 6%. Asian visitors now make up a third of the market.

Fisheries, the main source of employment in the outer atolls, has steadily declined from its peak in 2006. The total catch declined by about 5% in 2011, although the value of fish exports posted a strong gain on increases in price and volume of sales. The volume of the fish catch is not expected to improve, given the continued decline of fish resources in the Indian Ocean.

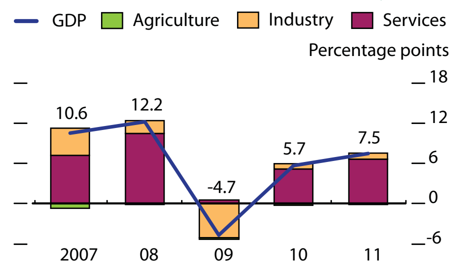
Inflation in 2011 moved to double digits, reflecting a steep rise in prices of fish, a staple, and increases in global food and oil prices, exacerbated by a 16% devaluation of the local currency against the US dollar (Figure 3.18.3).

The budget deficit improved substantially to 10.2% of GDP (16.1% in 2010). Although further tax reform was delayed, the Tourist General Service Tax (T-GST) that came into effect during the year helped lift revenue by 38.9%. Growth in expenditure was kept to 12.4% in line with the expansion in nominal GDP, holding expenditure to just over 40% of GDP.

Broad money supply (M2) increased by about 20%, driven by the rise of government claims and expansion of private sector credits. Credit to the private sector grew by 6%, largely owing to an increase in wholesale and retail trade and investment in resort development.

The current account deficit is estimated to have widened to $647 million (31.9% of GDP) from $463 million the previous year, reflecting the economic recovery, much higher commodity prices, and

3.18.1 Contributions to growth (supply)



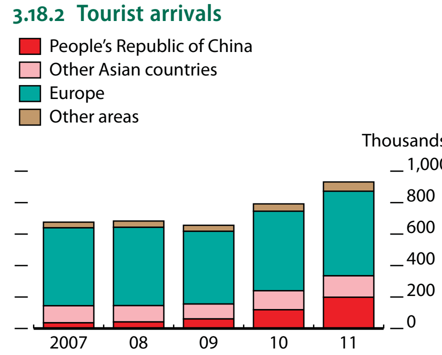
Source: Maldives Monetary Authority. 2012. *Monthly Statistics*. February. http://www.mma.gov.mv.

3.18.1 Selected economic indicators (%)

	2012	2013
GDP growth	3.5	4.5
Inflation	4.5	7.5
Current account balance (share of GDP)	-38.0	-38.0

Source: ADB estimates.

3.18.2 Tourist arrivals



Source: Maldives Monetary Authority. 2012. *Monthly Statistics*. February. http://www.mma.gov.mv

This chapter was written by Huiping Huang of the South Asia Department, ADB, Manila.

improved tourism receipts. Preliminary estimates indicate that financing fell short of the deficit and gross international reserves went down by about $15 million to $335 million.

Economic prospects

The economic outlook is of course tightly interwoven with developments in tourism. The political instability and unrest in the capital Malé and other atolls in early 2012, which were widely reported in the foreign media, caused some cancellations and will likely hold back the growth in bookings in 2012. Still, the Maldives has an established reputation as a high-quality destination and has traditionally strong marketing links with Europe and demand is fast growing among Asia's increasingly affluent middle class.

Assuming no major incidents of unrest in the lead-up to the presidential election (the date has yet to be set) tourism should stay robust. With the outlook underpinned by a sizable expansion in government expenditure, economic growth is expected to moderate to 3.5% in 2012 and then pick up to 4.5% in 2013.

The budget deficit for 2012 is set to ease slightly, but remains heavy at 9.7% of GDP. Total budget revenue in 2012 is expected to rise substantially despite reduced import tariff rates provided in the 2012 budget. Large deficits have been financed both domestically, mainly by issuance of Treasury bills and privatization of state-owned assets over the past several years, and externally by borrowings. But the privatizing approach is reaching a limit, and Treasury-bill financing cannot be sustained in the long term.

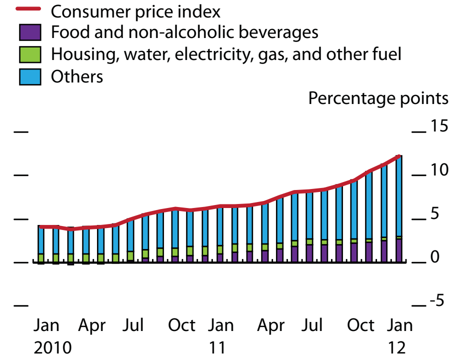
A more immediate complication for the budget is that already-programmed multilateral financing could be postponed due to the delays in completing the program because of unmet performance criteria. The GST Act that was approved by Parliament had a lower T-GST rate for 2013 and beyond.

On the expenditure side, the second phase of the redundancy plan of further downsizing the civil service will be difficult to implement in 2012 due to political conditions.

Inflation is expected to moderate in 2012 and then move higher in 2013 on domestic demand pressures, pacing global commodity prices. Pressure from the persistently large fiscal deficit remains, though tightening of monetary policy will be partly offsetting.

With likely slower growth in tourist arrivals, earnings are expected to moderate. Slower growth and an expected modest fall in global oil prices will ease the import bill a little, although the current account deficit will widen and as a share of GDP climb to about 38.0% in 2012 and 2013.

3.18.3 Contributions to inflation in Malé



Source: Maldives Monetary Authority. 2012. *Monthly Statistics*. February. http://www.mma.gov.mv

3.18.1 Policy challenge—reducing the budget deficit

Since 2009, the government has sought to implement an economic program aimed at reducing the large fiscal deficit, but with Parliament and presidency in the hands of different political parties, progress has been slow.

It looks set to remain that way in the medium term, too, because, although an initial voluntary redundancy plan for government staff and the first phase of a detailed plan for staff reduction has been carried out, the second phase (or raising taxes) faces strong political resistance.

Expanding the tax base could be one outcome of creating regional economic and commercial centers in larger islands outside Malé, with the right policy incentives for population consolidation.

Such moves would also help diversify the economy from tourism—four-fifths of the economy is directly or indirectly related to the industry—and create a more inclusive growth model other than expanding resorts.

The new centers could help bring forward myriad opportunities for trade, construction, and transport, and creating jobs for locals (tourism relies heavily on expatriate workers).