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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/43-2

10:35 a.m., May 29, 2019

2. Maldives—2019 Article IV Consultation

Documents: SM/19/95 and Correction 1; and Supplement 1; and Supplement 1, Correction 1; and Supplement 2; and Supplement 2, Correction 1

Staff: Karam, ICD; Haksar, SPR

Length: 43 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	I. Mannathoko (AE)
	M. Bangrim Kibassim (AF), Temporary
	J. Di Tata (AG)
N. Ray (AP)	
	P. Fachada (BR)
	K. Lok (CC), Temporary
	J. Suazo (CE), Temporary
	C. Williams (CO), Temporary
R. Kaya (EC)	
	A. Sode (FF), Temporary
	W. Kuhles (GR), Temporary
	P. Dhillon (IN), Temporary
	T. Persico (IT), Temporary
	Y. Saito (JA)
	K. Badsi (MD), Temporary
	S. Geadah (MI)
	R. Doornbosch (NE)
	J. Sigurgeirsson (NO)
	A. Tolstikov (RU), Temporary
	R. Alkhareif (SA)
A. Mahasandana (ST)	
	C. Wehrle (SZ), Temporary
	J. Stockill (UK), Temporary
M. Rosen (US)	

H. Al-Atrash, Acting Secretary
E. Tsounta, Summing Up Officer
A. Lalor, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Asia and Pacific Department: A. Gulde, J. Jonas, R. Moussa, C. Rhee, R. Salgado, B. Zhu. Finance Department: N. Denewet. Institute for Capacity Development: P. Karam. Legal Department: A. Aly. Monetary and Capital Markets Department: A. Marina. Research Department: E. Cerutti. Secretary's Department: A. Lalor. Strategy, Policy, and Review Department: V. Haksar. World Bank Group: N. Beisenova, F. Blum.

Senior Advisors to Executive Directors: W. Abdelati (MI), M. Choueiri (MI). Advisors to Executive Directors: P. Al-Riffai (MI), M. Bernatavicius (NO), J. Hanson (NE), M. Kikiolo (AP), M. Merhi (MI), E. Ondo Bile (AF), R. Pandit (ST), A. Zaborovskiy (EC).

2. MALDIVES—2019 ARTICLE IV CONSULTATION

Mr. Geadah and Ms. Choueiri submitted the following statement:

Background

Maldives has a population of around 436 thousand people, widely-dispersed across about 190 distant islands. The economy has undergone a remarkable transformation over the past three decades, largely due to the development of a dynamic high-end tourism sector, reflected in robust growth and considerable development of the country's infrastructure and connectivity. Real GDP growth over 2011-17 averaged 6.1 percent per annum. It was about 7.5 percent in 2018, reflecting robust growth in tourism, wholesale, retail, and construction supported by new resort development, infrastructure, and housing projects. Growth is projected to remain strong in 2019.

Climate change, high on the government's agenda, is an existential threat to the Maldives as over 80 percent of the land is less than one meter above sea level and is accordingly under threat from rising sea levels. The additional challenges associated with the country's dispersed geography include difficult service delivery and limited opportunities for job creation and economic diversification. To respond to these challenges, the government initiated a development strategy, focusing notably on the Greater Malé region. The strategy entailed investments in larger islands to improve basic service delivery, protect households from the impact of climate change and natural disasters, and create economic opportunities. The implementation of this strategy translated into construction and infrastructure spending as major drivers for economic growth.

The authorities are seeking to strike a balance between much needed investments to close infrastructure gaps—potentially allowing to increase resilience to climate change, boost tourism, and ease constraints in service delivery—and managing the temporary widening of the fiscal and external deficits associated with these investments. The new government is committed to maintaining macroeconomic stability and adjusting policies to manage risks and put public finances on a more sustainable footing. While the Maldives ranks better than peers in poverty and inequality, the authorities are aware that more efforts are needed to ensure inclusive growth. The new government also aims to fight corruption and improve the quality of growth by encouraging greater private sector involvement. The National Development Strategy focuses on decentralization, economic diversification, and integration of tourism with other industries.

External Sector

The authorities consider that high current account deficits (CADs) reflect temporary increases in imports associated with large infrastructure projects. Accordingly, they assess external sector risks to be balanced as growing tourism proceeds and the unwinding of large infrastructure projects should reduce the CAD starting this year. The CAD remained high in 2018, reflecting sizeable imports associated with public infrastructure projects and resort investments (10 new resorts opened in 2018 and another 20 resorts are expected to open in 2019).The CAD is projected to decline to 19.5 percent of GDP in 2019, as major infrastructure projects start to unwind, and it is expected to decline to below 10 percent of GDP over the medium term, as estimated by staff.

The EBA-lite models used by staff indicate that the current account (CA) norm is estimated at around 9 percent of GDP leading to a CA-gap of 15 percent. The authorities stressed during the mission that the CA-gap would be reduced substantially, if adjusted for the temporary spike in infrastructure spending that is estimated at 8 percent of GDP. They would have appreciated inclusion of this important adjustment in the external sector assessment, as they had requested.

Staff estimates that foreign exchange reserves, which increased markedly to 2.4 months of imports at end-January 2019, are below IMF reserve adequacy metrics. The authorities reiterate their view that assessing the adequacy of reserves in terms of import coverage may not be suitable for the Maldives, considering the large capital imports related to infrastructure projects and imports by the tourism sector. In any event, the Maldives Monetary Authority (MMA) is implementing a comprehensive reform plan aimed at building reserves buffers. The plan includes provision of incentives to hold domestic currency, support de-dollarization, strengthen foreign exchange market operations, and enhance the effectiveness of foreign exchange intervention. The MMA is also considering larger and longer-term swap arrangements with the Reserve Bank of India for emergency liquidity assistance.

The authorities do not agree with staff's assessment that important external financing challenges exist (¶14). In addition to building reserve buffers to alleviate financing pressures associated with the repayment of outstanding debt from major infrastructure projects, the authorities established in 2017 a Sovereign Development Fund (SDF) to serve as a fiscal reserve for the amortization of sovereign bonds coming due in 2022 and 2023. The SDF is financed mainly by airport development fees and airport service charges. The SDF balances reached US$124 million at end-February 2019, covering 35 percent of the sovereign bonds.

Fiscal Policies and Reforms

The authorities fully concur with staff that fiscal consolidation is needed to strengthen fiscal sustainability and increase fiscal buffers. Several expenditure-reduction measures were taken in 2016 and 2017. Social spending was increased in 2018 given the need for inclusive growth policies. The new government is committed to reducing the deficit by boosting revenues and cutting inefficient spending, while actively seeking new sources of financing at favorable terms. Although tax revenues are in line with comparator countries, the authorities intend to introduce a personal income tax in 2020 and to strengthen tax administration. They take note of staff's advice on additional tax reforms. They do not favor increasing the General Sales Tax, as it is regressive and would adversely impact SMEs, which is contrary to the government's policy on inclusive growth. They are also concerned that an increase in the airport service charge would negatively affect the guesthouse sector, which is important for the economies of non-resort islands. They consider that further fiscal adjustment should focus on addressing spending inefficiencies and leakages in the health care system, reforming subsidies, and enhancing the procurement policies and efficiency of State-Owned Enterprises (SOEs), which are a priority for the new government.

Fiscal reforms have continued with the establishment of a Tax Policy Unit at the Ministry of Finance aimed at strengthening capacity in analyzing and designing tax policies. Public financial management (PFM) measures have also progressed. In addition to budget preparation and better commitment control and cash management, the authorities improved the budget process by reducing expenditure reallocations. Important progress was also made in implementing the IMF 2016 Public Investment Management Assessment recommendations, which will also help reduce vulnerabilities to corruption. Other public sector reforms include the Civil Services Commission's completion of human resources audits of line ministries. The reform aims to institutionalize a fair and structured compensation system, which would retain technical staff and improve the efficiency of the civil service and thus contain the growth in expenditure.

The authorities recognize the risk that high public debt poses. The new administration is closely scrutinizing government guarantees and has been regularly auditing and publishing data on government guarantees on the Ministry of Finance's website. Recently the government expanded the coverage of public debt to include guaranteed debt. The authorities emphasize the role of the SDF in mitigating financing risks over the medium term and intend to continue building up funds for repaying debt.

Monetary and Financial Sector Policies

The MMA is grateful for the IMF's technical assistance in support of its comprehensive reform plan and it stresses the need for continued support of its efforts to modernize the monetary policy and the foreign exchange operations frameworks.

The MMA assesses the monetary policy stance as appropriate and does not see the need for monetary policy tightening in the absence of inflation and foreign exchange market pressures. The parallel market premium had indeed declined steadily in light of MMA decisions in 2016 and 2017 to increase foreign exchange sales. In the event of exchange market or inflation pressures, the MMA stands ready to activate alternative monetary instruments based on open market operations, if needed.

The authorities consider that current credit growth is well-paced. While private credit has grown above nominal GDP last year, it reflected financial deepening, with lending mainly geared to productive investment and no sign of sector-specific credit booms, as acknowledged by staff. Moreover, financial stability risks are low, given by banks' high capitalization, reserves exceeding the minimum reserve requirements, high profitability, declining nonperforming loans, and nearly total provisioning for specific loan losses. In addition, currency risk is limited, as banks extend foreign currency loans primarily to borrowers with income in foreign currency.

The MMA has continued to take measures aimed at strengthening financial stability and inclusion. It is improving reporting standards, drafting new liquidity regulations, improving on-site and off-site supervision, and increasing its operational capacity. The credit guarantee scheme is under review to mitigate risks and improve its effectiveness. The collection and dissemination of credit information are satisfactory and credit reports are widely used by institutions. The MMA also noted that the payment system development project will also facilitate financial inclusion. With regards to financial sector oversight, initiatives are also being taken to strengthen corporate governance requirements and risk management practices. To better combat financial crimes, the MMA continues to strengthen its AML/CFT capacity, including by improving the legal framework and increasing resources for the independent Financial Intelligence Unit.

The authorities welcome the opportunity to have an open and candid exchange of views with staff on their current policies. However, they regret the high frequency of IMF mission chief turnover, especially given their unique risks, vulnerabilities and operating context. They also highly appreciate the IMF's valuable technical assistance and the support provided by the Resident Representative Office based in Sri Lanka. To ensure deeper knowledge of the Maldivian institutions and stronger engagement with the IMF, the authorities would like to reiterate their call for a Maldivian national to be employed in the Resident Representative Office, and possibly based in Malé. The authorities welcome the IMF's continued focus on issues of relevance to small states.

Mr. Fachada and Ms. Mohammed submitted the following statement:

We thank staff for their report and Mr. Geadah and Ms. Choueiri for their helpful statement. Maldives is a small open economy that faces many constraints to economic development due to its high reliance on tourism and its vulnerability to natural disasters and climate change. This notwithstanding, the country has experienced impressive GDP growth in recent years. This positive performance has been accompanied with intensified budget pressures and fiscal and public debt sustainability concerns. We commend the authorities for their tax policy reforms and underscore that enhanced fiscal consolidation is key to putting public debt on a downward trend.

Fiscal consolidation is needed to preserve fiscal sustainability and to put the public debt ratio on a firm downward path. Despite the robust growth in the Maldivian economy, public debt sustainability risks remain high. Addressing these risks hinge on enhanced revenue measures, tighter spending control and improved efficiency. We see merit in strengthening tax administration and introducing the personal income tax. Greater effort is needed in expenditure controls for it to be more impactful, particularly with respect to recurrent expenditure. Prioritizing capital expenditure and continued PFM reforms together with proper management of contingent liabilities would also help promote fiscal and debt sustainability.

We take note that the external position in the Maldives is substantially weaker than fundamentals. Whilst the unwinding of large infrastructure projects will assist in the reduction of the external gap, the current account deficit is expected by staff to stay in double digits in the medium term. In the same vein, we take note that although international reserves have increased, they remain low at around 2.4 months of imports. The real effective exchange rate overvaluation and the high external debt warrant enhanced fiscal consolidation and implementation of structural reforms to boost FX inflows including foreign direct investment.

Increasing the role of private investment would enhance competitiveness and increase potential growth. Invigorated efforts to improve the country's business environment complemented by a strengthened regulatory framework would benefit Maldives, by encouraging private investment. In this regard, we welcome the authorities' National Development Strategy (NDS) in providing a holistic approach in promoting inclusive growth. We acknowledge the authorities' diversification efforts regarding integration of tourism into other industries, but consideration should also be given to broaden the tourism base.

The authorities' commitment to strengthen governance is welcome. We commend the authorities for their commitment to strengthen governance, combat corruption and ensure transparency but further advances to improve the anti-corruption framework and institutions, and strengthen AML/CFT compliance would be welcome. Procurement reforms focused on increasing spending efficiency and improving transparency should also be considered to reduce opportunities for corruption.

Maldives remains susceptible to natural disasters and climate change. We take note from the recommendations in the last Article IV consultation that risk-reduction and disaster-response programs should be integrated into Maldives core budget. In response to this, the authorities considered participating in the IMF-World Bank Climate Change Assessment Program (CCPA). Could staff indicate why Maldives has not been chosen among the pilot countries and whether there are any plans with respect to assessment under the recently discussed Board paper on Building Resilience to Large Natural Disasters?

Finally, we second Mr. Geadah and Ms. Choueiri views about the high turnover of IMF mission chiefs and the importance to have a resident representative office in Malé to enhance traction of IMF surveillance and capacity development.

Mr. Kaya and Mr. Zaborovskiy submitted the following statement:

We thank staff for the informative report and Mr. Geadah and Ms. Choueiri for their insightful buff statement. Macroeconomic imbalances and rapidly growing debt point to the need for rebuilding buffers and making necessary policy adjustments, duly taking into account the specificity of the Maldivian island economy and its susceptibility to climate related risks. We are encouraged that the new government is committed to maintaining macroeconomic stability and adjusting policies to put public finances on a more sustainable footing. We broadly share the thrust of the staff's appraisal and would like to make the following comments for emphasis.

Fiscal consolidation anchored by stronger budget and debt targets remains critical to lower the risk of debt distress. The results on the fiscal front remain disappointing against the widened fiscal deficit and surging debt with a high risk of distress. While acknowledging the importance of infrastructural developments and inclusive social spending as highlighted by Mr. Geadah and Ms. Choueiri, the scope and size of such expenditures and programs should be consistent with fiscal and external sustainability. We note that staff recommends adopting a fiscal consolidation strategy to reduce the deficit by over 3 percent of GDP to stabilize public debt, however, the off-budget and quasi-fiscal activities in the Maldivian economy have weakened the link between budget and debt accounts. Could staff comment on the fiscal target that may perhaps better capture all debt-creating flows? How should the Sovereign Development Fund activity be reflected in the fiscal accounts? Structural fiscal reforms, including the medium-term budget framework, fiscal risk management, integration of risk-reduction and disaster-response programs into the core budget, remain important to ensure fiscal sustainability and efficiency of public spending. We positively note the authorities' fiscal plans on the revenue and expenditure sides, outlined in the buff statement, and encourage them to steadfastly move forward with their implementation.

Tightening Monetary policy and advancing the FX market reforms could support external rebalancing. We note the differing views between staff and the authorities on the monetary and exchange rate policies as well as the results of the External Sector Assessment. While some adjustment of the current account (CA) gap for the temporary spike in infrastructure spending indeed seems reasonable, the CA deficit at 24 percent of GDP in 2018 and projected at 19.5 percent of GDP in 2019 points to significant external imbalances. Could staff make a decomposition of the CA deficit into private and public saving-investment gaps? Debt financing of the CA deficit further exacerbates the vulnerabilities of the Maldivian economy, complicating the FX market and exchange rate regime reforms. Before shifting the exchange rate target to a composite basket peg from the current peg to the US dollar, a full economic assessment of its impacts on the unhedged borrowers and public finance should be completed with the appropriate mitigating measures in place. We positively note that the Maldives Monetary Authority is committed to continue implementing reforms to build-up FX reserves, advance de-dollarization, and strengthen foreign exchange market operations.

Well-sequenced structural reforms, including in the financial sector, are indispensable for more inclusive and private-sector-led growth. We welcome the growing credit to private businesses and the ongoing financial deepening on the backdrop of broadly appropriate financial sector oversight and improving banks' balance sheets. However, as rightly pointed out by staff, Maldives' private sector credit-to-GDP ratio is still well below its peers. Could staff elaborate more on the authorities' strategy on developing the private sector and proceed with privatization, including the financial sector? Are there any specific plans for 2019 and 2020 in this area? We positively note the new government's commitments to strengthening governance, combating corruption, and ensuring transparency. Regarding the AML/CFT framework, further advancing the legislation and boosting institutional capacity in this area should be a priority. In light of the recent Executive Board discussion on building resilience to large natural disasters, we would welcome comments on how the three-pillar framework proposed by staff will be applied to Maldives.

Finally, we encourage the Maldivian authorities to close the remaining data gaps in their official statistics. We wish the authorities every success in their policy endeavors.

Mr. Doornbosch, Mr. Psalidopoulos, Mr. Hanson and Mr. Persico submitted the following statement:

We thank staff for their well-written report and Mr. Geadah and Ms. Choueiri for their insightful buff statement. We welcome the commitment of the new government to maintain macroeconomic stability and to put public finances on a more sustainable path. Addressing high public debt, balance of payment risks and climate-related risks requires an ambitious policy agenda. We broadly share staff's assessment and would like to make the following points for emphasis.

High public debt and external risks warrant a prudent fiscal and monetary stance.

We welcome the authorities' agreement with staff on the importance of ensuring fiscal sustainability and increasing fiscal buffers. At the same time, we note that public debt keeps increasing in the baseline scenario. We agree with staff's adjustment scenario that will put debt on a declining path while preserving productive infrastructure investment. The high current account deficit and the relatively low reserve ratio also call for a tighter monetary stance. The Sovereign Development Fund provides a welcome buffer to refinance the peak in sovereign bond amortization in 2022 and 2023. Still, a tighter monetary stance would support the build-up of reserves and mitigate the risk of a disorderly exchange rate correction, which is important to reduce risks related to the repayment schedule of external debt.

The authorities should carefully monitor the risks related to publicly guaranteed external SOE debt. We agree with staff on the need to limit public guarantees and improve oversight and governance and we welcome the authorities' three-pronged approach to improve SOE performance and reduce their fiscal risks. We note that staff's current account adjustment assumes a decline in SOE investment from 10 percent in 2018 to 3 percent in 2023, which could be ambitious. We noted the recent WB decision to provide to the Maldives IDA concessional financing on 50 percent grant and 50 percent credit basis (despite exceeding the income graduation threshold by 184 percent), due to non-compliance with IDA NCBP, in FY19. This affects the assessment for graduation from PRGT eligibility. Could staff provide more details on the reasons for the IDA grant-only classification? Moreover, The DSA does not include non-guaranteed SOE debt. We wonder whether non-guaranteed SOE debt could pose a greater than expected contingent liability for the government, and whether the SOE-shock in the contingent liabilities stress test should have exceeded the standard 2 percent of GDP given the size of the SOE sector. Staff comments are welcome.

We regret the limited attention given to climate-related risks in the report. In their buff statement, Mr. Geadah and Ms. Choueiri mention that climate change is an existential threat to the Maldives. However, besides two references in paragraph 1 and 17, this topic is not raised in the report. As acknowledged in the 2017 Article IV report, the 2004 Tsunami highlighted the country's vulnerability to climate-related events. Indeed, the recent Board paper on Building Resilience in Developing Countries Vulnerable to Large Natural Disasters mentions that the Maldives is at risk of major natural disasters. In the 2017 report, staff advised the authorities to integrate risk-reduction and disaster-response programs into the core budget, into public investment planning and into the debt management framework. Does staff still consider this to be a "key challenge" for the authorities? Can staff comment on progress on this front? We understand that the authorities expressed interest in a Climate Change Policy Assessment. We agree that this would be a useful product to assist the Maldives in further developing its climate change policy.

Mr. Rosen and Ms. Svenstrup submitted the following statement:

The Maldives is a small open economy, highly vulnerable to external shocks. Growth has been strong but volatile, reflecting the strong reliance on the tourism sector. Further, the previous government's sizable infrastructure scale-up initiative has driven an alarming rise in debt and the current account deficit, leaving the Maldives at a high risk of overall and external debt distress. In this context, the authorities' policy mix should aim to contain fiscal pressure, make debt more sustainable, and address large external imbalances. It is imperative that the authorities also develop and adhere to a transparent debt management framework and a rigorous project selection process. Further, the authorities' focus on addressing structural challenges, including longstanding governance challenges and tackling corruption, will support economic growth and diversification. We broadly agree with staff's appraisal and would like to emphasize points in three areas:

Debt sustainability: Public and publicly-guaranteed (PPG) debt has risen rapidly due to external borrowing, mainly by SOEs, to fund infrastructure investment. We agree with staff that fiscal consolidation is needed to put debt on a downward trajectory and enhance fiscal space to respond to shocks. We welcome the establishment of the Sovereign Development Fund to help mitigate future liquidity pressures.

It is critical for the authorities—as well as the public—to have a complete understanding of the entirety of the Maldivian government's outstanding debt obligations, including guarantees. To this end, the authorities have taken positive steps to enhance oversight of SOE operations and the issuance of government guarantees, and to increase transparency by publishing data on government guarantees on the Ministry of Finance's website. We also welcome the expansion of public debt to include guaranteed debt. Could staff confirm that the authorities now have the full picture of their debt obligations, including guarantees, and that this is reflected in the DSA?

Going forward, full costing of new projects will be critical to avoid once again running up public debt and to ensure that public investment yields the maximum returns to the country. Following the latest PIMA assessment, staff note that Maldives is still lagging in terms of efficiency of public investment, including problems with project selection, implementation, and assessment. Could staff provide more detail on the improvements made since the PIMA assessment and the priority outstanding areas of improvement needed?

External sector: Despite strong growth, external imbalances have worsened over the last year, and staff judge the external position to be substantially weaker than fundamentals. The exchange rate peg is supported primarily by exchange restrictions, and high debt and low FX reserves raise the risk of a disorderly correction. Tighter monetary conditions and fiscal consolidation—along with the decline of investment-related imports—would help to alleviate external imbalances. We also strongly urge the authorities to accept the obligations under Article VIII and accordingly take steps to eliminate the exchange rate restrictions and MCPs. Could staff provide an update on the expected timing for removing exchange rate restrictions and MCPs, as well as any technical work needed to facilitate the transition?

Economic diversification: We welcome the authorities' efforts to promote sustainable and inclusive growth outside of the tourism sector, primarily driven by private sector-led investment. The National Development Strategy is highly ambitious—potentially difficult to realize even for a government many times the size of that of the Maldives. The integration of tourism with other industries seems to be a particularly critical goal, given environmental limits on economic diversification. We urge the authorities to work closely with technical assistance providers to coordinate, sequence, and prioritize initiatives and capacity development activities.

Mr. Saito and Mr. Komura submitted the following statement:

We thank staff for the comprehensive report and Mr. Geadah and Ms. Choueiri for the informative statement. Maldives' growth has been strong supported by investment in tourism, commerce, and construction. However, the economy is highly vulnerable with large fiscal and external imbalances. Most importantly, public debt has significantly increased, and debt sustainability analysis indicates that the risk of external debt distress is high. The new administration should address these imbalances to preserve macroeconomic stability while taking pro-growth policies in a cost-effective manner. In this regard, we strongly support their clear commitment to the ambitious reform agenda toward these goals. As we broadly concur with staff appraisals, we would like to offer some comments:

Debt Sustainability and Fiscal Policy

We are concerned about public debt vulnerabilities. Despite recent strong growth, external PPG debt to GDP has rapidly increased by around 18 percent only for three years due to large infrastructure projects. Could staff comment on the quality of those infrastructure projects? In addition, we note that the authorities are of the view that institutional weaknesses are not the primary cause for the increase in external PPG debt owed to China. What does the new administration consider as the primary cause? Does staff agree on its view? Furthermore, the new administration pointed out a possible underreporting of debt previously contracted to finance the large executed infrastructure projects. Does staff have rough estimates of the possible size of underreported debt? Could staff comment on its impacts on debt sustainability assessment? On domestic debt, around half of them is short-term debt. The staff report mentions the risk that banks may not be willing to extend their purchases at fixed-rate auctions. Does staff see any rollover risks of domestic debt in the near-term?

The Maldives needs fiscal consolidation while taking well-prioritized pro-growth policies. Moreover, the Maldives is required to improve its fiscal governance. On fiscal consolidation, we agree with staff that the new administration needs to take a balanced fiscal adjustment relying on revenue and expenditure measures. We encourage the authorities to steadily implement necessary measures, including the planned tax policy reforms and the tax administration strengthening. On the fiscal governance, the Maldives should take a holistic approach, including enhancing debt transparency, improving debt management capacity, and raising efficiency of selecting and implementing capital projects. In particular, we agree with staff that limiting public guarantees and improving the oversight and governance of SOEs are warranted to reduce fiscal risks. We commend that the new administration is well aware of debt vulnerabilities and has committed to implement necessary reforms, including publishing data on government guarantees, developing the project appraisal guidelines by using Fund TA, and implementing three-pronged approach for SOE reforms.

Monetary Policy and Exchange Rate Management

We see merits in staff's recommendation for the Maldives Monetary Authority (MMA) to tighten its monetary policy stance. Together with fiscal consolidation, tighter monetary policy would contribute to narrowing current account deficits and preserving foreign reserves. We note that the MMA assesses that the current monetary policy stance is appropriate and is implementing a comprehensive reform plan aiming at building reserves, including provision of incentives to hold domestic currency. Does staff believe that the reform plan is adequate for preserving reserves?

Governance and Corruption

We strongly support that the new administration sets governance reforms as its priority. Governance and institutions need to be strengthened in a broad range of areas, such as fiscal governance and AML/CFT. We look forward to seeing steadily implementations of necessary reforms. We encourage staff to deepen the analysis of this area in the future Article IV consultations.

Mr. Sun and Ms. Lok submitted the following statement:

We thank staff for the comprehensive report and Mr. Geadah and Ms. Choueiri for the useful buff statement. The Maldives economy demonstrated robust performance in recent years, and growth is expected to remain strong in 2019 supported by tourism, commerce, and construction activities. Nevertheless, the economy faces challenges both domestically and stemming from the external environment and climate change. Strong efforts are needed to safeguard macroeconomic stability and achieve sustainable and inclusive growth, and we welcome the authorities' commitment in this regard. We broadly agree with staff's appraisal and would like to confine our comments as follows.

Fiscal consolidation is critical to preserving debt sustainability and rebuilding fiscal buffers. The authorities' planned tax policy reforms including the introduction of the personal income tax are a welcome development. We also see merit in staff's suggested three-pronged strategy to increase budget revenues, keep spending under control, and improve public financial management and budget control. In particular, for infrastructure investment to effectively support economic development, robust management is needed to ensure efficiency. We encourage the Fund to continue to closely engage with the authorities to strengthen their public financial management capacity, in order to fully reap the benefits of infrastructure development in the Maldives. Meanwhile, we see room for enhancing the oversight and governance of SOEs, as well as tackling their inefficiencies. In this regard, we take positive note of the authorities' efforts to improve SOE performance and reduce related fiscal risks.

We support the ongoing implementation of the Maldives Monetary Authority's Strategic Plan with the support of Fund's technical assistance.

Various indicators suggest Maldives' financial sector is largely sound and is supported by robust oversight and active measures by the authorities to safeguard financial stability. We encourage the authorities to remain vigilant and maintain their efforts in strengthening financial sector resilience, including through filling data gaps and introducing a comprehensive crisis management framework. Meanwhile, we look forward to further progress in promoting financial inclusion with the support of appropriate institutional, legal, and regulatory frameworks, as well as sound infrastructure and careful management of potential risks. On the external sector assessment, we note that the authorities do not share the view of staff. Could staff elaborate on the reasons why the suggested adjustment for temporary spike in infrastructure spending had not been incorporated?

Careful sequencing and prioritization would be key to the successful implementation of the extensive National Development Strategy to promote sustainable and inclusive growth. Noting that various ministries are involved in carrying out this economic reform agenda, it is also important to ensure effective communication and coordination across these ministries. Economic diversification away from reliance on the tourism sector would be conducive to achieving more stable growth. In doing so, it is important that efforts to diversify are well-targeted and focused on areas of greatest potential. On promoting inclusiveness, staff have highlighted many important areas where further efforts are needed, such as better-targeted social protection and housing affordability programs, improving energy reliability, and addressing skill gaps, to name a few. Going forward, we encourage staff to continue to closely engage with the authorities and provide guidance and technical assistance where needed to support the authorities' implementation of these many objectives in a well-sequenced manner.

Stronger private sector participation and investment in the economy would also support sustained and resilient growth in the Maldives. Addressing governance vulnerabilities and tackling corruption are important steps for building a healthy business environment and attracting private sector investment. We look forward to an amended AML Act that is in line with the Financial Action Task Force 2012 Standard.

Finally, noting the issue of high turnover of mission chiefs has been raised again, we believe the Fund should consider this issue – which is relevant for many economies – in a comprehensive manner, including in the context of the 2020 Comprehensive Surveillance Review and CCBR.

With these remarks, we wish the authorities every success in their policy endeavors.

Ms. Mannathoko and Mr. Essuvi submitted the following statement:

We thank staff for the informative set of reports and Mr. Geadah and Ms. Choueiri for their insightful buff statement. We agree for the most part with the staff appraisal and wish to offer the following points regarding fiscal challenges, the external sector, monetary policy, financial inclusion and diversification.

Fiscal Challenges

Given that Maldives is a small island middle income economy that has seen rapid growth over the past few decades driven by the dynamism of its high-end tourism sector, we commend the authorities on the economic success seen over this period. However, the limitations of the old model with its narrow productive base are becoming evident as unemployment remains high and climate change poses continued risks. With respect to the latter; apart from ongoing flooding and cyclone risks, the World Bank reports that over two thirds of the island state's critical infrastructure is under threat from rising sea levels. We recognize, therefore, the tremendous challenges stemming from these risks that have contributed to the rapid buildup of public debt, a widening of the current account deficit with efforts to build resilience, and inadequate foreign exchange reserve cover. As noted by Mr. Geadah and Ms. Choueiri, the main consideration will be how best to balance essential infrastructure investments needed for resilience, against the widening of fiscal and external deficits that accompanies these investments. To this end, while we welcome the establishment of the Maldives Inland Revenue Authority (MIRA) and the Tax Policy Unit alongside planned tax policy reforms, we urge speedy implementation of outstanding revenue measures. We also encourage the authorities to contain the expansion in recurrent spending that added to the fiscal deficit this past year, and to consider a structured intertemporal approach to the investment program that will help maintain external debt and the external deficit within manageable levels. Could staff share their thoughts on the authorities' debt plan. In addition, given concerns expressed in the risk matrix regarding the need for efficient public investment management, could staff also elaborate on any multilateral assistance in this area and on the prioritization of investment projects?

External Imbalances

We note that the worsening of the current account deficit in 2018 reflected the doubling of public infrastructure investment in that year. Although we recognize that the external position will probably improve as ongoing investment projects are completed, we nevertheless encourage caution in incurring and managing external debt given the fact that repayments of outstanding debt from major projects are rising. Could staff elaborate on the extent of concessional and grant climate financing Maldives has been able to access for recovery and resilience investment? We also note the inadequacy of one month import cover. Could staff also elaborate on plans to increase resilience to external shocks and rebuild foreign exchange buffers in the context of the proposed adjustments to the exchange rate regime?

The Monetary Framework

We note the inadequacies in the current monetary policy framework and welcome the multi-year TA program that will help to put in place necessary instruments and help resolve the FX market shortages that have led to rationing and a parallel foreign exchange market. While we note the authorities' indication that the parallel market premium has declined, we nevertheless encourage a continued focus on the reforms needed to modernize the monetary policy framework and reduce inefficiencies.

Financial Stability and Inclusion

Addressing supervision gaps and enhancing financial inclusion remain important. We welcome the tightening of macroprudential tools and plans to put in place liquidity regulation under Basel III. Like staff we encourage continued monitoring of financial stability risks including in the housing sector, addressing supervision data gaps, operationalizing a bank resolution framework and aligning the lender of last resort policy. We welcome the National Financial Inclusion Strategy (NFIS) and the recent upgrade of the payment system that will facilitate financial inclusion. Could staff elaborate on the extent of Fintech usage and its role in this plan? We'd also welcome some information on whether the authorities are receiving TA to help develop the appropriate institutional, legal and regulatory framework to support a more efficient payments system?

Diversifying the Economy

Diversification is clearly a necessity, given the economy's over reliance on tourism receipts in the face of rising climate risks that may someday impact the performance of the industry. In this regard, we encourage the effective implementation of the National Development Strategy aimed at diversifying the economy through the expansion of agriculture and fisheries. We also welcome the authorities' efforts to improve energy supply, to promote the adoption of financial technologies, to address skills gaps by improving the quality of education, and to address legislation needed to improve the business environment.

On economic governance, we are encouraged by the authorities' commitment to strengthening systems and addressing financial leakages through broad reforms and enhanced accountability with respect to sovereign guarantees, public investment and SOE operations; and by the attention being given to AML/CFT capacity. We encourage continued efforts in this regard.

In closing, we urge staff to give due consideration to the authorities' concerns regarding high mission chief turnover. Finally, we wish the Maldives authorities success in their reforms.

Mr. Sigurgeirsson and Mr. Bernatavicius submitted the following statement:

We thank staff for the set of reports and Mr. Geadah and Ms. Choueiri for their helpful buff statement. We broadly concur with the staff appraisal. Despite relatively strong economic growth, the fiscal deficit has widened further, and the external position deteriorated. The authorities face an urgent need to rebuilt fiscal buffers to address long-term challenges related to climate change and to work towards enhancing economic diversification. We encourage the authorities to consent to the publication of the report.

We support staff's recommendation to adopt an ambitious fiscal consolidation strategy in line with the scenario presented in Annex IV. There is room to further improve tax administration and address public spending inefficiencies, as the public sector wage bill remains relatively high. These reforms would contribute positively to the creation of additional fiscal space, which would allow the authorities to address major long-term challenges. As indicated in the buff statement, the Maldives are particularly vulnerable to climate change.

Most of major infrastructure projects continue to be carried out by SOEs and remain off-budget, which warrants close monitoring and further efforts to improve debt data transparency. There is an urgent need to limit public guarantees and contingent liabilities associated with SOEs, which pose large additional fiscal risks. It is encouraging to note that enhancing the efficiency of SOEs is seen as a priority for the new government as indicated in the buff statement.

We welcome the decision to establish the Sovereign Development Fund. While it provides a reserve buffer that already covers 35 percent of the maturing sovereign bonds, it may not be sufficient going forward, as the Maldives remain at high risk of debt distress and significant interest and amortization payments are set to rise markedly in 2022. Significant reliance on short-term debt financing could pose additional challenges if the economic environment deteriorates more than expected.

We support staff's recommendation on the need to reform the exchange rate regime. FX controls and other restrictions should be removed to ensure the consistency with Article VIII of the IMF Articles of Agreement. To ensure the credibility of the current fixed-exchange rate regime, monetary policy should be gradually tightened.

Despite strong tourism receipts, the external position has deteriorated further and is assessed to be substantially weaker than suggested by fundamentals. In this context, there is an urgent need to replenish official reserves, which remain below recommended levels and cover only 2.4 months of imports.

Finally, we agree with the staff assessment on the need for improved governance, improving the regulatory environment, and the role of the rule of law. This is especially important in light of fiscal position and the strong role of SOEs in the eoconomy. While tackling corruption is on the authorities' agenda, further efforts are needed.

Mr. Mouminah, Mr. Alkhareif and Mr. Rouai submitted the following statement:

We thank staff for a well-written set of reports and Mr. Geadah and Ms. Choueiri for their informative buff statement. We broadly concur with staff assessment and policy recommendations and would therefore confine ourselves to the following few comments for emphasis.

The Maldives economy continues to progress at a strong pace, but risks are also growing. Real GDP growth has been high in recent years, benefiting from large public investment, FDI, and an accommodative monetary policy. At the same time, risks are mounting, as reflected in high debt, declining international reserves, and widening fiscal and current account deficits. Against this background, we take comfort in the commitment by the new government to ensure macroeconomic stability and implement an ambitious reform agenda to address long-term challenges.

SOEs are playing an important role in the economy, while at the same time they remain a source of vulnerability. We note that SOEs continue to play a major role in the delivery of services and in the financing of large infrastructure projects, with government guarantees. Annex III shows the significant increase in the publicly guaranteed debt in 2018. Could staff provide further insights on the possible role of SOEs in promoting an increasing contribution by the private sector in the growth and diversification of the economy? More specifically, does the National Development Strategy (NDS) foresee a growing role of the private sector? Similarly, do the authorities have now a clear indication on the level of contingent liabilities associated with SOEs' activities after their decision to expand the coverage of public debt to include guaranteed debt?

We encourage the authorities to further strengthen fiscal buffers. Absent corrective actions, Public and Publicly Guaranteed Debt (PPG) is projected to rise to 83 percent of GDP by 2021, thus threatening debt sustainability. We therefore support staff recommendation for a balanced fiscal consolidation to enhance revenue, control spending and improve its efficiency. To this end, we welcome the authorities' commitment to reduce the deficit to strengthen fiscal sustainability and increase buffers, including through strengthening tax administration. We encourage them to also focus on improving spending efficiency and on reducing the burden and risks of SOEs on the budget.

On the financial sector, we welcome the authorities' continuous efforts to strengthen financial stability and inclusiveness. We take comfort in staff's conclusion that the rapid growth in credit should not raise concerns. However, we would appreciate staff elaborations on any potential vulnerability that could be associated with the fast increase in credit to construction in 2018. Separately, we note from the report that staff sees merit in eventually shifting the exchange rate target to a composite basket peg. Hence, we invite staff to elaborate on the authorities' views on this recommendation.

On the adequacy of reserves, we take note of the difference of views between staff and the authorities and we would appreciate if staff could provide indications on the adequacy of reserves based on metric other than import coverage.

Finally, we sympathize with the point made by Mr. Geadah and Ms. Choueiri regarding the high frequency of mission chief turnover.

With these comments, we wish the authorities all the success.

Mr. Ray, Ms. Preston and Mr. Kikiolo submitted the following statement:

We thank Mr. Geadah and Ms. Choueiri for their useful buff statement and staff for the comprehensive reports. The Maldives is a country that shares the challenges of remoteness, a widely-dispersed population, infrastructure gaps, financing constraints and vulnerability to climate change with many members in our Constituency. Impressively it has been able to develop a high-end tourism industry that has supported a remarkable economic transformation. To achieve sustainable and inclusive growth going forward, we encourage authorities to find the right balance between investment in infrastructure and sustainability of government finances over the medium term. We support the thrust of the staff appraisal and highlight only a few points for emphasis.

We agree with staff that the authorities should undertake fiscal consolidation to contain the deficit and put debt on a downward path. We acknowledge the new government's commitment to reduce the fiscal deficit. This will be important to limit external vulnerabilities, improve debt sustainability and provide the authorities with a buffer for dealing with adverse shocks. We support staff's three-pronged strategy to raise revenue, reduce inefficient expenditure and strengthen PFM. We share staff's concerns about the potential to boost spending on the back of concessional financing that may become available, but that could impact sustainability. We welcome the completion of the HR audit report and hopes it offers useful feedback into any public sector 'rightsizing' exercise. Can staff comment on the key findings of the audit report and provide an assessment of whether it is feasible to implement the recommendations?

It is imperative that investment in infrastructure is directed towards high-quality, productive projects and that the authorities also develop and adhere to a transparent debt management framework and a rigorous project selection process. We also urge the authorities to strengthen the oversight of state-owned enterprises to minimize future liabilities to the public sector.

We welcome the authorities' commitment to promote sustainable and inclusive growth. Progressing legislative and structural reforms are critical to improve business conditions and support a thriving private sector. Steps should also be taken to improve female labor participation, address skills gaps and improve social spending.

Like the small states in our constituency, climate change remains a macro critical issue for the Maldives. We noted from the 2017 Article IV report that the authorities were willing to participate in the Climate Change Policy Assessment (CCPA). We were surprised that there appear to have been no follow up discussion of this concern in the latest Article IV report. Staff comments are welcome.

Lastly, we share the authorities' concern regarding the frequency of mission chief turnover. We agree with the authorities that understanding the unique operating context of small island economies takes some time. In addition, Mission Chiefs play an important role as a trusted advisor in countries like the Maldives, where the Fund may be a lone source of macroeconomic advice. But relationships, and trust, take time to build. In this respect we call for stronger incentives for staff to work on small and fragile states to be developed, in the context of the HR Strategy and Comprehensive Compensation and Benefits Review.

Mr. Inderbinen, Mr. Merk, Ms. Kuhles and Ms. Wehrle submitted the following statement:

We thank staff for the informative report and Mr. Geadah and Ms. Choueiri for their insightful buff statement. We view rebuilding buffers and resilience to shocks as a priority, following the wave of recent infrastructure projects. We welcome that the new authorities have expressed their commitment to macroeconomic stability and to launching structural reforms to put public finances on a more sustainable footing, improve public financial management, and strengthen governance. We would like to make the following points for emphasis.

We regret the rapid rise in public and publicly-guaranteed debt and the widening fiscal deficit. We support staff's call to better target social transfers to vulnerable population groups and avoid the reintroduction of subsidies. Keeping recurrent spending under control, improving public financial management, strengthening SOE oversight, efficiency, and governance, as well as strengthening public investment management would be important levers to contain public debt, especially given the significant risk created by public guarantees. We are encouraged by the progress made to implement the 2016 PIMA recommendations. However, we note the remaining capacity issues with regard to proper project appraisal, as well as the need to increase the transparency and efficiency in implementing capital projects.

The weakening external position and low international reserves create further risks to external stability. We take note that the unwinding of large infrastructure projects will contribute to a gradual reduction of the current account deficit. We welcome the planned multi-year technical assistance program provided to the MMA to continue to strengthen monetary policy and foreign exchange operations, in particular by developing functioning FX markets, and advancing de-dollarization.

We encourage the authorities to continue their efforts to strengthen the overall governance framework. We welcome the commitment of the authorities to enhance the operational independence and investigative powers of the Anti-Corruption Commission, as well as the amendment of the related legal framework. The effectiveness of the AML/CFT framework will hinge on the ability to impose appropriate sanctions.

Given the Maldives' high vulnerability to rising sea levels, we would have welcomed more details on the longer-term economic impact and challenges related to climate change. Some advice or guidance on how to best mitigate risks and build resilience would seem appropriate and macrocritical.

Lastly, we take note of the authorities' concern about the high mission chief turnover. We invite management to ensure that area departments follow up on the longstanding management action to target a three year average tenure for country assignments.

Ms. Levonian, Ms. McKiernan and Mr. Sylvester submitted the following statement:

We thank staff for their comprehensive report and Mr. Geadah and Ms. Choueiri for their helpful buff statement. As a small open economy, Maldives has achieved strong growth in recent years. However, this growth performance has occurred alongside growing risks and imbalances. The authorities' policy priorities should focus on reducing fiscal and external imbalances, building resilience to shocks, and fostering sustained and inclusive growth. As we broadly concur with staff's appraisal and recommendations, we offer the following additional comments for emphasis.

We note positively the authorities' commitment to building resilience to natural disasters and climate change. Like many countries in our constituency, Maldives faces significant challenges from climatic events, including rising sea level. The authorities have rightfully prioritized efforts to build resilience to natural disasters and climate change, as highlighted in their helpful buff. That said, we note that the report was very light on building resilience to natural disasters and climate change. Could staff comment whether and to what extent such costs were incorporated into to the macro-fiscal framework and policy advice to the authorities?

We welcome the authorities' planned commitment to fiscal consolidation to strengthen fiscal sustainability and reduce debt vulnerabilities. In light of Maldives high risk of debt distress, fiscal consolidation should be appropriately prioritized. The authorities have committed to reducing the fiscal deficit and debt through a combination of revenue and expenditure measures. Efforts to better manage risks from contingent liabilities and to further strengthen public finance management (PFM) will support putting public debt on a sustainable footing.

We encourage the authorities to take steps to address their huge external imbalances. The high level of current account deficit and the low international reserves position are key sources of vulnerabilities to changes in external conditions. While we note the divergence of views between staff and the authorities on the assessment of the external sector and the appropriate monetary policy stance, we are encouraged by the authorities' Strategic Plan aimed at building reserves buffers. We note the authorities' request for continued TA support to improve their monetary policy and exchange rate frameworks and we urge staff to support this request.

We share staff's assessment on the need to accelerate structural reforms aimed at, inter alia, enhancing the role of private sector, diversifying the economy, and boosting competitiveness. We welcome the authorities' National Development Plan (NDP), which focuses on achieving decentralization, economic diversification, and integration of tourism with other industries.

Finally, we welcome the authorities' commitment to strengthening governance, combating corruption, and ensuring transparency. We note positively the planned efforts to strengthen policies related to the issuance of government guarantees, improving the framework for conducting public investment and SOEs oversight. Efforts to further strengthen AML capacity and improve corporate governance and risk management practices are also noteworthy.

Mr. Gokarn and Ms. Dhillon submitted the following statement:

We thank staff for their reports and Mr. Geadah and Ms. Choueiri for their informative buff statement. Maldives has achieved robust growth driven by tourism, commerce, and construction. Real GDP growth reached 6.9 percent in 2017 and about 7.5 percent in 2018. Looking at the medium term, however, growth is expected to moderate. Maldives' development challenges stemming from the country's geography and climate change persist as do external risks from tighter global financial conditions and weaker global growth. We commend the authorities for their commitment to macroeconomic stability, for creating greater economic opportunities and reform focus for inclusive growth. We agree with the thrust of the staff report and offer the following points for emphasis.

Fiscal consolidation should be prioritized to target rising debt and deficits. The risk of external debt distress in the Maldives remains high and there is a predominance of infrastructure investment being financed by external debt. Bearing this in mind, we place a premium on prioritizing productive infrastructure, development spending, revenue measures and effective tax administration. Beyond this, the focus of the authorities on addressing spending inefficiencies, leakages in the health care system, reforming subsidies, and enhancing the procurement policies and efficiency of State-Owned Enterprises is commendable.

We concur with staff on the tighter monetary policy stance to ensure compatibility with the exchange rate peg. The authorities have a divergence in the view citing the absence of inflation and foreign exchange market. Staff has however emphasized the large CAD, slow accumulation of foreign reserves, and related external imbalances. In this context, could staff elaborate more on the usefulness of alternate instruments which could be deployed to manage the exchange market? We are encouraged by the efforts MMA has on consolidating financial stability. Further, strengthening of AML/CFT compliance would be welcome.

On the structural side, inclusive growth could emanate from a more diversified private sector, an enhanced regulatory environment, and effective anticorruption efforts. In this direction, the authorities' diversification, commitment to strengthen governance and fighting corruption is notable and should continue.

Finally, we support Mr. Geadah and Ms. Choueiri concerns on the high turnover of IMF mission chiefs and the benefits of a resident representative office in Malé.

Mr. Castets and Mr. Sode submitted the following statement:

We thank staff for the quality of their documents and Mr. Geadah and Ms. Choueiri for their insightful buff statement. While the Maldives experienced strong growth over the last years, high vulnerabilities in terms public debt sustainability and external imbalances call for strong rebalancing measures. We broadly support staff analysis and recommendations and we would like to highlight the following points for emphasis:

Given the high levels of public debt and fiscal deficit, we support staff call for a more ambitious consolidation scenario. A combination of measures aiming at increasing revenues and spending efficiency appears warranted to put public debt on a firm downward path. Could staff further elaborate on the relatively muted impact on the growth rate of the alternative fiscal consolidation scenario presented in annex?

The very high current account deficit is also a source of vulnerability and measures should be taken to reduce it. While more ambitious fiscal consolidation would go into this direction, we wonder which other measures staff recommend in the short run. We would also like staff to elaborate on the refinancing risk of external borrowing (noting the high share of FDI inflows in the financial account).

Pursuing the strengthening of the monetary policy and exchange rage frameworks are necessary. We welcome IMF technical assistance in these areas which will notably help to remove existing multiple exchange rate practices. For the medium term, does staff consider that the Maldives should adopt a flexible exchange rate regime?

We welcome staff analysis on how to strengthen governance and welcome the government commitment to tackle this issue. As staff, we see the strengthening of the AML/CFT legal framework as a key priority. We encourage staff to further strengthen its policy dialogue with the authorities on these issues.

Ms. Mahasandana and Ms. Pandit submitted the following statement:

We thank staff for well-written report and Mr. Geadah and Ms. Choueiri for their informative buff statement. The Maldivian economy has performed well with a strong growth of an average 7 percent during the 2016 to 2019. We praise the country’s progress in transiting from low- to middle-income level in a short span of time, with significant rise in per capita income and infrastructure development. Nevertheless, promoting growth sustainability, with equitable income distribution, addressing corruption and building resilience against natural disaster and climate change still remain as critical priorities. Moreover, elevated debt level and external sector imbalances pose significant challenges to the economy. We commend the new government's commitment to macroeconomic stability and ambitious reform agenda. We broadly agree with the thrust of staff's appraisal and would like to raise the following comments for emphasis.

A front-loaded fiscal consolidation is warranted to ensure debt sustainability and macroeconomic stability. We note that public and publicly-guaranteed debt (PPG) debt is at historical high of 72 percent of GDP in 2018 and external debt at 35 percent. The PPG is projected to reach 83 percent of GDP in 2021. Fiscal deficit is also predicted to increase to 5 percent in 2019. Given this scenario, a fiscal consolidation strategy is vital to address the fiscal sustainability. In this regard, we concur with staff's recommendation on reducing the deficit by 3 percent of GDP to stabilize public debt and rebuild the fiscal buffers. The suggested three-pronged strategy of strengthening tax policy measures and tax administration, controlling expenditure spending and improving public financial management are essential to the fiscal adjustment. We welcome the authorities' planned tax policy reforms, particularly on the introduction of personal income tax (PTI) and other specified service charges. Similarly, we encourage the authorities to rationalize the subsidies program with more targeted social protection mechanism and to strengthen the Public Finance Management (PFM). We also encourage authorities to review its essential and sizeable infrastructure program and secure concessional financing for capital and social projects to improve the debt dynamics. As Maldives is a vulnerable country for natural disaster and climate change effect, staff comments on the fiscal effort to build the resilience in this matter are welcome.

The external sector imbalances should be calibrated in a sustainable way. Maldives's current account deficit has widened sharply to 24 percent of GDP in 2018. Large infrastructure investment need is still imposing pressure to the current account. Low level of reserve and growing external payment also put further pressure to the external stability and the peg system. In this context, we commend the MMA's effort in implementing a comprehensive reform plan to building reserve buffer along with the authorities' effort to build the Sovereign Development Fund (SDF) as noted in the buff. However, rationing of the import and calibration for the appropriate exchange rate policy could be crucial for the longer-term stability. In this regard, we see merit on staff suggestion towards the gradual move on basket pegged exchange rate regime. The preparation and implementation strategies for regime change have to be well articulated and plan to ensure smooth transition, staff comments are welcome.

We note that the excess liquidity in the banking system, credit expansion that support strong domestic demand and expansionary fiscal policy could put pressure on the domestic market as well as external front. However, we observe the divergent views between staff and the authorities on the monetary policy stance, in this regard, could staff elaborate further on the rationalization behind the tightening monetary policy? We encourage the authorities' intention on reforming the board range along with the MMA's strategic plan to strengthen monetary policy and operational framework, setting of interest rate corridor and directing the interbank rate, re-activating of OMOs and implementing foreign exchange reforms.

We commend the authorities' efforts in making growth more inclusive and diversifying the economy, while ensuring financial resilience. We welcome the new government effort on the formation of National Development Strategy (NDS) along with time-bounded sectoral plan. Similarly, we see scope for economic diversification in high value agriculture product, marine product, and SMEs sector.

We welcome the progress in strengthening financial resilience and encourage the authorities to improve the AML/CFT framework in line with FATF.

With these comments, we wish Maldives and its people success in their future endeavors.

Mr. Daïri and Mr. Badsi submitted the following statement:

We thank staff for the well-written set of papers and Mr. Geadah and Ms. Choueiri for their informative buff statement.

While faced with significant risks posed by climate change and natural disasters like many small island economies, the Maldivian economy continues to display strong and sustained growth with low inflation, even though the twin deficits remain large, reflecting strong robust demand fueled by credit growth and expansionary fiscal policy. We recognize, however, that much of the large investment needs are of a temporary nature and aim at better tapping the significant tourism potential while increasing opportunities for economic diversification. We welcome the authorities' commitment to macroeconomic stability and encourage them to push ahead with their ambitious reform agenda. Risks to the outlook are tilted to the downside, mainly stemming from inadequate fiscal adjustment and control over SOE investment spending, excessive credit growth, slowdown in global growth, and tighter global financial conditions. The proposed policy mix aimed at containing external and fiscal imbalances while safeguarding financial stability goes in the right direction. We agree with the thrust of the staff appraisal.

In view of the large and rising public debt-to-GDP ratio, we take comfort from the authorities' recognition of debt sustainability challenges and welcome their commitment to fiscal consolidation to put public debt on a declining trend by boosting revenues and cutting inefficient spending while strengthening public financial management. We are encouraged by the shared view between the authorities and staff on the need for increasing fiscal buffers which would permit implementation of new policy initiatives while maintaining fiscal sustainability. We are pleased to note the strides made in establishing a modern tax administration and improving budget discipline, including in implementation of PIMA recommendations. We look forward to the introduction of the personal income tax aimed at rendering the tax system more progressive. Contingent liabilities stemming from public guarantees pose fiscal risks that need to be carefully monitored, and we are encouraged to note from Mr. Geadah and Ms. Choueiri that the new administration is closely scrutinizing government guarantees. We commend the authorities for the completion of the HR audits of line ministries by the Civil Service Commission with the objective of bringing the wage bill under control and improving public service delivery. We note from the buff statement that the authorities do not share staff assessment on the scale of external financing needs, and would appreciate staff clarification on this divergence of views.

Credit should be given to the authorities for ongoing reforms on monetary and exchange rate policies. However, they should be vigilant to excessive credit growth and bank liquidity. While moving to pegging against a basket needs further consideration, the current exchange rate regime has served as a useful nominal anchor for monetary policy but should be more effectively coordinated with fiscal and monetary policies to better support external stability. Against a backdrop of declining and well-provisioned nonperforming loans, the banking sector is well-capitalized and liquid and enjoys high but volatile profitability. We commend the authorities for the steps taken to safeguard financial stability and the strides made in setting up a credit information bureau and improving financial inclusion, including the formulation of the National Financial Inclusion Strategy.

We welcome the authorities' efforts under the National Development Strategy aimed at promoting higher and more inclusive growth. Like other tourism-dependent economies, the Maldives is subject to significant vulnerabilities, requiring a more dynamic private sector and enhanced diversification and competitiveness. We take positive note of the new initiatives aimed at boosting private investment, including FDI, and commend the authorities for their focus on streamlining regulations and their commitment to strengthening governance, improving transparency, and fighting corruption to provide an enabling business environment, and encourage further efforts in these areas.

We wish the authorities success in their endeavors.

Mr. Sylla, Mr. Nguema-Affane and Mr. Bangrim Kibassim submitted the following statement:

We thank staff for their reports, and Mr. Geadah and Ms. Choueiri for their informative buff Statement.

Maldives is a good case of small state whose vulnerability to climate change is of an existential nature as rightly emphasized in the buff statement. Under the threat of rising sea levels, and confronted with a singular geographical position and a multiplicity of scattered islands, Maldives has engaged in a ambitious development strategy that requires significant resources, both domestic and foreign, We commend the authorities for their commitment to invest in transformative investments to enhance the delivery of basic services, improve resilience against natural disasters, and foster economic activity, including through greater diversification. These efforts which cause significant external and fiscal imbalances, deserve to be supported by the international community. The Fund should continue supporting this country, in line with its stated engagement with small states, through technical assistance to strengthen relevant institutional and policy frameworks and help catalyze the support necessary to meet the country's financing needs.

Sustaining the strong economic performance over the longer run will require tackling the large fiscal and external imbalances. Recent economic developments have been broadly positive with growth further increasing in 2018 driven by strong public and private investment. As a consequence, fiscal and external deficits have widened international reserves remains low albeit a slight improvement recently. We note the prospect that development in the tourism sector and public infrastructure projects going forward will contribute to alleviate the current account deficit but share the view that policies going forward should address macroeconomic imbalances, while pursuing inclusive growth and diversification policies contemplated in the new government's National Development Strategy (NDS). Growth-friendly fiscal consolidation is a priority to preserve fiscal and debt sustainability. We welcome the authorities' plans to reduce the fiscal deficit through tax policy reforms and improved efficiency of expenditures. This should be accompanied by enhanced oversight of SOEs to contain contingent liabilities. We appreciate the progress made in strengthening public financial management through the enhancements of the budget process, completion of the 2016 PIMA recommendations and the improvement in risk management of sovereign guarantees. The authorities' action to improve debt data transparency and the establishment of the Sovereign Development Fund (SDF) to serve as a reserve to ensure adequate service of sovereign bonds when they are due in the next few years are also positive steps.

Monetary policy should support external stability consistent with the exchange rate peg. However, we note the disagreement between the authorities and staff on the appropriate monetary stance going forward. Could staff elaborate more on their recommendation to further tightening monetary policy—noting that inflation seems under control—and assess the impact of keeping the actual stance? We welcome the authorities' 2018-2022 Strategic Plan aiming at modernizing the monetary and exchange rate policies and support Fund's TA in that regard. We note that the FX rationing to banks has resulted in the emergence of measures inconsistent with Article VIII of the IMF Articles of Agreement, and recommend the inclusion of obligations of Article VIII as an objective of the Strategic Plan.

The strengthening of the financial supervision framework and progress in financial inclusion should be pursued, with the view to preserve financial stability. We take positive note the continued soundness of the Maldives' financial system and stress the importance of closely monitoring credit growth to help prevent a buildup of vulnerabilities. We encourage the authorities to consider staff recommendations to reinforce the financial supervision framework. We see merit in further improving financial inclusion notably through the upgraded payment system and the formulation of National Financial Inclusion Strategy (NFIS) aiming at easing the access to affordable financial services. In the same vein, we look forward to additional progress in reinforcing legal and institutional frameworks.

A successful implementation of the NDS will require accelerating reforms to foster economic diversification and strengthen governance. We support the authorities' ambitions laid out in their NDS with respect to competitiveness, economic diversification and raising standards of living. The measures already taken to enhance private investments, align the legal framework of foreign investment with international best practices and have a one-stop-shop for investors are positive steps toward reinvigorating development of the private sector and diversifying the economy. The authorities' ongoing measures against corruption and financial crimes, with notably the revision of the AML Act to comply with the Financial Action Task Force (FATF) 2012 Standard are noteworthy. Efforts should also be maintained to alleviate impediments related to fiscal governance, the rule of law and the regulatory framework in order to preserve confidence in the governance structure.

Mr. Villar and Mrs. Suazo submitted the following statement:

We thank staff for its report and Mr. Geadah and Ms. Choueiri for their informative buff statement. We view fiscal consolidation as a priority given the rapid rise in public and publicly-guaranteed debt and the widening fiscal deficit, which generates downside risks and leaves little room to respond to adverse shocks, despite Maldives strong economic activity. In this regard, we urge authorities to improve public financial management, limit sovereign guarantees, handle budgetary pressures from SOE's activities and strengthen governance to place public finances on a more sustainable footing and public debt on a downward path. We make the following points for emphasis.

Since the risk of external and overall debt distress is high in Maldives, we commend the authorities on the establishment in 2017 of a Sovereign Development Fund to serve as a fiscal reserve, their expansion in the coverage of public debt to include guaranteed debt and their commitment on monitoring the activities of the SOE's (whose external borrowing has greatly contributed to the rapid rise of PPG debt), as well as increasing their efficiency which will contribute in reducing their fiscal vulnerabilities. Given the increase in coverage, can staff comment if the authorities have a more complete picture of the debt contingencies related to SOE's and if this data is included in the DSA?

One of the main reasons why Maldives is at high risk of debt distress and has a weakened external position is related to the sizeable investments in large public infrastructure projects. Since these projects are nearing completion, authorities believe they will generate spillovers that should translate to higher growth. Could staff provide more detail on the differences between staff's and the authorities' outlook in this regard and if the returns on these infrastructure projects are being included in the growth projections.

As the authorities expressed in their buff statement and staff corroborated in its recent board paper, Building Resilience to Large Natural Disasters (which mentioned that Maldives was ranked as having experienced one of the top ten natural disasters in 2004, with a damage of 179 percent of GDP), Maldives is very vulnerable to climate change and natural disasters. In the 2017 Art. IV, staff recommended integrating risk-reduction and disaster-response programs into the core budget. Could staff comment on the advances in this and other related policies for building resilience, such as insurance.

Given Maldives high dependence on tourism, we urge authorities to encourage private sector-led investment by enhancing the regulatory environment, strong rule of law, and decisive anticorruption efforts, all of which have been described as priorities by the current government as stated in their buff statement and included in the National Development Strategy, whose objectives are very ambitious. Because of this, we encourage staff to continue providing technical assistance and aid authorities in its implementation mainly to appropriately sequence and prioritize objectives.

The Acting Chair (Mr. Zhang) made the following statement:

Before I give the floor to the staff, let me put the discussion in context. Maldives has recorded strong economic growth, and the medium-term outlook is positive. Many Directors highlighted the high risk of debt distress, rising pressures on external stability, and vulnerabilities to natural disasters and climate change, and emphasized the need to prioritize policies that reduce fiscal and external imbalances and build resilience to shocks.

Gray statements raised concerns regarding the high turnover of mission chiefs for the Maldives. I recall the issue was discussed on some other occasions, for example, in the discussion on Samoa. Management and the staff are working on it, and we will do our best to address these issues in the period ahead. There are already some concrete proposals that will soon be implemented in the country concerned. We will address these concerns to the extent possible.

Mr. Geadah made the following statement:

I thank Directors for their interest and thoughtful advice. I also thank the staff for their diligent work and for the constructive and candid dialogue with the authorities. I would like to make a few points.

First, there is no question that there is a need for fiscal consolidation, a point made by almost all Directors, notwithstanding the importance of infrastructure investment for economic development and to mitigate the impact of climate change. The authorities fully agree with the intent to introduce a personal income tax in 2020 and to strengthen tax administration. They will also be addressing spending inefficiencies in health care, subsidies, public procurement, and in state-owned enterprises.

Second, on the issue of public debt being underreported, as indicated in the buff statement, public debt was never underreported. It is closely monitored, and detailed information on it is readily available and regularly shared with the staff. The coverage of public debt was recently expanded to include publicly guaranteed debt, which may have been the source of the confusion. Information on government-guaranteed debt, including the largest beneficiaries and purpose of guarantees is now reported in the quarterly Public Debt Bulletin. In any event, the authorities are satisfied that the reference to underreporting was deleted from the staff report and accordingly agree to its publication.

Third, on reserve adequacy, we noted in the buff statement that assessing the adequacy of reserves in terms of imports may not be suitable for the Maldives considering the large capital imports related to infrastructure projects and imports by the tourism sector. In the answer to question No. 26, the staff indicates that other metrics were also used, namely reserves in percent of short-term debt and in percent of broad money, which are not mentioned in the staff report. Gross reserves are about 4½ times short-term debt, and gross usable reserves are almost double short-term debt.

Fourth, on climate change, this is an existential issue for the Maldives. More than 80 percent of land is less than one meter above sea level. The authorities have the climate change policy framework, which was shared with the staff some time ago, which lists the challenges and policies that are important to address climate change. On the basis of that framework, the Maldives have been investing in food and water security, infrastructure resilience, public health, coastal protection, fishing, waste management, and renewable energy. The government is also promoting voluntary resettlement to regional hubs and improving transport. They look forward to a more detailed discussion with the staff on a Climate Change Policy Assessment (CCPA), including the way in which it might facilitate access to climate financing.

Finally, on the turnover of mission chiefs, I do not understand why there is such a high turnover. The Maldives is a beautiful place, and its economy has challenges that get Fund economists excited. I thank the many Directors who supported the authorities' concern about the high turnover. I also thank Mr. Fachada and Mr. Gokarn for the support on a resident representative office in Mali. Both issues are relevant for many countries, particularly small states. Like Mr. Sun and Mr. Ray, I believe that these issues should be addressed in a comprehensive manner, including in the context of the Comprehensive Surveillance Review (CSR), the HR strategy, and Comprehensive Compensation and Benefits Review (CCBR). I listened to what the Chairman said about the way to handle this, and I thank him for his comments on this, and we look forward to it.

To conclude, I thank Directors again for their interest and advice and staff for the appreciated work. This is Mr. Karam's last Article IV consultation with the Maldives. I wish him well in his new position, and good luck.

The staff representative of the Asia and Pacific Department (Mr. Karam) made the following statement:[1]

I thank Directors for their gray statements and Mr. Geadah and Ms. Choueiri for their buff statement. We have circulated answers to technical questions. I will now offer some quick remarks on key issues in four areas to help frame the policy discussion.

The first two areas highlight interrelated problems of foreign exchange shortage, parallel foreign exchange markets, high dollarization, and a weak monetary policy transmission. To that effect, the staff sees normalization of the foreign exchange market as a much-needed critical action to facilitate partial and gradual de-dollarization of the economy and to enhance monetary policy transmission. The staff also sees activation of monetary policy to be critical for foreign exchange market normalization. Here the limited transmission of monetary policy to the banking system and the economy at

[1] Prior to the Board meeting, SEC circulated the staff's responses by email. For information, these are included in an annex to these minutes.

large is due to the combination of relatively high dollarization of banks' balance sheets, and the abundant liquidity surplus in domestic currency, which does not incentivize banks to remunerate domestic currency deposits.

In response, the staff has proposed a strategy to address these challenges based on two interlinked pillars. One is a de-dollarization strategy relying on incentives in the first place and in the short term and foreign exchange regulation. The second is management of domestic currency liquidity to ensure a balanced liquidity situation.

The third area I would like to touch on is debt data quality, contingent liabilities, and the debt management strategy. On debt data, the staff confirms that the authorities have shared comprehensive data on project loans outstanding financed by public and public-guaranteed external debt, and hence, the staff does not have a reason to believe there is underreporting of debt in the Debt Sustainability Analysis (DSA).

On SOE guarantees, the staff believes the authorities have a good grasp of "audited guarantees," with the authorities reporting on the size, the purpose; and the biggest beneficiaries of the government-guaranteed debt in the Ministry of Finance's quarterly Public Debt Bulletin, as Mr. Geadah mentioned.

On debt management and the rollover risk of domestic debt, the pension Fund for now is the major investor in government securities. It has sustained its demand for government securities, and it is currently experiencing significant net inflows. On the medium-term debt strategy, externally the authorities appropriately emphasized the need to borrow on concessional terms. Domestically they aim to introduce higher tenors of government securities and issue benchmark bonds to fill critical points on the yield curve, including providing sufficient supply of longer-term securities to meet demand from institutional investors and the pension fund.

On tackling climate change risk and building resilience, the staff has on more than one occasion advised the authorities to consider the benefits of participating in the Fund's CCPA pilot. Our advice has been to ensure a proper classification of mitigation and adaptation projects in the budget to accurately capture the climate aspects, with the CCPA playing a catalyst role for climate change-related financing.

Mr. Di Tata made the following statement:

We thank the staff for the informative report and Mr. Geadah and Ms. Choueiri for their insightful buff statement. As noted in the buff statement, the Maldives has experienced a remarkable transformation over the last three decades owing mainly to the development of a dynamic tourism sector, and the economy has grown at a strong pace for several years.

The authorities are now seeking to close infrastructure gaps while managing the temporary widening of the fiscal and external deficits associated with these investment projects. We will focus on four issues.

First, fiscal consolidation is a priority to ensure debt sustainability, create fiscal space to support investment and respond to adverse shocks, and reduce the external current account deficit. In this regard, we concur with the staff on the need to reduce the fiscal deficit by about 3 percentage points of GDP to put the public-debt-to-GDP ratio on a clear downward path over the medium term. We welcome the authorities' planned reforms, which include introducing a personal income tax, strengthening tax administration, focusing on addressing spending in the health care system, reforming subsidies, and enhancing the efficiency of the public enterprises. At the same time, however, we notice that the authorities disagree with some additional tax measures proposed by the staff and that there is a need to rationalize the relatively high public sector wage bill. Could the staff elaborate on whether the measures planned by the authorities would be enough to achieve the objectives envisaged in the fiscal adjustment scenario?

The second issue is the coverage of the fiscal accounts and the performance of SOEs. Currently, fiscal coverage includes only the central government and excludes the SOEs which carry out most of the investment projects. Increased borrowing by these enterprises with large government guarantees has created substantial fiscal risks for the government. Clearly, there is an urgent need to broaden the coverage of the fiscal accounts and enhance debt transparency, including by better understanding and monitoring contingent liabilities. We encourage the authorities to vigorously implement their three-pronged strategy consisting of improving data reporting of the activities of SOEs, enhancing the oversight and efficiency of those enterprises, and reassessing their role in the economy.

Third, we are inclined to agree with the staff that a tighter monetary policy stance is needed to strengthen the reserves position in the context of the exchange rate peg. The current account deficit remains large, even after considering the unwinding of major infrastructure projects, and international reserves indicators including the import cover of usable reserves and their ratio relative to short-term debt at remaining maturity, rather than only short-term debt, are still relatively low.

Fourth, in line with a point made by other Directors, we believe that the report should have given more attention to the country's vulnerability to climate-related risks. We would re-emphasize the importance of efforts to properly integrate resilience and disaster reform programs into the budget, debt management, and the macro-fiscal framework.

Ms. Mannathoko made the following statement:

We have issued a gray, so I will just highlight one or two points. The first is on the issue of climate change. The authorities are rightly taking significant measures to build resilience. Climate change risks nevertheless remain substantial, with critical infrastructure under threat from rising sea levels. I am just raising this because in our constituency we also face repeated climate shocks, cyclones, and flooding episodes in some countries. Others are facing frequent droughts. We empathize with the Maldivian authorities. It is worrying that these destructive climate episodes are only projected to get worse, which means that even with resilience building, the future remains unclear. There will be ongoing fiscal demands placed on countries, so one does hope that the multinational community will manage to develop a more lasting and meaningful solution to this issue, because the current solution is not clear because with climate funds just enabling new financing, the new financing is still new debt, and so it is still new fiscal pressure. It is a big challenge for countries that are vulnerable to ongoing climate shocks, and one wants to avoid a scenario where multiple countries suffer from climate-induced economic crises.

On staff turnover, we also noted that this is becoming a generalized problem that keeps coming up, so we welcome the serious attention that has been given to this issue. It has even come up in the Independent Evaluation Office's evaluation of unconventional monetary policy. I would suggest it might be more of a Fund-wide practice maybe linked to progression incentives and the need for rotation, which means the Fund may have moved away from promoting expertise and experience within departments.

Mr. Ray made the following statement:

I thank the Chairman for the introductory remarks on the question of mission chief turnover. Many of us are very concerned about this issue. I just wanted to add two points for emphasis.

First, on the question of climate change, as Mr. Geadah said this morning, this is an existential issue for the Maldives, and it is striking how little attention is paid to this issue in the staff report. It does make me wonder about the balance in the staff report as a result and whether the staff is focusing on the issues that are front of mind for the authorities on each and every occasion. In the future, it is important for the staff to come at surveillance with evenhandedness, using all of the tools, but also focusing on things that are of primary importance in an individual country, particularly in a small state where the capacity to absorb advice is constrained. It is important that our advice focuses on what really matters and it is quite clear when a country is only a meter above sea level in the middle of the Indian ocean, climate change is something that is probably on their minds every day.

The second point is on mission chief turnover, I could not agree more with what Ms. Mannathoko has said. This is a systemic issue for the Fund. We are going to discuss it again with the IEO report, and in that case it is about the most systemically important countries. We have raised it in the case of small states, and it was raised in the case of fragile states, and it is now being raised in the case of the most systemically important countries, so this is clearly an issue that we collectively need to address holistically. As Mr. Sun has said on more than one occasion, it goes to the HR strategy, it goes to the CCBR, and it also goes to the CSR, so I encourage management to think about this as a holistic issue that needs to be addressed as a priority.

Mr. Doornbosch made the following statement:

I support Ms. Mannathoko and Mr. Ray on the importance of assisting the Maldives in their climate change resilience strategy. It is hard to see how the staff could discuss a macro-fiscal framework and contingency planning without taking this into account.

I have a question on this. As I understand it, the CCPA has been offered to the Maldives, and now the ball is in the court of the Maldives to say yes. This is always an issue because the capacity of the Fund to do a CCPA is extremely limited, it is like one or two a year, and I suppose there is more demand than supply. Can the staff confirm whether the offer will still stand for the next year, or is there a term when it expires? Could the staff please tell us a bit more about the capacity of the Fund to give the CCPA to the Maldives.

Mr. Alkhareif made the following statement:

First, on fiscal policy, I agree with Mr. Di Tata on the need to proceed with fiscal consolidation. We are happy to note that the underreporting of debt is not an issue, and we welcome the authorities' consent to the publication of the Article IV report.

On the exchange rate policies, we appreciate the staff's feedback and answers to our technical questions. We appreciate the detailed answer, and we fully agree on the need for a well-communicated strategy in the exchange rate regime shift.

Finally, on climate change, I agree with my colleagues on the importance of the subject. However, I would also emphasize the role of the World Bank and the cooperation on the climate change issue. We all agree it is extremely important for many countries, but it is equally important to engage the World Bank in these discussions. With these remarks, I wish the authorities continued success.

Mr. Fachada made the following statement:

I want to commend the authorities for the good performance of the economy. When I started reading the staff report and the first chart on page 4 showing the growth performance of the Maldives, I thought it was an error because Maldives grew on average 7 percent between 2006 and 2018. Very few countries in the world had such a performance for such a long period, and no small state had such a performance in the same period. With high growth, it is normal to generate some imbalances on the fiscal front or on the external front, but I believe the authorities are fully conscious of the imbalances and dealing with them in a sustainable manner.

I fully support the comments that were made by the previous colleagues on climate change. In terms of consistency of the message of the Fund, if we are bringing new policies and frameworks, it is important that this be addressed case-by-case with the countries where they are relevant, where they are macrocritical. Maldives is a country where we should apply the framework. I hope that after the evaluation of the CCPA with the World Bank and after the six pilots, whatever is decided in terms of sequence, that Maldives is included.

Finally, I would like to reinforce the comments that were already made about mission chief turnover and especially resident representatives. If we want to have more traction, it is not enough to have the annual bilateral surveillance exercise. A presence in the country is also fundamental.

The staff representative of the Asia and Pacific Department (Mr. Karam), in response to further questions and comments from Executive Directors, made the following additional statement:

I will start with climate change, the position of the staff and the communication with the authorities. As I mentioned on more than one occasion, starting in the Spring Meetings of 2018, staff and the Fiscal Affairs Department (FAD) gave the Maldivian delegation a presentation with details of the pilot program. At the time, there were good vibes and the intention to proceed with the pilot. With the change of administration in November 2018, there has been a new mandate of the Ministry of Environment and Energy. The staff changes at all levels of the civil service. They never said that they do not want the assessment program, but they just want to get the full details and learn more about other country experiences and where the benefits lie, so they could coordinate their position with the Fund and with other international organizations.

The offer stands. As a matter of fact, last week, we connected with them again, and they told us that they are still working with the Ministry of Finance on coordinating how to integrate the fiscal costing in the budget, and this is still in the works. They have not fully responded with a definite answer, but interest is there.

I believe there was a question on the tax revenue and the balance of fiscal consolidation, whether the staff suggested revenue measures are sufficient and whether an increase in the General Goods and Services Tax (GST) is needed, along with adding an export service charge. We left the authorities with a scenario, and I believe the consolidation was well balanced, about 1.5 percentage point GDP in revenue measures, with an emphasis on introducing the personal income tax (PIT) starting in 2020 so that it is phased in over a few years given the complexity of the issue. We are saying that the full scope of the PRT revenue will be seen over two years.

On our recommendation for an increase in the GSD from 6 to 7 percent, we did not believe that this would have a very negative impact on the growth and on the development of small- and medium-sized enterprises, so we were careful in striking balanced measures that did not interfere with growth momentum in the economy.

> We reiterated the importance of introducing a user fee for the newly constructed bridge that connected the main city to the suburbs of Malé.
>
> On the good performance of growth, it is an issue of volatility. The way we understand it is that the construction has weighed heavily on the growth momentum, buoyed by the very large infrastructure investment. This is about to taper off, and the authorities are saying that there will be a spillover to other ancillary sectors in the economy, including the services. We are a bit more conservative on the medium-term growth and ensuring that the education spending is in the proper place and that labor will carry those new activities from the spillover of the infrastructure project. This is a positive risk if we believe that productivity of labor is increased. Given other factors of potential growth and the increased diversification effort, then FDI there could be a positive risk on growth.

The staff representative from the Strategy, Policy, and Review Department (Mr. Haksar), in response to questions and comments from Executive Directors, made the following statement:

> I just wanted to pick up on the climate change point and make three points. The remarks made by the authorities and by Directors about the centrality of the existential challenge to the Maldives is very well taken, and that is something that has certainly been a high point of emphasis in our surveillance of the Maldives over the past several years.
>
> The second point is that staff has hopefully conveyed a sense of the intense engagement that they have had with the authorities on this very complicated topic, both in terms of coming up with the elements of the three-pillar strategy to deal with it, recognizing the centrality of it, and the fact that we remain committed to further engagement in the context of cooperation also with the World Bank.
>
> The third is to note that the climate change topic is existential. It is something which is there. It is not going to go away unfortunately any time soon. The staff has looked at this topic periodically in the Maldives, so it is a matter of perhaps emphasis, but the point is well taken. I just wanted to draw Directors' attention to the 2016 Article IV consultation on Maldives, which had a detailed treatment of the topic, and looked into what the risks were and what the challenges were. Hopefully this provides the kind of surveillance that Directors would like, setting up the risks, the needs, the context, and then that provides a useful context for the staff to continue the dialogue with the authorities and what options there are in terms of mitigation. We look forward

> to continuing to engage with the Board and seek Directors guidance on how we can help members like the Maldives on this very difficult topic.

The Director of the Asia and Pacific Department (Mr. Rhee) remarked that the issue of resident representatives had been discussed with the authorities during the Spring Meetings, but that there were resource implications.

Mr. Geadah, in a brief concluding statement, noted that the authorities were not asking for a resident representative office in the Maldives. There was a resident representative office in Colombo that covered the Maldives. They were instead asking for more frequent contact with either a local economist in the Maldives or from a local office.

The Director of the Asia and Pacific Department (Mr. Rhee), in response to further questions and comments from Executive Directors, made the following additional statement:

> We fully understand. For those who have a local office and are asking some of our resident representatives to cover that office, there are budget issues. We already asked for consideration from the Office of Budget and Planning (OBP), so I will get back to you and depending on how many additional resources will be required, the answer can be given. The reason I cannot give a final remark is that if we open this channel, there will be many other requests from other countries to open a local office, so please understand it is not just the Maldives. There are many other requests, and they have budget implications, and given that the budget issue is now being discussed, I have to wait for OBP's and management's endorsement. This is not only a Maldives issues. We have definitely noted the request for a local office.
>
> On the tenure of mission chiefs for small states, and as we discussed in the Samoa meeting, I am considering this issue very seriously. The Asia and Pacific Department will try to increase mission chiefs' tenure with small states, which we capped at two years. Now we are trying to increase that cap to three years. Except under specific circumstances of staff movement, we will try to extend this tenure from two years to three years, which I hope can address this issue. I hope that we can discuss this issue with OBP in more detail.

The Acting Chair (Mr. Zhang) noted that the Republic of Maldives is an Article XIV member but no longer maintained any measures under that provision. It maintained exchange restrictions and multiple currency practices subject to Article VIII, Section 2(a) and 3. No decision is proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the strong growth of the Maldives' economy, supported by tourism, commerce, and construction and indicated that the medium-term growth outlook remains positive. Noting Maldives' high and growing public and external debt, moderate foreign reserves, and vulnerabilities to shocks, Directors called for policies to reduce fiscal and external imbalances, build resilience to shocks, including from natural disasters and climate change, and that foster sustained and inclusive growth.

Directors welcomed the authorities' commitment to fiscal consolidation to restore fiscal and debt sustainability and reduce external imbalances. They noted that a combination of revenue and expenditure measures is needed to achieve a growth-friendly fiscal consolidation. In this context, Directors welcomed the authorities' intention to introduce a personal income tax and emphasized the need for strengthened tax administration. Directors also called for keeping current spending under control, investment spending prioritization and continuous improvements in public financial management and budget control. Directors also noted the potential fiscal risks associated with external borrowing by state-owned enterprises (SOEs) and associated public guarantees and stressed the need for a strengthening of debt management, including the oversight and institutional framework of the SOE activities.

Directors indicated that a tighter monetary policy stance would ensure compatibility with the exchange rate peg, and together with fiscal consolidation would contribute to lower external imbalances and a build-up in reserves. They noted that the authorities' decision to establish the Sovereign Development Fund was a welcome development. Directors encouraged increasing technical assistance to support the Maldives Monetary Authority's ongoing efforts to modernize monetary policy and the foreign exchange operations framework.

Directors commended the authorities' efforts in making growth more inclusive and diversifying the economy, while ensuring financial resilience. They welcomed the formation of the National Development Strategy focusing on building resilience and creating economic opportunities and encouraged the authorities to implement structural reforms, such as strengthening the rule of law, property rights, and the legal and regulatory environment, to improve the business climate and boost competitiveness. On the financial sector, while noting strong capital positions and profitability of banks, they encouraged the authorities to address supervisory data gaps and enhance financial inclusion.

Directors also welcomed the authorities' commitment to strengthening governance and transparency. They noted that further improvement is needed to strengthen AML/CFT compliance and to improve the anti-corruption framework.

It is expected that the next Article IV consultation with the Maldives will be held on the standard 12-month cycle.

APPROVAL: April 6, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal Policy & Debt Sustainability

1. Could staff comment on the fiscal target that may perhaps better capture all debt-creating flows? How should the Sovereign Development Fund activity be reflected in the fiscal accounts?

- The existence of quasi-fiscal activities may have weakened the link between budget and debt accounts. In staff's view, this issue should not be addressed by changing the design of the fiscal target, but rather by enhancing the transparent recording of these activities, including the clear assessment of fiscal risks, and by enforcing policies (for e.g., the guidelines on extending public guarantees) affecting the creation of quasi-fiscal activities.
- Regarding the treatment of the Sovereign Development Fund (SDF) in fiscal accounts, contributions to the SDF are not considered part of budget expenditure considering that they do not correspond to the spending for the budget period. The contribution represents a cash transfer between two funds (the SDF, and the domestic budget or public bank account) owned by the government. Therefore, there would be no change to the total spending of the government by these transfers as these transactions would be set-off between these two funds. As the transfers to the SDF are made from revenues received during the year (which would otherwise be used to settle government expenditure), additional financing equivalent to the transfers is needed to be raised. This is reflected in higher domestic financing increased by the amount of contributions to the SDF. At the time of drawing the SDF balances, domestic financing will be correspondingly reduced.

2. Could staff share their thoughts on the authorities' debt plan.

- The authorities are aware of the fiscal and macroeconomic risks resulting from the recent increase in public debt. The debt management strategy aims at minimizing these risks. Externally, the authorities appropriately emphasize the need to borrow on concessional terms. Domestically, as most of the domestic debt consists of treasury bills with a tenor of less than one year, they aim at addressing related rollover risks by increasing the average tenor of the domestic debt through issuing treasury bonds of longer maturity. Staff also supports the authorities' effort to develop the secondary market for domestic securities, which should expand the domestic market and support increased market participation and liquidity. To that effect, the Ministry of Finance

(MOF) and the Maldives Monetary Authority (MMA) have produced an action plan for the domestic debt market development.

3. ***Despite recent strong growth, external PPG debt to GDP has rapidly increased by around 18 percent only for three years due to large infrastructure projects. Could staff comment on the quality of those infrastructure projects? In addition, we note that the authorities are of the view that institutional weaknesses are not the primary cause for the increase in external PPG debt owed to China. What does the new administration consider as the primary cause? Does staff agree on its view?***

- Investment in infrastructure is warranted, considering large infrastructure gaps. Infrastructure projects have been focused on connectivity, bridge, airport, sanitation and housing projects –important areas for development in the Maldives. In this regard, staff has supported efforts to improve project appraisal and selection. We continue to see the potential in large infrastructure scale up to transform the economy but emphasize the need to improve 'efficiency' to maximize the economic and social impact of public investment. Following through on PIMA recommendations should raise it.

- The authorities are further strengthening the institutional mechanisms in place to comprehensively record and monitor SOEs external borrowing, including government-guaranteed borrowing, to prevent excessive external indebtedness and fiscal risks. To that effect, the authorities are strengthening the role of the MOF-Public Enterprises Monitoring Division, responsible for overseeing the companies with government shareholding.

4. ***Could staff provide more detail on the differences between staff's and the authorities' outlook in this regard and if the returns on these infrastructure projects are being included in the growth projections.***

- A number of major infrastructure projects undertaken by the government has reached completion in 2018, while some remaining projects are expected to be completed over the next few years. Thus, the fast-growing construction sector, buoyed by large infrastructure projects, is expected to decelerate relative to past few years. However, the authorities believe that the already completed projects would promote growth in the medium-term as directly-linked sectors would prosper. Policies seeking to enhance the role of the private sector, raise productivity and potential growth, along with better-targeted spending on education and enhanced efficiency in spending can be positive factors to (baseline) growth projections. Staff has further emphasized financing constraints to play a potential dampening role in the current baseline growth projections, including availability of well-trained local employees in services and technology related jobs.

5. ***Could staff confirm that the authorities now have the full picture of their debt obligations, including guarantees, and that this is reflected in the DSA?***

- The authorities are confident that they have now a relatively accurate picture of PPG debt. Up to 2015, public guarantees have been audited and reconciled. As for 2016-17, the audit still has to be completed but the authorities are confident that they have a reasonably accurate picture. The authorities have been transparent and cooperative in sharing with staff comprehensive data on project loans outstanding, financed by PPG external debt.

6. ***Similarly, do the authorities have now a clear indication on the level of contingent liabilities associated with SOEs' activities after their decision to expand the coverage of public debt to include guaranteed debt?***

7. ***Given the increase in coverage, can staff comment if the authorities have a more complete picture of the debt contingencies related to SOE's and if this data is included in the DSA?***

- Reply to Q 6-Q7: The authorities are making a resolute effort to improve the understanding of contingent liabilities associated with the SOE's activities and have comprehensive data on guaranteed debt. While the audit of these guarantees is still ongoing, staff is confident that the authorities have now a reasonably good understanding of the value of government guarantees. Importantly, the authorities are now reporting in their Quarterly Public Debt Bulletin the information about the size of the government-guaranteed debt as well as the biggest beneficiaries and the purpose of these guarantees. SOE's guarantees are included in the DSA.

8. ***Does staff have rough estimates of the possible size of underreported debt? Could staff comment on its impacts on debt sustainability assessment?***

- Staff has issued a correction (evident ambiguity), clarifying that the authorities noted that publicly guaranteed debt was previously outside their definition of public debt, but now currently include it (what is public guaranteed) in their definition of public debt. Staff does not have a reason to believe that debt data included in the DSA is underreported

9. ***The DSA does not include non-guaranteed SOE debt. We wonder whether non-guaranteed SOE debt could pose a greater than expected contingent liability for the government, and whether the SOE-shock in the contingent liabilities stress test***

should have exceeded the standard 2 percent of GDP given the size of the SOE sector. Staff comments are welcome.

- Although staff does not have data on the non-guaranteed portion of SOE debt, it would be very difficult for SOEs to secure external financing without the guarantee of the government. This limits the risk stemming from non-guaranteed SOE debt.

10. Could staff provide more details on the reasons for the IDA grant-only classification?

- Maldives falls under the Small Island Economies (SIE) exception, which recognizes the SIEs special characteristics that affect their creditworthiness and access to finance (size and remoteness, vulnerability to external shocks, trade dependence with limited diversification, distance to major markets, small domestic market, lack of economies of scale, high per capita cost of service provision). Fifteen SIEs with GNI per capita above the operational cut-off receive special treatment from IDA under this exception, of which ten have been granted the status of IDA-only country. Maldives is one of those countries.

11. Does staff see any rollover risks of domestic debt in the near-term?

- Staff does not see a large risk of domestic debt in the near term. Even though the share of short-term debt in domestic government debt is high, close to 60 percent, the pension fund is currently experiencing significant net inflows that needs to be invested mainly domestically, and thus provide a source of demand for government securities. However, given their long-term liabilities, pension funds should invest more in longer-term assets. Therefore, extending gradually the maturities of government securities is important, not only to reduce the domestic debt rollover risk, but also to provide sufficient supply of longer-term securities to satisfy the demand of institutional investors. There is a risk that banks (main buyers of T-bills) may not be willing to extend their purchase at fixed-rate auctions under possibly rising global yields.

12. **Could staff further elaborate on the relatively muted impact on the growth rate of the alternative fiscal consolidation scenario presented in annex?**

- The main reasons are: (i) the composition of the proposed fiscal measures, focusing on revenue increase and spending constraints with relatively lower fiscal multipliers and less reliance on capital spending reduction (relatively high fiscal multipliers); and (ii) the relatively high dependence of the Maldivian economy on imports. As most goods are imported rather than produced domestically, reduction of demand as a result of increased tax revenues and reduced government spending is affecting mainly imports and the current account balance.

13. ***Could staff provide more detail on the improvements made since the PIMA assessment and the priority outstanding areas of improvement needed?***

- Following the PIMA mission, the authorities have reviewed how development projects are being implemented and have begun to implement the recommendations regarding the planning, budget allocation, and implementation of the public sector investment projects (PSIP). This includes training of public agencies on screening of PSIP projects. More recently, the new administration has begun to change the process of capital budget management and the so-called New Policy Initiatives are used to bring in proposals from line ministries. These initiatives are now screened and prioritized before submitted to policy makers, to ensure that they are in line with the priorities of the National Development Plan (NDP). SARTTAC and FAD have assisted the MOF with developing project appraisal guidelines to be implemented by all line ministries. Looking ahead, it is important that the newly established Ministry of National Planning and Infrastructure (MNPI) enforces the implementation of these guidelines, and also that the roles and responsibilities of the President's Office in the project selection is clarified.

14. ***In addition, given concerns expressed in the risk matrix regarding the need for efficient public investment management, could staff also elaborate on any multilateral assistance in this area and on the prioritization of investment projects?***

- In addition to the IMF technical assistance, the World Bank is funding a Public Financial Management (PFM) Project which includes several components that should assist in the area of prioritization of investment projects. This should include developing a project planning training manual and undertake capacity assessment of line ministries in project management and oversight. UNDP and AsDB are also considering some support in the PFM area.

15. ***We welcome the completion of the HR audit report and hopes it offers useful feedback into any public sector 'rightsizing' exercise. Can staff comment on the key findings of the audit report and provide an assessment of whether it is feasible to implement the recommendations?***

- The HR audit was completed before the new government took office and covered 15 ministries. Since then, 5 new ministries have been created, increasing moderately the civil service staff (most staff were transferred from existing ministries). The audit was submitted to the Coordination Committee (which includes the President's Office) for follow-up action. The main finding of the audit is that while some ministries are understaffed, others are overstaffed. Also, each atoll, even a small one, has a local council which requires some staff. As a result, the size of civil service is large, 15 percent of the working population. The plan is to prepare a package of measures to reduce the overall size of civil service and to ensure that staffing of separate ministries corresponds to the government's policy priorities. For example, each ministry has a research office, and some could be closed. In addition, some ICT services could be outsourced. Another issue that needs to be addressed is the salary level and structure that makes it difficult to hire new qualified staff. Civil service salaries are relatively low, and this has been compensated by reduction in daily working hours (from 7 to 6 hours) which allows civil servants to take second jobs. Also, salaries are the same across atolls, despite different costs of living. Pay Commission has been set up to look into these issues.

Monetary Policy & External Sector

16. Could staff provide an update on the expected timing for removing exchange rate restrictions and MCPs, as well as any technical work needed to facilitate the transition?

- On soliciting readiness to accept the obligations of Article VIII and lift the MCPs, the authorities surmised that "improvements in the fiscal and external balances will help ease the exchange rate restrictions and multiple currency practices", with no specific timeline provided for their removal. As a reminder, Staff has recommended accepting the obligations of Article VIII, and lifting the MCPs as a measurable goal of the MMA Strategy Plan.

- Taking action to normalize the FX markets (eliminating MCPs and unifying the exchange rate), supported by TA, through foreign currency regulatory reforms and setting appropriate incentives for banks and other economic agents (by making monetary policy relatively more favorable for the domestic currency) is part of the MMA Strategic Plan (MMA-SP).

17. Separately, we note from the report that staff sees merit in eventually shifting the exchange rate target to a composite basket peg. Hence, we invite staff to elaborate on the authorities' views on this recommendation.

- The authorities acknowledge the benefits of adopting a composite in raising resilience to shocks, accumulating reserves, and better stabilizing local prices. In 2016, the MMA requested a review of its FX framework focusing on stabilizing the exchange rate against a currency composite, considering greater tourism from Asia and prospective Chinese financing. A key MMA goal is to 'develop the FX market'. The policy measure aiming to 'review the current exchange rate regime in order to maintain exchange rate stability' is specified into a detailed action plan which include: (i) identifying the composite operational parameters (currencies to include in the basket, and corresponding weights); (ii) deciding on the initial parity and frequency of the currency basket adjustments; (iii) developing a communication policy with key stakeholders, and a reliable strategy for FX intervention.

18. In this regard, we see merit on staff suggestion towards the gradual move on basket pegged exchange rate regime. The preparation and implementation strategies for regime change have to be well articulated and plan to ensure smooth transition, staff comments are welcome.

- Staff agrees that the introduction of a currency composite should be carefully prepared, given related operational and communication challenges. Operational issues include the determination of the calculation method for the composite (arithmetic average or geometric average), level of transparency for the currency composition, initial parity of the domestic currency MVR against the composite [To note: A previous TA has advised on choosing an initial parity that eliminates any existing parallel FX market premium when the new regime is introduced], procedure for periodic adjustments, determination of the trading band, and training of MMA staff. Just as important, the strategy for MMA intervention to maintain the value of the composite has to be well determined. Communication challenges suggest a careful determination of its timing. This said, times of relative political and economic stability will reduce the risks of an introduction having undesirable short-term effects on the banks and the economy at large. Nonetheless, we have emphasized the move to a basket as an objective rather than something with any implied specific timeline.

19. We concur with staff on the tighter monetary policy stance to ensure compatibility with the exchange rate peg. The authorities have a divergence in the view citing the absence of inflation and foreign exchange market. Staff has however emphasized the large CAD, slow accumulation of foreign reserves, and related external imbalances. In this context, could staff elaborate more on the usefulness of alternate instruments which could be deployed to manage the exchange market?

- Monetary policy should be tightened to support the buildup of reserves and the pegged arrangement. The MMA can follow a strategy for the normalization of the FX market based on setting appropriate incentives – namely, modifying incentives for banks, and consequently all economic agents, to be active in MVR vs FX. It can rely, in the short term, on less drastic and potentially disruptive changes to FX regulations as previous efforts based on regulatory measures have not materialized so far. This said, enactment of the Foreign Currency Regulation (draft was stalled since 2012, largely because of the opposition of stakeholders / resort industry in particular) is necessary, as recommended by the 2016 IMF TA mission, which should ensure a minimum supply of FX (by the tourist sector) in the domestic market by requiring the payment of the local component of the export industry in local currency (salaries, taxes). MMA could also use the new inflow of FX to run a currency swap facility and help make markets in MVR/USD.

20. ***For the medium term, does staff consider that the Maldives should adopt a flexible exchange rate regime?***

- Based on a technical logistic regression method, analysis has pointed out that economic factors, size and openness of the Maldivian economy, increase the probability of choosing a fixed exchange rate (as high as 95 percent). (MCM TA, 2016). Nonetheless, in practice, challenges have put pressures on the regime because of low official FX reserves, and fiscal imbalances and a previous history of fiscal dominance. The MMA-SP is taking steps to address those challenges.

- Staff has not considered a move to a flexible exchange rate regime, considering a weak monetary policy transmission mechanism, hampered by dollarization and excess liquidity. As the MMA adopts a more active liquidity management to achieve more balanced liquidity conditions and as dollarization decreases toward its 'optimal' level, the transmission of monetary policy should gradually improve. Any added flexibility outside a pegged regime, should be put within the Maldivian economy's structure (small, open with tourism being by far the first sector) which would otherwise favor a form of a pegged regime. For now, taking the fixed rate as a start, we have recommended a move to an import-weighted basket in improving resilience to shocks and improving (exchange rate) risk management.

21. **However, we observe the divergent views between staff and the authorities on the monetary policy stance, in this regard, could staff elaborate further on the rationalization behind the tightening monetary policy?**

22. ***Could staff elaborate more on their recommendation to further tightening monetary policy—noting that inflation seems under control—and assess the impact of keeping the actual stance?***

- Reply to Q19-Q20

- The tightening of monetary policy is recommended for (i) stabilization reasons (coordinated with tighter fiscal policy to reduce the internal and external imbalances, and given recently closing credit gap), supporting the buildup of reserves and the pegged arrangement, and (ii) in addressing abundant structural excess liquidity conditions hampering the transmission mechanism. On the latter, better liquidity management with re-activation of monetary operations would move the MMA toward a situation where the indicative policy rate (IPR) plays a better signaling role in restoring an appropriate monetary policy transmission. The structural excess liquidity in MVR has decreased the price of MVR liquidity well below the MMA's IPR. OMOs should be reintroduced to manage MVR liquidity more actively and bring the price of MVR liquidity closer to appropriate levels from a monetary policy perspective. To note, excess liquidity and ensuing disincentive in holding domestic liquidity and rising deposit-liability dollarization in banks have contributed to the parallel market premium, undermining the pegging regime.

23. Could staff also elaborate on plans to increase resilience to external shocks and rebuild foreign exchange buffers in the context of the proposed adjustments to the exchange rate regime?

- The exchange rate arrangement should be flexible enough to absorb external shocks. In the authorities' regime of choice (that is, fixed exchange rate), we have suggested pegging to a composite. With greater tourism from Asia and prospective Chinese financing, the authorities have thought about stabilizing the exchange rate against a currency composite instead of the USD (in 2016). It was thought that an import-weighted composite would eliminate the pass-through of exchange rate fluctuations to domestic prices (under a large import content of the CPI basket) and, thus, help the MMA to achieve its objective of stabilizing customer price inflation. The composite would also increase awareness of risk management by banks and market participants, an important factor to support a gradual de-dollarization strategy, and rebuilding buffers.

24. Does staff believe that the reform plan is adequate for preserving reserves?

- Yes, over the timeframe set by the MMA. A dedicated unit mandated with overseeing the implementation of the MMA-SP over 2018-2022 is critical to the monitoring and evaluation mechanism. A well-executed SP, supported by monitorable clear Key Policy Indicators (for e.g., an appropriate quantitative target for FX reserves) to track progress will help the MMA achieve a sustained and viable reserves position. In a key policy measure, namely, to "Review measures to accumulate reserves", policy actions to operationalize such measure are seeking to (i) identify major drains on reserves (e.g., FX requirement to import oil and outward remittances), and coordinate with related government agencies and private parties to solicit buy-in on net savings on reserves relying on developing alternative policies to address reserve drains; (ii) coordinate with the government to incorporate these policies in national development plans and policies, to facilitate reserve accumulation and economic development; (iii) and enhancing FX receipts including from diversification efforts and strengthening the business environment to attracting FDI. Associated with that are strengthening FX operations and markets in support of building reserves.

25. The very high current account deficit is also a source of vulnerability and measures should be taken to reduce it. While more ambitious fiscal consolidation would go into this direction, we wonder which other measures staff recommend in the short run. We would also like staff to elaborate on the refinancing risk of external borrowing (noting the high share of FDI inflows in the financial account).

- Infrastructure projects undertaken by SOEs are outside of the government budget and fiscal consolidation would not impact plan for these off-budget expenditures. The pace of SOE investment (subject to increased oversight) is set to decline over the medium term with the current account deficit expected to narrow accordingly. Since infrastructure projects have a high-import content, making sure that they are subject to a thorough selection process and are appropriately paced will be important in managing the size of the current account deficit.

- The authorities are making efforts to continue building up the SDF to use to pay off the maturing sovereign bonds (issued in 2017-18). It will also be important to negotiate the best possible terms for future project loans and to access concessional financing where available.

26. On the adequacy of reserves, we take note of the difference of views between staff and the authorities and we would appreciate if staff could provide indications on the adequacy of reserves based on metric other than import coverage.

- Common metrics used in tandem with import coverage is reserves in percent of short-term debt and in percent of broad money. Gross reserves are about 460 percent of short-term debt and gross usable reserves are around 180 percent of short-term debt. It should be noted that short term external debt is relatively limited in Maldives, and the metric should be viewed in this light. Reserves make up around 35 percent of broad money.

27. ***We note from the buff statement that the authorities do not share staff assessment on the scale of external financing needs and would appreciate staff clarification on this divergence of views***.

- The authorities view the risk from external financing pressures to be fully contained by the SDF. Staff acknowledge that the SDF acts as a mitigating factor to the external financing needs but view that external financing pressures are still present (hence the call for sustained FDI, and a buildup in reserves).

28. Could staff make a decomposition of the CA deficit into private and public saving-investment gaps?

- The public saving-investment gap was -4.3 percent of GDP in 2018. The private saving-investment gap, which also includes SOEs, was -19.6 percent. Of this gap, 10.6 percent of GDP was SOE investment and 8.5 percent of GDP was private investment

29. Could staff elaborate on the reasons why the suggested adjustment for temporary spike in infrastructure spending had not been incorporated?

- The CAD in 2018 is not a one-off spike due to a temporary factor. The elevated CAD is the outcome of a ramp-up in infrastructure investment in recent years and it is set to decline gradually over the medium term. For this reason, it is not possible to judge a portion of imports as being temporary in the sense that they are a short-term feature of 2018, to be reversed in 2019.

Financial Sector

30. We take comfort in staff's conclusion that the rapid growth in credit should not raise concerns. However, we would appreciate staff elaborations on any potential vulnerability that could be associated with the fast increase in credit to construction in 2018.

- Staff does not see specific risks arising from this sector as this stage. This is predicated on banks prudential measures in place to prevent over-extension in exposure to a given sector, including construction. The major bank has mentioned current/prospective lending (as a share of the bank's total loan portfolio) approaching 'uncomfortable' levels close to imposed regulated limits, would trigger immediate measures. In this vein, loans and performance related to the expansion in the construction of housing in Hulumale undergo strict evaluation process, with commensurate collateral and down payment.

31. Could staff elaborate on the extent of Fintech usage and its role in this plan? We'd also welcome some information on whether the authorities are receiving TA to help develop the appropriate institutional, legal and regulatory framework to support a more efficient payments system?

- The authorities have adopted strategic plans to expand financial inclusion through a modernized payment system, harnessing where possible innovative fintech measures to ensure fast, convenient, secure and affordable means of making payments while keeping up with international payment modernization initiatives. Fund/ World Bank

TA would focus on the authorities' providing an enabling environment, including consumer protection laws and financial education.

- The Fund has discussed with the authorities, among other things the need to: (i) to set up the appropriate institutional, legal and regulatory framework to enable efficient financial and payment systems; (ii) enhance the technical infrastructure and sharing it among stakeholders [the inter-operability between the mobile service providers and the banking system is key to increasing the financial infrastructure efficiency. A common switch and payment gateways should be introduced to facilitate connectivity among all service providers and sharing the existing framework must be facilitated by the regulator underpinned by banks' cost sharing of establishing the infrastructure]; and (iii) improve data availability to facilitate financial inclusion in the Maldives [the rapid growth of mobile wallets may cause systemic risks if not monitored. Effective risk monitoring and understanding financial stability issues requires access to data from multiple sources, and the MMA needs sufficient powers to collect such data to carry out the needed analysis. A coordination mechanism for information flow between institutions, including Maldives Credit Information Bureau, must be set up to ensure financial resilience.]

- While the above areas draw on FinTech solutions and measures within the capability of the Maldives financial system, the authorities have further expressed an interest in Cybersecurity, a specific area in FinTech. MCM's developed Cybersecurity program, and Cybersecurity workshops to be delivered through the IMF RTACs would be most helpful in raising awareness and providing guidance on the subject.

- In supporting the MMA-SP's implementation, the MMA and MCM-TA needs assessment team agreed to prioritize TA in monetary and FX policy and operations and financial sector supervision and regulation while advising the MMA to seek further support in other areas for e.g., payments systems development and respective legislative and regulatory framework from others, for e.g., from the World Bank.

Structural Reforms

32. Could staff elaborate more on the authorities' strategy on developing the private sector and proceed with privatization, including the financial sector? Are there any specific plans for 2019 and 2020 in this area?

- With respect to FDI, efforts are undertaken to attract it to sectors other than tourism, including setting up a one stop shop for investors into the economy. Encouraging well planned public-private-partnerships would also share the financing of well-vetted projects based on improved governance which accounts for fiscal risks.

- The authorities have also prioritized the development of the fishing and agriculture sectors. They plan to introduce training programed aimed at increasing productivity and helping the move to higher value-added products. The authorities plan to make available financing through the banking sector for these private sector goals. They also aim to promote the inclusion of women in the labor force. In addition to fisheries and agriculture, the guesthouse industry is viewed as a potential to increase economic activity in the atolls. These efforts will be costed to ensure appropriate funding.
- More broadly, the authorities aim to promote trade by eliminating barriers to trade and corruption. They also intend to open a new bank focused on SMEs with the aim of developing new businesses involving new technology and with special attention to the employment of youth and women.

33. Could staff provide further insights on the possible role of SOEs in promoting an increasing contribution by the private sector in the growth and diversification of the economy? More specifically, does the National Development Strategy (NDS) foresee a growing role of the private sector?

- The authorities are seeking to promote increased role of private sector in the economy, as part of the effort to increase the diversification and sustainability of growth. Thus far, majority of FDI has been allocated to tourism, generally not allowed in other sectors. The authorities are now reviewing these policies and are considering setting up new areas open to FDI, including possibly agriculture and fisheries. This should also help increase the value added of exported products (fishery in particular). New laws to improve investment climate and reduce red tape should further assist in supporting private sector development.

Climate Change

34. In light of the recent Executive Board discussion on building resilience to large natural disasters, we would welcome comments on how the three-pillar framework proposed by staff will be applied to Maldives.

- In way of background and putting the question in context, the mentioned framework views disaster risk management through the lens of *a three-pillar strategy for building structural, financial, and post-disaster resilience.* Enhancing *structural resilience* requires infrastructure and other investments to limit the impact of disasters (Pillar I); building *financial resilience* involves creating fiscal buffers and using pre-arranged financial instruments to protect fiscal sustainability and manage recovery costs (Pillar II); and *post-disaster (including social) resilience* requires contingency planning and related investments ensuring a speedy response to a disaster (Pillar III). A full national disaster resilience strategy (DRS) requires actions on all three pillars, grounded on a clear diagnostic.

- Regarding Pillar I, the authorities are allocating a part of their budgetary spending to enhancing structural resilience and limiting the impact of disasters, while also increasing the use of renewable energy, water and sewage treatment, and promoting environmentally sustainable development. Pillar II, building financial resilience, including creating fiscal buffers to protect fiscal sustainability and manage recovery costs, underlies the reasoning for a sustainable fiscal adjustment, including the effort to increase domestic revenues and rationalizing non-priority spending. Pillar III, contingency planning and related investment: contingency planning is laid out in the Disaster Management Act of 2015 which includes the early warning system, emergency response, and disaster response and recovery plan, including national disaster management financing mechanism as well as the responsibilities of different domestic agencies and of international organizations.

35. In the 2017 report, staff advised the authorities to integrate risk-reduction and disaster-response programs into the core budget, into public investment planning and into the debt management framework. Does staff still consider this to be a "key challenge" for the authorities? Can staff comment on progress on this front?

- The integration of the said program remains a key challenge. The authorities continue to consider the integration of risk-reduction and disaster-response programs into the core budget and public investment planning an important priority, however a comprehensive and coordinated action plan still in the works. Staff has emphasized the importance of proper classification of climate change-mitigation and adaptation projects for the purpose of facilitating access to climate change-associated funds. Coordination between the Ministry of Environment and Energy (MEE) and the MOF on program medium-term costing, and integration in the budget should be accelerated.

36. In response to this, the authorities considered participating in the IMF-World Bank Climate Change Assessment Program (CCPA). Could staff indicate why Maldives has not been chosen among the pilot countries and whether there are any plans with respect to assessment under the recently discussed Board paper on Building Resilience to Large Natural Disasters?

- Staff has discussed the CCPA with the authorities during the 2018 Spring Meetings and presented its main features and potential benefits to the Maldives of participating (with the help of FAD). The authorities have expressed interest in joining the pilot then. With the change in the government in Nov 2018, the new administration has informed staff that they will consider participation pending their understanding of the full benefits of such exercise. Efforts, including coordinating with other participating international organizations and bilateral countries, are underway.

37. We noted from the 2017 Article IV report that the authorities were willing to participate in the Climate Change Policy Assessment (CCPA). We were surprised that there appear to have been no follow up discussion of this concern in the latest Article IV report. Staff comments are welcome.

- Staff has followed up with the authorities during the Staff Visit and AIV on the topic. Authorities have expressed interest in the CCPA participation and noted that they will study the pilot and after carefully considering the potential benefits will come back to staff with a decision.

38. In the 2017 Art. IV, staff recommended integrating risk-reduction and disaster-response programs into the core budget. Could staff comment on the advances in this and other related policies for building resilience, such as insurance.

39. That said, we note that the report was very light on building resilience to natural disasters and climate change. Could staff comment whether and to what extent such costs were incorporated into to the macro-fiscal framework and policy advice to the authorities?

- Replies to Q38-Q39

- Staff has been emphasizing the importance to ensure a proper integration of risk-reduction and disaster-response programs into the budget, debt management and macro-fiscal framework. To achieve this, a proper classification of climate change-related adaptation and mitigation measures in the budget is required. Staff has emphasized that proper integration of these programs should facilitate securing external financing. In this context, the CCPA could play a useful role. In addition, staff has also emphasized the need to mobilize more domestic resources to improve the capacity to finance investment aimed at building the resilience to natural disasters and climate change. Regarding insurance, there is currently available insurance for flooding and high water, but there is no climate change-related insurance covering, e.g., coastal erosion which could cause significant damage and could be very expensive. The Maldives as a member of Alliance of Small Island States has been calling for insurers and developed countries to assist with financing the climate change-related insurance.

40. As Maldives is a vulnerable country for natural disaster and climate change effect, staff comments on the fiscal effort to build the resilience in this matter are welcome.

- Given the high dependency of the Maldives on tourism, climate change-induced erosion of islands could pose a significant risk to tourism industry. Creating fiscal space to finance climate-adaptation investment is an important part of the fiscal effort. Participation in the CCPA (highly encouraged) should assist in integrating climate change impact and policy responses in the budget and the macro framework. The features of such program and integration of adaptation measures in capital spending going forward, have been communicated to the authorities, including demonstrated country experiences that underwent a similar exercise.

41. Could staff elaborate on the extent of concessional and grant climate financing Maldives has been able to access for recovery and resilience investment?

- Staff has solicited the MEE's input for a full listing of funds accessed / under negotiation for recovery and resilience investment, which we can report back on. Gleaning through budget documents, the WB has provided MVR27 million for climate change adaptation project Addu City, Italy MVR10 million Climate Vulnerability & Risk Assessment, UNEP. Maldives received technical assistance from the ADB in 2018 to build capacity in rural and urban flood protection, clean energy and transport systems. According to the Stockholm Environment Institute, between 2010 and 2015, Maldives was allocated around US$86 million of projects targeting climate change adaptation and mitigation.