

### Summary

A structural country risk the Maldives are facing is climate change. If the sea level rises only by a couple of meters, the majority of the Maldives will be submerged. The political situation is very unstable, as the opposition and the ruling party are frequently at loggerheads hindering any progress on reforms. The economy is small and undiversified. The fiscal and external position have been troublesome ever since 2004, when the country was hit by a devastating tsunami. However, an IMF loan extension of USD 92m announced end-2009 is very good news for the short term. The economy is estimated to grow by 3% yoy in 2010 and 4-5% yoy in 2011.

### Things to watch:

- Climate change
- Domestic politics
- Fiscal consolidation

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Maldives			
<b>National facts</b>		<b>Social and governance indicators</b>	
Type of government	Republic	Human Development Index (rank)	rank / total 107 / 169
Capital	Male	Ease of doing business (rank)	85 / 183
Surface area (thousand sq km)	298	Economic freedom index (rank)	148 / 179
Population (millions)	0.4	Corruption perceptions index (rank)	143 / 178
Main languages	Dhivehi	Press freedom index (rank)	52 / 178
Main religions	Sunni Muslim	Gini index (income distribution)	37.4
		Population below \$1 per day (PPP)	40%
		<b>Foreign trade</b>	
Head of State (president)	Mohamed Nasheed	2009	
Head of Government (prime-minister)	Mohamed Nasheed	<i>Main export partners (%)</i>	<i>Main import partners (%)</i>
Monetary unit	MRF	France	Singapore
		Thailand	UAE
		Italy	India
		UK	Malaysia
			9
<b>Economy</b>		<b>2009</b>	
<i>Economic size</i>		<i>Main export products (%)</i>	
	<i>bn USD</i>	<i>% world total</i>	
Nominal GDP	1	0	Marines exports
Nominal GDP at PPP	n.a.	n.a.	Re-exports
Export value of goods and services	n.a.	n.a.	Garments
IMF quotient (in mln SDR)	n.a.	n.a.	Other
			1
<i>Economic structure</i>		<i>Main import products (%)</i>	
	<i>2009</i>	<i>5-year av.</i>	
Real GDP growth	-3	5.6	Intermediate and capital goods
Agriculture (% of GDP)	11	n.a.	Consumer goods
Industry (% of GDP)	23	n.a.	Petroleum products
Services (% of GDP)	65	n.a.	
			51
			33
			15
<i>Standards of living</i>		<i>Openness of the economy</i>	
	<i>USD</i>	<i>% world av.</i>	
Nominal GDP per head	4383	n.a.	Export value of G&S (% of GDP)
Nominal GDP per head at PPP	5479	n.a.	Import value of G&S (% of GDP)
Real GDP per head	3159	n.a.	Inward FDI (% of GDP)
			n.a.
			n.a.
			n.a.

Source: EIU, CIA World Fact book, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank, IMF, Maldives Monetary Authority.

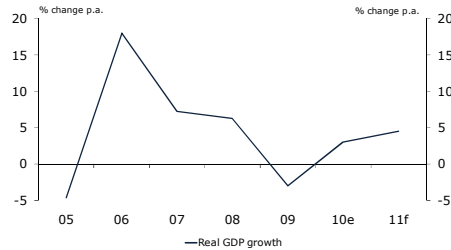
### Economic structure and growth

The Maldives islands were long a sultanate, first under Dutch, then under British protection. It became a republic in 1968. The island group is situated in the Indian Ocean, south west of India's southern tip. The country is small; the land area only encompasses 298 sq. km and inhabits a population of only 395,000. A structural country risk for the Maldives is global warming. Since the Maldives are elevated only 1.2 meters above sea level, climate change is a serious threat for the country's existence. The economy itself is very small and highly undiversified. The services sector dominates as it makes up 65% of the economy. Industry and agriculture follow with 23% and 11% respectively. The country has two key sectors: fishing and tourism. It derives income not only from its own fish catch, but also from selling fishing licenses to other nations. These licenses are required to fish in Maldives' exclusive economic zones. As the economic base is very weak, the Maldives are very dependent on development assistance. In 2009, the economy contracted by 3% yoy as tourism arrivals fell. Tourism is an important growth driver for the small economy since it contributes 27% to total GDP at factor cost. Economic activity is estimated to expand by 3% yoy in 2010 as tourism has recovered this year and expansion plans for bungalows are being materialized.

### Political and social situation

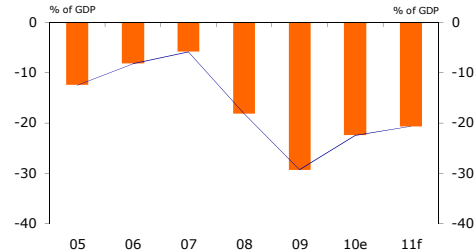
Before the first multi-party elections in 2008, the Maldives were ruled for 30 years by president Gayoom. While he won six successive elections, he was heavily criticized for failing to push through

Chart 1: Growth performance



Source: Global Insight

Chart 2: Budget balance



Source: IMF

democratic reforms. As a result of the growing discontent, Gayoom faced a number of political coup attempts from members of his own government. In response, Gayoom cracked down on any form of opposition on multiple occasions. He backed a blocking of the registration of the Maldivian Democratic Party (MDP), a group that includes former members of cabinet and of the legislative body. In 2002, several journalists were imprisoned after publicly criticizing the government and in 2006 the government detained over 100 MDP activists to prevent demonstrations. Even so, Gayoom did commence with political reforms under heavy public criticism of its slow pace. Finally, in 2008, the first multi-party elections were held and won by Gayoom's main opponent, Mohamed Nasheed, leader of the MDP. The victory of Nasheed indicated a need for change. He won as he is a well-known proponent of political reform. His popularity also stemmed from his economic policy pledges, promising a raft of reforms which included higher spending on healthcare. Unsurprisingly, these pledges have resonated among a population out of which around 40% lives on less than USD 1 a day.

Disappointingly, Nasheed has not been able to live up to his economic pledges, as he is blocked at almost every decision by the main opposition party, the Dhivehi Rayyithunge Party (DRP), led by Gayoom. This is possible because of the opposition's large presence in parliament. Tensions rose to the extent that 13 ministers of Nasheed's cabinet resigned, claiming the opposition made a functioning government impossible. While all ministers were re-appointed a week later, this underscores the large differences between the two parties. As long as Nasheed does not find reconciliation with Gayoom, who wields large political influence after 30 years of rule, the political situation will remain highly unstable.

The Maldives enjoys good relations with Sri Lanka and India, its closest neighbours. It even called upon Sri Lankan president Rajapakse, to mediate between the DRP and MDP after Nasheed's cabinet resigned. The Maldives holds close relations to these neighbours since it wants to purchase land in the event the Maldives themselves are submerged. The country publicly criticizes the US for failing to sign the Kyoto Protocol, as the Maldives are obviously an avid proponent of the reduction of greenhouse gas emissions worldwide.

### Economic policy

The public finances of the Maldives are extremely weak, ever since the devastating tsunami of 2004. The budget deficit recorded a whopping 29% of GDP in 2009. Several reasons exist for this terrible fiscal budget position. Firstly, the costly reconstruction efforts after the tsunami weighed heavily. Secondly, the previous government's long-standing commitment to expand the civil service to keep youth employment down. Thirdly, the high cost of providing basic services to remote islands. The government did encourage inhabitants to move to larger or "focus" islands. However, as the population seems reluctant to move, infrastructure spending to improve access to remote islands has continued. Finally, fuel subsidies and civil servant pay hikes have further

strained the fiscal balance. The fiscal deterioration forced the government to enter into a three-year financing programme of USD 93m with the IMF in December 2009.

The IMF loan package does come with a set of fiscal austerity measures. To meet these requirements, energy subsidies were withdrawn and public sector pay cuts were introduced. Also, a goods and services tax on tourism was introduced. Only a moderate improvement is expected from these measures, as the fiscal troubles are significant. Furthermore, the Civil Service Commission highly opposes the public sector pay cuts and is taking legal action. In response, the government has put plans to reduce the size of the total public sector work force on hold. No data on total public debt is available.

The exchange rate of the Maldivian currency, the rufiyaa (Mrf), is pegged to the USD at a fixed rate of 12.8 Mrf/USD since 2001. The Mrf has depreciated against other major trading partner currencies since early 2010, but has shown a little appreciation in recent months.

**Balance of Payments**

The current account has posted whopping deficits in recent years and expected to do so as well in 2010 with a huge deficit of 26% of GDP. The small country lacks an industrial base, meaning all of its manufactured goods and raw materials must be imported. This heavy reliance on imports has resulted in large trade deficits. In 2009, the trade deficit amounted to 55% of GDP. The income and transfer balanced further added to the current account deficit, both posting deficits of 4% of GDP in 2009. The only positive contributor was the services balance, which posted a surplus of 30% of GDP last year.

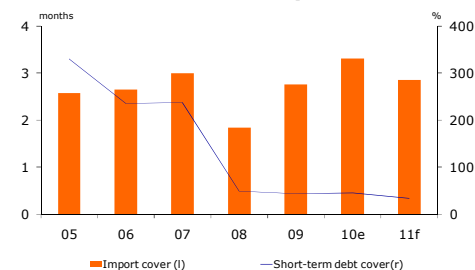
The large import-dependency makes the country highly susceptible to swings in global commodity prices. In 2008, when global oil and food prices soared, this resulted in a record 52% of GDP current account deficit. Overall, the balance of payments is in very bad shape and the deficit on the current account needs to be financed with debt, as net FDI inflows are insufficient.

**Chart 3: Trade balance**



Source: EIU

**Chart 4: Covers offered by FX-reserves**



Source: Global Insight

**External position**

The external position is weak ever since the 2004 tsunami and has not been able to recover. FX-reserves only cover 3 months of imports. However, the IMF loan mentioned earlier has shored up FX-reserves, which are estimated to stand at USD 341m at end-2010. This covers short-term debt with a mere 45%. Short-term debt is little less than half of total external debt, which stands at USD 1,430m at end-2010. This is very high as it is equivalent to 96% of GDP. Maldives does have sound access to donor aid from several countries, including the US, India and EU member states. India is one of the largest contributors, as it is a neighbour country with strong cultural similarities. Other countries provide donor aid via the UN Development Program. As several countries are required to focus their assistance on the category Least Developed Countries, and the Maldives is placed under this category by the UN, it will receive a continued amount of donor aid.

Maldives							
Selection of economic indicators	2005	2006	2007	2008	2009	2010e	2011f
<i>Key country risk indicators</i>							
GDP (% real change pa)	-4.6	18.0	7.2	6.3	-3.0	3.0	4.5
Consumer prices (average % change pa)	3.3	3.5	7.4	12.3	4.0	4.4	4.3
Current account balance (% of GDP)	-36.4	-33.0	-41.5	-51.4	-31.7	-26.0	-17.4
Total foreign exchange reserves (mln USD)	186.3	231.4	308.3	240.6	261.0	341.0	310.0
<i>Economic policy</i>							
Budget balance (% of GDP)	-12.5	-8.2	-5.9	-18.2	-29.3	-22.4	-20.7
Consumer prices (average % change pa)	3.3	3.5	7.4	12.3	4.0	4.4	4.3
Exchange rate LCU to USD (average)	12.8	12.8	12.8	12.8	12.8	12.8	12.8
<i>Balance of payments (mln USD)</i>							
Current account balance	-273	-302	-437	-647	-370	-372	-273
Trade balance	-494	-590	-737	-891	-651	n.a.	n.a.
Export value of goods and services	162	225	228	331	166	n.a.	n.a.
Import value of goods and services	656	815	965	1221	817	n.a.	n.a.
Net direct investment flows	9	14	15	15	20	35	42
Net portfolio investment flows	0	0	0	0	0	0	0
<i>External position (mln USD)</i>							
Total foreign debt	390	484	576	987	1205	1430	1647
Short-term debt	56	98	130	484	602	751	908
Debt service due, (Interest + Long-Term Principal)	35	39	50	65	70	90	110
Total foreign exchange reserves	186	231	308	241	261	341	310
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Current account balance (% of GDP)	-36.4	-33.0	-41.5	-51.4	-31.7	-26.0	-17.4
Foreign debt (% of GDP)	52.0	52.9	54.7	78.3	88.8	95.5	99.3
Foreign debt (% of XGSIT)	79.9	62.1	65.5	95.1	144.9	152.2	160.9
FX-reserves Short-term debt cover (%)	330.8	235.6	237.2	49.7	43.3	45.4	34.2
FX-reserves import cover (months)	2.6	2.7	3.0	1.8	2.8	3.3	2.9
FX-reserves debt service cover (%)	525	593	611	371	373	379	282

Source: EIU

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