

Economic Review:

October 2011

Overview:

Maldivian economy showed expansion and growth especially in the tourism industry, which is one of the leading indicators of the economy. This supplements growth in other sectors of the economy and puts it on a stronger footing. Inflation however continued to be an issue as it has been increasing mainly due to higher food and transport prices. But, this is not singular for this economy as rising prices have been witnessed across the globe. It is expected that the cooling of international commodity prices due to the global slowdown will substantially help to temper prices going ahead. This will also help to reverse gradually the trend of the present widening trade deficit and declining foreign exchange reserves, which in turn will better be able to reflect the benefits of the , rufiyaa depreciation.

Overall GDP:

Table 1: GDP Growth (%)

%	2007	2008	2009	2010	2011
GDP	12.1	12.0	-6.5	9.9	8.3*

Source: MMA

*Estimated

The GDP is estimated to grow at 8.3% in 2011, reflecting recovery of the economy following the downturn in 2009. This growth is supported by continued buoyant growth in tourism and related sectors such as construction and transportation. Excluding 2009, the average growth in the period 2007-2011 would be impressive at 10.6%.

Tourism

Tourism sector is the main driver of the Maldivian economy. In cumulative terms, total tourist arrivals reached 597.2 thousand during Jan – Aug 2011, increasing by 18% from 506.2 thousand in Jan – Aug 2010. In the meantime, bed nights grew by 9.7% during the first eight months of 2011 which is less than the arrival growth rate. Consequently, the average stay declined to 7.2 days from 7.7 days in the corresponding period of 2010.

Going ahead, this component will be critical for the economy especially so as tourist traffic will be affected particularly by developments in the euro area as traffic is dense from this region. However, there has been significant diversification witnessed in the inflow of tourist traffic from Asia, which in turn will help to negate this effect. In fact this component has been growing fast, and given that the emerging

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markets would be growing at a higher rate in the coming years, it may be expected to compensate for this possible pressure of tourist traffic from the euro region.

Inflation

Inflation, measured by the Consumer Price Index (CPI) for Male, stood at 8.3% at the end of Aug 2011 from 6.2% at the end of Dec 2010. Inflation during the period was mostly influenced by food index owing to the increase in prices of both fish (41.6%) and other food items (11.19%) followed by the increase in the transportation costs. *The price rise can be attributed partly to the higher costs of imports due to the depreciation in the currency in April. Inflation has hence, been rising.*

World Bank data shows that during the last two quarters there has been a decline in the price indices of energy, agriculture (including raw materials) and metals. These lower prices are expected to be transmitted through lower import prices provided there is no turnaround in the direction of movement of prices. This will automatically put downward pressure on prices.

Fiscal Deficit Position

Total Revenue is projected to increase to 29% of GDP in 2011 from 23% in 2010. *The increase is projected to come mainly from the introduction of new revenue measures such as goods and services tax on tourism and business profit tax.* Total expenditure to GDP ratio is projected at 41% in 2011 according to MMA from 37% in 2010. The increase in expenditure mainly reflects the restoration of wages of government employees to the levels prior to 2009. The government has however, taken some steps in terms of rationalization of manpower. The overall fiscal deficit is estimated to remain at 11% of GDP.

During the year, 75% of the deficit is projected to be financed domestically mainly through proceeds from privatization and issuance of T-Bills, while 25% is to be financed from external borrowings.

Table 2: Tourist Arrivals and Bed nights

Thousands	2010	2011
	Jan- Aug	
Tourist Arrivals	506.2	597.2
Tourist bed nights	3913.5	4292.2
Average stay (days)	7.7	7.2

Source: MMA

Table 3: Inflation

Inflation (%)	2010	2011
	Dec	Aug
Male	6.2	8.3
Food and non-alcoholic beverages	7.5	15.5
Transport	3.3	8.0
Health	4.6	7.0
Hotels, cafes and restaurants	3.2	6.1

Source: MMA

Goods and Services tax and business profit tax introduced

Unchanged fiscal deficit

Table 4: Money and Banking

Rf Million	2010		2011
	Aug	Dec	Aug
Broad Money	14,372	15,863	18,603
Net Foreign Asset	-1,299	686	1,338
Net Domestic Asset	15,671	15,178	17,265
Net Claims to Government	5,254	5,381	6,584
Claims on Private Sector	15,332	15,191	16,795

Source: MMA

Table 5: Private Sector Interest Rate

%	2010		2011
Private Sector	Aug	Dec	Aug
Minimum	5.0	5.0	5.0
Maximum	14.0	14.0	14.0
Weighted Average	10.36	10.45	10.15

Source: MMA

Table 6: Balance of Trade

US Million	2010	2011
	Jan – Aug	
Exports	122.6	205.3
% Growth	-	67.4
Imports	668.6	853.7
% Growth	-	27.7
Trade Deficit	546	648.4

Source: MMA

Declining international reserves and import cover

Money and Credit

Board money (M2) registered a year-on-year increase of 29.4% and totaled Rf 18,603 million at the end of Aug 2011. It grew by 17.3% from Dec 2010 to Aug 2011. Net foreign asset and Net domestic assets of the banking system in Aug 2011 totaled to Rf 1,338 million and Rf 17,265 million respectively.

Of the domestic claims, Net Credit to government by the banking system increased by 25.3% on an annual basis and by 22.3% between Dec 2010 and Aug 2011, while claims on the private sector registered an annual growth of 9.5% and 10.6% between Dec 2010 and Aug 2011.

The Interest Rate on loans by private sector ranges from 5% to 14%. The weighted average of the same went up from 10.36% in Aug 2010 to 10.45% in Dec 2010 which lowered to 10.15% in Aug 2011.

Balance of Trade and Gross International Reserves

In cumulative terms, the value of merchandise exports amounted to US \$ 205.3 million during Jan – Aug 2011 and registered a growth of 67.4% from US \$ 122.6 million in Jan – Aug 2010. The value of merchandise imports amounted to US \$ 853.7 million and registered a growth of 27.7% from US \$ 668.6 million in 2010.

With the increase in imports more than offsetting the growth in exports, the trade deficit widened to US \$ 648.4 million during Jan – Aug 2011 from US \$ 546 million in 2010

Gross international reserve declined to US \$ 323 million at the end of Aug 2011 from US \$ 350.2 million at the end of Dec 2010, although when compared to Aug 2010, gross reserves show an increase of US \$ 33.2 million. *Despite the annual increase in gross reserves, in terms of import cover gross reserves fell to 3.0 months in the review month from 3.3 months in Aug 2010 owing to the strong increase in imports during the period.*

Exchange Rate

With effect from April 10, 2011 the Rufiyaa was allowed to fluctuate within a band of 20% on either side of a central parity of Rf 12.85 per US dollar, in order to ease the pressure on foreign exchange market. Since the introduction of the exchange rate, the Rufiyaa has depreciated by almost 19%. The exchange rate against the US dollar stood at Rf 15.37 per US dollar by the end of Aug 2011.

Impact of Exchange Rate Devaluation

Maldivian economy is primarily dependent on imports. In cumulative terms, the value of merchandise imports amounted to US \$ 513.4 million during Apr –Aug 2011 from US \$ 396.9 million in Jan – Mar 2011. *Hence, while depreciation raises costs, given that there is full dependence on imports, demand for the same will not come down.* However, declining global commodity prices will help to lower the dollar cost of imports.

The value of exports amounted to US \$ 113.5 million during Apr – Aug 2011 (post devaluation) as against US \$ 91.7 million during Jan–Mar 2011 (pre devaluation. There is hence no clear cut impact so far in terms of giving a competitive edge to exports. It is expected that the full effect of depreciation would work out over a longer period of time.

It has been observed that gross international reserves have been falling since April 2011 along with widening trade deficit.

Concluding Remarks

While the economy appears to be picking up, increasing inflation, widening trade deficit and declining foreign reserves are concerns. However, the progressive policy measures taken by the government especially on the exchange rate combined with declining commodity prices globally would help to reverse these trends.

Table 7: Balance of Trade

US Million	2010	2011	2010	2011
	Apr – Aug		Jan- Mar	
Exports	76.1	113.5	46.6	91.7
% Growth	-	49.1	-	96.6
Imports	396.9	513.4	249.9	313.3
% Growth	-	29.3	-	25.4
Trade Deficit	320.8	399.9	203.3	221.6

Source: MMA

Depreciation yet to improve the reserves situation

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