Executive Summary: A Digital Dawn

The COVID-19 pandemic brought global tourism and travel to a standstill. Thus, although the health impact of the pandemic has been fairly contained in Maldives, its economic consequences have been devastating. To contain the spread of the virus, the country closed its borders for the first time in history, between March 27 and July 15, 2020, leading to a sudden stop in tourism – the main driver of growth, jobs, and revenues.

According to preliminary official estimates, real Gross Domestic Product (GDP) contracted by 33 percent in the first nine months of 2020, year on year (y-o-y). Only 555,494 tourists visited Maldives in 2020 – the lowest number since 2002 and 67 percent lower than the 2019 record high of 1.7 million tourists. Construction activity also came to a halt, owing to logistical difficulties and COVID-19 outbreaks among foreign workers. The World Bank estimates that the Maldivian economy contracted by 28 percent in 2020. To put this in perspective, real GDP contracted by 13.1 percent in 2005 following the 2004 Indian Ocean tsunami.

The overall price level fell by 1.4 percent on average in 2020, reflecting weak demand, low global oil prices, government subsidies on utilities, and temporary relief on housing payments. Lower telecommunications prices also helped, as service providers adhered to the government's call to facilitate access to the Internet during the pandemic. Despite deflation, the poverty rate is estimated to have increased by 5.1 percentage points in 2020. The pandemic has also disproportionately affected women's health and incomes.

With the drop in tourism, government revenues plummeted. Total revenues and grants fell by 35 percent y-o-y due to the impact of the pandemic on economic activity and tourist-dependent tax and non-tax revenues. Although non-priority expenditures were reduced, total expenditures were only 4.5 percent lower than in 2019. This is because the government increased spending on capital expenditures relative to 2019 and spent more on health, social and economic relief measures. As a result, the fiscal deficit reached nearly USD 900 million or 20 percent of estimated GDP.

The large public and external financing gaps were mostly met by support from bilateral donors, especially the Government of India, and international financial instutions. Claims on the central government increased due to higher issuances of T-bills and T-bonds, especially to the State Bank of India Malé as part of the Government of India's financial assistance of USD 250 million). The government also temporarily monetized the deficit, obtaining USD 262 million through short-term advances from the Maldives Monetary Authority (MMA) in July 2020. Total public and publicly guaranteed debt rose from USD 4.4 billion or 78.4 percent of GDP in 2019 to USD 5.6 billion or 139.3 percent of estimated GDP in 2020.

The MMA took proactive measures to preserve monetary and financial conditions. With the sharp decline in travel receipts, shortages of US dollars led the parallel market rate to widen. The MMA activated a USD 400 million swap agreement with the Reserve Bank of India to reduce pressures on the exchange rate. Lower minimum reserve requirements helped inject more liquidity to the financial system. In addition, a loan moratorium provided short-term relief to both firms and households.

Maldives is expected to experience a slow but steady recovery from the economic crisis caused by COVID-19. Real GDP is expected to grow by 17 percent in 2021 and 11.5 percent in 2022. This is based on an assumption that 1 million tourists will visit the country in 2021, climbing to 1.4 million in the following year. Tourists have been steadily returning, with nearly 100,000 arrivals per month in January and February 2021 (albeit still 42 percent below pre-pandemic levels). However, the forecast assumes that the 2019 record of 1.7 million tourists will only be reached in 2023, when global tourism and aviation return to pre-pandemic levels.

External and public financing needs continue to be significant. The current account deficit is expected to widen as the normalization of services exports from tourism would be linked to an increase in imports and remittance outflows. The fiscal deficit is expected to decline as revenues recover, but remain in double digits relative to GDP. The 2021 Budget projects a substantial increase in expenditures even as revenues have not yet fully recovered. The government plans to ramp up infrastructure projects under the PSIP, half of which are to be externally financed by loans. With higher growth and a smaller fiscal deficit, the debt-to-GDP ratio is projected to moderate, but remains high.

	2019	2020e	2021f	2022f	2023f
Real GDP Growth (%)	7.0	-28.0	17.1	11.5	8.3
Inflation (%)	0.2	-1.4	2.5	1.1	1.0
Current Account Balance (% of GDP)	-26.8	-26.3	-27.1	-27.5	-27.7
Fiscal Balance (% of GDP)	-6.6	-20.1	-18.5	-15.2	-12.7
Debt (% of GDP)	78.4	139.3	135.2	132.1	131.4

Note: Estimates and forecasts as of 18 March, 2021.
Source: World Bank estimates for 2020-2023.

There are both upside and downside risks to the forecast. Should the normalization of international travel occur more quickly than anticipated as more people are inoculated from COVID-19, the outlook could improve. However, the opening up of other tourist destinations would mean intensified competition for Maldives. On the other hand, there is much that is still unknown about the effectiveness of existing vaccines against multiple new variants of the virus. Should the vaccine rollout be slower than expected in major tourist markets, leading travel restrictions to persist for a longer period, this could dampen the outlook for tourism and hence growth. In the medium term, however, Maldives' growth prospects remain strong given its unique reputation as a luxury destination. The expansion of the main international airport and new resorts in the pipeline should also boost tourism and growth.

While improving access to basic services and infrastructure are critical to Maldives' longer term development prospects, the same can be said about maintaining fiscal and debt sustainability. The pandemic has led to a sharp increase in debt vulnerabilities across the globe and Maldives is no exception. However, considering Maldives was already at high risk of debt distress before the pandemic, it is essential to strike a balance between infrastructure needs and restoring fiscal buffers. Better prioritization of spending – especially capital spending— can help Maldives reduce rollover risks and bring down debt to more manageable levels. Creating more fiscal space can further bolster its medium-term economic prospects and minimize the impact of future shocks.

In the longer term, digital technologies can be game changers for Maldives' growth and development. The COVID-19 pandemic has accelerated the digital transition that was already underway in Maldives. As in other countries, mobility restrictions have highlighted the importance of e-payment systems, telehealth, online education, and many other digital applications. However, the digital transformation is only just beginning: given relatively high broadband and mobile internet penetration in the country, there is tremendous potential for scaling up the use of digital technologies in various sectors. For instance, wider use of technologies can help the government improve delivery of health and education services across the hundreds of small, dispersed islands that make up Maldives, thus supporting social inclusion and decentralization. Greater adoption of technologies by businesses, especially small and medium-sized enterprises, can lead to efficiency gains that boost economic growth and create more jobs, especially for women. For example, increased use of digital technologies could help to optimize resource management and improve the productivity of the fisheries and tourism sectors. There is also potential to further develop the nascent ICT sector and digital entrepreneurship.

The special focus article of the April 2021 Maldives Development Update ("A Digital Dawn") explores how Maldives can leverage digital technologies to build back better for green, resilient, and inclusive development in the post-COVID world. It identifies the main bottlenecks to greater digital adoption and provides preliminary recommendations on how the government can address them. For digital development to play a more prominent role in Maldives' economic recovery, the government could consider measures to:

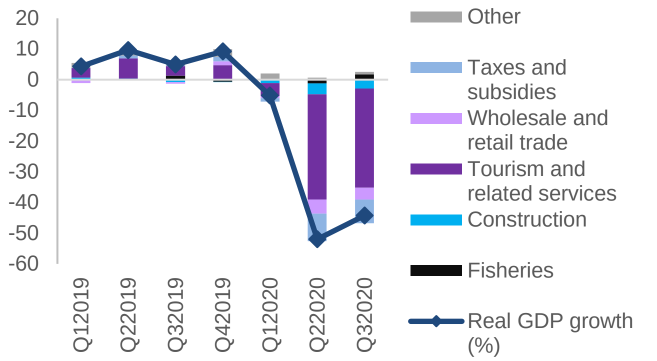
(i) Address spatial disparities in access to affordable, secure and reliable high-speed connectivity;
(ii) Increase coordination of digital government activities;
(iii) Address legal and regulatory gaps to promote digitalization of businesses and to develop the ICT sector; and
(iv) Develop capabilities and skills to nurture a digitally-savvy population.

Closing the digital divide between Male' and the atolls, and across income groups, is critical to ensure that all Maldivians can benefit from digital technologies. Only then will the country be able to reap the many benefits of the digital transformation.

Executive summary in pictures

The COVID-19 pandemic led to Maldives' deepest economic contraction in history…

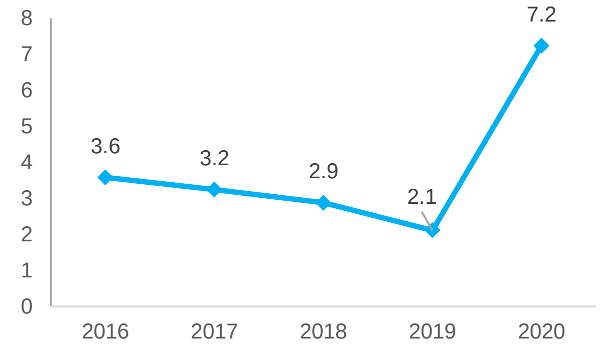
Contribution to growth, percentage points



Source: National Bureau of Statistics Maldives, staff calculations.

…and an increase in the estimated poverty rate, after years of steady decline.

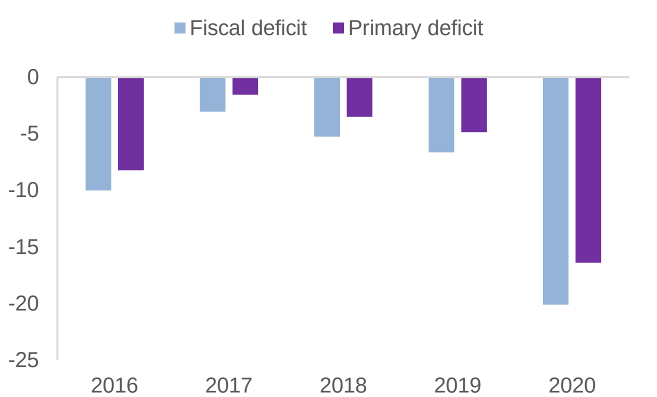
Share of the population, percent



Source: Staff estimates based on HIES (2016).

Continued momentum in expenditures amid an unprecedented revenue shock led to a large fiscal deficit…

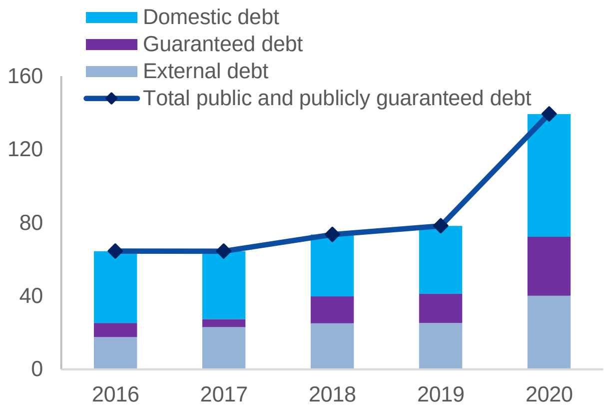
Percent of GDP



Source: Ministry of Finance, staff calculations and estimates.

…and exacerbated the risks from already high levels of public debt prior to the crisis.

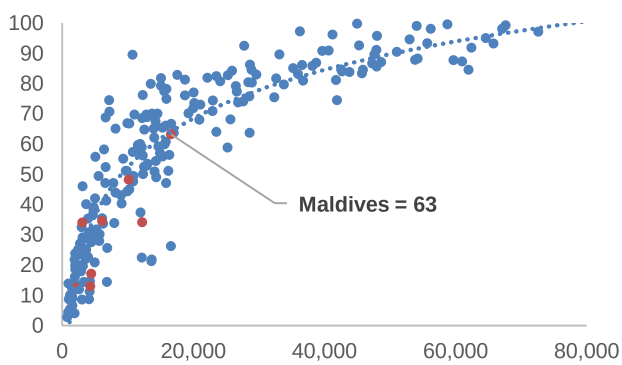
Percent of GDP



Source: Ministry of Finance, staff calculations and estimates.

Maldives can leverage its high Internet penetration for growth and development…

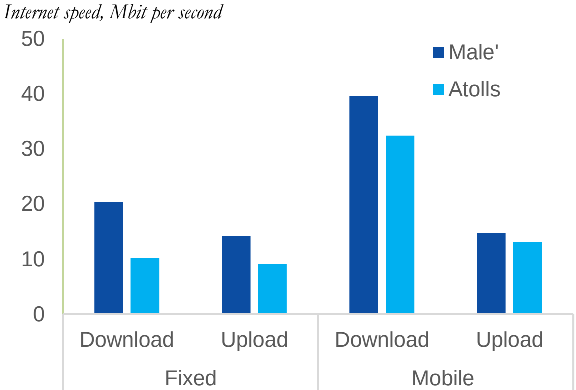
Y-axis: Share of the population who use the Internet, percent; X-axis: GNI per capita



Source: World Bank WDI and ITU (2019).

…but it must address the digital divide to ensure all Maldivians can benefit.

Internet speed, Mbit per second



Source: Based on the World Bank's analysis of Speedtest Intelligence® data from January 2020 to January 2021.