



Asia & Pacific SMALL STATES MONITOR

April 2018

Issue 08

In this issue of the APD *Small States Monitor*...

We provide an update on economic developments in the Pacific Islands. Growth at 2.9 percent in 2017 was broadly unchanged from the year before. Fiji continued to recover after the effects of Cyclone Winston, while growth remained relatively subdued in commodity exporters, due to low oil prices. Risks to the forecast are on the downside but have become more balanced, with the potential for further upside surprises to growth in advanced economies. Cyclones Gita, Josie, and Keni, are reminders that natural disasters remain the main downside risk to the region.

Access to financial services in some Pacific islands is at risk from the closure of the bank accounts of money transfer operators (MTOs) and the withdrawal of correspondent banks. This makes it difficult for Pacific Islanders to send (and receive) money to (from) family in the islands. We held Pacific roundtables to discuss these problems with banks, MTOs, and Pacific Island regulators in Sydney, Auckland, and Suva. The Sydney event was jointly hosted with the ADB, and Australia and New Zealand provided co-financing. As well as strong AML/CFT standards, participants identified solutions in several areas for action by banks/MTOs and regulators. We will follow up with a report and a further roundtable discussion.

PFTAC workshops cover a wide range of issues. We highlight the workshop on Fishing Revenue Forecasting and Management held in February, in partnership with Marshall Islands (RMI) and with co-financing from the Asian Development Bank (ADB) with participants from fisheries agencies, ministries of finance and central banks. This is a highly relevant topic given that fishing revenues are a significant but volatile revenue source for several Pacific nations.

In March, PFTAC stakeholders met in Suva on March 27 and 28 at the annual Steering Committee meeting to review program delivery and to endorse a work program for the coming year.



Kenneth Kang, Deputy Director of APD, at the Pacific Roundtable Discussions in Sydney, Australia

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By APD Small States Division

Stella Kaendera (Project Leader)

Fatma Bahr Ibrahim (Project Coordinator)

with inputs from Alison Stuart, David Kloeden, Leni Hunter, Scott Roger, Dongyeol Lee, Si Guo, Irene Zhang and APD small states mission teams

The analysis and policy considerations discussed in this publication are those of the IMF staff and do not represent official IMF policy or the views of IMF Executive Directors or their national authorities. Please send questions and comments to APDSS@imf.org

Economic Developments

- **Growth in APD small state countries remained around 2.9 percent in 2017**, broadly unchanged from the year before. In Fiji, growth jumped to 3.8 percent given the recovery from Cyclone Winston, while in Papua New Guinea and Timor-Leste, growth remained relatively subdued, partly reflecting weak commodity export prices.
- **In the oil exporters (PNG and Timor-Leste) growth remained subdued in 2017.** In PNG, weak prices for major export commodities, a severe drought, and the end of a major investment project have led to weak growth since 2016. The fiscal situation in 2017 was better than expected owing to higher revenues but large financial account outflows related to project debt repayments have contributed to a shortage of foreign exchange. In Timor-Leste, the contraction of total output is likely to continue as the oil stock depletes. Despite the severity and persistence of the price shock, the adjustments of REER in these two countries have been limited due to their exchange regimes (stabilized arrangement and dollarized, respectively).
- **Countries with large tourism sectors (Fiji, Palau, Vanuatu and Samoa).** Fiji and Vanuatu generally benefited from the continued growth in tourist arrivals. In 2017, the number of visitors to Fiji and Vanuatu and Samoa increased. Tourist arrivals fell by 17 percent in Palau, resulting in lower tax revenues and a higher current account deficit. In Fiji, GDP growth reached 3.8 percent in 2017, up from 0.4 percent in 2016. The economy continued its recovery from the impact of Cyclone Winston that struck in February 2016 but reconstruction efforts and a likely increase in public sector wages will weigh heavily on the fiscal deficit in 2017–18. In Palau, the economy contracted by 1 percent in 2017, as tourist arrivals fell partly reflecting policies to limit chartered flights, in order to reduce mass tourism that strained infrastructure. Samoa's economy has shown resilience and continues to perform well. Growth is projected to temporarily moderate to 1.8 percent in 2017/18 (from 2.5 percent in the previous year), due to the negative impact of the closure of the Yazaki manufacturing plant, but to rebound in subsequent years, supported by infrastructure projects and preparations for the Pacific Games that Samoa will host in 2019. Inflation rates and current account balance in these countries were generally lower than their historical average, thanks to the low oil prices.
- **Northern states (Micronesia, Marshall Islands, Nauru and Kiribati) and Tuvalu** benefited from a surge in fishing license revenue under the Parties to the Nauru Agreement (PNA) which improved the fiscal position and strengthened the current account. Public spending also increased, which boosted output growth. However, in some cases, spending increases have been concentrated in recurrent expenditures which may be hard to reverse. For some countries, this makes fiscal adjustment ahead of the expiration of compact grants from the United States more challenging. Inflation has been moderate due to low commodity prices.

Regional Developments and Outlook

- Tonga and Solomon Islands.** Economic growth in Tonga remained strong in 2016–17, supported by construction, agriculture, tourism, and exports. Inflation spiked temporarily in FY2016/17 due to a one-off increase in import tax, that affected domestic food prices. On February 12, 2018 Tonga’s main island suffered a direct hit from category 4 cyclone Gita. The cyclone damage is at around 30 percent of GDP, particularly in the agriculture and tourism sectors. Reconstruction efforts would have positive impact on growth in the medium term. However, fiscal and external sustainability may be at risk, due to impact of economic slowdown on government revenues and exports, and the financing needs arising from the reconstruction. The growth performance in Solomon Islands remained almost unchanged in 2016–17, buoyed by logging, infrastructure spending, fisheries and agriculture. However, the fiscal position has been fragile, depleting buffers and leading to an accumulation of domestic payment arrears and heightening the vulnerability of the economy to shocks. The current account deficit has been widening but international reserves levels are comfortable.

APD Small States: Real GDP				
(Year-on-year change; in percent)				
	2016	2017(est)	2018(proj)	2019 (proj)
Bhutan	6.3	6.0	7.1	7.6
Fiji	0.4	3.8	3.5	3.4
Kiribati	1.1	3.1	2.3	2.4
Maldives	4.5	4.8	5.0	5.0
Marshall Islands	1.9	1.9	1.8	1.7
Micronesia	2.9	2.0	1.4	0.9
Nauru	10.4	4.0	-3.0	0.0
Palau	0.5	-1.0	1.0	4.0
Papua New Guinea	2.4	2.5	2.9	2.6
Samoa	7.1	2.5	1.8	2.8
Solomon Islands	3.5	3.2	3.0	2.9
Timor-Leste ¹	5.3	-0.5	2.8	5.7
Tonga	3.1	3.1	3.2	2.9
Tuvalu	3.0	3.2	3.5	3.1
Vanuatu	3.5	4.2	3.8	3.5
APD small states and Pacific islands ²	2.9	2.9	3.4	3.5
Small Pacific island countries ^{2, 3}	2.1	3.3	3.1	3.1
1/ Non-oil GDP; 2/ Weighted average by nominal GDP;				
3/ Includes Fiji, Kiribati, Marshall Islands, Micronesia, Nauru, Palau, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.				

Outlook and Risks

Growth in APD small Pacific island countries is expected to pick up to 3.4 percent in 2018 and 3.5 percent in 2019.

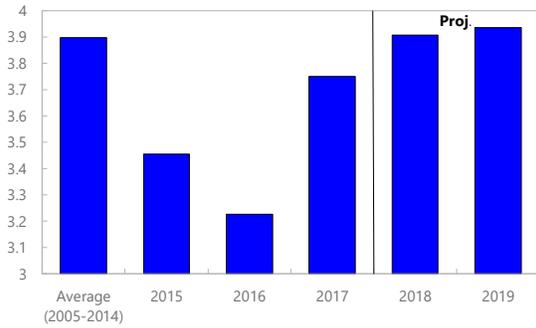
- The large earthquake in PNG this year disrupted production and exports of natural gas (LNG), oil and minerals; fiscal financing difficulties and the shortage of foreign exchange will likely continue, all dampening economic activity. In Fiji growth momentum is projected to continue in the coming years underpinned by reconstruction activities, a vibrant tourism sector, and the recovery of agriculture production. Prospects of favorable global developments will boost tourist arrivals in other countries in the region (Fiji, Samoa, Vanuatu) contributing to GDP growth and improving external balances. Revenues from fishing license fees are expected to remain high (Micronesia, Marshall Islands, Kiribati, and Tuvalu), however growth rates can be volatile for each individual country (depending on weather cycles). Securing fiscal sustainability ahead of the FY2023 reduction of Compact grants remains important for the northern Pacific, more broadly strengthening the regulatory framework including AML/CFT to address pressures on correspondent banking relationships (CBRs), addressing the challenges related to climate change and implementing structural reforms to promote economic diversification and inclusive growth remain policy priorities. Inflation is likely to gradually pick up in most countries following a moderate pick up in oil and commodity prices.
- Risks to the forecast are tilted to the downside but have become more balanced, especially because of the potential for further upside surprises to growth in advanced economies. Natural disasters remain the main downside risk to the region. The recent impact of Cyclone Gita in Tonga illustrates once again the vulnerability of the region to natural disasters and the importance of strengthening resilience by building fiscal buffers and restoring fiscal discipline, which has proved to be challenging for most countries. Another major downside risk is the withdrawal of CBRs by global banks, which could disrupt the inflow of remittances and foreign exchange flows to some countries. Other risks include increased global protectionism, steeper-than-expected slowdowns in major economies, including China which may affect the region indirectly through its impact on Australia and New Zealand; and a decline of foreign grants over the medium term.

Regional Developments and Outlook

Despite a favorable global growth outlook...

Global Output Growth

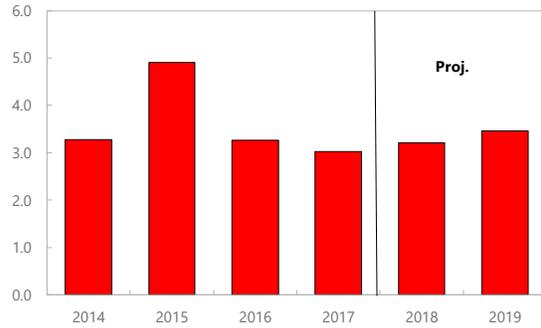
(In percent)



...APD small states are seeing a moderate growth.

Average Growth in APD Small States

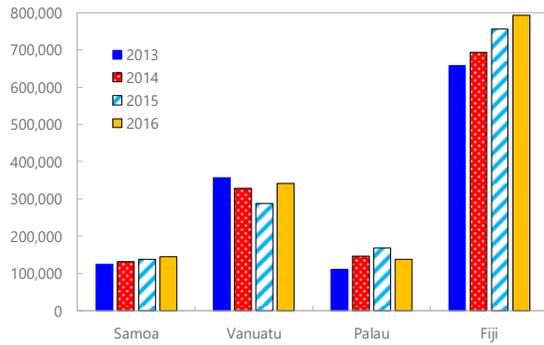
(In percent)



Stronger global activity promoted tourism, boosting growth in Vanuatu and Fiji...

Tourist Arrival

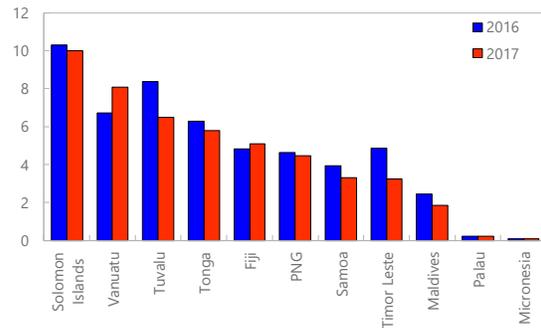
(Annual visitor number)



...and reserves strengthened in the tourism countries.

Reserve Levels

(In months of imports)

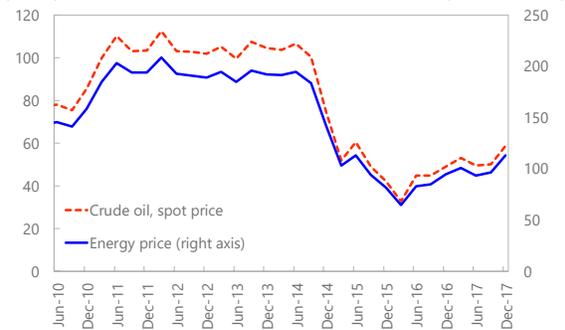


Relatively low energy prices, weighs on growth in PNG and Timor-Leste...

Energy prices

(In USD)

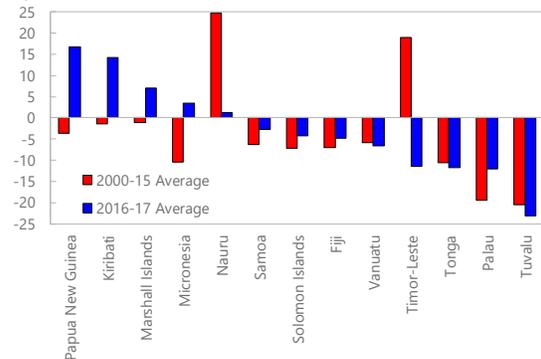
(Index, 2005=100)



...but other countries' external positions improved.

Current Account Balance

(In percent of GDP)

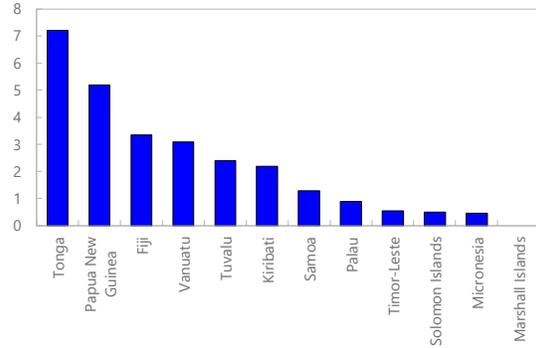


Regional Developments and Outlook

Inflation has remained moderate in most countries due to low commodity prices,...

Inflation - APD small states and Pacific islands, 2017

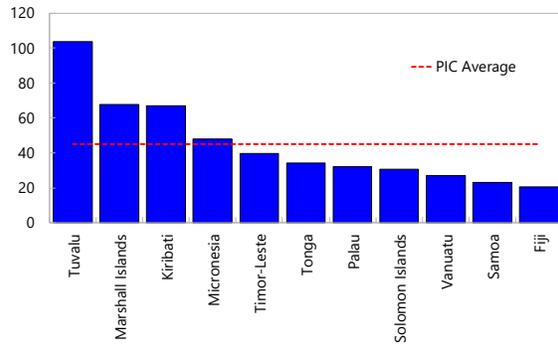
(In percent)



...and current expenditures are contained to below average in most.

Current Government Expenditure

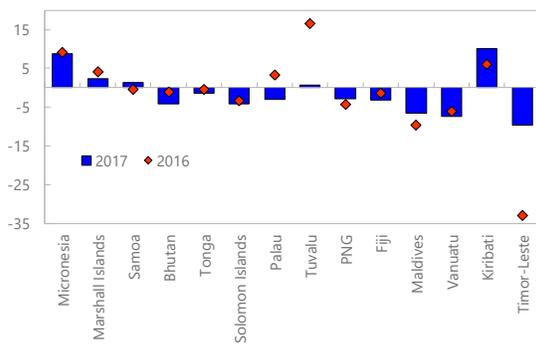
(In percent of GDP, 2017)



However fiscal positions weakened in most countries,...

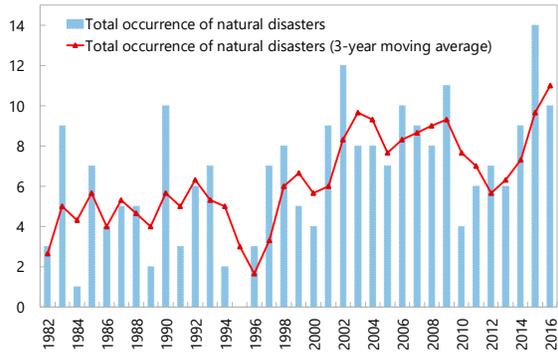
Overall Balance - APD small states and Pacific islands

(In percent of GDP)



...highlighting the importance of restoring buffers to strengthen resilience against frequent natural disasters.

Occurrence of Natural Disasters in PICs



Prepared by Irene Zhang.

Access to financial services in some Pacific islands is at risk from the closure of the bank accounts of money transfer operators (MTOs) and the withdrawal of correspondent banks. This makes it difficult for Pacific Islanders to send (and receive) money to (from) family in the islands. IMF staff held three roundtables to discuss the issues with banks, money transfer operators (MTOs), and Pacific Island regulators in Sydney, Auckland, and Suva in February and March.

Attendance. The Sydney and Auckland roundtables were attended by around 70 representatives from banks and money transfer operators (MTOs) based in Australia, New Zealand and the Pacific islands. Representatives from the Financial Stability Board, Asia Pacific Group on Money Laundering, Financial Services Volunteer Corporation, World Bank, Asian Development Bank, Australian and New Zealand authorities also participated. Pacific regulators from eleven jurisdictions attended the roundtable in Suva.

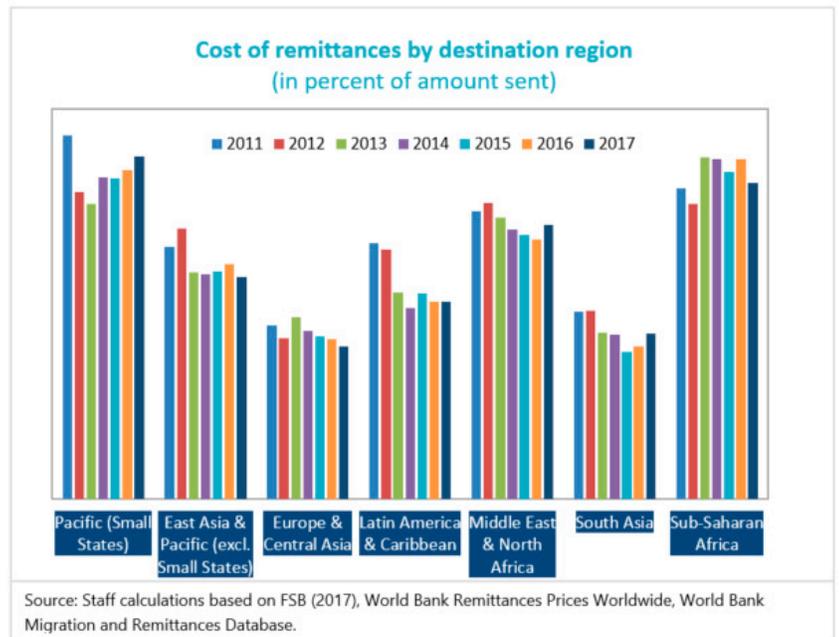
Discussion. This was the first time that banks and MTOs, including those from the Pacific, had gathered to discuss the issues. Problems mainly stem from limited profitability of the remittance sector, reflecting the small scale of transactions (around US\$300 on average), set against potentially large reputation costs, and banks rigorously applying AML/CFT standards, and requiring substantial information from MTOs to maintain/open bank accounts. Some suggested that the Australian banks were also under pressure from U.S. correspondent banks not to handle “risky-looking” businesses or customers. MTOs argued that they are often given no notice or explanation of why their bank accounts are being closed.

Potential Solutions. In addition to strong AML/CFT standards, the discussions identified solutions in four areas for action by banks/MTOs and regulators: communication, information sharing (including to improve customer due diligence), audits and industry associations.

- **Communication.** Regulators could further clarify expectations of AML/CFT standards and make sure that policy statements on supervisory priorities are on their websites. Banks should provide information on the questions MTOs need to answer to maintain their accounts—this could be developed into a best practice template.
- **Information sharing.** MTOs should improve customer due diligence; new technology, such as mobile payments or biometric data, could help, though some participants thought the use of Fintech was premature.
- **Audits.** For larger MTOs, verification risk management practices could be achieved through external audits by globally recognized auditors, though the costs and benefits of this would need to be weighed.
- **Industry associations.** In Australia, small MTOs had formed an association—the Australian Remittance and Currency Providers Association (ARCPA)—which had helped support MTOs including through certification and training. Forming similar associations in New Zealand and the Pacific could be one way forward.

- A more regular dialogue between banks and MTOs along the lines of the roundtable was also viewed as valuable. Regulators could facilitate discussion between banks and MTOs. Greater regional coordination, including with Australian and New Zealand regulators would be helpful; and the Pacific regulators felt that greater outreach to U.S. regulators was needed.

Next steps. IMF Staff will pursue facilitating the development of best practice information, encourage the adoption of KYC databases, and help promote the idea of an MTO association for the Pacific. There may also be scope for further capacity development in the financial literacy area, as well as AML/CFT. There will be follow up with the industry including a report on potential solutions, and a meeting with participants will be arranged in February/March 2019.



During the Pacific Roundtable discussions on correspondent banking relationships, Emmanuel Mathias of the IMF's Legal Department explains the IMF's approach to the issue.



In a February 2018, joint effort between the PFTAC Macroeconomics and Public Financial Management programs, and in partnership with the Government of the Republic of the Marshall Islands (RMI) as well as with co-financing from the Asian Development Bank (ADB), PFTAC organized a sub-regional workshop in Majuro on **Fishing Revenue Forecasting and Management** for analysts and senior management from the fisheries agencies, ministries of finance, statistics

offices, and central banks from the countries of the Parties to the Nauru Agreement (PNA), Federated States of Micronesia, Kiribati, Nauru, Palau, Papua New Guinea, RMI, Solomon Islands, and Tuvalu, plus Cook Islands and Tokelau. This was a very relevant topic for this innovative workshop facilitated by PFTAC given that fishing revenues are a significant but volatile revenue source for several Pacific nations. The event brought together experts from the fishing sector along with officials from national institutions to build a more common understanding of sustainably exploiting the rich marine resources of these nations while optimizing the benefits to their citizens in both the short and long run. A consensus was reached that transparency and reliable data are crucial to effective fishery sector management and ensuring optimal contributions and outcomes for national budgets. A sample of comments from workshop participants:

"A major takeaway was the important need for collaboration between the marine resource and finance ministries." Maybelline Bing, Marshall Islands Secretary of Finance.

"This workshop has given us deeper understanding of what is happening in the fisheries sector." John Lakani, Bank Papua New Guinea.

"From this week's workshop, exercises and discussions, one thing that I have learned is the importance of having more collaboration and discussions with other relevant ministries and agencies to do with forecasting and revenue budgeting." Lily Wheatley, Solomon Islands Ministry of Fisheries economist.

"Close communication and collaboration will benefit the ministries of finance and fisheries and the whole of the government." Tanga Morris, Cook Islands Statistics Office.

APD Small States Staff Changes



Masahiro Nozaki, mission chief for Micronesia, is a Senior Economist in the Asia and Pacific Department of the IMF. In the IMF, he has worked on several Asian, Caribbean, and Central American countries, including Belize, Trinidad and Tobago, Costa Rica, Indonesia, the Philippines, and Sri Lanka. His research interests include fiscal policy and social security reforms. He holds a Ph.D. in Economics from Brown University.



Niklas Westelius, mission chief for Timor-Leste, is a Senior Economist in the Japan Division in APD. He joined the IMF in 2009 and has worked on a wide range of issues and countries, including Azerbaijan, Turkmenistan, Saudi Arabia, Oman, Qatar, Dominican Republic and the United States. Prior to joining the IMF, he was an Assistant Professor at Johns Hopkins School of Advanced International Studies and the City University of New York. Niklas is a Swedish citizen and holds a Ph.D. from Columbia University in New York, USA.



Deniz Igan, mission chief for Kiribati, is currently Deputy Division Chief in the Research Department and has extensive experience in the IMF. Previously, she worked at the European Department and the Western Hemisphere Department, covering most recently the United States. She has been the team lead for several policy papers on macro-financial issues, has contributed to various volumes of the World Economic Outlook and the Global Financial Stability Report, and has received the IMF Research Award for her innovative work for the IMF-FSB Early Warning Exercise. Her research has been published in academic journals and presented widely in conferences. She holds a PhD in Economics from Princeton University.



Stella Kaendera, mission chief for Nauru, is a Senior Economist in the Small States division. Previously she was the resident representative in Bangladesh, Stella was also a Senior Economist in the F2 Division, Fiscal Affairs Department (FAD), IMF (Jan 2011- May 2014), she worked as a fiscal economist on Bangladesh and Tanzania; was the policy reviewer for Ireland, Spain, Ukraine and Iceland; signed-off reviews for Bangladesh, Moldova, Latvia and DRC; and contributed to the Fiscal Monitor publication. Prior to working in FAD, Stella worked in the Africa department as a desk economist on Uganda and on Rwanda.



Mareta Kaiteie, a national of Kiribati, joined the Small States division as a Special Appointee in January 2018. Prior to that, Mareta was a Senior Economist at the National Economic Planning Office within the Ministry of Finance and Economic Development with major roles in; (i) managing of scarce financial resources through enhanced budget planning; and (ii) advising on national policy with respect to existing national, regional and international approved development plans. Ms. Kaiteie holds both a Bachelor and a Master's degree from the University of the South Pacific in Fiji.



Farewell to Tubagus. After three and a half years in the Pacific, Tubagus Feridhanusetyawan moved to an assignment in the IMF Office in Indonesia as the Deputy Resident Representative starting in February 2018 to help prepare for the IMF/World Bank Annual Meetings. He said in his letter: *"It has been a great privilege for me to live and work in the Pacific, visit many beautiful islands, and make many new friends. I will surely miss the gorgeous sunset and friendly people across the Pacific. I would like to thank you for your support over the past years, I am looking forward to meeting you again during the IMF Annual Meetings in Bali. Please stay in touch."*



New Res Rep, Leni Hunter. Leni took over as the new IMF Regional Resident Representative for Pacific Island Countries. Leni was most recently the desk economist for Myanmar, and has contributed to APD's work on Pacific Islands and small states including Fiji, Papua New Guinea, Timor-Leste and Solomon Islands. Leni joined the IMF in 2011, in the Executive Director's Office, and prior to that was at the Reserve Bank of New Zealand. She is a New Zealand/Cook Islander and moves to Suva with husband Alistair and two year old son Sebastian.

Country Work and Missions. Arti Devi has joined the Palau desk after finishing her work on Kiribati. Reshika Singh is a desk economist on Samoa and Nauru, and participated in the Article IV consultation mission to Apia in February 2018. She also participated in the Article IV consultation mission to Solomon Islands in September 2017. Jacinta Hesaie is a desk economist on Papua New Guinea. The recent missions include Article IV consultations to Vanuatu (January) and Samoa (February/March), and a staff visit to Solomon Islands in February.

Pacific Roundtable. Ms. Pule Sukanaivalu, Ms. Reshika Singh, and Ms. Maria Samuela (PFTAC Sr. Administrative Assistant) helped organize workshops on the Pacific Roundtables on correspondent banking relationships and remittances in Sydney and Auckland in February 2018. Follow-up meetings were organized for supervisory authorities' officials on March 26, to discuss practical next steps.

Outreach. Leni joined the PFTAC Steering Committee Meeting held in Suva on March 27 and 28, speaking on the Fund's economic outlook for the Pacific.



Capacity Development (CD) in the Pacific – News from PFTAC

It has been a busy and productive year for PFTAC, with Capacity Development (CD) delivery at or above the highest previous annual levels. This was 20 percent above FY2017, an abnormal year given staff turnover and budget uncertainty between phases. With the end of the IMF's fiscal year approaching in April, PFTAC stakeholders met in Suva on March 27 and 28 at the annual Steering Committee meeting to review program delivery and outcomes, to endorse a work program for the coming year, and to provide strategic oversight of PFTAC operations. The meetings were extremely well attended with around 90 participants, including 44 representatives from all but two (Niue and Tokelau) of PFTAC's 16-member countries. Participants included a finance minister, five central bank governors, and senior finance ministry and other agency officials. All five donors (ADB, Australia, EU, Korea, and New Zealand) participated, plus wide representation of development partners (World Bank, UNDP, UN/ESCAP) and regional organizations (PASAI, PIFS, PITAA, SPC, USP). In his opening remarks, the Fiji Attorney-General and Minister of Economy, Sayed-Khaiyum, noted that this is the 25th anniversary since establishment of PFTAC as the first Fund RTAC in 1993 and commended PFTAC on its contributions to Fiji and the Pacific over the years.



Tonga was the intended host of the Steering Committee meetings, but in the aftermath of the devastation by Cyclone Gita, particularly to Nuku'alofa, the venue changed to avoid distracting from Tonga's reconstruction and recovery efforts. The recent impact of Cyclone Gita in Tonga and elsewhere in the Pacific illustrates once again the extreme vulnerability the region faces against natural disasters and the importance of building resilience through strong institutions, appropriate policy measures, and fiscal space that PFTAC Capacity Development strives to assist its membership to create.



We said farewell to Ms. Chita Marzan in February one of two PFTAC PFM advisors at the end of her three-year assignment assisting Pacific nations build stronger Public Financial Management (PFM) institutions and systems. Chita's quiet yet influential impact in the Pacific will be missed, although South East Asian countries will now benefit from her vast PFM knowledge from her new assignment at TAOLOM, the IMF center in Thailand. Otherwise PFTAC has been benefited from a stable and highly experienced team that has delivered an impactful program of technical assistance (TA), with missions delivered to all 16 member countries, and regional training provided to twice as many participants (of which 46 percent were women) as FY2017.

Working collaboratively with regional partners and across the PFTAC programs, our workshops have covered a wide range of technical issues as well as very topical and innovative subjects such as *Managing Fishing Revenues*, a large, but often volatile revenue source for some member countries (see Box). Other recent training events have included a separate joint Macro/PFM workshop delivered in Samoa jointly with UN/ESCAP on *Medium-term Expenditure Planning for National Sustainable Development*, technical training in Government Financial Statistics and a course for the compilers and users of GD, along with several revenue administration courses with the Pacific Islands Tax Administration Association (PITAA).

Peer-to-peer initiatives have been reintroduced with plans for further expansion, including attachments of officials from one country to another with capacity or reform experience of interest to others. Several Fijian tax officials joined a mission to Niue to share their experience, and exchanges of staff have been arranged between Samoa, Tonga and Fiji.

An important anniversary will be celebrated later in 2018 to mark 25 years since PFTAC was established in Suva in 1993. Not only is this a major milestone for PFTAC and its Pacific stakeholders, particularly the member countries, it also heralds the success of the IMF's model of Regional CD Centers that was emulated with a second center in the Caribbean a decade later, followed by the roll-out of centers across Africa and the world to a network of around sixteen. A big event is planned in Fiji in early December to showcase the impact of the model and particularly PFTAC. We would welcome ideas for the event—please email Fibrahim@imf.org title PFTAC25.

Recent Research / Publications

Self-insurance Against Natural Disasters: The Use of Pension Funds in Pacific Island Countries by Si Guo and Futoshi Narita

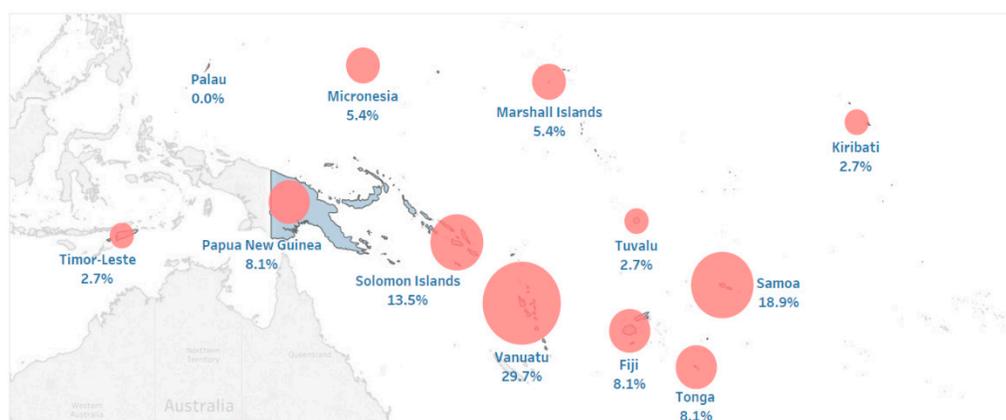
Pacific island countries are exposed to significant risks from natural disasters. As a disaster relief measure, Fiji introduced a policy change that allows pre-retirement pension withdrawals in the wake of Cyclone Winston in 2016. Motivated by this policy action, the paper provides a normative analysis of the use of early pension withdrawals after disasters, by setting up a life-cycle saving model with myopic households facing large natural disaster shocks. The model demonstrates the key trade-off between building up sufficient retirement savings and ensuring the access to savings against natural disaster shocks, and sheds light on welfare implications of early pension withdrawals.

The analysis sheds light on welfare implications of early pension withdrawal. It shows that if the shock is large enough, or the amount allowed for early withdrawal is not “too generous”, a one-time early withdrawal can improve welfare. More generally, a recurrent early withdrawal policy contingent on the realization of natural disasters can further improve welfare. Under such a policy, however, households could anticipate that the early withdrawal option would always be granted whenever a disaster hits, and thus, would face less need to make precautionary (non-pension) savings against natural disasters ex-ante. Meanwhile, because pension savings are more “liquid” when early withdrawals are allowed when disasters happen, the welfare cost for increasing the mandatory contribution rate is smaller. Therefore, there would be room to increase the mandatory contribution rate.

The Economic Impact of Natural Disasters in Pacific Island Countries: Adaptation and Preparedness by Dongyeol Lee, Huan Zhang and Chau Nguyen

Pacific island countries (PICs) are highly vulnerable to various natural disasters which are destructive, unpredictable and occur frequently. The frequency and scale of these shocks heightens the importance of medium-term economic and fiscal planning to minimize the adverse impact of disasters on economic development. The paper identifies the intensity of natural disasters for each country in the Pacific based on the distribution of damage and population affected by disasters, and estimates the impact of disasters on economic growth and international trade using a panel regression. The results show that “severe” disasters have a significant and negative impact on economic growth and lead to a deterioration of the fiscal and trade balance. We also find that the negative impact on growth is stronger for more intense disasters. Going further the paper proposes a simple and consistent method to adjust IMF staff’s economic projections and debt sustainability analysis for disaster shocks for the Pacific islands. Better incorporating the economic impact of natural disasters in the medium- and long-term economic planning would help policy makers improve fiscal policy decisions and to be better adapted and prepared for natural disasters.

Probability of Severe Natural Disasters in PICs



Note: The size of circle denotes the probability that each country is hit by a severe (above 75th percentile) natural disaster.

Kiribati

Country Note

IMF staff visited Kiribati in in September 2017 and the IMF Executive Board

concluded the Article IV consultation in December 2017. After registering a double-digit rate in 2015, real GDP growth declined to 1.1 percent in 2016, but is estimated to have reached about 3 percent in 2017. Inflation has remained subdued. Strong fishing revenue improved the fiscal position and strengthened the current account. With several donor-financed infrastructure projects in the pipeline and fishing revenue projected to remain robust over the medium term, economic prospects are broadly favorable and the authorities have made commendable progress in structural reforms. Risks to near-term growth, however, are substantial and skewed to the downside particularly related to the large volatility of fishing revenue. Support from development partners is essential to mitigate these downside risks. Prudent management of public resources remains the key policy priority, especially against the considerable long-run spending pressure. Strengthening macroeconomic management capacity is critical for the effective implementation of the authorities’ development strategy. Other priorities include enhancing climate change adaptation capacity, establishing a comprehensive banking regulation and supervision framework, and better aligning the investment strategies of the public funds with their institutional roles.

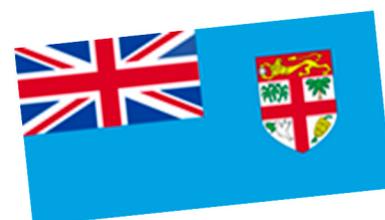


Sources: [IMF Executive Board Concludes 2017 Article IV Consultation with Kiribati](#)

IMF staff visited Samoa in March 2018 for the Article IV Consultation. Samoa's economy has shown resilience and continues to perform well. Growth is projected to temporarily moderate to 1.8 percent in 2017/18 (from 2.5 percent in the previous year), due to the negative impact of the closure of the Yazaki manufacturing plant, but to rebound in subsequent years, supported by infrastructure projects and preparations for the Pacific Games that Samoa will host in 2019. Inflation recently picked up, but remains well below the authorities' target of 3 percent. The current account deficit narrowed to 2.3 percent, driven by temporary factors, and is expected to widen to just above 4 percent of GDP in the next few years, driven by a rebound in imports to support investment for the Pacific Games. The authorities have made progress in implementing measures to mitigate risks from the partial loss of Correspondent Banking Relationships.



The 2017 Article IV Consultation for Fiji was discussed at the Board in February 2018. The economy continued its recovery from the impact of Cyclone Winston that struck Fiji in February 2016. GDP growth reached 3.8 percent in 2017, up from 0.4 percent in 2016. Growth is expected to reach 3.5 percent in 2018, underpinned by ongoing reconstruction activities, a vibrant tourism sector, and the recovery of agriculture production. Inflation declined sharply in recent months as the supply of food items started to normalize and is projected to remain around 3 percent. Monetary policy will remain accommodative in the near-term, but should be tightened and normalized as the recovery firms. Fiscal policy will be supportive during fiscal year 2017–18 behind ongoing rebuilding of public infrastructure and a projected increase in average public-sector wages, weighing heavily on the fiscal deficit in 2017–18. The deficit is expected to decline thereafter to 2.5–3 percent as capital expenditure normalizes. The current account deficit was estimated to be around 4.5 percent of GDP in 2017 and is projected to gradually decline in the medium-term as the impact of Winston on external accounts wanes. Foreign reserves are expected to remain sufficient to cover over 5 months of imports.



IMF staff visited Vanuatu for the Article IV Consultation in February 2018 and the IMF Executive Board concluded the consultation in April 2018.

Three years after Cyclone Pam struck Vanuatu, reconstruction is near completion with full recovery in sight.

Following 0.2 percent growth in 2015, real GDP is expected to grow around 4 percent annually in 2016–18, driven by recovery in tourism and agriculture combined with scaling-up of infrastructure. Inflation is estimated to pick up to 3.1 percent in 2017 driven by domestic demand, and rise further to 4.8 percent in 2018 mainly due to a temporary VAT increase from 12.5 to 15 percent, before gradually reverting to modest levels in the medium term.

The current account deficit is expected to widen to around 9 percent of GDP in 2017 and 2018, due to the high import content of the projects to scale-up infrastructure. The fiscal deficit is expected to remain high at around 7 to 8 percent of GDP in 2017 and 2018 reflecting reconstruction and infrastructure expenditure. The largest uncertainties facing the economy relate to the rate of implementation of public infrastructure projects, and the ever-present danger of natural disasters.



Tonga

Country Note

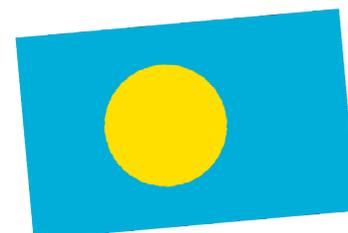
IMF staff visited Tonga for the Article IV consultation in September 2017 and the IMF Executive Board concluded the consultation in January 2018.

Over the recent years, Tonga has enjoyed robust growth and macroeconomic stability. Growth continued to be strong at 2.7 percent in FY2017, supported by construction, agriculture, tourism, high remittances, and strong private credit growth. Inflation spiked in FY2017 because of a new import tax and an increase in domestic food prices. The country's external position weakened slightly owing to construction-related imports, but with the international reserves remained comfortable supported by strong remittances and donor aid.

The overall balance of risks is tilted to the downside, with risks stemming global conditions and the potential implementation of inward looking policies that could negatively impact Tonga via reduced remittances, donor funds, and tourism. Domestic risks mainly relate to fiscal sustainability. On February 12, 2018 Tonga's main island suffered a direct hit from category 4 cyclone Gita, called the worst storm to hit the country in the last 60 years. The impact is preliminary estimated at around 30 percent of GDP with high reconstruction needs. The IMF stand ready to support Tonga and is working closely with the World Bank, the ADB, and bilateral development partners on the needs assessment.



IMF staff concluded a visit to Palau in November 2017. Economic growth decelerated significantly in 2016, following a tourism boom. This partly reflects policies to limit chartered flights, in order to reduce mass tourism that strained infrastructure. The economy is projected to contract by 1 percent in 2017, as tourist arrivals fell by 17 percent, resulting in lower tax revenues and a higher current account deficit. In the medium-term growth is expected to recover, supported by a recovery in tourism and construction activities in the energy and sanitation sectors. In addition, the Compact of Free Association (agreed in 2010) with the United States was ratified by the US Congress, and funding has since been appropriated. This ensures continuing substantial financial support, helping Palau achieve fiscal sustainability. For long-run fiscal sustainability, tax reform should continue to be a priority, as the country approaches the end of the Compact in 2023.



On February 16, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the 2017 Article IV Consultation with Solomon Islands. The Solomon Islands' economy grew by 3.5 percent in 2016 driven by a peak in the forestry sector. Growth remained solid in 2017 buoyed by logging, infrastructure spending, fisheries and agriculture. Inflation is contained at an annual rate of 1.7 percent. The current account deficit has been widening but international reserves levels are comfortable. However, the fiscal position has been fragile, depleting buffers and leading to an accumulation of domestic payment arrears. The weakening fiscal position heightens the vulnerability of the economy to shocks and highlighted the need for fiscal adjustment—including revenue raising measures, expenditure control and a plan to eliminate arrears.

More recently, measures to place the fiscal position on a stronger footing have been included in the budget strategy for 2018, and these were discussed with the IMF team during a staff visit on February 27 to March 2, 2018. Strengthening the regulatory framework including AML/CFT to address pressures on correspondent banking relationships also remains a policy priority.



Recent and Upcoming Events on Asia and Pacific Small States

Recent Events

South Pacific Central Bank Governors' Meeting

November 14-17, 2017, Nuku'alofa, Tonga

2018 Pacific Roundtable on Correspondent Banking Relationships and Pressure on Remittances

February 5, 7-8, 2018, Sydney, Australia and Auckland, New Zealand

Day Session on Correspondent Banking Relationships and Pressure on Remittances with Regulators

March 26, 2018, Suva, Fiji

PFTAC Steering Committee

March 27-28, 2018, Suva, Fiji

Upcoming Events

Spring Meetings

April 20-22, 2018, Washington, DC, USA

Forum Economic Ministers' Meeting

April 25-27, 2018, Koror, Palau

Pacific Regional Donor Roundtable

April 27, 2018, Koror, Palau

IMF Annual Meetings

October 12-14 2018, Bali Nusa Dua, Indonesia

Heptagon Meeting

October 2018

South Pacific Central Bank Governors' Meeting

November 2018, Apia, Samoa

PFTAC 25th Anniversary

December 3-7 2018, Nadi, Fiji

Recent IMF Missions and Small State Events

