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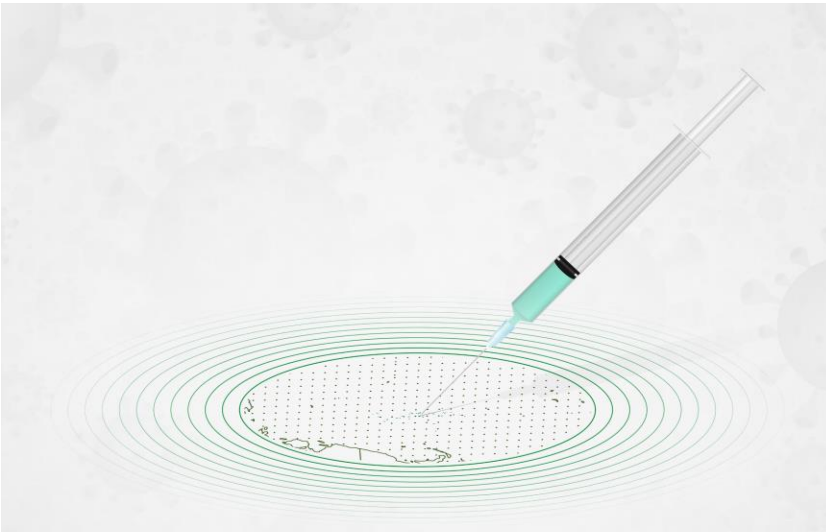

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By APD's Pacific Islands Division

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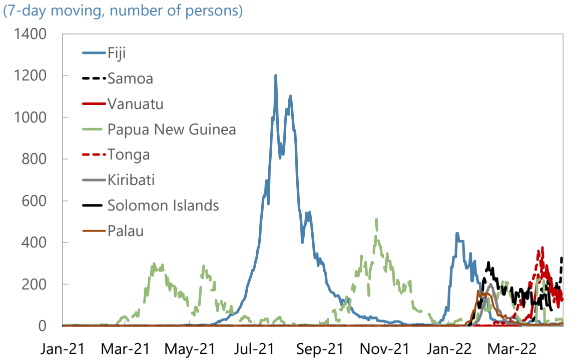
Please send questions and comments to APDPI@imf.org .

Recent Developments

Fallout from the COVID-19 pandemic continued to affect many of the Pacific Island Countries (PICs) in the last year. While global growth rebounded in 2021, real GDP in the islands declined by an average 2.0 percent, on top of an average contraction of 3.5 percent in 2020. Growth performance among the PICs has been heterogenous—largely as a function of key sectors (such as tourism and commodity exports), the presence of local COVID outbreaks and associated lockdowns, and the size and efficacy of policy support. As a group, the unweighted average real GDP of Pacific Islands with a reliance on tourism (Fiji, Palau, Samoa, Tonga, and Vanuatu) contracted by 6.4 percent in 2020 and 5.9 percent in 2021. Countries with a heavier reliance on commodity exports (Papua New Guinea and Solomon Islands) saw economic activity shrink by about 3.9 percent in 2020, but saw growth recover to an average of 0.8 percent in 2021 as global demand rose. In other countries (Kiribati, Marshall Islands, Nauru, and Tuvalu), a mild economic recovery emerged in 2021 with average real GDP growth estimated at 1.8 percent.

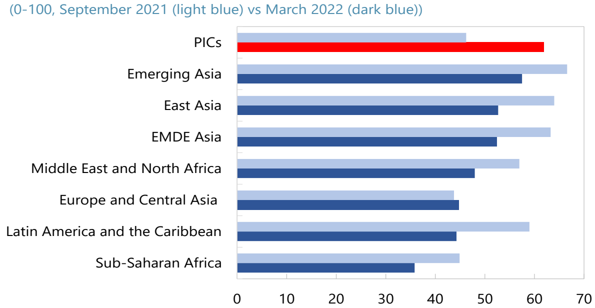
Some PICs have experienced domestic outbreaks of COVID-19 during 2022Q1. Since early 2022, Fiji, Palau, Samoa, Solomon Islands, Tonga, Palau, and Vanuatu have seen a sharp rise in confirmed cases related to the emergence and rapid transmission of the Omicron variant. As country authorities implemented mobility restrictions to contain local outbreaks, the PIC average of the stringency index as of March 2022 rose substantially compared with the level of September 2021. Local transmission of COVID-19 had some dampening effects for tourism-reliant countries in the early months of 2021 via new delays on border reopening. More broadly, progress on vaccination has been uneven, and some PICs may only achieve the pre-conditions for successful reopening and recovery in 2023.

Selected Pacific Islands: Confirmed COVID-19 Cases
(7-day moving, number of persons)



Sources: John Hopkins University; and Our World in Data. Data as of 04/18/2022.

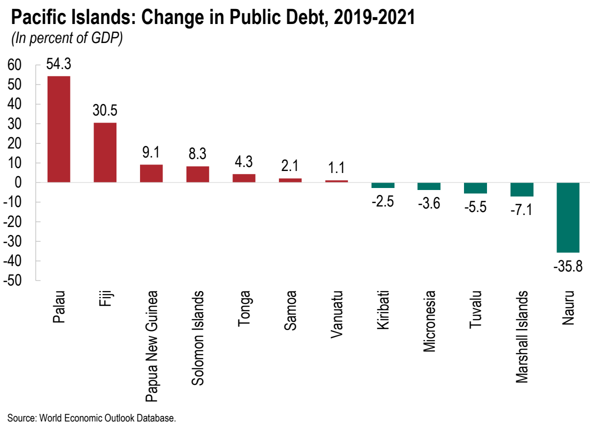
COVID-19 Stringency Index
(0-100, September 2021 (light blue) vs March 2022 (dark blue))

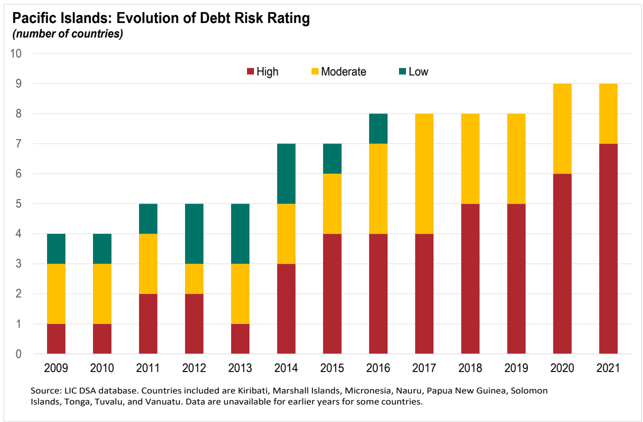


Source: Oxford COVID-19 Government Response Tracker.
Note: COVID-19 Stringency Index is a composite measure based on nine response indicators including school closures, workplace closures, and travel bans, rescaled to a value from 0 to 100 (100 = strictest). Higher values indicate stricter response level.

Rising global commodity prices have put upward pressure on inflation throughout the region. Average inflation rose to 1.9 percent in 2021 from 1.0 in 2020 as economic activity began to pick up together with a rise in global food and fuel prices. This increase in inflation has been greatly exacerbated by the conflict in Ukraine given PIC's heavy reliance on food and fuel imports. Supply chain disruptions also added to price pressures.

The effects of the pandemic on fiscal and debt positions have varied across the islands. The unweighted average fiscal balance among the PICs deteriorated from a surplus of 2.4 percent of GDP in 2020, to a deficit of 0.2 percent in 2021. This shift stemmed mainly from lower growth and weaker tax collection together with continued high spending needs to mitigate adverse effects of the pandemic. Fiji, Kiribati, and Palau recorded the most severe fiscal impact, with deficits in these countries rising into the double digits. For Samoa, Micronesia, Marshall Islands, Nauru and Tuvalu, government finances have weathered the pandemic relatively well (albeit partly due to an influx of grant financing from donors), recording surpluses in both 2020 and 2021. Tourism-oriented countries such as Palau and Fiji saw the largest increases in public debt-to-GDP over the past two years. followed by commodity exporters Papua New Guinea and Solomon Islands which experienced relatively smaller increases. For Micronesia, Tuvalu, Marshall Islands and Nauru, the debt-to-GDP ratio decreased as their economic activities were less affected.





External balances have generally weakened but foreign exchange reserves have thus far remained relatively stable. The unweighted average current account balance of the PICs deteriorated from a surplus of 1.2 percent in 2020 to an estimated deficit of 2.4 percent in 2021. The external position of tourism-reliant countries continued to deteriorate in 2021, with the average current account deficit increasing from 11.6 percent of GDP in 2020 and to an estimated 14.4 percent in 2021. Foreign reserves increased despite weak external positions on the back of continued donor support in the form of loan and grant financing together with the IMF’s 2021 SDR allocation.

Financial sector risks have risen in the context of the pandemic and in line with economic contraction. While banking sectors appear generally sound based on financial soundness indicators (see text chart), the sharp contraction of economic activity in some Pacific Islands has contributed to a rise in nonperforming loans (NPLs) and declining profitability. Further, the widespread use of financial sector measures to combat the effects of the pandemic—such as relaxation of loan classification requirements, loan repayment holidays, and debt moratoria—may have masked some vulnerabilities in banks’ balance sheets. Careful monitoring will be needed in the months ahead.

Text Chart: Selected Financial Soundness Indicators

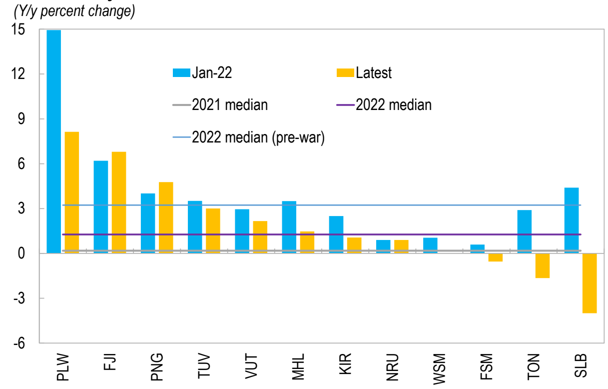
	NPL ratio		ROA		ROE	
	2019Q4	2021Q2	2019Q4	2021Q2	2019Q4	2021Q2
Fiji	3.8	9.0	2.8	1.4	17.2	7.7
Kiribati	-	-	-	-	-	-
Marshall Islands 1/	2.2	1.1	3.5	1.9	27.9	16.5
Micronesia	0.3	0.1	2.0	0.6	26.2	9.3
Nauru	-	-	-	-	-	-
Palau	0.7	1.7	2.1	0.6	-	-
Papua New Guinea	3.8	5.9	4.1	5.2	28.4	17.9
Samoa	4.0	3.7	2.4	2.8	11.2	12.0
Solomon Islands	10.4	11.4	3.0	2.5	11.9	13.4
Tonga	3.2	3.3	8.5	2.9	29.0	10.2
Tuvalu	13.4	15.0	2.9	1.9	12.0	13.4
Vanuatu	14.4	18.2	0.1	1.1	0.9	9.0

1/ Palau and Vanuatu data are as of 2021Q1, Tuvalu as of 2020Q4; and Marshall Islands as of 2020Q3

Outlook and Risks

Growth is expected to rebound in 2022, but the war in Ukraine appears set to shave off part of the recovery in GDP growth. Average output growth of the PICs is projected to reach 1.9 percent in 2022. By country groups, growth for tourism dependent countries is expected to recover to an average of 3.1 percent in 2022 as Omicron waves subside, borders reopen, and tourism activities resume. A milder recovery is expected for commodity exporting countries (0.4 percent). On the downside, the war in Ukraine and its attendant effects on food and fuel prices as well as global growth has been felt in every corner, including the Pacific. IMF staff estimate that the spillovers from the Ukraine conflict will shave off about half the expected recovery in economic growth (relative to projections at the time of the January update to the World Economic Outlook).

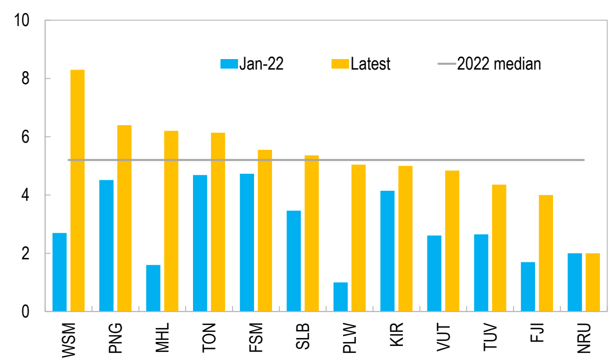
Growth Projections, 2022
(Y/y percent change)



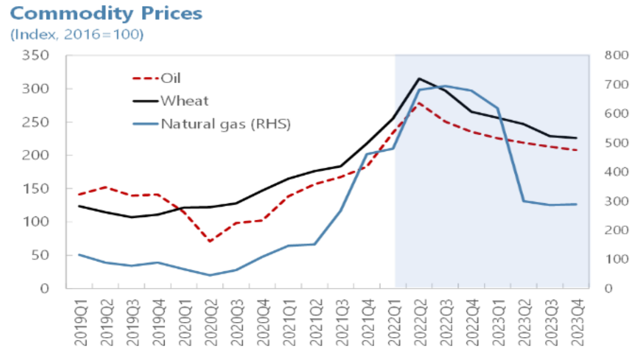
Source: World Economic Outlook and IMF staff projections.

Reflecting recent developments, inflation projections for the PICs in 2022 have been revised up by 2.4 percentage points (compared to the October 2021 WEO) to 5 percent on average. Existing administered price mechanisms and long-term energy contracts in some PICs may ease slow immediate domestic price increases, but upward adjustment is largely inevitable.

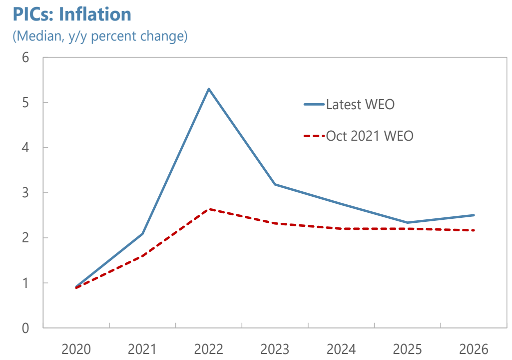
Inflation Projections, 2022
(Y/y percent change)



Source: World Economic Outlook and IMF staff projections.



Source: WEO.



Source: WEO.

The negative terms of trade shock are expected to lead to a deterioration in external balances for most PICs. The main channels for balance of payment impacts from the Ukraine-Russia conflict are likely to be linked with exposures to petroleum product and food imports. Elevated oil and other commodity prices are expected to widen trade deficits and, together with a reduction in official transfers for some countries, put downward pressure on external balances in the near term. The average current account deficit among the PICs is projected to widen to 6.9 percent of GDP in 2022.

Fiscal positions in most PICs will likely remain weaker than pre-pandemic levels for some time. The unweighted average fiscal deficit among the PICs is projected to widen from 0.2 percent of GDP in 2020 to 3.3 percent of GDP in 2022. While revenues are expected to improve in line with GDP growth, many PICs will likely maintain a supportive fiscal stance in the near to medium term to buffer the scarring impact of the pandemic, promote growth, and ease the impact of surging inflation. Given limited fiscal space, careful prioritization of spending pressures and targeting support to the most vulnerable will be needed. Resumption of infrastructure projects stalled during the pandemic will also increase capital expenditure once supply chain disruptions are resolved and borders reopen.

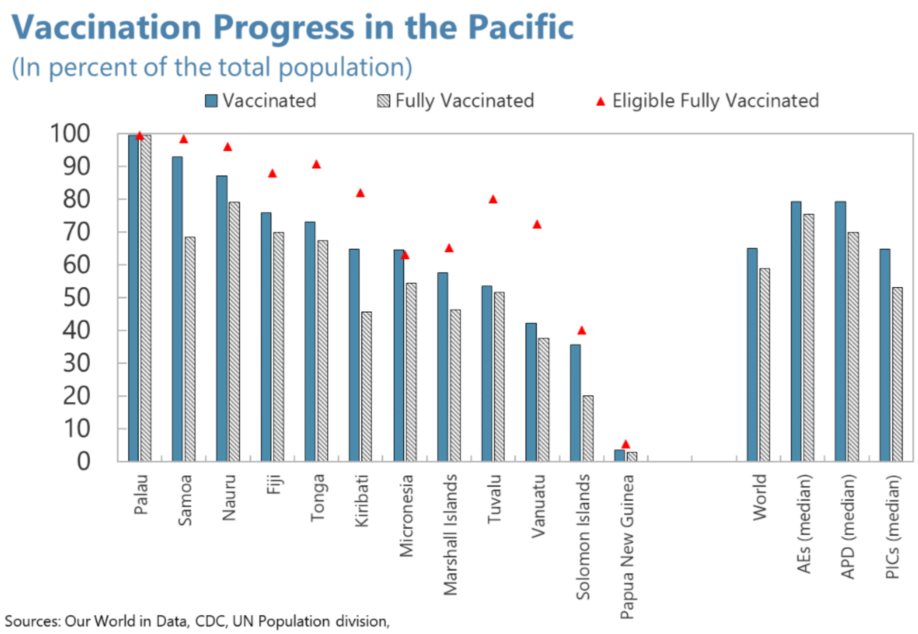
The degree of uncertainty surrounding the economic outlook remains extremely high and risks are tilted to the downside. Key downside risks include emergence of a new COVID variant, further delays in border reopening, a prolonged period of high commodity prices, and large natural disasters (to which PICs are particularly vulnerable). A global slowdown and inflation pressures associated with the war in Ukraine could also dampen tourism prospects through negative wealth effects and higher travel and transportation costs.

APD Pacific Island Countries: Real GDP
(Year-over-year change; percent)

	Actuals and Latest Projections					Difference from Oct 2021 World Economic Outlook				Difference from Pre-Pandemic January 2020 World Economic Outlook			
	2020	2021	2022	2023	2024-27	2021	2022	2023	2024-27	2021	2022	2023	2024-27
Pacific island countries 1/	**-3.5**	**−2.0**	**1.8**	**4.9**	**2.8**	**0.4**	**−2.1**	**0.3**	**0.3**	**−4.4**	**−0.5**	**2.5**	**0.5**
Fiji	-15.2	−4.0	6.8	7.7	4.4	0.0	0.6	−0.6	0.0	−7.2	3.6	4.5	1.2
Kiribati	-0.5	1.5	1.1	2.8	2.2	−0.3	−1.4	0.5	0.3	−0.6	−0.9	0.9	0.4
Marshall Islands	-1.6	1.7	1.5	3.2	1.7	3.2	−2.0	0.7	0.0	−0.3	−0.4	1.6	0.5
Micronesia	-1.8	−3.2	−0.5	2.8	1.4	0.0	−1.1	−0.4	0.5	−4.0	−1.1	2.2	0.8
Nauru	0.7	1.6	0.9	2.0	2.0	0.0	0.0	1.3	1.5	0.3	−0.7	0.2	0.0
Palau	-9.7	−17.1	8.1	18.8	2.7	2.5	−6.8	4.0	0.0	−19.3	6.1	16.8	0.7
Papua New Guinea	-3.5	1.7	4.8	4.3	3.0	0.5	0.8	0.9	0.2	−0.8	1.7	0.9	-0.5
Samoa	-2.6	−8.1	0.0	4.0	3.3	−0.8	−1.0	0.0	0.2	−10.3	−2.2	1.8	1.0
Solomon Islands	-4.3	−0.2	−4.0	3.2	3.0	−1.4	−8.4	−1.3	0.0	−2.9	−6.7	0.4	0.2
Tonga	0.7	−0.7	−1.6	3.0	2.3	1.3	−4.5	−0.7	0.1	−3.6	−4.1	0.9	0.3
Tuvalu	1.0	2.5	3.0	3.5	3.7	0.0	−0.5	−0.3	0.0	−1.7	−1.1	−0.4	1.0
Vanuatu	-5.4	0.5	2.2	3.4	3.3	−0.7	−0.8	−0.7	0.4	−2.3	−0.6	0.5	0.4

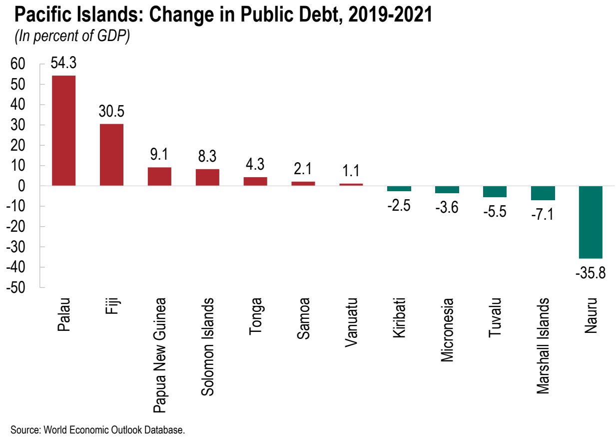
Sources: World Economic Outlook; and IMF staff estimates.
1/ Unweighted average.

Most Pacific Islands Countries have made steady progress in their COVID-19 vaccination campaigns. Many countries in the region have caught up with the global average—with more than 60 percent of total populations vaccinated and about 50 percent fully vaccinated. Most tourism-dependent countries are reopening their borders and starting to implement booster campaigns. As well as logistical challenges, vaccine hesitancy continues to be an obstacle in the Pacific Islands that have made less progress since end-2021. However, there has been some increase in vaccination demand in countries that experienced a local outbreak in early 2022. Addressing vaccine hesitancy through information campaigns will be key to make further progress.

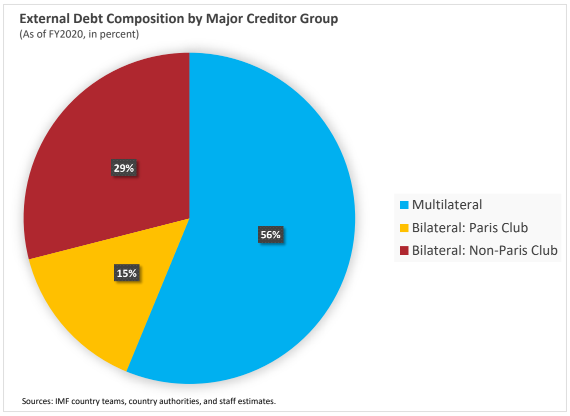


Sources: Our World in Data, CDC, UN Population division, country authorities and IMF Staff Calculations. Note: Data as of 04/20/2022. "Vaccinated" means at least one dose received in percent of total population, "Fully vaccinated" means receiving a full course of the vaccine (one or two doses) in percent of total population. "Eligible fully vaccinated" is the number of fully vaccinated people as percentage of the eligible population aged 18+. For Marshall Islands and Palau, eligible population aged 5+; for Fiji, Micronesia and Tonga, eligible population aged 12+.

Coordinated global action continues to be necessary to solidify progress in mass vaccination progress and to ensure no country is left behind in a world with endemic COVID-19. With border reopening emerging in the horizon in 2022, countries need to prepare for life after COVID. Ensuring adequate COVID-19 diagnostics and therapeutics remains a priority, even when vaccination targets are met. Recurrent booster shots might become a reality and competition with campaigns for other infectious diseases might create new challenges for Pacific Islands with limited human and financial resources and scattered populations.



The pandemic saw an increase in average debt among the Pacific Islands, but the impact has been uneven. Tourism-dependent economies have been the hardest hit in terms of both growth and the impact on public finances. With tourism coming to a sudden stop after March 2020, growth and fiscal revenues plummeted, while spending needs with respect to healthcare and support for the most vulnerable groups went up. Not surprisingly, countries such as Palau and Fiji saw the largest increases in debt-to-GDP over the past two years. Commodity exporters such as Solomon Islands and Papua New Guinea also saw a notable impact, but substantially less severe than tourism economies. Importantly, external debt is predominantly from multilateral creditors and often on concessional terms.



In addition to common metrics of debt risk analysis, there are some additional risks in the Pacific Islands exacerbated by the pandemic—some of which may only unfold over the medium-term. These include:

- ***Quasi-fiscal operations and contingent liabilities***. These are not well understood in many Pacific Island Countries, as data on public debt most commonly refers only to central government rather than the entirety of the public sector. Quasi-fiscal liabilities most likely increased during the pandemic as support to state enterprises has risen. National Airlines are a key case in point.

- ***Scarring from the pandemic*** – to the financial sector, private companies, or both. Many countries in the region have resorted to direct or indirect public support over the past two years which has potentially masked the depth of damage to balance sheets. As these measures are unwound, additional government support may be needed – potentially adding to fiscal and debt risks.

- ***Rising financing risk***. For many of the Pacific Islands, fiscal buffers have already been reduced or eliminated. Multilateral, bilateral, and even private financial support was ramped up during the pandemic. As the pandemic recedes, these financing sources are also likely to be reduced – posing a particular risk for those countries needing more time to exit the pandemic.

There are ample reasons to focus on debt in the Pacific Islands in the years ahead. The PICs—like small states as a group—consistently have lower real GDP growth than most other country groups, which is a consistent drag on debt dynamics. Debt management capacity is also generally underdeveloped. And fiscal buffers are at all-time lows in some PICs—a concern given high exposure to external shocks (both terms of trade and natural disasters). This highlights the need for continued focus on building debt management capacity and rebuilding fiscal buffers.

The IMF is providing financial assistance and debt service relief to member countries facing the economic impact of the COVID-19 pandemic. To date, the Fund has provided financial assistance (US$ 170,570.3 million) through emergency support and precautionary lending to 90 countries and provided debt service relief (US$ 965.3 million) through the Catastrophe Containment and Relief Trust (CCRT) for 31 countries. Overall, the IMF is currently making about $250 billion—roughly one-quarter of its $1 trillion lending capacity—available to member countries.

Pacific Island Participation in DSSI

Potential DSSI Savings (May 2020 – December 2021)

Country	Millions of US$	Percent of GDP
Fiji	40.0	0.7
Papua New Guinea	377.4	1.5
Samoa	26.2	3.1
Tonga	18.7	3.7
Total	**462.3**	**1.4**

Source: World Bank Staff Calculations

The international community is supporting the Pacific Islands to weather the pandemic. To date, the IMF has approved financing request to four PICs (Papua New Guinea, Samoa, Solomon Islands, and Tonga) amounting US$424.1 million through the Rapid Credit Facility (RCF) and the Rapid Financing Instrument (RFI). Solomon Islands has also benefited from debt relief under the Catastrophe Containment and Relief Trust. Four PICs benefited from the Debt Service Suspension Initiative (DSSI) established by the G20, Paris Club, and the IMF and World Bank.

IMF's Financial Assistance to PICs

Country	Type of Emergency Financing	Million of US$	Percent of GDP	Date of Approval
Papua New Guinea	RCF	363.6	1.5	June 9, 2020
Samoa	RCF	22.0	2.7	April 24, 2020
Solomon Islands	RCF	9.5	0.6	June 1, 2020
	RFI	19.0	1.2	
Tonga	RCF	10.0	2.0	January 25, 2021
Total		**424.1**	**1.6**	

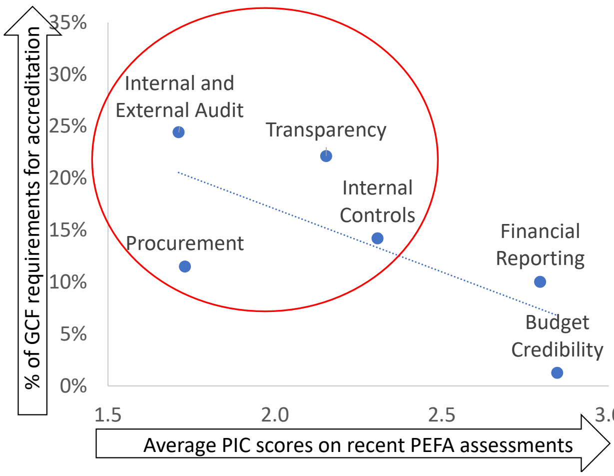
Source: IMF Staff Calculations.

PIC Challenges in Accessing Climate Finance and the Resilience and Sustainability Trust

By Manal Fouad, Natalija Novta, Gemma Preston, Todd Schneider and Sureni Weerathunga

The Pacific Island Countries (PICs) urgently need greater access to external sources of finance for climate adaptation. IMF (2021a) estimates that PICs need 6-9 percent of GPD per year for 10 years to climate-proof their infrastructure and increase coastal protection. However, the track record of access to climate finance has fallen short of this estimated need (IMF 2021 b). Accreditation requirements and low capacity are enormous hurdles for PICs when trying to access international climate finance facilities.

GCF PFM-related accreditation requirements focus on areas where PICs are relatively weak



Source: GCF, and IMF staff calculations.

The most common challenge reported by PIC authorities is a lengthy process for direct access accreditation bound up in a complex set of requirements. For the few PIC entities that managed to secure accreditation, the process lasted 2-6 years. Public Financial Management (PFM) standards are a critical hurdle in the accreditation process. This is because the most prevalent PFM-related accreditation requirements—internal and external audit, transparency, internal controls, and procurement—are also PFM areas where PICs, on average, score relatively poorly in PEFA assessments (see chart). The Fund is supporting PICs in developing PFM capacity, but progress has been slow, sometimes non-linear, and insufficient to meet the urgency of climate adaptation needs.

Other key challenges that PICs report include difficulty finding an accredited international partner to support PIC priority projects, and disbursement delays. The demand for international support in developing and implementing projects is simply too high, leaving some PICs behind. This is a key reason PICs seek direct access to climate funds, despite the hurdles. Regional accredited entities are also limited in their capacity and can typically only support small or medium projects. Some countries that do have approved GCF projects report disbursement delays, for example due to budget overruns which were caused by rising transportation costs during the pandemic (Samoa).

The Fund will soon start to offer financial support to poorer and vulnerable members undertaking macro-critical reforms to reduce risks to prospective balance of payments stability arising from structural challenges such as climate change and pandemics through the Resilience and Sustainability Trust (RST). To qualify for RST support, a concurrent financing or non-financing IMF-supported program would be needed, together with a package of high-quality climate adaptation and/or mitigation measures, sustainable debt, and adequate capacity to repay the Fund. Loans would be concessional, capped at 150 percent of IMF quota, and likely have 20-year maturity and a 10-year grace period. PICs—being vulnerable small states—are all expected to be eligible for the RST.

Federated States of Micronesia (FSM)

The COVID-19 pandemic and related containment measures have put severe strains on the FSM economy. A public health emergency and international travel restrictions were adopted at the onset of the pandemic, and subsequently extended through end-May 2022. Thanks to these measures, there has been no confirmed COVID-19 case in the FSM and about 66 percent of eligible population was fully vaccinated so far (as of March 13, 2022). The economic policy response has been strong and generally appropriate, helping counter the negative effects of the pandemic. As the international borders remain shut, the economic contraction deepened with growth estimated at -3.2 percent in FY2021 and the recovery is likely to further delay. Uncertainty surrounding the outlook remains high, and risks are tilted to the downside mainly related to the evolution of the pandemic and the spillovers from the conflict in Ukraine through high and volatile commodity imported prices. The FSM is facing significant medium-term uncertainty, owing to the possible expiration of grants and other assistance provided under the Compact Agreement with the United States. The FSM is also highly vulnerable to climate change-induced natural disasters. Near-term policies should prioritize targeted measures to protect vulnerable population and underpin a robust economic recovery. To ensure fiscal resilience, a comprehensive medium-term fiscal framework is needed that copes with the possible fiscal cliff and safeguards debt sustainability. Accelerating structural reforms would be key to develop a dynamic private sector, diversify the sources of growth, and adapt to climate change. The 2021 Article IV consultation was concluded in October 2021. For more details, please see the press release and the staff report https://www.imf.org/en/Publications/CR/Issues/2021/11/01/Federated-States-of-Micronesia-2021-Article-IV-Consultation-Press-Release-Staff-Report-and-501362.

Fiji

The 2021 Article IV Consultation was completed in December following a virtual mission in September-October. Fiji has been among the hardest hit by the pandemic—with infection rates at one point among the highest in the world and the largest economic contraction in the island's history. The pandemic came at a heavy social cost, including large-scale layoffs, surging unemployment, and high levels of non-performing loans. Multilateral and bilateral support has been critical in helping Fiji weather the worst of the crisis and has facilitated a strong government response—including rapid acceleration of the government vaccination program underpinning Fiji's reopening to international tourism. The economy is expected to recover starting in 2022, following the opening of borders and resumption of tourism activities. However, the margin of uncertainty is high, and two years of unprecedented hardship have left Fiji in a precarious position. Vulnerabilities have been exacerbated by scarring and diminished fiscal space. Contingent liabilities have surged during the pandemic as the government extended loan guarantees to state enterprises. As tourism resumes and recovery takes hold, policy adjustments to address macroeconomic imbalances and reduce vulnerability will be a clear priority. Most importantly, fiscal consolidation will be needed to put public debt on a sustained downward path and ensure a sustainable macro-fiscal trajectory.

Kiribati

The IMF Kiribati team completed the virtual 2021 Staff Visit mission in December 2021. The pandemic hit the Kiribati's economy severely in 2020, resulting in a real GDP contraction at 0.5 percent. A gradual recovery started in 2021 with inflationary pressures rising substantially, in part due to supply disruptions. Given the nascent recovery and high uncertainty, supportive fiscal measures

should remain in place until the recovery is firmly underway. However, all pandemic related spending should be well-targeted and focused on the most vulnerable, with proper safeguards in place. Once the recovery is on a firm footing, fiscal consolidation will be necessary, underpinned by both revenue and expenditure measures. Fiscal discipline could also be further reinforced by adhering to the rules-based policy regarding withdrawals from the sovereign wealth fund, strengthening the medium-term fiscal framework, and making explicit budget provisions for climate change adaptation for a greener post-COVID recovery. Accelerating structural reforms—including those outlined in the new Kiribati Development Plan (2020-23) — remain critical to support more sustainable, greener, and inclusive growth. Several new pieces of legislation have been passed to forge ahead with structural reforms in the financial sector, environment, and social protection. Effective implementation of these reforms will strengthen Kiribati's long-term growth potential. Continued efforts are needed to strengthen the governance and oversight of SOEs, enhance their commercial mandate, and ensure timely publication of their audited reports. The authorities' plans to reopen Phoenix Islands Protected Area (PIPA) to commercial fishing should be designed to ensure sustainability of fishing and preserve marine biodiversity.
More details about the mission findings can be accessed at:
https://www.imf.org/en/News/Articles/2021/12/20/pr388-imf-staff-completes-2021-virtual-staff-visit-to-kiribati

Marshall Islands

The IMF Marshall Islands team completed the virtual 2022 Staff Visit mission in April.
After a moderate contraction of 1.6 percent, real GDP growth is projected to have recovered in FY2021, thanks to higher fishing activities as well as strong donor support. Growth in FY2022, however, is expected to be slower than previously expected as extended travel restrictions and high global commodity prices weigh on economic activities. The negative terms of trade shock together with a reduction in grants will put pressures on current account and fiscal balances. Inflation is expected to rise above 6 percent during FY2022, driven by higher food and fuel prices. The authorities have taken strong measures to respond to the COVID-19 pandemic—with 80 percent of the Covid support package (around 20 percent of GDP) implemented by end-March. The mission recommended to prioritizing and reallocating the remaining Covid funds as needed given the state of the economy, while continuing efforts to accelerate vaccinations. The authorities should also promptly develop a gradual but credible fiscal adjustment plan to prepare for the potential expiration of Compact grants and reduce fiscal risks and protect long-term income. The country should continue to exercise caution when pursuing initiatives, such as the digital currency SOV as a second legal tender, the Digital Economic Zone (DEZRA), and the newly enacted Law on Decentralized Autonomous Organizations. These initiatives introduce potentially significant macroeconomic, financial stability, and financial integrity risks and, unless effective mitigating measures are implemented, could jeopardize the RMI's last USD CBR, resulting in a significant drag on the economy. Accelerating the preparation of the national adaptation plan is critical to address challenges in climate change and integrate climate adaptation investment and disaster costs in fiscal planning. Stepping up reform momentum to put SOEs on a more sustainable and commercial footing is important to help reduce fiscal pressures and improve economic efficiency. Generating new sources of growth requires structural reforms and efforts to fostering private sector development. More details of the mission findings can be accessed at:

https://www.imf.org/en/News/Articles/2022/04/13/pr22118-imf-staff-completes-virtual-staff-visit-to-the-republic-of-marshall-islands

Nauru

The 2021 Article IV consultation with Nauru was completed in December 2021, with the Board discussion in February 2022. The mission team met with the Finance Minister of Nauru, officials from the Treasury, Statistics Office, Bendigo Agency Bank, Financial Intelligence Unit, as well as the private sector and development partners. Nauru has weathered the COVID-19 pandemic relatively well so far. The economy continued to expand in FY20 and FY21 owing to the sizeable policy response and the authorities' decisive public health measures, which prevented COVID-19 from reaching Nauru. The resolution of a long-standing sovereign debt default in March 2021 lowered external debt by an estimated 83 percent of its outstanding value. Nauru's debt is now assessed as sustainable, thanks to the settlement and progress in resolving domestic debt. In FY22, growth is expected to moderate, due to the scaling down of the Regional Processing Center (RPC). Detailed plans to absorb, relocate, or upskill RPC employees need to be developed expeditiously. Other key structural challenges include tax reforms, improvements in Public Financial Management, SOE reforms, updating of public procurement procedures, and strengthening statistical capacity. Improving the perceived jurisdictional risk of Nauru is essential to integrate the economy with international financial markets. For long-term development, it is important to pursue new sources of growth and revenue and improve the quality of education and health, in accordance with Nauru's SDG goals. A greener and sustainable future requires Nauru to have a well-planned climate finance strategy. The climate-resilient port and the solar power project are important steps towards Nauru's greater climate resilience. More details about the mission findings can be accessed at:
https://www.imf.org/en/Publications/CR/Issues/2022/02/07/Republic-of-Nauru-2021-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-512874

Papua New Guinea (PNG)

Papua New Guinea (PNG) is a fragile state, vulnerable to recurrent shocks. From 2014 to 2020, low commodity prices, a severe drought in 2015-16, and a major earthquake in 2018 softened growth, led to shortages of foreign exchange, and contributed to the build-up of public debt. The COVID-19 pandemic has further strained public finances. Widespread vaccine hesitancy has contributed to very low uptake of the vaccines with less than 3 percent of the population fully vaccinated. If the authorities can overcome the current COVID-19 wave, real GDP is projected to grow by 4.8 percent in 2022 as mining activity resumes and the non-resource sector expands. The country is heading toward elections which will take place in June 2022.

Papua New Guinea has engaged extensively with the IMF in recent years, including a Rapid Credit Facility (RCF) and two Staff Monitored Programs (SMPs). The first SMP, requested pre-pandemic, expired in June 2021. To address the pandemic, US$363.6 million (1.5 percent of GDP) was disbursed in June 2020 under the RCF, and the 2021 increase in the general allocation of SDRs (1.3 percent of GPD) was used for budget financing. A successor SMP was approved in December 2021 and will run till June 15, 2022, which aims to consolidate recent progress in reforms. The first Safeguards Assessment of the BPNG has been completed. The authorities are also receiving IMF technical assistance in national accounts, debt and external sector statistics, revenue administration, banking supervision and regulation, and macroeconomic forecasts.

Samoa

The IMF APD team and Samoan authorities discussed economic developments and policies during a virtual staff visit in November 2021. While Samoa has avoided a domestic outbreak of COVID-19 so far, the economy remains in a recession due to the pandemic. Given the continued closure of Samoa's international borders and the importance of tourism to the economy, economic activity remains sluggish, with real GDP growth forecast at 0.0% in FY2022 (ending in June) after a decline of -8.1% in FY2021. Meanwhile, inflation has risen sharply, mainly due to exogenous factors, reaching 11.3% y/y at end-2021. While the loss of tourism inflows has been partially offset by higher private remittances, the current account deficit for FY2022 is projected at -12 percent of GDP. The Samoan authorities have sought to buffer the impact of the pandemic through accommodative fiscal policies. Most notably, the annual budget and a supplementary budget approved in December provides assistance to affected households and firms, with a total budget deficit of 2.4 percent of GDP planned for FY2022, after a 1.9 percent of GDP surplus in FY2021.

The report of the October 2021 Climate Macroeconomic Assessment Program (CMAP) mission was recently finalized. The CMAP assists countries vulnerable to climate change and natural disasters in developing policy responses to cope with the economic effects and build resilience, and Samoa was the first pilot country to participate. The CMAP found that Samoa places climate resilience building and disaster management as key priorities in its national development and economic strategies. It recognized Samoa's significant advances in coping with climate change and natural disasters with donor support but identified sizable funding gaps. The CMAP found that greater investment in climate adaptation would lessen the impact of natural disasters, leading to higher long-term growth and lower overall financing needs, while emphasizing that given Samoa's limited fiscal space, additional grants and/or concessional loans are needed to support this higher investment. The report has been published and is available at: [insert link here once available].

Solomon Islands

On January 7, 2022, the International Monetary Fund (IMF) concluded the [Article IV consultation] (following a virtual mission between October 18 and November 5, 2021) with Solomon Islands. The authorities have enacted strong and timely measures to contain COVID-19. Measures implemented by the government include temporary suspension of all commercial international flights and ban on entry of non-citizens strict mandatory quarantine for all returning passengers, and following first evidence of domestic transmission in January 2022, temporary and focused restrictions on mobility. Progress in advancing vaccinations has been relatively slow and should be accelerated to meet the authorities target to allow timely and safe border reopening. Solomon Islands' economy has been hit hard by the impact of the COVID-19 pandemic. Real GDP contracted in 2020 and growth is estimated to have remained subdued in 2021, owing to lower global demand and the impact of containment measures on trade and economic activity. Labor market conditions have deteriorated, and the pandemic is likely to have disrupted progress in poverty reduction and human development. While the unrest in late November 2021 and domestic transmission of COVID-19 starting in January 2022 increases downside risks, economic activity is projected to recover gradually and to gain strength as containment measures are relaxed and borders reopened. The fiscal balance is estimated to have increased in 2021, reflecting revenue loss and additional spending in response to COVID-19. Central government debt remained low but is estimated to have increased in 2021. At end -December 2021, foreign reserves remained robust at about 11.1 months of prospective imports, reflecting inflows from development partners, subdued imports in 2020, and the new allocation of IMF Special Drawing Rights. Inflation remains low (at 2 percent in November 2021) but is expected to increase, reflecting, in part, the impact of higher commodity prices. Risks to economic activity are tilted to the downside. Domestic virus transmission could lead to a significant increase in human, as well as economic costs. Additional downside risks include persistent social unrest, negative impact of climate change, and volatile commodity prices. On the upside, a stronger than expected global recovery owing to a faster than expected containment of the virus, a quicker rebound in tourism driven by regional reopening and acceleration in infrastructure investment could spur a stronger recovery.

Tonga

Tonga's AIV mission is scheduled on April 25-May 10 in a virtual setting. Since the last AIV, Tonga's economy had been gradually recovering. However, economic activity was severely disrupted by a double blow from the volcanic eruption and the first local outbreak of COVID-19 at the start of 2022. Extensive humanitarian relief and restoration efforts are underway with support from donors.
The mission will assess the economic impacts of the recent shocks and discuss policies to build a more resilient economy. For this fiscal year, GDP is expected to contract further while inflation will accelerate due to higher commodity prices. In FY2023, reconstruction will support GDP growth, but the investment needs also imply significant financing needs. Policies in the near term should focus on restoring economic activity and mitigating the effect of external shocks (e.g., the Ukraine conflict). Both fiscal and monetary policy should be nimble and data dependent. Over the medium to long term, public debt level is expected to rise substantially due to development spending needs and climate resilience. A combination of domestic fiscal measures and additional donor support is needed to ensure debt sustainability. Structural reforms aimed at enhancing resilience to natural disasters and developing private sector are critical to Tonga's long-term prosperity.

Resident Representative's Corner

By Leni Hunter, Resident Representative for Pacific Island Countries

Bula vinaka, Kaselehlia, Mauri, Ekamwir-omo, Alii, Halo, Lakwe, Talofa, Halo olaketa, Malo e lelei, Fakatalofa atu, Hello and Kia orāna,

With the increase in COVID-19 case numbers in some Pacific Island countries, we sincerely hope that everyone is safe and well. Our thoughts are also with the Tongan authorities, in their recovery effort from the devastating eruption and tsunamic from Hunga Tonga-Hunga Ha'apai. We have followed these events closely alongside HQ-based colleagues, as well as participating in a number of virtual IMF missions over the last six months.

Pule, Leni, Deven, Peter and Munesh, Seruwaia.

Seruwaia joined the Article IV consultation for Nauru, the Vanuatu staff visit, and will soon join the Vanuatu Article IV. Munesh worked on Article IV consultations with both the Solomon Islands' and Samoan authorities. Devendra has worked on the Staff Monitored Program with Papua New Guinea. I joined several missions, participated in mission meetings with the Palau and Kiribati authorities, and joined Fiji's virtual Article IV last October. Pule assisted with arrangements for Fiji's 2022 staff visit, our first in-person surveillance mission since the pandemic.

My term as regional resident representative for Pacific Island countries ended in late March. Given the closure of travel in the second half of my term I was fortunate to visit nearly all the countries covered by our office during my first two years. I joined many memorable surveillance missions and Management visits. COVID-19 has dominated the last two years and added to existing economic challenges, by reducing fiscal space in some countries. Nonetheless, I was glad to be able to see economies starting to reopen and the initial return of international tourism in Fiji before my term concluded.

Neil Saker is the incoming resident representative and looks forward to meeting everyone. Neil brings a huge amount of experience to the role – his most recent positions were as the IMF's resident representative for Myanmar and Mongolia, and prior to that Neil worked as mission chief for Timor-Leste in Asia and Pacific Department, and in the Monetary and Capital Markets Department. Welcome Neil!

Neil Saker, incoming regional resident representative.

Tourists at a resort in Fiji, March 2022.

It has been a great privilege to work with Pacific Island country authorities over the last four years. I would like to express my gratitude to all colleagues and friends for the constructive engagement and support. Special thanks to our wonderful and talented team in the Suva regional res rep office. Very best regards, Leni Hunter

By David Kloeden, PFTAC Director

The COVID-19 situation remains mixed across the Pacific, with several nations that had otherwise been infection free now dealing with outbreaks, but others encouragingly beginning to emerge from lockdowns with economic activity picking up. Vaccination rollout has been strong in some countries, but more is needed in others. Those with high vaccination and declining infection rates are shifting their focus towards economic recovery. To revive its dominant tourism industry, Fiji reopened its borders for travel partner countries from December 1, 2021, initially challenged by a wave of the Omicron variant that is now receding. Provided the COVID-19 situation improves and a transition to endemicity arrives, more borders will hopefully reopen with a resumption of travel and trade accompanied by improving health and economic recovery prospects. For two years now, PFTAC has remotely delivered its Capacity Development (CD) programs, but with improving prospects of travel gradually resuming and a return to in-person engagement from May 1, 2022, the start of the final year of PFTAC's fifth phase of operations. This is particularly welcome as remote CD delivery has become increasingly more challenging as COVID-19 constraints have persisted.

More than half (11 of 18) of the workshops/events planned in FY2022 were delivered by PFTAC between May and end January, all virtually. The Revenue program organized three workshops in conjunction with Pacific Islands Tax Administration Association (PITAA) on ***Effective Taxpayer Services and Communication*** and a series of engagements on ***Leadership, Integrity and Good Governance*** over several months, and then over five days between November 9 – 20, 2021, a virtual workshop on ***Improving the Integrity of The Taxpayer Register*** and supporting registration processes. This workshop built on the registration concerns highlighted in the PFTAC Pacific Island Review of Tax Reforms (2017 – 2020). The Macro program convened two regional events, both in conjunction with the Singapore Training Institute (STI) on ***GDP Forecasting*** and ***Inflation Forecasting*** respectively. During October over four days, the PFM program delivered a virtual workshop **on *SOE Fiscal Risk and Transparency***. A financial sector supervision (FSS) webinar addressed ***Building Cyber Resilience*** and the real sector statistics (RSS) program delivered two training events, one on ***Quarterly National Accounts Compilation*** and another on ***Annual National Accounts Compilation*** between November 23 – December 8, 2021. Finally, the Debt Management program organized a remote event on ***Fundamentals of Debt Reporting and Monitoring*** with the first component delivered over four days in late October with the balance delivered in early November.

Plans, priorities, and resource implications for Phase VI that is due to launch on May 1, 2023, are now defined and reflect member country policy and CD needs. With the IMF's Interdepartmental Working Group efforts wrapped up in November after drawing extensively on the inputs from the 2021 Steering Committee (SC) and stakeholder virtual working groups, a Phase VI Strategy Note was finalized and approved by the IMF. This was presented and explained at the virtual SC meeting on December 2, 2021. Several long-standing priorities have crystallized from the pandemic, including fiscal risks and rising debt and contingent liabilities (e.g., SOEs), macroeconomic and financial stability (e.g., lower budget revenues and increased vulnerabilities), and diminished growth prospects from natural disasters and climate change. Medium-term frameworks and strategies supported by CD will help ensure the institutional capacity and legal frameworks are implemented to address the fiscal, debt, balance of payments and growth challenges arising from the pandemic and other shocks, while continuing to strengthen resilience to disasters and climate change. The Phase VI strategy aims to meet the rising and evolving CD needs that have intensified with the COVID-19 pandemic while enhancing the CD's impact, traction, and sustainability, as underscored by the recent external evaluation.

To respond to post-COVID-19 priorities, current PFTAC programs will continue in Phase VI, with targeted expansion responding to needs but within the delivery and absorptive constraints of the region. The FSS, RSS, Revenue, and the current Macro programs will all continue into Phase VI, and the long-term expert (LTX) position for the Government Finance Statistics (GFS) program that was discontinued in August 2021 will be reinstated to additionally cover Public Sector Debt Statistics (PSDS). With increasing demand for CD to strengthen PFM systems to be responsive to climate change issues and for member countries to potentially qualify for access to climate change financing, further efforts under the PFM program are planned with a third LTX devoted to climate issues. An additional PFM resource focused on climate change would provide space for the other PFM advisors to respond more deeply to other PFM topics where country demand exists such as fiscal transparency and gender aspects of PFM. Finally, a second Macroeconomic advisor and program is proposed with backstopping by the Institute of Capacity Development (ICD) with a focus on macroeconomic frameworks, work that has begun in FY2022 with IMF financing. Greater emphasis and support to fragile states is planned, in absolute terms and to expand the Phase V average share of resources and delivery beyond 34 percent.

Proposed resources will expand from the Phase V average of seven to ten resident advisors comprising: (1) five fiscal LTX, two each for PFM and Revenue and a new third PFM advisor focused on climate change; (2) two Statistics, one each for RSS and GFS/PSDS; and (3) an LTX each for FSS, the APD-backstopped Macro program, and the proposed ICD-backstopped Macro Frameworks program. These numbers are exclusive of the Debt Management program and LTX that is financed by the Government of Japan through end-FY24**. A fund-raising envelope of $US 40 million is targeted over five years (FY24 – FY28)** sufficient to finance the proposed ten advisors and programs based on average Phase V annual costs. At least a further $US 3.5 million IMF contribution will finance the director, local staff, and other overheads as in Phase V. **The draft Phase VI Program Document has been circulated to stakeholders.** Following feedback, an updated final version will be ready by late-April for circulation with ample lead-time ahead of the May 2022 SC meeting when initial pledges are expected from several donors and potential commitments from others. Sufficient Letters of Understanding are expected to be signed and in place to facilitate initial financial contributions in late 2022 to ensure a seamless transition to Phase VI on May 1, 2023.

PFTAC welcomed Katrina Williams to the role of Revenue Administration Advisor in October to work alongside Georg Eysselein, previously PFTAC's only and long-standing revenue advisor. Katrina has 40 years public sector experience, the last 24 years in Inland Revenue in New Zealand bringing

expertise in the design and delivery of all core revenue functions, in strategic and multi-year planning, and in compliance-related intervention design. With an extensive background in organizational reform, revenue administration modernization, and change and innovation, Katrina most recently led Inland Revenue's organizational design and change group. Katrina feels a real affinity with the Pacific, not the least that she is of Pacific, Maori, and European background, but also building an understanding and appreciation of the Pacific as the New Zealand Inland Revenue observer at PITAA annual conferences for several years, and more recently as an IMF short-term expert for PFTAC.

The team of PFTAC resident advisors is now complete with the recent arrival in Fiji of the second Revenue advisor, Ms. Katrina Williams and the new Debt Management advisor, Ms. Briar Ferguson. Ms. Williams and Ms. Ferguson are pictured from left to right in the PFTAC office with the PFTAC Office Manager, Ms. Nina Samuela.

Spending Needs for Achieving SDGs with Climate Resilience

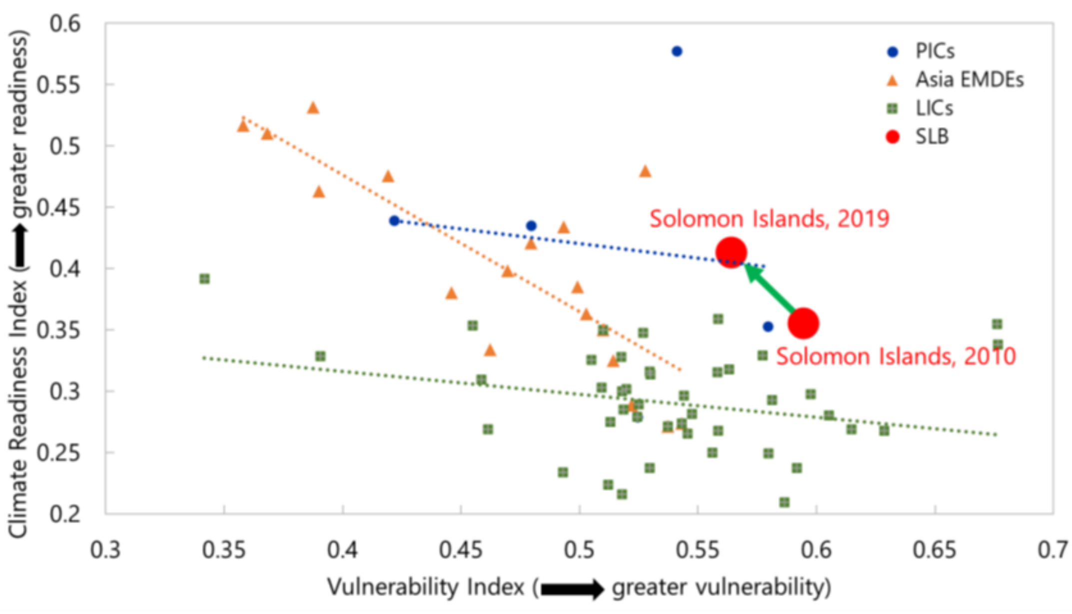
Prepared By Manabu Nose (FAD)

Solomon Islands continues to face challenges stemming from vulnerability to natural disasters and climate change. Around 80 percent of the national population live in low-lying coastal areas. The densely populated areas with main transport network access in coastal areas are highly exposed to climate risks. Despite the progress made over the decades, Solomon Islands remains one of the most vulnerable countries to extreme climate events among low-income countries (LICs). This creates challenges for the development of education, health, and basic physical infrastructure.

Climate adaptation and the progress towards achieving SDG targets are among the top policy concerns and are well-integrated into the National Development Strategy (NDS). The authorities are committed to implementing their long-term decarbonization plan with progress made in the energy sector by transitioning from fossil fuel-based to renewable energy. However, the gap in key SDG indicators remains large.

The SDG performance gap indicates large financing needs for investing in education, health, and infrastructure over the medium term, adding a challenge on fiscal sustainability. Basic national and sector-level strategies in SDGs and climate adaptation are in place, but there is room to improve their implementation.

Figure 1. Climate Change Readiness and Vulnerability index, 2019



Staff analysis, using the comparison of the latest performance level with those of best performers in the comparable group, indicates sizable additional spending needs of 6.9 percent of 2030 GDP per year. The national policy targets for SDGs by 2030 are also reflected in the costing exercise. Raising health outcomes to reach the SDGs requires an improvement in both the quantity and quality of health services, which would cost about 1.4 percent of GDP. An additional cost is about 0.5 percent of GDP for education, with priority given to improving the spending efficiency**.** Additional cost for energy, road, and water and sanitation (WASH) is estimated at 4.9 percent of GDP, with the largest needs in the energy sector for extensive investment pipelines in hydropower and solar power projects. The estimated additional spending does not include maritime transportation and digital connectivity, which has potential to unleash the country's long-term economic transformation. The COVID-19 pandemic has hit the development agenda hard, requiring additional spending in human and physical capital to avoid a permanent setback towards SDGs.

An integrated financing strategy with a mix of additional concessional financing and front-loaded fiscal measures is needed and should be properly sequenced to achieve SDGs by 2030. Besides concessional financing, Staff's analysis on the medium-term financing strategy highlights the importance of designing properly sequenced annual deficit target. The authorities' operational deficit target of 1.5 percent of GDP should be relaxed in the short term to ensure the durable recovery from the pandemic. However, once the durable recovery is in place, front-loaded fiscal measures should be pursued, as anchored by an effective debt-based fiscal rule, to create space for additional development spending.

A multipronged strategy is needed to meet mounting development spending needs for the SDG and climate adaption objectives. Recommended fiscal policies include 1) prioritizing climate-proofing capital investments to mitigate disaster impacts while raising fiscal space and potential growth; 2) expenditure rationalization, especially on education and health, from recurrent to capital; and 3) maximizing access to concessional external financing and strengthening domestic revenue mobilization. Better integration of climate-related fiscal commitments into the PFM law would create stronger political support to achieving climate adaptation objectives in the fiscal operation.

Recent and Upcoming Events on Pacific Island Countries

Recent Events

PFTAC: State Owned Enterprise (SOE) fiscal risk oversight and management. *October 19, 21, 26, and 28, 2021*

PFTAC: Fundamentals of Debt Reporting and Monitoring. *October 25 – 29 and November 8 – 12, 2021*

PFTAC/STI: Virtual Workshop on Inflation Forecasting. *October 27 –29, 2021*

PFTAC/PITAA: Revenue Workshop on Leadership, Governance, and Integrity. *Sessions in October, November 2021 & February 2021*

PFTAC: Workshop on Taxpayer Register and Data Cleansing: *November 9 – 11 and 16 – 18, 2021*

PFTAC/MCM: High level webinar on Addressing Climate Risks in financial sector prudential supervision and regulation: *November 19, 2021*

PFTAC: Workshop on Annual National Accounts: *November 23 – December 8, 2021*

PIFS with PFTAC contribution: Public Financial Management (PFM) Symposium: *March 23 – 25, 2022*

PIFS: Pacific Regional Debt Conference: *April 5 – 8, 2022*

Upcoming Events

PFTAC/OCO: Workshop on VAT Risks and Investigation: *April 27 – 28, 2022*

PFTAC: Workshop on Basel III: *April 26 – 29, 2022*

PFTAC: 2022 Annual Steering Committee Meeting: *May 25 – 26, 2022*