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TUVALU

2012 ARTICLE IV CONSULTATION

September 2012

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2012 Article IV consultation with Tuvalu, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 6, 2012, with the officials of Tuvalu on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 6, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- **Public Information Notice** (PIN)summarizing the views of the Executive Board as expressed during its August 3, 2012 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Tuvalu.

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July 6, 2012

TUVALU

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

KEY ISSUES

Context and growth prospects. Growth has returned after the financial crisis but remains slow, as demand for seafarers, Tuvalu's largest source of private employment and foreign exchange, has not recovered. The strong Australian dollar, which Tuvalu uses as its currency, has helped keep inflation under control, but has contributed to a widening current account deficit. The budget deficit has begun to fall as tax compliance has improved and the government has taken steps to control spending. But financing buffers are nearly empty, and global financial uncertainty has kept the country's asset holdings below the level at which they can be used to help.

Risks. A renewed shock to global growth would further dent demand for seafarers and seasonal employment, hurting growth, while financial market turmoil would depress Tuvalu's asset holdings. A sudden devaluation of the Australian dollar could also cause inflation to spike.

Ensuring macroeconomic sustainability. Reining in the fiscal deficit is key to restoring both fiscal and external sustainability. This will require further trimming of non-priority spending and improved tax compliance among public enterprises. Improving the prospects for Tuvaluans to work abroad will be essential to long-term replacement of seafarer income and stabilizing the current account.

Supporting private sector growth. Continued progress on moving public enterprises to a commercial orientation will help improve the business climate. Stronger risk management at the country's banks will eventually allow balance sheets to be rebuilt and better support private sector lending.

Approved By
Masato Miyazaki and Thomas Dorsey

Discussions took place in Funafuti during May 28-June 6, 2012. The staff team comprised Mr. J.P. Walsh (head), Mr. Y. Yang (resident representative), Mr. S. Tapsoba (APD), Ms. M. Pant (SPR), Mr. P. Merrick and Ms. L. Pan (both World Bank). Mr. C. Becker (OED) participated in the discussions.

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BACKGROUND AND OUTLOOK

1. **Tuvalu is the Fund's smallest member.** With a population of only 11,000, the scope for economic diversification, including for exports, is minimal, and nearly all goods are imported (Figure 1). Tuvalu uses the Australian dollar as its currency and has no central bank. The main sources of foreign exchange have been the earnings of Tuvaluans working abroad, particularly as seafarers, and donor assistance. Absolute poverty is rare and access to primary education effectively universal. Though provision of health services is limited by the country's small size, Millennium Development Goals health targets are on track to be reached by 2015. Including its roles in health and education, the public sector employs around a tenth of the country's population, and deficits have been persistent even in good times. These are generally closed via donor support, but also via disbursements from the country's budget support fund, the Consolidated Investment Fund (CIF).

2. **Growth has been slow following the global financial crisis.** After two consecutive years of decline, the economy revived in 2011, growing by 1.1 percent. Recovery was led by an increasingly competitive private retail sector and increased education spending. But seafarer employment, which has not recovered from the financial crisis, has dragged on growth. Inflation, at 0.5 percent in 2011, has remained under control as increased retail competition, the strong Australian dollar, and shifting trade patterns have countered upward commodity price pressures.

3. **A large fiscal expansion during 2009-10, now slowly being unwound, has nearly exhausted available financing buffers.** Between 2005 and 2008, government expenditure averaged 80 percent of GDP while grants and revenue averaged 71 percent (Figure 3). But by 2010, expenditure had risen to 104 percent, while revenue remained at 74 percent. The result was that the CIF fell from 34 to 21 percent of GDP. In 2011, expenditure fell to 93 percent of GDP, lowering the before-grants budget deficit to A$12.9 million. To bolster revenue, the government has signed two joint ventures (JVs) with Asian fishing companies. These have yet to produce significant revenue, but Tuvalu's share of their A$20 million in market-rate debt could represent a contingent liability of 28 percent of GDP. In all, despite higher donor financing, the CIF fell to only 11 percent of GDP, or A$3.1 million, by end-year.

4. **The trade and current account deficits are widening, but reserves continue to rise.** Imports have risen strongly in recent years, and the trade deficit in 2011 reached 58 percent of GDP. Remitted wages fell during most of the 2000s, from around 30 percent of GDP in 2001–2003 to only 8 percent in 2011. Donor grants and income from the country's large holdings of foreign assets (see below) are substantial, but the current account deficit (less errors and omissions) in 2011 still reached 8 percent of GDP[1]. This was partly financed through the rundown of the CIF, but high capital grants from donors compensated, allowing reserves to grow to 6.7 months of import coverage.

5. **Tuvalu's asset holdings are recovering, but remain below pre-crisis peaks.** The Tuvalu Trust Fund (TTF), originally capitalized by donors in 1988, aims to provide a stable principal from which income can be used for budget support. The investment strategy aims at a 4½ percent real return. Holdings are global, but Australian assets are weighted heavily. At end-March 2012 it held A$122.9 million (345 percent of GDP). The TTF is not fully sovereign: its principal cannot be drawn down without consent of its Board, upon which donors are represented. When its investment value exceeds a "maintained value" indexed to Australian CPI, the excess can be transferred into the CIF, which can be freely drawn upon for budget support. Over its history, returns have averaged 8.4 percent, but during 2008-2011 this fell to 0.5 percent, pulling the TTF well below its maintained value. However, a recovery in early 2012 has closed this gap to only 3.6 percent. This has come at the same time as a shift in portfolio strategy, from static benchmark-matching to dynamic targeting of risk and return, has defensively shifted the portfolio toward low-risk assets.

6. **The government has laid out an agenda to address economic challenges.** A Policy Reform Matrix (PRM) of commitments stemming from Tuvalu's development strategy *Te Kakeega II* (TKII) will serve as disbursement criteria for increased program support from donors. The PRM has four main areas: governance, social development, education and human resources, and macroeconomic growth and stability. Implementation should ease fiscal constraints by raising growth, improving tax collections and reducing non-priority expenditure, and unlocking additional budget support (Box 1).

[1] Before errors and omissions the deficit was around 29 percent of GDP, but the authorities believe this is an overstatement. The 2010 current account deficit was 3¾ percent of GDP.

7. **Growth prospects depend on creating conditions for private sector growth and encouraging work abroad.** Exports of goods and services in 2011 totaled only 12 percent of GDP. Increasing competitiveness thus relies upon developing opportunities, such as seasonal labor schemes in Australia and New Zealand, and skills so more Tuvaluans can work abroad; broadening financial intermediation to allow for greater accumulation of savings, particularly for returning and retired workers; and macroeconomic policies that buffer the economy as much as possible against external shocks.

8. **Short-term risks are on the downside.** With minimal exports and the slow recovery of seafarer employment, upside growth risks are small. On the other hand, linkages to global growth trends and imported commodity price shocks are a serious concern (Box 2). In addition, the country's large asset holdings constitute a significant channel by which financial market shocks can feed into the domestic economy (Box 3). Finally, the volatile Australian dollar swings imports and government revenue in ways difficult to accommodate, and natural disasters such as drought are always a concern. With fiscal buffers still weak and no other significant levers, additional donor support would be the only potential source of funds to respond to a shock of almost any nature.

9. **Long run risks are significant.** In the long run, internet and telephone licensing revenue may decline as these technologies age, and fishing resources could be depleted unless stocks are better studied and managed. Most overseas employment opportunities are for unskilled labor. Higher productivity migrants are less likely to return, raising prospects for remittances but possibly hurting long-run skills development in such a small country. Most crucially, climate change is a fundamental risk to the world's second lowest-lying country. Rising sea temperatures and irregular rainfall are already cited as reasons for declining income from fish and crops, and higher sea levels could render much of the country uninhabitable.

10. **Authorities' Views.** The authorities share the mission's views on economic conditions. They note that the PRM aims at both near-term macroeconomic management to address fiscal and external challenges, as well as supporting health, education, and private sector growth, to enhance Tuvalu's long-term prospects.

POLICY DISCUSSIONS

Macroeconomic Stability

11. **Fiscal policy is the only macroeconomic policy lever and buffer against external shocks.** With no monetary policy independence, a highly mobile labor force, reliance on imported goods, and minimal financial diversification, Tuvalu's only policy instrument for dealing with external shocks is fiscal policy, particularly the buffer of the CIF. The real exchange rate has also appreciated in recent years, largely due to the strength of the Australian dollar, which may at the margin be discouraging Tuvalu's main external adjustment mechanism, labor migration (Appendix I).

A. Fiscal Policy

12. **The government has taken important measures, though difficult choices remain.** Much of the 2009/10 jump in spending went to approval of new scholarships for Tuvaluans studying abroad and payments for medical services in Fiji conducted under the Tuvalu Medical Treatment Scheme (TMTS). Despite large unspent balances in the Falekaupule Trust Fund (FTF), which pools funds for such projects, central government spending on Outer Islands capital programs also grew. Some reforms to the TMTS have been made, such as eliminating free travel for caretakers, reducing housing costs, and the hiring of a surgeon in Tuvalu. A committee of doctors has also been established to approve referrals, a crucial step both for reducing costs and for securing donor support for severe cases. The government will also approve no new scholarships this year, but ongoing costs for current recipients remain high. Capital expenditure is budgeted to fall from 13.3 percent of GDP in 2011 to 5.9 percent of GDP in 2012, close to pre-crisis levels, and is expected to remain low.

13. **Revenue reforms may support long-run consolidation, but will not provide much support this year.** Licensing revenues for the .tv domain will rise under a new regime. But with all telecommunications and most fishing revenue denominated in U.S. dollars, continued Australian dollar strength depresses proceeds. Compliance with Tuvalu's new VAT is rising among private companies but remains poor among public enterprises (PEs). A rise in rates from 4 to 7 percent, though postponed from 2012 to 2013, will help. Going forward, the PRM aims to improve VAT

compliance to 75 percent of eligible taxpayers, including all PEs, and the government has recommended a further rate increase, to 10 percent, in 2015. A new obejctive-based investment strategy for the TTF is intended to allow more flexibility in achieving target returns with less volatility, with additional oversight to ensure investments do not present undue risks.

14. **Authorities' Views.** The government remains strongly committed to improving Tuvalu's fiscal outlook. They emphasize that the agenda for reforms is ambitious: large tax increases, reductions to popular programs, and tougher penalties for tax evasion; and that significant steps have already been taken. They further note that while donors have in some areas taken up the slack from declining government support, here too, more work will be necessary.

B. External Sustainability

15. **The risk in Tuvalu is not an immediate balance of payments crisis but a liquidation of the country's asset holdings.** Freely usable foreign reserves are comprised of the CIF and the foreign assets (mostly Australian time deposits) of the National Bank of Tuvalu (NBT). This stock peaked in 2008 at 8.6 months of import coverage. Government financing needs have nearly drained the CIF, while a sustained period of low seafarer employment could eventually force the NBT to run down its own holdings as deposits are liquidated. Nominal and real appreciation have also widened the current account deficit and reduced the domestic currency value of seafarers' U.S. dollar wages and government licensing revenue, but the authorities have few levers beyond the CIF and seeking additional donor support for managing these risks.

16. **Authorities' views.** The authorities also remain concerned about the effect of the strong Australian dollar on public and private earnings, and agree that income sources need to be diversified. To mitigate risks, they note that the new investment strategy of the TTF has reduced the allocation to risky assets, fiscal consolidation will help rebuild the CIF, and that rising uptake by workers on seasonal schemes should raise incomes, while replacing U.S. dollar-denominated seafarer wages with wages denominated in Australian dollars.

Creating the Conditions for Private Sector Growth

17. ***TKII* sets a goal that the private sector will constitute half of GDP by 2015.** As of 2010, private sector activity – that is, GDP less government services and PEs - accounted for only around a quarter of GDP, and has not risen significantly in the past ten years. Stronger private growth will be predicated on a more sustainable macroeconomic, especially fiscal, framework, as discussed above, but will also require addressing various drags on growth. Improving the ability of the financial sector, comprised of the state-owned Development Bank of Tuvalu (DBT) and NBT, to lend will require sustained reforms that, in turn, are part of a broader agenda to reform Tuvalu's PEs.

18. **Government intervention is widespread.** Public enterprises dominate the economy. Management has historically been poor, and the introduction of a VAT has raised the stakes for weak tax compliance[2]. A broad reform agenda has had mixed results (Box 4). On the other hand, the government also runs the Tuvalu National Provident Fund (TNPF), which invests a share of all workers' earnings. TNPF holdings are collectible upon retirement, but before maturity can be borrowed against up to a third of total holdings. Recently, delinquencies have been rising for these small loans. In addition, almost all retirees take lump-sum withdrawals, reducing the TNPF's usefulness for retirement savings.

19. **Financial sector lending capacity is limited.** Around half the assets at the NBT, the country's sole deposit-taking bank, are nonperforming. Around one-third of this is PE lending, but the largest share is now related to a rental housing-construction scheme, initiated by the government but financed by the NBT, which has now been ended. Interest rates are set by fiat, with deposit rates fixed for more than four years and lending rates fixed since they were cut in 2010 by an across-the-board government directive. Nevertheless, high spreads have kept lending profitable. The NBT also has a monopoly over foreign exchange transaction fees, and these are its main source of income. Small businesses in Tuvalu are more likely to borrow from the smaller DBT, though here too, around half the lending portfolio is nonperforming. Both banks have now tightened lending standards, but the process began earlier at the DBT, which has now begun to write off its nonperforming portfolio.

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[2] However, given large arrears by the government to PEs, the net fiscal gain from enforcement could be small.

20. **Authorities' views.** The government remains committed to PE reform, and while acknowledging that progress has been mixed, notes improved collections and compensation practices. They agree with the staff's views on the financial system, but emphasize the need to ensure financial system inclusiveness.

Other Issues

21. **Article XIV/VIII**. At the time of joining the Fund, Tuvalu availed itself of the transitory provisions of Article XIV, Section 2. While the exchange control regulations are quite restrictive and prescribe approval requirements from the NBT or the Finance Minister for most payments or transfers, in practice, no approval is required and payments and transfers for current international transactions are administered liberally. Staff recommended that the regulations be updated in line with current practice so that Tuvalu can accept the obligations of Article VIII, Sections 2, 3 and 4. Spreads charged on NBT wire transactions also differ by currency, which is a long-standing practice, but has little commercial basis and may even constitute a multiple currency practice.

22. **Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)**. While a law on AML/CFT was drafted in consultation with Australia and approved in 2006, Tuvalu should consider applying for membership in a Financial Action Task Force (FATF)-style regional body.

23. **The authorities are working closely with PFTAC in a range of areas.** Capacity at Tuvalu's statistics office has grown as regular PFTAC missions have assisted in the compilation of balance of payments and national accounts data, but given the small size of the office, further support from donors will be necessary to produce a better picture of the country's economic situation. The authorities have also expressed a willingness to move fiscal data to GFS 2001 format, and an initial mission visited Tuvalu in early May. Revenue administration has benefitted strongly from on the job training from a PFTAC-funded long-term consultant in Funafuti. PFTAC will also support the development of a reform plan for public financial management, a key element of the PRM.

24. **Authorities' view.** The authorities agree that payment restrictions on current transactions are unlikely to be necessary and have expressed a willingness to introduce eliminating legislation. The authorities indicated their openness to participate in the Asia/Pacific Group on Money Laundering (APG). They look forward to further cooperation with PFTAC on various areas, noting

that in areas such as public financial management, tax collection and statistical capacity, further donor support for long-term advisors would be helpful.

STAFF APPRAISAL

25. **Now is the time to build on last year's successful measures to bring the budget under control.** Steps taken to bring down TMTS costs, and the decision to approve no new scholarships this year were difficult and commendable. Thanks to these steps, improved tax compliance by the private sector, and a large one-off Australian grant, the fiscal position has improved in the past year. But budget support next year will be tied to implementing the PRM. Raising VAT rates is important, but raising compliance among PEs – currently none of which pay VAT– will be crucial both to bring deficits down in the future and for securing budget support from donors. The next step for direct taxes is to follow through with penalties for noncompliance, including nonfinancial ones. On subsidies, returning TMTS referrals to a committee of doctors should begin to bring costs down. The authorities should also continue to coordinate with donors to ensure scholarships remain at a sustainable level and bring subsidies to PEs transparently on budget. Public wage increases should also be tied more closely to inflation. Finally, new JVs should be signed with care, and only after verifying that any borrowing does not endanger concessional assistance from donors.

26. **Going forward, expenditure should be reoriented toward supporting social goals and growth.** The PRM rightly focuses on primary education and streamlining health expenditure. More support for training, particularly for women and in nontraditional areas, and by determining priority areas for scholarships, will improve Tuvalu's ability to send productive workers abroad, as will taking more advantage of seasonal labor schemes in Australia and New Zealand. Cuts to capital expenditure should not postpone needed infrastructure improvements, and Outer Islands projects should be clearly prioritized and financed by the FTF's unspent balances rather than relatively scarce government resources.

27. **These and other ongoing efforts will make Tuvalu's external position more sustainable.** Given labor, donor and trade flows, the use of the Australian dollar remains appropriate, but buffers should be rebuilt to restore resilience. Smaller budget deficits will allow the government's assets to be rebuilt while better training and more opportunities for Tuvaluan workers,

in New Zealand and increasingly in Australia, will help cushion the blow of declining seafarer demand. The new objective-based asset allocation of the TTF should be implemented with a strong bias toward protecting Tuvalu's asset holdings, both of the TTF and the TNPF, from risky conditions in global financial markets.

28. **Continuing to implement the PE reform agenda is key to supporting growth.** Addressing tax arrears and poor customer payment culture is especially challenging in small countries. Improved accounting procedures should help sort out the net position of unpaid government supplier payments to PEs and PE tax arrears, but more important in the long run will be ensuring both parties make all payments on time and transparently. The effort to commercialize PE operations is paying off with improved risk management at the NBT and higher utilities collections. In the long run, this will increase the flow of dividends to the government, easing fiscal pressures and freeing capital for lending.

29. **The financial system has made significant strides, and progress seems likely to continue.** The improved focus on credit quality and financial position of the DBT and NBT are encouraging. In particular, the DBT has begun to clean its balance sheets by writing down uncollectible loans. As the NBT's risk monitoring capabilities improve, it should begin to do the same. To ensure the continued financial health of the TNPF, the authorities should seek to have its actuarial viability assessed, and also amend the law to encourage retirees to take annuities rather than lump-sum withdrawals.

30. **Government intervention in the economy should also be reduced.** As they return to health, the DBT and NBT should gradually be allowed to set their own rates, at least in areas, such as lending to businesses, where they are already effectively in competition. Installing a new and fully professional board at the electric company to ensure the company's independence will show that Tuvalu is serious about improved PE management.

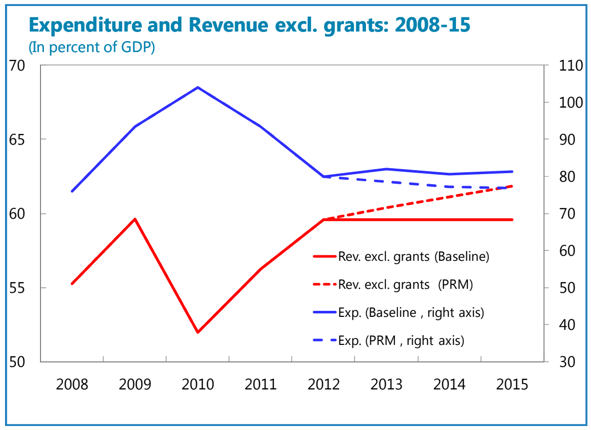
31. **Data shortcomings, particularly in the national accounts and balance of payments, hamper surveillance.** Additional resources will need to be provided to compile data necessary for surveillance and to support policymaking.

32. **Staff recommends that the next Article IV consultation take place on a 24-month cycle.**

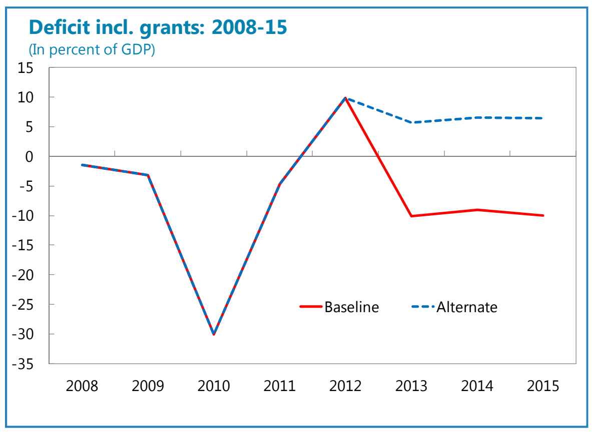
Box 1. Tuvalu's Policy Reform Matrix

A new Policy Reform Matrix (PRM) aims to strengthen the policy framework and coordinate budget support. With the assistance of key donors, the exercise aims to tie future budget support to a common list of measures focused on preserving fiscal sustainability, rebuilding the government's reserves in the Consolidated Investment Fund (CIF), and improving the macroeconomic environment.

Fiscal sustainability is the overriding goal. Keeping the deficit below 10 percent of GDP will return the CIF to a sustainable level. Key measures include tying wages more closely to inflation, reducing travel costs and nonpriority transfers and subsidies, while Community Service Obligations (CSOs) would be contained below 5 percent of GDP (See Box 4). Concurrently, priority health and education spending would rise. Higher VAT rates and better enforcement will further increase fiscal space.



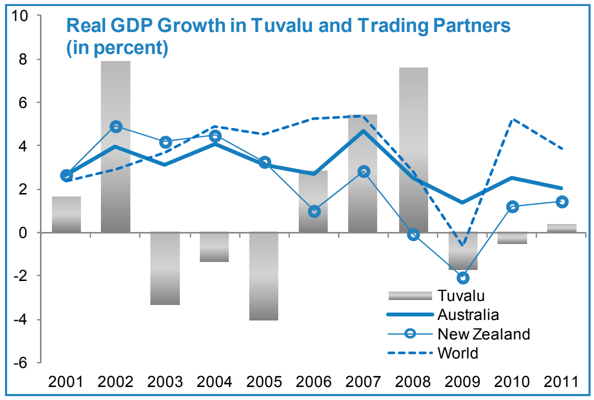
Without implementation, financing constraints will force spending cuts. Revenues would stall at around A$24 million, recurring grants at around A$4½ million, and additional World Bank financing of around A$1¾ million. With expenditure expected at around A$33 million, the government would have to make unpalatable cuts or exhaust the CIF.



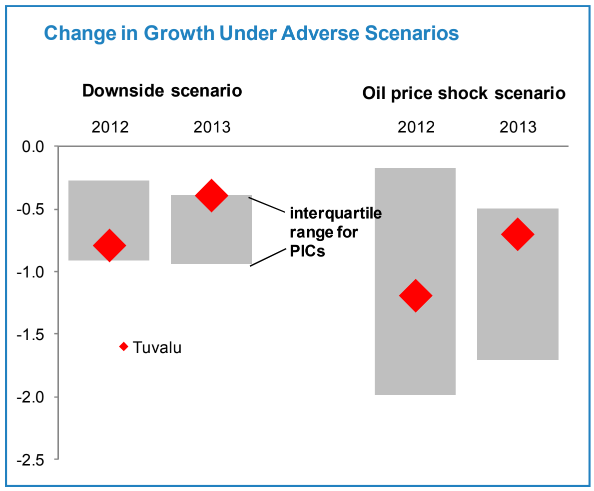
PRM implementation would support growth and widen the fiscal envelope. Staff estimates that a better business climate and additional capital spending could raise growth by around ½ - ¾ percent of GDP. Aside from fiscal space created through better expenditure control and revenue collection, implementation would also unlock donor support: commitments from the ADB, Australia, and New Zealand would rise from A$4.5 million to A$9 million. Staff calculates that full implementation would allow higher and more focused public spending, rising to around A$40 million by 2017. The implications of PRM implementation for Tuvalu's debt sustainability are discussed in the accompanying Debt Sustainability Analysis.

Box 2. Tuvalu and Global Shocks

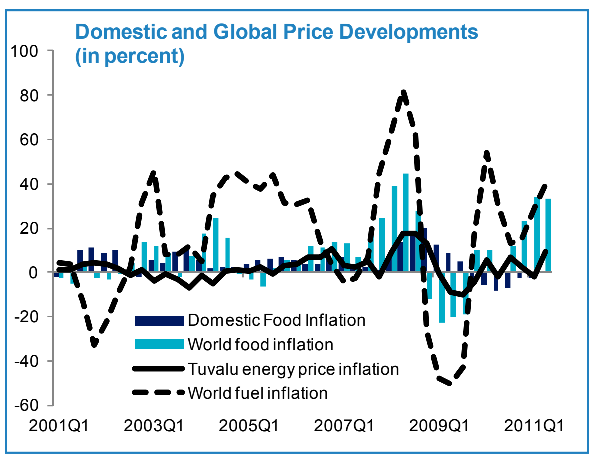
Tuvalu's economy is small and open. Work on merchant ships is traditionally the largest source of foreign exchange and is tied to volatile global trade, while the shift to seasonal employment in Australia and New Zealand will expose Tuvaluans to those countries' labor markets. Nearly everything, including skilled services, is imported, with fuel and food constituting about half of total goods imports. The recent shift to Asian suppliers has helped contain inflation, but a sudden depreciation of the Australian dollar, as in 2008, could lead to a spike in prices of consumer goods.



Growth is tied to global and regional cycles, and exposed to commodity price shocks. Growth is linked to Australian GDP (correlation of 0. 36) but not with New Zealand (-0.01). Recent IMF analytical work assesses linkages between Pacific Island countries and broader economies, finding an elasticity of Tuvaluan GDP growth to global growth of 0.5.[1] The paper further finds under a 2012-13 shock to global growth of 1.5 percent emanating from the Euro Area, the effect on Tuvalu would be relatively strong but short-lived. A 50 percent rise in oil prices would also affect Tuvalu similarly to the median Pacific Island country.



Pass-through of global price shocks is not complete. Price controls on staple foods dampen the effect of global food price shocks, though these do follow global trends. The correlation of domestic energy prices with global fuel prices is 0.36, reduced by government subsidies for inter-island freight[2]. However, these measures drag on private retailers and the budget, respectively.



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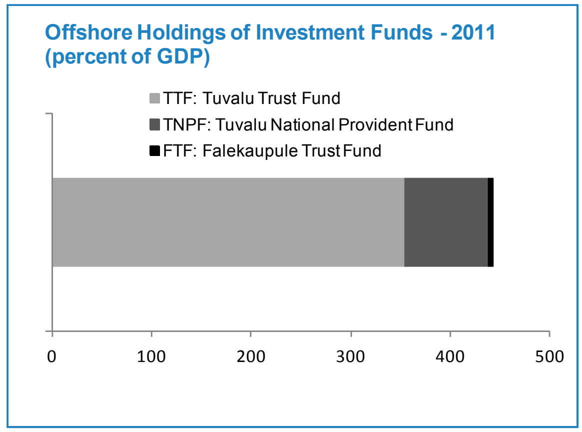
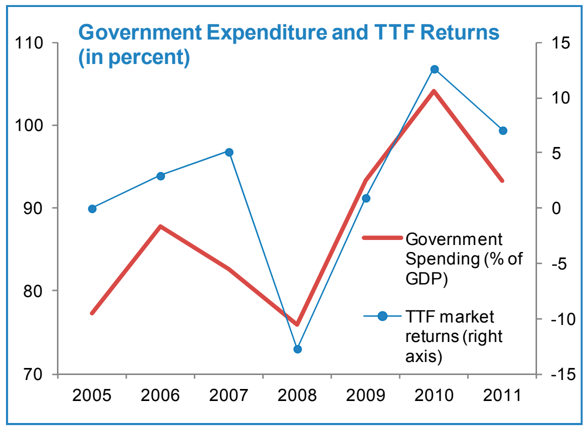
1. Sheridan, N., P. Tumbarello, and Y. Wu, "Global and Regional Spillovers to Pacific Island Countries," IMF Working Paper 12/154.
2. Tuvalu has eight Outer Islands located several hours by high-speed boat from the capital. Freight to these islands is paid for by the government.

Box 3. Links to Global Financial Markets

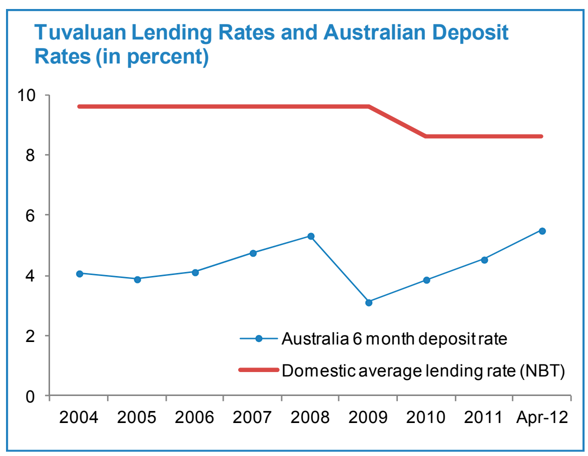
The government has extensive foreign asset holdings, though these funds are not fully sovereign. The TTF, jointly controlled with Australia and New Zealand, is by far the largest. The Tuvalu National Provident Fund (TNPF) invests social contributions from slightly more than half the country's population, and the Falekaupule Trust Fund (FTF) is a pool to finance investment projects in the Outer Islands. All three funds are invested along TTF guidelines, exposing not only the government but also local governments and the retirement holdings of individuals to global market fluctuations.



While an important source of funds for the government, the TTF has not reduced procyclicality. As the TTF disburses only when the market value of its assets exceeds a long-run index, the government's available resources tend to rise when market returns are high. Recognizing this, the Tuvaluan authorities have in many cases recapitalized the TTF with unspent CIF funds even when times are good. But in general, higher market returns coincide with periods of fiscal expansion. Recently, the government, donors, and the TTF's advisory committee have discussed modalities to make TTF disbursements more regular and reduce procyclicality.



Even Tuvalu's effectively closed banking system is somewhat exposed to global risks. Funding costs for the NBT are stable as it is entirely deposit-financed and, with no competition, changes deposit rates very infrequently. The Development Bank of Tuvalu, however, is partly capitalized by EIB credit lines, exposing the bank to exchange rate and funding cost risk, while the NBT invests surplus cash in Australian time deposits. Interest on these deposits, which now exceed half of GDP, are linked to Australian, and thus Tuvaluan, business cycles, raising the opportunity cost of NBT lending and increasing the bank's profits and government dividends when the economy does well.



Box 4. Public Enterprises in Tuvalu

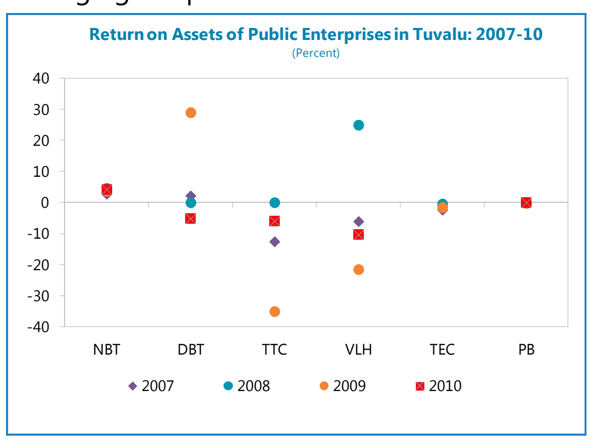
Most public enterprises (PEs) are financially weak. Low tariff structures, arrears on payments by the government, and structural inefficiencies, many aggravated by Tuvalu's small size, are the major impediments. Limited availability of experienced managers and boards chaired by civil servants hinder the prospects of PEs to operate on a commercial basis. But PE losses strain government finances, lead to overdrafts at the NBT, and worsen the country's business climate.

Assets of Public Enterprises in Tuvalu: 2007-10

Public enterprises	Year	Assets (Percent of GDP)	Solvency (Profit/Liabilities in Percent)
National Bank of Tuvalu (NBT)	2010	81	5
Development Bank of Tuvalu (DBT)	2010	11	-15
Tuvalu Telecommunications Corporation (TTC)	2010	7	-5
Vaiaku Lagi Hotel (VHL)	2010	1	-28
Tuvalu Electricity Corporation (TEC)	2010	20	0
Philatelic Bureau (PB)	2009	0	-38
Tuvalu Maritime Training Institute (TMTI)	2007	4	0
National Fishing Company of Tuvalu (NAFICOT)	N.A.	N.A.	N.A.

Source : ADB TA Inception report: Capacity Development for Public Financial Management in Tuvalu

An ambitious reform plan was launched in 2008. A Public Enterprise Act (PEA) was passed in 2010 establishing a unit tasked with monitoring and managing the performance of all PEs. The act requires operation of PEs on a commercial basis and removal of civil servants from boards. It also aims to regularize government financial relations with PEs, which are undermined by disagreement over the net size of tax arrears and unpaid government bills. The government is also now obliged to compensate PEs on-budget for necessary but uneconomical services, such as provision of electricity and banking services to the Outer Islands, through allocations for Community Service Obligations (CSOs), which amounts are negotiated with the PEs.



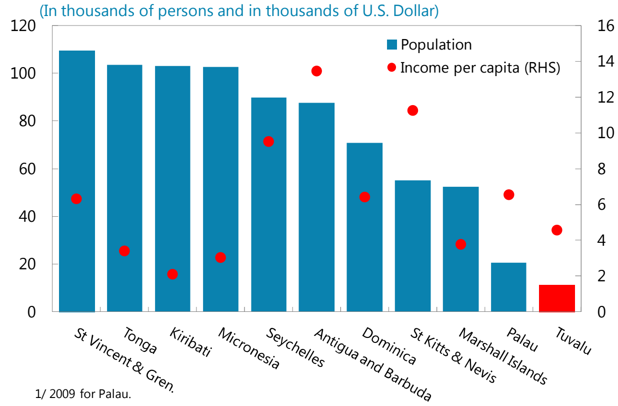
The process has been slow and success has been mixed. Beyond the NBT and TEC, prospects for profitability are poor without improved management. When profitable, few PEs pay corporate income tax, none pay VAT, and some do not make social contribution payments for employees. In 2011, the independent board of TEC was suspended following a billing dispute, reversing one of the PEA's main successes. CSOs were also dropped from the 2012 budget. On the other hand, TTC and TEC tariffs were reviewed in 2010 and the government is considering privatization of the Vaiaku Lagi Hotel. Beyond this, government departments responsible for public works such as roads and ports are being considered for corporatization.

Figure 1. Tuvalu in Context

Tuvalu has the smallest population of any Fund member, and per capita income is relatively low.

Population and GNI per Capita 1/

(In thousands of persons and in thousands of U.S. Dollar)

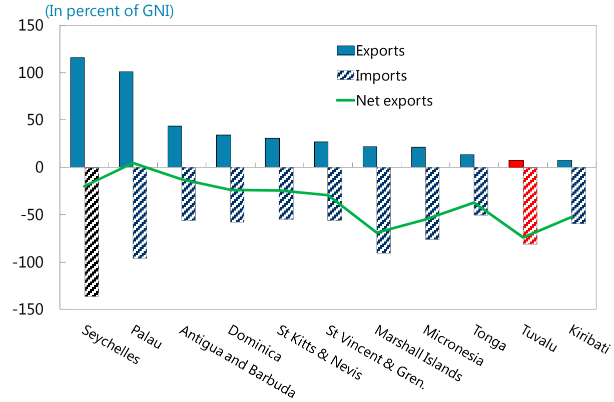


1/ 2009 for Palau.

Exports are smaller than most other small countries, while imports are very large.

Trade of Goods and Services

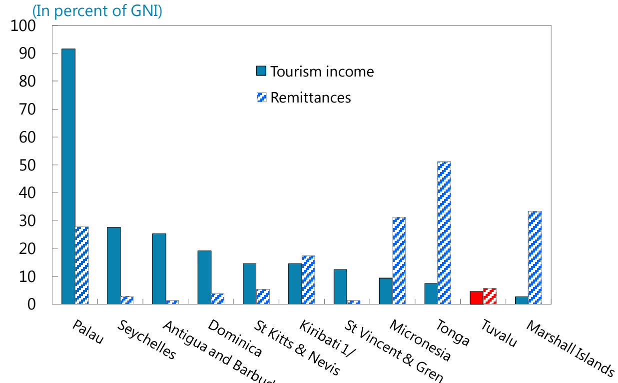
(In percent of GNI)



Neither tourism nor remittances are as high as in many other small countries. . .

Private sector sources of foreign exchange

(In percent of GNI)

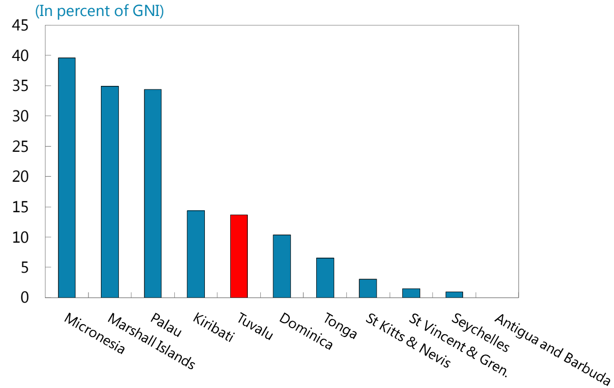


1/ In percent of GDP for Kiribati.

. . .while donor flows are quite large.

External Government Grants

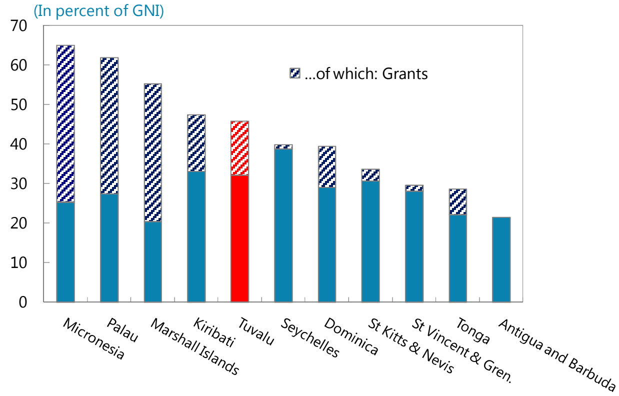
(In percent of GNI)



These grants are an important component of government resources, though own revenues are also large. . .

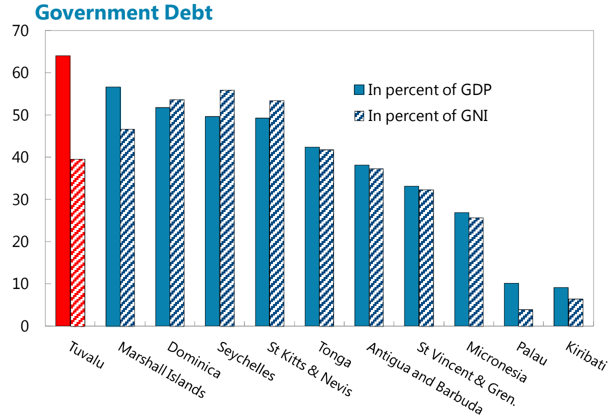
Government Total Revenue...

(In percent of GNI)



. . .though the stock of public debt remains quite high.

Government Debt

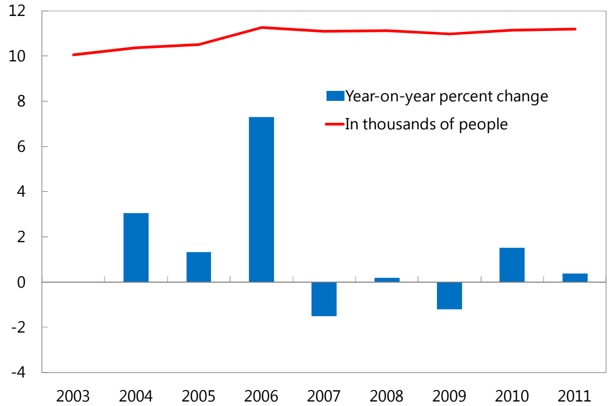


Sources: WEO, APDLISC, and staff calculations.

Figure 2. Tuvalu: Economic Developments

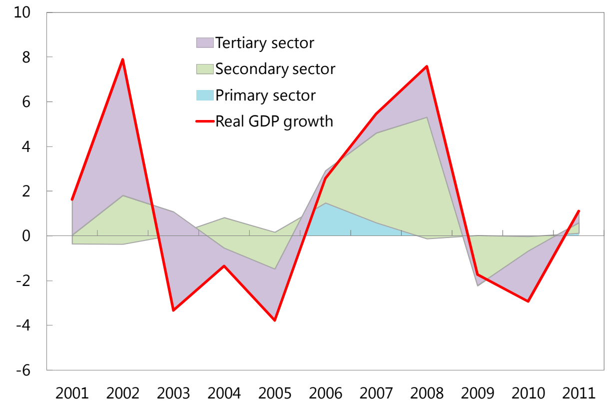
Emigration means Tuvalu's population fluctuates dramatically.

Population



Growth is highly volatile, with services and construction the most important contributors.

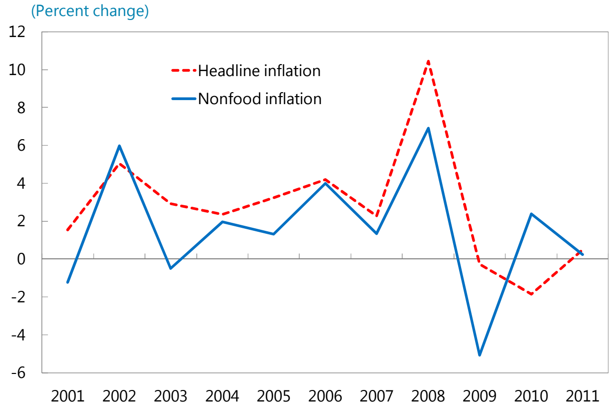
Contribution to Real GDP Growth



Inflation has been restrained in recent years.

Consumer Price Index

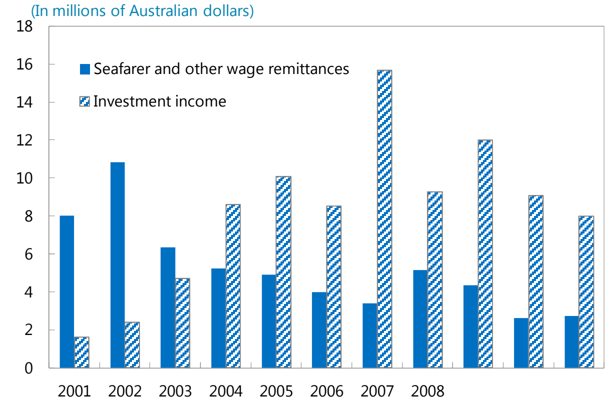
(Percent change)



Income from remitted wages has broadly declined over the past ten years, while investment income has remained strong.

Sources of Foreign Exchange

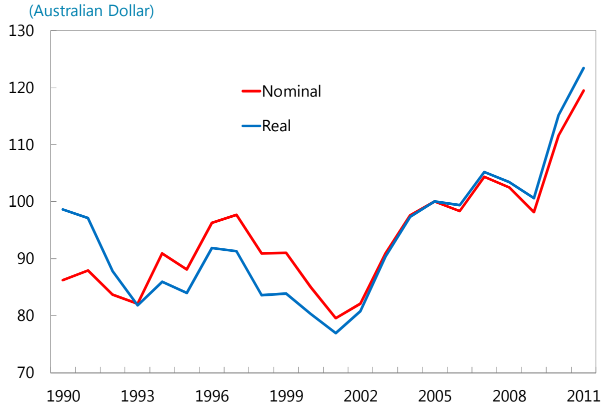
(In millions of Australian dollars)



The strong Australian dollar has led to real appreciation even following the global financial crisis. . .

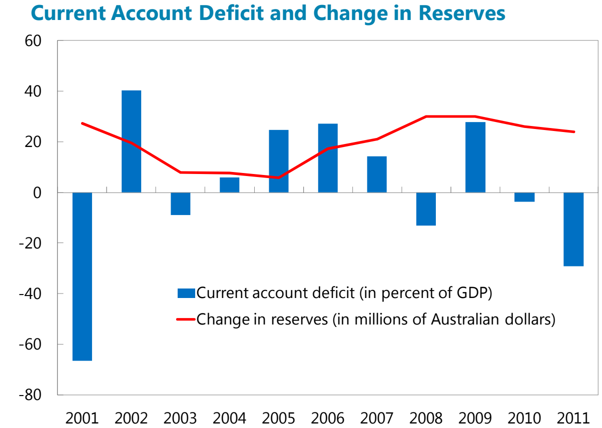
Effective Exchange Rates

(Australian Dollar)



. . .while the current account has weakened and reserves have begun to fall.

Current Account Deficit and Change in Reserves



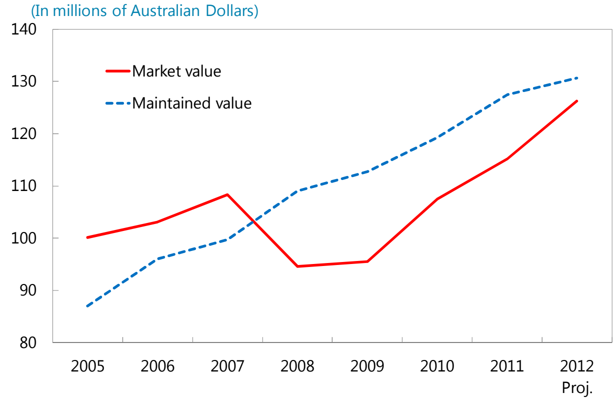
Sources: Information Notice System, Tuvalu authorities, and staff calculations.

Figure 3. Tuvalu: Fiscal Outlook

The financial crisis depressed the value of Tuvalu's asset fund below the value at which disbursements are made.

Tuvalu Trust Fund

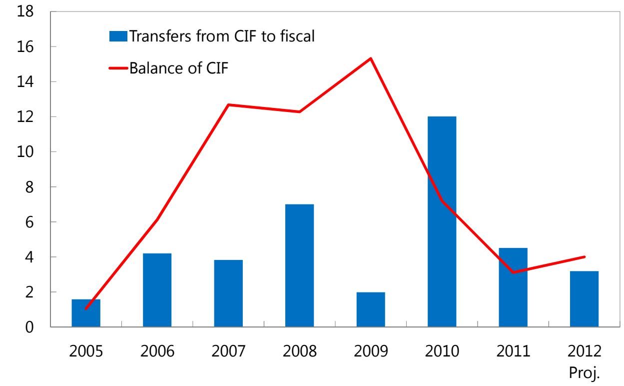
(In millions of Australian Dollars)



Without these flows, the government's liquidity fund has declined rapidly in recent years.

Consolidated Investment Fund

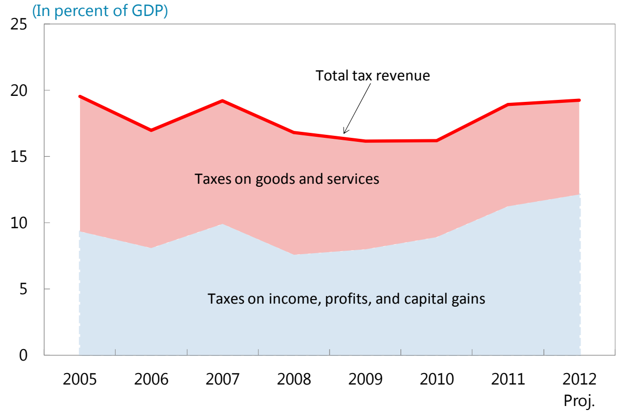
(In millions of Australian Dollars)



Despite recent tax reforms, tax revenue remains flat.. .

Government Tax Revenue

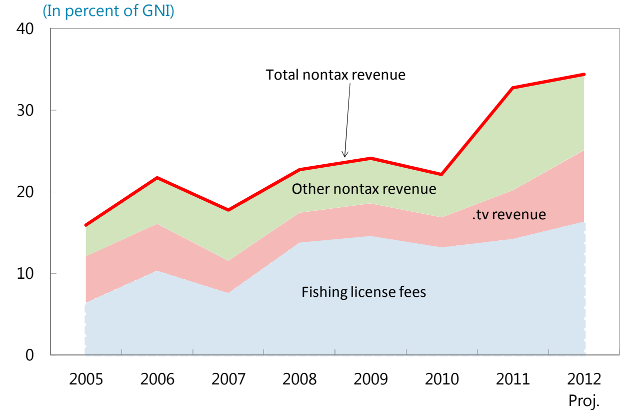
(In percent of GDP)



. . .while the strong Australian dollar has weakened US dollar-denominated licensing flows.

Government Nontax Revenue

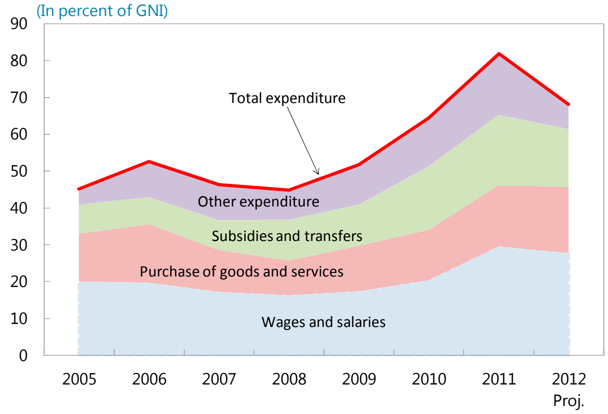
(In percent of GNI)



Expenditure is now coming off crisis-period peaks. . .

Government Expenditure

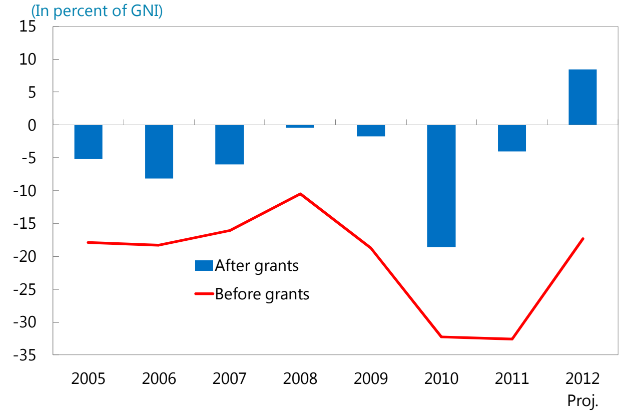
(In percent of GNI)



. . .but the persistent deficit remains quite large.

Fiscal Deficit

(In percent of GNI)



Sources: Tuvalu authorities and staff calculations.

Table 1. Tuvalu: Selected Social and Economic Indicators, 2008–2013

	2008	2009	2010	2011	2012 Proj.	2013 Proj.
	(Percent change, unless otherwise indicated)					
Real sector						
Real GDP growth	7.6	-1.7	-2.9	1.1	1.2	1.3
Consumer prices (period average)	10.4	-0.3	-1.9	0.5	2.6	2.7
	(In percent of GDP)					
Government finance 2/						
Revenue	72.4	90.2	74.0	94.5	84.1	71.9
of which Taxes	16.8	16.2	16.2	18.9	19.3	19.3
of which Grants	17.1	30.6	22.1	38.2	24.5	12.3
Total Expenditure	75.9	93.3	104.1	93.3	79.8	82.0
Expense	67.9	77.7	87.1	78.5	75.6	76.5
Net Acquisition of Nonfinancial Assets	5.1	15.6	17.0	14.9	4.3	5.5
Net Lending/Borrowing	-0.7	-3.1	-30.0	1.1	4.2	-10.1
Tuvalu Trust Fund 3/	262.8	275.8	310.0	331.7	354.7	364.0
Consolidated Investment Fund 3/	34.1	44.2	20.8	9.0	11.2	5.6
	(Percent change, unless otherwise indicated)					
Money and credit						
Deposits	49.9	5.6	-7.1	-15.1	…	…
Credit to non-government	35.3	9.7	-7.3	-15.2	…	…
Lending interest rate (in percent) 4/	11.1	11.1	10.6	10.6	…	…
	(In millions of Australian dollars, unless otherwise indicated)					
Balance of payments						
Current account balance	-4.7	9.6	-1.3	-10.1	-3.0	-1.2
(In percent of GDP)	-13.2	27.8	-3.8	-29.2	-8.5	-3.3
Trade balance	-18.3	-16.0	-18.6	-19.5	-18.0	-16.5
Exports	0.6	0.6	0.5	0.6	0.7	0.7
Imports	-19.0	-16.6	-19.1	-20.2	-18.7	-17.2
Services balance	-26.8	-21.9	-22.7	-28.9	-20.8	-21.3
Income balance	24.9	27.8	21.4	18.8	24.2	25.0
Current transfers (net)	15.5	19.8	18.7	19.4	11.6	11.6
of which: government	12.7	17.2	16.2	17.0	9.3	9.1
Gross official reserves 5/	30.0	29.9	26.0	23.9	23.1	23.8
(In months of imports of goods and services)	8.6	7.9	6.0	6.7	6.6	6.8
Remittances and employee compensation	6.2	5.2	3.3	3.3	3.9	4.1
Debt indicators						
Gross external public debt	17.4	18.3	17.0	14.5	12.8	13.1
(In percent of GDP)	48.3	53.0	49.1	41.7	36.1	35.8
Debt Service	0.9	0.6	0.5	0.4	0.6	0.6
(In percent of exports of goods and services)	21.4	15.4	11.2	10.7	14.5	15.1
Exchange rates						
Australian dollars per U.S. dollar						
Period average 6/	1.2	1.3	1.1	1.0	0.9	…
End-period 6/	1.5	1.1	1.0	1.0	1.0	…
Nominal effective exchange rate (2005=100)	102.5	98.1	111.6	119.3	…	…
Real effective exchange rate (2005=100)	103.5	100.7	115.2	123.2	…	…
Nominal GDP (In millions of Australian dollars)	36.0	34.6	34.7	34.7	35.6	36.6
Nominal GNI (In millions of Australian dollars)	58.7	60.8	55.5	58.9	62.1	65.5

Sources: Tuvalu authorities, PFTAC, and IMF staff estimates.

1/ Tuvalu uses the Australian dollar as its currency. It has no central bank operations.
2/ Data for 2011 are Tuvalu authorities and staff estimates.
3/ Data for 2011 are provisional from Tuvalu Trust Fund Advisory Committee.
4/ Average of personal, business, overdraft and housing loans.
5/ Defined as sum of foreign assets of the National Bank of Tuvalu, the Consolidated Investment Fund, and SDR holdings. Excludes the Tuvalu Trust Fund. Data for 2010 are as of October.
6/ Data for 2012 are as of end-May.

Table 2. Tuvalu: Illustrative Medium-Term Baseline Scenario, 2006/07-2016/17

							Projections					
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Growth and inflation												
Real GDP growth	2.6	5.5	7.6	-1.7	-2.9	1.1	1.2	1.3	1.2	1.2	1.2	1.0
CPI inflation (period average)	4.2	2.3	10.4	-0.3	-1.9	0.5	2.6	2.7	2.7	2.7	2.7	2.7
	(In percent of GDP)											
Fiscal accounts												
Total revenue and grants	70.1	68.8	72.4	90.2	74.0	94.5	84.1	71.9	71.5	71.2	67.5	67.2
Total revenue	53.2	50.9	55.3	59.6	52.0	56.2	59.6	59.6	59.6	59.6	56.4	56.4
External grants	16.9	17.9	17.1	30.6	22.1	38.2	24.5	12.3	12.0	11.7	11.1	10.8
Total expenditure and net lending	87.8	82.6	75.9	93.3	104.1	93.3	79.8	82.0	80.6	81.2	81.2	81.2
Overall balance (including grants)	-13.6	-10.7	-0.7	-3.1	-30.0	1.1	4.2	-10.1	-9.1	-10.0	-13.7	-14.0
External financing, net												
Domestic financing, net												
	(In millions of Australian dollars)											
Balance of payments												
Current account	8.3	4.6	-4.7	9.6	-1.3	-10.1	-3.0	-1.2	0.7	1.6	1.7	1.7
(In percent of GDP)	27.2	14.2	-13.2	27.8	-3.8	-29.2	-8.5	-3.3	1.9	4.2	4.3	4.2
Merchandise trade balance	-12.3	-11.2	-18.3	-16.0	-18.6	-19.5	-18.0	-16.5	-16.0	-16.4	-16.8	-17.3
Exports, f.o.b.	0.6	0.5	0.6	0.6	0.5	0.6	0.7	0.7	0.7	0.7	0.7	0.8
(Annual percent change)	25.9	-13.7	35.1	-12.0	-17.0	36.0	2.6	2.8	2.7	2.7	2.7	2.7
Imports, c.i.f.	-12.9	-11.7	-19.0	-16.6	-19.1	-20.2	-18.7	-17.2	-16.7	-17.1	-17.6	-18.0
(Annual percent change)	-8.2	-9.3	62.8	-12.5	15.1	5.5	-7.4	-7.9	-3.1	2.7	2.7	2.7
Services	-13.6	-23.4	-26.8	-21.9	-22.7	-28.9	-20.8	-21.3	-21.8	-22.3	-22.9	-23.6
Net Income	20.2	25.3	24.9	27.8	21.4	18.8	24.2	25.0	25.8	26.6	27.3	28.1
Current transfers, net	14.0	13.9	15.5	19.8	18.7	19.4	11.6	11.6	12.7	13.7	14.1	14.5
External debt and reserves												
Gross external public debt (percent of GDP)	39.8	35.7	48.3	53.0	49.1	41.7	36.1	35.8	36.1	36.8	38.5	40.7
NPV of external public debt (percent of GDP)	…	…	…	…	…	36.0	31.0	28.7	27.1	25.7	25.2	25.4
External debt-service ratio 1/	4.9	21.1	5.4	-15.2	79.9	75.7	49.9	45.3	40.1	39.2	33.7	22.7
Gross official reserves (millions of U.S. dollars)	17.3	20.9	30.0	29.9	26.0	23.9	23.1	23.8	26.7	30.4	34.2	38.2
(In months of next year's imports of GNFS)	5.5	5.1	8.6	7.9	6.0	6.7	6.6	6.8	7.4	8.2	9.0	9.8

Sources: Data provided by the Tuvalu authorities and Fund staff projections.

1/ In percent of exports of goods and services.

Table 3a. Tuvalu: Government Budget, 2008-13

	2008	2009	2010	2011	2012 Proj.	2013 Proj.
	(In millions of Australian dollars)					
Revenue	26.8	31.2	25.7	32.8	29.9	26.3
Taxes	6.0	5.6	5.6	6.6	6.9	7.0
Taxes on income	2.7	2.8	3.1	3.9	4.3	4.4
Personal	2.1	2.0	2.0	2.1	2.5	2.5
Company	0.6	0.8	1.1	1.8	1.9	1.9
Taxes on goods and services	0.7	0.7	0.8	0.8	0.9	0.9
Consumption	0.4	0.2	0.0	0.1	0.1	0.1
Excise and others	0.3	0.6	0.8	0.8	0.7	0.8
Taxes on international trade	2.6	2.1	1.7	1.9	1.7	1.7
Grants	6.9	10.6	7.7	13.3	8.7	4.5
Other revenue	13.8	15.0	12.4	13.0	14.4	14.8
Property income	11.1	12.6	10.0	10.2	11.9	12.2
Fishing license fees	8.4	9.1	7.4	5.6	6.8	7.0
Interest and dividends	0.5	1.0	0.6	2.2	1.4	1.5
.tv revenue	2.2	2.5	2.1	2.4	3.7	3.8
Other income	2.7	2.4	2.4	2.7	2.4	2.5
Expenditure	26.3	32.3	36.1	32.4	28.4	30.0
Expense	24.4	26.9	30.2	27.2	26.9	28.0
Wages and salaries	9.9	10.9	11.4	11.7	11.6	11.7
Purchase of goods and services	5.7	7.7	7.6	6.6	7.5	7.5
Subsidies and transfers 1/	6.8	7.0	9.7	7.6	6.6	7.5
Interest payments	0.2	0.0	0.1	0.1	0.1	0.1
Other expense	1.8	1.4	1.4	1.3	1.2	1.3
Net acquisition of nonfinancial assets 2/	1.8	5.4	5.9	5.2	1.5	2.0
Gross operating balance	2.3	4.3	-4.5	5.6	3.0	-1.7
Net lending / borrowing (overall balance)	0.5	-1.1	-10.4	0.4	1.5	-3.7
Net financial transactions	0.5	-1.1	-10.4	0.4	1.5	-3.7
Net acquisition of financial assets	-8.0	-2.0	-12.0	-4.5	-3.7	-2.1
Domestic	-1.0	0.0	0.0	0.0	0.0	0.0
Loans	-1.0	0.0	0.0	0.0	0.0	0.0
Foreign	-7.0	-2.0	-12.0	-4.5	-3.7	-2.1
Currency and deposits	-7.0	-2.0	-12.0	-4.5	-3.7	-2.1
Net incurrence of liabilities	-8.5	-0.9	-1.6	-4.9	-5.2	1.7
Domestic	-7.9	-0.4	-1.2	-4.6	-4.7	0.7
Loans	-7.9	-0.4	-1.2	-4.6	-4.7	0.7
Foreign	-0.6	-0.6	-0.4	-0.3	-0.5	1.0
Loans	-0.6	-0.6	-0.4	-0.3	-0.5	1.0
Memorandum Items:						
Overall balance (NLB) excluding grants	-6.4	-11.7	-18.1	-12.9	-7.2	-8.2
Externally-financed extra-budgetary expenditure (XB) 2/	13.0	12.0	17.1	30.7	10.2	10.2
Total central government debt (incld. guarantees)	20.2	22.7	21.4	17.3	15.5	15.5
Tuvalu Trust Fund (TTF) balance (market value)	94.6	95.5	107.5	115.1	126.3	133.2
Consolidated Investment Fund (CIF) balance	12.3	15.3	7.2	3.1	4.0	2.1
Nominal GDP	36.0	34.6	34.7	34.7	35.6	36.6

Sources: Tuvalu authorities and IMF staff estimates.

1/ Includes medical treatment scheme and scholarships, as well as Community Service Obligations (CSO).

2/ Includes capital expenditure as well as in-kind and technical assistance.

Table 3b. Tuvalu: Government Budget, 2008-13

	2008	2009	2010	2011	2012 Proj.	2013 Proj.
	(In percent of GDP)					
Revenue	74.5	90.2	74.0	94.5	84.1	71.9
Taxes	16.8	16.2	16.2	18.9	19.3	19.3
Taxes on income	7.6	8.0	8.9	11.2	12.1	12.1
Personal	6.0	5.7	5.8	6.1	6.9	6.9
Company	1.6	2.3	3.1	5.2	5.2	5.2
Taxes on goods and services	1.9	2.1	2.3	2.3	2.5	2.5
Consumption	1.1	0.5	0.1	0.2	0.4	0.4
Excise and others	0.8	1.6	2.2	2.2	2.1	2.1
Taxes on international trade	7.3	6.1	5.0	5.4	4.7	4.7
Grants	19.2	30.6	22.1	38.2	24.5	12.3
Other revenue	38.5	43.4	35.8	37.3	40.3	40.3
Property income	30.9	36.5	28.9	29.4	33.5	33.5
Fishing license fees	23.3	26.4	21.3	16.2	19.2	19.2
Interest and dividends	1.3	3.0	1.6	6.4	4.0	4.0
.tv revenue	6.2	7.2	6.0	6.8	10.3	10.3
Other income	7.6	6.9	6.8	7.9	6.8	6.8
Expenditure	73.0	93.3	104.1	93.3	79.8	82.0
Expense	67.9	77.7	87.1	78.5	75.6	76.5
Wages and salaries	27.6	31.4	32.9	33.7	32.5	31.8
Purchase of goods and services	15.8	22.2	22.0	18.9	21.0	20.5
Subsidies and transfers 1/	18.8	20.1	27.9	21.8	18.4	20.4
Interest payments	0.6	0.0	0.3	0.4	0.3	0.3
Other expense	5.1	4.0	3.9	3.7	3.4	3.5
Net acquisition of nonfinancial assets 2/	5.1	15.6	17.0	14.9	4.3	5.5
Gross operating balance	6.5	12.5	-13.0	16.0	8.5	-4.7
Net lending / borrowing (overall balance)	1.4	-3.1	-30.0	1.1	4.2	-10.1
Net financial transactions	1.4	-3.1	-30.0	1.1	4.2	-10.1
Net acquisition of financial assets	-22.3	-5.8	-34.6	-13.0	-10.4	-5.6
Domestic	-2.9	0.0	0.0	0.0	0.0	0.0
Loans	-2.9	0.0	0.0	0.0	0.0	0.0
Foreign	-19.5	-5.8	-34.6	-13.0	-10.4	-5.6
Currency and deposits	-19.5	-5.8	-34.6	-13.0	-10.4	-5.6
Net incurrence of liabilities	-23.7	-2.7	-4.6	-14.1	-14.6	4.5
Domestic	-22.0	-1.0	-3.5	-13.2	-13.2	1.9
Loans	-22.0	-1.0	-3.5	-13.2	-13.2	1.9
Foreign	-1.8	-1.6	-1.0	-0.9	-1.4	2.6
Loans	-1.8	-1.6	-1.0	-0.9	-1.4	2.6
Memorandum Items:						
Overall balance (NLB) excluding grants	-17.8	-33.7	-52.1	-37.1	-20.3	-22.4
Externally-financed extra-budgetary expenditure (XB) 2/	36.2	34.6	49.2	88.4	28.6	27.8
Total central government debt (incld. guarantees)	56.2	65.6	61.7	50.0	43.4	42.2
Tuvalu Trust Fund (TTF) balance (market value)	262.8	275.8	310.0	331.7	354.7	364.0
Consolidated Investment Fund (CIF) balance	34.1	44.2	20.8	9.0	11.2	5.6
Nominal GDP	36.0	34.6	34.7	34.7	35.6	36.6

Sources: Tuvalu authorities and IMF staff estimates.

1/ Includes medical treatment scheme and scholarships, as well as Community Service Obligations (CSO).

2/ Includes capital expenditure as well as in-kind and technical assistance.

Table 4. Tuvalu: Balance of Payments, 2008-13
(In millions of Australian dollars, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013
					Projections	
Trade balance	-18.3	-16.0	-18.6	-19.5	-18.0	-16.5
Exports, f.o.b.	0.6	0.6	0.5	0.6	0.7	0.7
Imports, f.o.b.	-19.0	-16.6	-19.1	-20.2	-18.7	-17.2
Services (net)	-26.8	-21.9	-22.7	-28.9	-20.8	-21.3
Receipts	3.5	3.1	3.7	3.4	3.5	3.6
Payments	-30.2	-25.0	-26.4	-32.2	-24.3	-24.9
Construction	-9.4	-4.5	-6.3	-10.6	-3.0	-3.0
Transport and Communications	-6.8	-6.5	-6.4	-5.7	-6.4	-6.5
Travel	-8.7	-6.1	-5.5	-6.2	-6.1	-6.3
Other 1/	-5.3	-7.9	-8.3	-9.8	-8.9	-9.1
Income (net)	24.9	27.8	21.4	18.8	24.2	25.0
Receipts	25.8	28.6	22.0	19.5	24.7	25.6
Compensation of employees	5.2	4.3	2.6	2.7	3.3	3.5
Investment income	9.3	12.0	9.1	8.0	10.7	11.1
Other property income	11.4	12.3	10.4	8.8	10.7	11.0
Payments	-0.9	-0.8	-0.7	-0.7	-0.5	-0.5
Compensation of employees	-0.2	-0.1	0.0	0.0	0.0	0.0
Investment income	-0.7	-0.7	-0.7	-0.7	-0.5	-0.5
Other property income	0.0	0.0	0.0	0.0	0.0	0.0
Current transfers	15.5	19.8	18.7	19.4	11.6	11.6
Private	2.8	2.6	2.5	2.4	2.3	2.5
Inflows	1.1	0.9	0.7	0.6	0.6	0.6
Outflows	-1.7	-1.7	-1.7	-1.8	-1.7	-1.9
Official	12.7	17.2	16.2	17.0	9.3	9.1
Inflows	11.8	16.8	15.8	16.5	8.7	8.5
Outflows 1/	-0.8	-0.4	-0.4	-0.6	-0.6	-0.6
Current account balance						
including official grants	-4.7	9.6	-1.3	-10.1	-3.0	-1.2
excluding official grants	-17.4	-7.6	-17.5	-27.2	-12.3	-10.3
Capital Account	13.6	13.8	11.1	15.1	13.7	14.1
Financial Account (less reserves)	7.3	14.3	8.7	10.3	11.4	12.1
Net Portfolio Investment	9.6	12.8	11.1	9.4	11.4	11.7
Other	-2.3	1.4	-2.4	0.9	0.0	0.4
Errors and omissions	-9.7	1.5	0.6	-7.3	0.0	0.0
Overall balance	6.1	3.4	-3.9	-2.8	-0.8	0.7
Change in official reserves (increase -)	6.1	3.4	-3.9	-2.8	-0.8	0.7
Memorandum items:						
Current account balance (percent of GDP)	-13.2	27.8	-3.8	-29.2	-8.5	-3.3
excluding official grants	-48.3	-21.9	-50.6	-78.3	-34.7	-28.1
Gross official reserves	30.0	29.9	26.0	23.9	23.1	23.8
(in months of imports of goods and services)	8.6	7.9	6.0	6.7	6.6	6.8
External public debt 2/	17	18	17	14	13	13
(in percent of GDP)	48	53	49	42	36	36
External debt service	0.2	0.4	0.3	0.5	0.5	0.4
(in percent of exports of goods and services)	5	-15	80	76	50	45
NPV of external debt (percent of GDP) 2/	…	…	…	36	31	29

Sources: Tuvalu authorities, PFTAC, and IMF staff estimates.
1/ Includes government's overseas contributions.
2/ Projections for 2012-15 are based on outstanding debt as of 2011.

Table 5. Tuvalu: Assets and Liabilities of the Banking Sector, 2006-11
(In millions of Australian dollars, unless otherwise indicated)

	2006	2007	2008	2009	2010	2011
	National Bank of Tuvalu					
Assets						
Bank reserves						
Cash	1.1	1.0	0.9	0.9	0.8	1.1
Deposits	8.6	9.7	12.4	13.4	14.4	16.2
Securities	0.0	0.0	0.0	0.0	0.0	0.0
Claims on government	5.0	4.9	3.6	1.7	2.1	0.3
Loans and advances 1/	14.7	14.0	15.1	14.3	16.2	15.8
Of which: nonperforming loans	…	…	…	6.2	7.6	7.5
Claims on other banks	2.5	0.6	2.2	1.1	1.6	1.0
Fixed assets	0.5	0.4	0.4	0.5	0.4	0.3
Other assets	2.1	2.1	2.3	4.7	2.4	3.1
Liabilities						
Government deposits	4.4	4.3	3.4	2.6	3.9	3.3
Other deposits						
Demand deposits	4.9	2.7	6.4	5.3	3.7	4.3
Time and savings deposits	12.4	12.1	12.2	13.2	12.0	13.6
Other deposits	1.4	1.5	1.3	0.2	1.1	0.0
Securities	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities to other banks	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	0.5	0.4	0.8	0.1	0.6	0.6
Capital						
Paid-up capital	0.5	0.5	0.5	0.5	0.5	0.5
Retained earnings	3.4	4.1	5.1	5.4	7.3	6.9
Provision for credit impairment	6.7	6.9	7.4	7.5	7.6	7.5
Other	0.3	0.2	0.0	1.8	1.2	1.2
	Development Bank of Tuvalu					
Assets						
Bank reserves						
Cash	0.1	0.2	0.3	0.6	0.4	0.5
Deposits	1.1	0.6	0.4	0.4	0.4	0.5
Securities	0.0	0.0	0.0	0.0	0.0	0.0
Claims on government	0.0	0.0	0.0	0.0	0.0	0.0
Loans and advances 1/	1.4	2.8	4.5	4.2	5.0	5.4
Claims on other banks	0.0	0.0	0.0	0.0	0.0	0.0
Fixed assets	0.1	0.1	0.0	0.0	0.0	0.0
Other assets	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities						
Government deposits	0.0	0.0	0.0	0.0	0.0	0.0
Other deposits						
Demand deposits	0.0	0.0	0.0	0.0	0.0	0.0
Time and savings deposits	0.2	0.8	0.9	1.0	0.6	1.0
Other deposits	0.0	0.0	0.0	0.0	0.0	0.0
Securities	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities to other banks 2/	1.4	1.4	2.3	1.0	0.7	0.6
Other liabilities	0.0	0.0	0.0	0.0	0.0	0.1
Capital						
Paid-up capital	2.6	2.9	3.3	3.5	4.1	4.2
Retained earnings	-1.7	-1.8	-2.0	-1.4	-1.6	-1.8
Provision for credit impairment	0.1	0.4	0.8	0.1	0.4	0.4
Other	0.1	-0.2	-0.2	-0.2	1.3	1.7

Sources: National Bank of Tuvalu; and Development Bank of Tuvalu.

1/ Gross loans and advances.

2/ Loans from the European Investment Bank.

Table 6. Tuvalu: Social Indicators

Millennium Development Goals	Baseline		Latest Data	
Eradicate extreme poverty and hunger 1/	(2015 target = halve 1990 $1 a day poverty and malnutrition rates)			
Population below $1 per day (in percent)	17.0	(1994)	…	
Population below national poverty line (in percent)	29.0	(1994)	26.3	(2010)
Poverty gap at $1 per day (in percent)	13.0	(1994)	…	
Percentage share of income or consumption held by poorest 20 percent	7.0	(1994)	6.2	(2010)
Prevalence of child malnutrition (in percent of children under 5)	0.0	(1997)	…	
Population below minimum level of dietary energy consumption (in percent)	...		4.1	(2010)
Achieve universal primary education 2/	(2015 target = net enrollment to 100)			
Net primary enrollment ratio (in percent of relevant age group)	98.0	(1992)	98.1	(2007)
Percentage of cohort reaching grade 5 (in percent)	72.7	(2000)	91.2	(2004)
Youth literacy rate (in percent of ages 15–24)	95.0	(1991)	98.6	(2007)
Promote gender equality 3/	(2015 target = education rate to 100)			
Ratio of girls to boys in primary education (in percent)	1.02	(1999)	0.96	(2009)
Ratio of young literate females to males (in percent of ages 15–24)	0.96	(1991)	1.00	(2007)
Share of women employed in the nonagricultural sector (in percent)	38.0	(1991)	36.0	(2007)
Proportion of seats held by women in national parliament (in percent)	8.0	(1990)	0.0	(2010)
Reduce child mortality 4/	(2015 target = reduce 1990 under 5 motality by two thirds)			
Under 5 mortality rate (per 1,000 live births)	53.0	(1990)	24.6	(2009)
Infant mortality rate (per 1,000 live births)	42.0	(1990)	14.8	(2009)
Immunization, measles (in percent of children under 12 months)	95.0	(1990)	90.0	(2008)
Improved maternal health 5/	(2015 target = reduce 1990 maternal mortality by three fourths)			
Maternal mortality ratio (modeled estimate, per 100,000 live births)	434.8	(1990)	418.4	(2003)
Births attended by skilled health staff (in percent of total)	95.0	(1990)	97.9	(2007)
Combat HIV/AIDS, malaria, and other diseases 6/	(2015 target = halt, and begin to reverse, AIDS, etc.)			
Prevalence of HIV, female (in percent of ages 15–24)	0.0	(1990)	…	
Contraceptive prevalence rate (in percent of women ages 15–49)	39.0	(1990)	30.5	(2007)
Number of children orphaned by HIV/AIDS	0.0	(1990)	…	
Incidence of tuberculosis (per 100,000 people)	297.0	(1990)	162.0	(2009)
Tuberculosis cases detected and successfully treated under DOTS (in percent)	…		100.0	(2007)
Ensure environmental sustainability 7/	(2015 target = various, see notes)			
Forest area (in percent of total land area)	33.3	(1990)	33.3	(2005)
Nationally protected areas (in percent of total land area)	0.2	(1996)	0.2	(2009)
GDP per unit of energy use (PPP$ per kg. oil equivalent)	0.2	(1993)	0.2	(1999)
CO2 emissions (metric tons per capita)	0.2	(1993)	0.2	(1999)
Use of solid fuels (in percent of households)	70.0	(1991)	25.0	(2007)
Access to an improved water source (in percent of population)	90.0	(1990)	97.0	(2008)
Access to improved sanitation (in percent of population)	78.0	(1990)	84.0	(2008)
Access to secure tenure (in percent of population)	…		…	
Develop a global partnership for development 8/	(2015 target = various, see notes)			
Youth unemployment rate (in percent of total labor force ages 15–24)	3.0	(1991)	24.0	(2002)
Telephone lines (per 100 people)	1.3	(1990)	17.2	(2009)
Cellular subscriptions (per 100 people)	4.8	(2000)	20.1	(2009)
Internet user (per 100 people)	4.9	(1995)	43.3	(2009)

		Same Region/Income group	
Other indicators	Tuvalu	East Asia and Pacific	Lower-Middle Income
Population (millions)	0.011	1,931	3,702
Urban (percent of toal)	50.0	44.1	41.3
GNI per capita (in U.S. dollars)	4,386	2,515	2,015
Adult literacy rate (in percent of people ages 15 and over)	99.0	92.8	82.6
Life expectancy at birth (in years)	64.0	72.0	68.0
Total fertility rate (births per woman)	3.2	1.9	2.5

Sources: Tuvalu authorities, Asian Development Bank, UNDP, and World Bank.

1/ Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

2/ Goal 2 targets: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

3/ Goal 3 targets: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

4/ Goal 4 targets: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

5/ Goal 5 targets: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

6/ Goal 6 targets: Halt by 2015, and begin to reverse, the spread of HIV/AIDS. Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases.

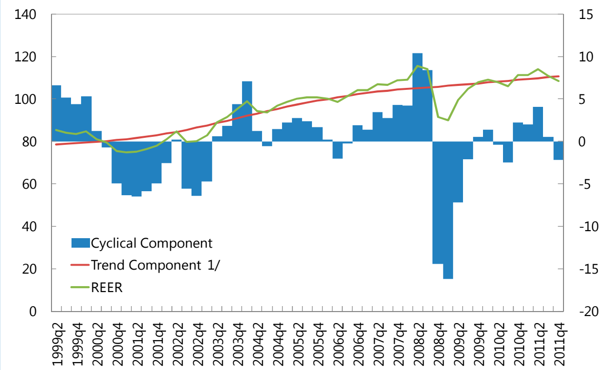
7/ Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

8/ Goal 8 targets: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of the Least Developed Countries. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

APPENDIX I. TUVALU – EXCHANGE RATE ASSESSMENT

Tuvalu's real effective exchange rate (REER) is high relative to historical levels. After sustained increases during the 2000s, the REER dipped in 2008, but has now recovered strongly (Figure 1). The upward trend is pronounced over time, though short-term factors accelerated appreciation in the runup to the global financial crisis and afterward. These cyclical factors have now dissipated, but the REER has continued to appreciate since the crisis.

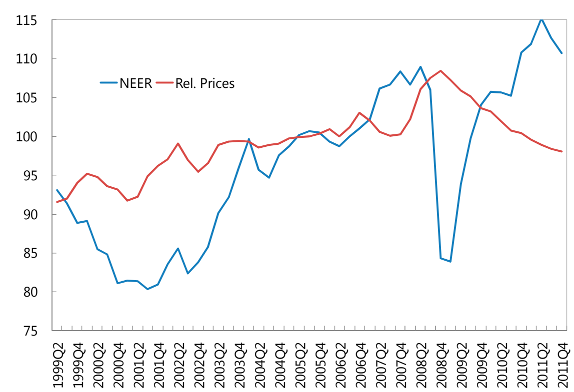
Figure 1. Tuvalu REER: Trend and Cyclical Components



1/ Based on Hodrick-Prescott Filter.

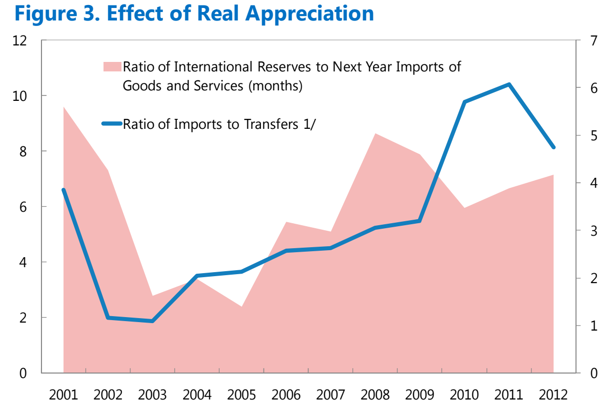
The main reason for the appreciation is the strengthening Australian dollar, not rising wages in Tuvalu. Tuvaluan inflation has been below trading partner inflation since mid-2009, mitigating nominal Australian dollar strength (Figure 2). However, this may largely be due to a shift toward cheaper Asian import sourcing and recent increase in domestic retail competition, both one-off factors. Also, public employees– who constitute slightly less than a tenth of the population – generally receive annual real salary increases of around 1½ percent, adding to domestic demand.

Figure 2. Tuvalu: NEER and Level of Relative Prices



Real appreciation has likely affected Tuvalu's external position. With a minimal tradables sector and capital markets, external adjustment occurs through labor mobility: higher domestic wages reduce emigration and raise imports, while lower rages raise emigration and remittances. Since 2002, the ratio of imports to remittances has risen, implying less emigration, and reserves coverage remains below pre-crisis levels (Figure 3).

Figure 3. Effect of Real Appreciation



1/ Ratio of imports of goods to private transfers and remitted compensation.

Continued real appreciation could challenge external sustainability. Tuvalu does not publish sufficient data for CGER analysis. But Tuvalu's terms of trade have not improved to the extent Australia's have, and nominal appreciation has expanded imports. Damage has so far been contained, but continued appreciation could lead to falling public and private asset balances, and concerns about sustainability

INTERNATIONAL MONETARY FUND

July 6, 2012

TUVALU

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Staff Representatives for the 2012 Consultation with Tuvalu

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ANNEX I. TUVALU: FUND RELATIONS

(As of June 14, 2012)

I. Membership Status: Joined June 24, 2010; Article XIV

II. General Resources Account:	**SDR Million**	**% Quota**
Quota	1.80	100.00
Fund holdings of currency (Exchange Rate)	1.37	76.00
Reserve Tranche Position	0.43	24.06

III. SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	1.69	100.00
Holdings	1.26	74.40

IV. Outstanding Purchases and Loans: None.

V. Financial Arrangements: None

VI. Projected Payments to Fund: None

VII. Exchange Arrangements:

Tuvalu's legal tender is the Australian dollar. There is no central monetary institution. Tuvalu avails itself of transitional arrangements under Section 2 of Article XIV and has not yet accepted the obligations under Article VIII, Sections 2, 3, and 4. The legal framework for the exchange and trade system is the Exchange Control Law of 1981 and the Exchange Control Regulations of 1983, as amended. Staff continue to conduct a comprehensive review of the exchange system to assess jurisdictional implications. While the Exchange Control Regulations are quite restrictive and prescribe approval requirements from the National Bank of Tuvalu (NBT) or the Minister of Finance for most payments or transfers, in practice, no approval is required and transactions are administered liberally.

The NBT is the only bank in Tuvalu handling foreign exchange transactions. The NBT buys and sells foreign exchange at rates determined daily by the NBT's board on the basis of rates quoted in the international markets plus specific spreads dependent on the specific foreign currency.

VIII. Article IV Consultation:

The previous Article IV consultation discussions were held in Funafuti in November 2010. The staff report (IMF Country Report No. 11/46) was discussed by the Executive Board on January 28, 2011.

IX. Technical Assistance:

The Pacific Financial Technical Assistance Centre (PFTAC) has provided assistance on tax policy and administration (2007, 2008, and 2010); financial sector supervision (2008); and balance of payments and national accounts statistics (2006, 2009, 2010, and 2012).

X. Resident Representative:

A Resident Representative office, covering Pacific islands and based in Fiji, was established in September 2010.

ANNEX II. TUVALU: WORLD BANK–IMF COLLABORATION

The Bank and Fund country teams, currently led by Mr. James P. Walsh (Fund mission chief for Tuvalu) and Mr. Piers Merrick (country officer, EACNQ), have maintained a close working relationship since Tuvalu's decision to pursue membership of the Bretton Woods institutions in 2009. The Bank team has joined all IMF missions to Tuvalu since the country's membership mission, including both Article IV missions and the 2011 IMF staff visit.

The teams agree that Tuvalu's main macroeconomic challenges are to put revenues and expenditure on a more sustainable footing, strengthening public service delivery, and creating a more supportive environment for development. Based on this shared assessment, the teams identified the following structural reform areas, all of which are also addressed in the authorities' Policy Reform Matrix (PRM), as macro-critical:

i. **Strengthening public financial management.** In the absence of its own currency and monetary policy, sound fiscal policy is key to maintaining macroeconomic stability. However, the large run-up in spending in recent years has almost exhausted the country's fiscal buffers. While those buffers are rebuilt, asset income needs to be saved, and the medium-term budget framework used to highlight the longer-term impact of current fiscal stance and new spending initiatives. Moreover, budget reporting and monitoring need to be improved and economic and policy analysis capacity should be strengthened.

ii. **Reforming public enterprises.** The government, with ADB support, has begun a comprehensive public enterprise reform program to improve current weak performance and profitability. Ensuring public enterprises are independently and professionally run, address issues of tax arrears and payment delinquency, and are transparently subsidized for provision of essential but noneconomic activities will strengthen Tuvalu's business climate and lessen the drain on public resources.

iii. **Exploring opportunities for poverty reduction, job creation, and private sector development.** Tuvalu's geographic isolation, small size, and poor land quality have made it challenging to generate domestic private sector employment. Demand for Tuvaluan seafarers on the international maritime employment market is declining, due to rising competition from other countries, and existing labor migration schemes have not been well utilized. Adequate education and training need to be provided for Tuvaluans to better utilize overseas job opportunities and to reduce rising poverty.

iv. **Strengthening public service delivery.** The Government of Tuvalu in the TKII and the medium term reform agenda identified improving service delivery in the health and education sectors as key objectives. Based on analysis from the Health and Education Medium Term Expenditure Framework and other analytical work, the Government has begun to consider reforms to ensure appropriate allocation between primary and tertiary service delivery, and maximizing returns on scare resources.

v. **The teams expect to sustain the close cooperation going forward.** Attachment 1 details the specific activities implemented and planned by the two teams over the period July 2010—October 2012

Attachment 1
Tuvalu: Bank and Fund Implemented/Planned Activities in Macro-Critical Areas
July 2010—October 2012

	Products	Expected/Actual Delivery Date
World Bank Work Program	• Joint participation in Article IV Mission	November 2010
	• Country Assistance Strategy for Tuvalu FY2012-2015	November 2011
	• Tuvalu Aviation Investment Program	November 2011
	• Participation in the Article IV Mission, and Debt sustainability analysis to decide IDA eligibility (jointly with the IMF)	May 2012
	• Country Policy Institutional Assessment	Annual
IMF Work Program	• PFTAC: balance of payments TA mission	July 2010
	• PFTAC: national account TA mission	October 2010
	• Article IV mission	November 2010
	• Staff visit	July 2011
	• Article IV mission	June 2012

ANNEX III. TUVALU: RELATIONS WITH THE ASIAN DEVELOPMENT BANK

Partnerships

The Asian Development Bank (ADB) has partnered with the Government of Tuvalu since 1993, and has provided US$7.82 million for three loan projects, one program grant of US$3.24 million, and 20 technical assistance projects amounting to US$5.91 million.

The country partnership strategy, 2009–2012, was prepared in collaboration with the Australian Agency for International Development, the New Zealand Aid Programme, and other major development partners. ADB's operational strategy complements Te Kakeega II by focusing on improving governance and economic management, in particular public financial management and public enterprise reforms.

ADB participates as a team member of the International Monetary Fund Article IV Mission to Tuvalu, and liaises closely with the Pacific Financial Technical Assistance Centre—particularly on macroeconomic management and fiscal conditions.

ADB is an active member of the Tuvalu donor group network, disseminating information and participating in meetings, including the development partners meetings held in December 2011 and March 2012. Following the request from government for budget financing, the government has prepared, in collaboration with development partners, a Policy Reform Matrix (PRM) containing a set of agreed policy actions, which when implemented would trigger the release of budget support.

ADB has also committed to undertake joint missions with development partners to improve coordination and lessen demands on country capacity. A joint donor mission to Tuvalu was undertaken in April 2012 to further discuss the PRM.

ADB observes the biannual meetings of the Tuvalu Trust Fund (TTF) Board and cooperates with civil society organizations in Tuvalu to strengthen the effectiveness, quality, and sustainability of its services.

ADB Supported Projects and Programs

From November 1999 to July 2001, ADB worked closely with the government to implement the Island Development Program loan and technical assistance program. This focused on improving governance and economic management, enhancing employment opportunities through skills development, and improving services on the outer islands. The loan was closed in 2001 and rated *successful*. ADB also completed the upgrade of the Tuvalu Maritime Training Institute in 2010. Rated *partly successful*, the new structures and training facilities enable the institute to remain accredited with the International Maritime Organization, and will improve the education and skills of Tuvaluan seafarers so that they can compete for jobs overseas.

ADB supports programs under the Pacific Plan for Strengthening Regional Cooperation and Integration, approved by heads of government at the Pacific Islands Forum in 2005, which emphasizes regional public goods and services. Collective management of increased aviation safety and security requirements under the ADB-financed Pacific Aviation Safety Office is a good example of its potential.

The Improved Financial Management Program grant for US$3.24 million was approved in December 2008. In early 2009, the first tranche of US$1.24 million was disbursed after agreed conditions were met. A public enterprise reform and monitoring unit was formed to monitor public enterprise performance. Early in 2011, a public expenditure and financial accountability assessment was undertaken, which will help the government identify weaknesses in public financial management systems. The second tranche of US$2 million was disbursed in 2011.

Supportive technical assistance helped build the government's capacity to meet commitments under the program. Overall, the performance of public enterprises is encouraging, collectively showing a positive return on equity, instead of the historical break even or loss.

Future Directions

ADB's operational strategy will focus on improving public financial management, and supporting the process of public enterprise reform, with specific objectives to improve their governance, administration, and profitability.

A second program grant and supporting technical assistance is planned to help Tuvalu build on the previous program, and ensure that the reform momentum is sustained.

Tuvalu will continue to benefit from regional projects in the areas of economic management and governance, climate change, solid waste management, and support from the Pacific Infrastructure Advisory Center in the energy and utilities sectors.

ANNEX IV. TUVALU: PFTAC COUNTRY STRATEGY 2012 –2014

Background

Tuvalu has faced a difficult macroeconomic environment in recent times which has resulted in pressures on fiscal sustainability. Following the global economic crisis growth stagnated and the resources available for budget financing from the Tuvalu Trust Fund (TTF) declined due to its fall in value. With domestic revenues under performing and weakened expenditure control fiscal pressures became overbearing. This was exacerbated by drought conditions in 2011. Development partner budget support has enabled operations to continue while the authorities work with partners to develop a joint policy matrix to underpin future budget support. Tuvalu became an IMF and World Bank member in 2009.

PFTAC TA has been moderate and concentrated in the revenue and statistics sectors. Recent PFTAC TA has been focused on assisting the authorities achieve the gains planned from revenue reforms through on-the-job assistance in revenue administration following the completion of an ADB project that supported the PFTAC-designed reforms. There has also been significant assistance in developing national accounts and balance of payments statistics, in part to allow Tuvalu to meet the requirements of IMF membership.

Strategy 2012-2014

PFTAC's TA strategy is guided by the APD regional strategy note and is planned within the results framework for the current PFTAC funding cycle.[1]

PFTAC TA aims to support the authorities sustain progress on improving fiscal sustainability. PFTAC will continue to work closely with the broader development partner group to ensure coherence and will aim to support implementation of actions in the authorities' shared policy matrix. Development of a PFM Roadmap and enhancement of national accounts statistics are expected to be the main focus.

[1] The specific result in the framework that activities target is identified in italics in the section, for example cash management is referred to as (*1.6*), where 1.6 is the code in the result framework in the program document.

In the **Public Financial Management** area, PFTAC will be ready to provide support to the development of a PFM roadmap based on the 2011 PEFA (*1.2*). Support to implementation of specific elements will also be available, in coordination with other development partners and in particular the AusAID-supported budget and treasury advisors. PFTAC would look to assist the authorities implement a follow-up PEFA assessment, probably in 2015 (*1.1*).

In the **revenue** area, the main focus will be on providing support to the proposed AusAID-financed resident advisor to the revenue administration. Maintenance of appropriate IT solutions will be a critical element of this advisor's work (*2.3*) and PFTAC will look to support this by integrating Tuvalu officials in regional and sub-regional support groups being developed under PITAA. In 2013 and beyond, PFTAC will provide assistance to enable the administration to adopt risk management and compliance improvement strategies and to enhance corporate planning (*2.5 and 2.3*).

In **statistics**, PFTAC will continue to provide regular assistance on national accounts compilation (*4.1*) and training to increase capacity in the statistics office so that ultimately broader measures of national income and saving (*4.3*) can be regularly produced. IMF HQ will provide resources to produce better current and capital accounts of the balance of payments (*4.6-4.8*), however, PFTAC will continue its program of support to BoP compilation with a mission in mid-2012.

In **financial sector supervision**, PFTAC will be available to provide strategic support should the authorities begin implementing the financial institutions act passed in 2010. Given the lack of in-country capacity, establishing a basic on and off site supervision program (*3.1 and 3.4*) will require TA resources well in excess of PFTAC's availability. As in other sectors though, PFTAC would be able to provide strategic oversight to the process if other partners were able to provide resources for on the job support.

No direct **macroeconomic** support is currently envisaged, with the TTFAC and ADB's PEM TA currently taking the lead in these areas. Planned regional training in longer-term budget planning and financial programming will provide skills transfer though and PFTAC could provide follow-up TA if requested.

ANNEX V. TUVALU: STATISTICAL ISSUES

(as of June 13, 2012)

I. Assessment of Data Adequacy for Surveillance	
General: Data have shortcomings that hamper surveillance. Shortcomings are most serious in the national accounts and balance of payments. The Pacific Financial Technical Assistance Centre (PFTAC) has provided technical assistance to the Central Statistics Division (CSD) of the Ministry of Finance to help start compiling those statistics for surveillance and the authorities' own policy analysis and formulation. The CSD will require additional staff to improve data provisioning.	
National accounts: With PFTAC assistance since 2009, the compilation methodology for the national accounts was improved. Attention needs to be paid to improving source data for national accounts.	
Price statistics: The consumer price index (CPI) is the only price index compiled in Tuvalu. The CSD produces a quarterly CPI, which is timely and of reasonable quality. The CPI weights were revised in 2011, based on the 2010 Household Income and Expenditure Survey.	
Government finance statistics: The MOF compiles the central government data for budget analysis and control. However, the classifications of some accounts, particularly on capital spending, need to be improved to be in line with international standards.	
Monetary and financial statistics: Tuvalu uses the Australian dollar as its legal tender and does not have a central bank. Monetary and financial statistics are currently not produced in Tuvalu. The National Bank of Tuvalu and the Development Bank of Tuvalu provided the Article IV mission with their balance sheets and income statements, which were used to produce the monetary data on the two banks.	
Balance of payments: Balance of payments statistics have been compiled by visiting PFTAC experts. PFTAC is assisting the authorities in developing a balance of payments compilation system to enable CSD staff to compile the balance of payments data. They have noted that many of the underlying data have inconsistencies and errors, resulting in poor quality of the balance of payments statistics. In addition, the mission noted that the CSD needs better trained staff to produce quality balance of payments statistics.	
II. Data Standards and Quality	
Not a General Data Dissemination System participant.	No data ROSC are available.
III. Reporting to STA	
No data are currently reported to STA for publication.	

Tuvalu: Table of Common Indicators Required for Surveillance

(As of June 13, 2012)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange rates[1]	6/13/12	6/13/12	D	NA	NA
International reserve assets and reserve liabilities of the monetary authorities[2]	04/2012	05/2012	M	I	NA
Reserve/base money	NA	NA	NA	NA	NA
Broad money	NA	NA	NA	NA	NA
Central bank balance sheet	NA	NA	NA	NA	NA
Consolidated balance sheet of the banking system	04/2012	05/2012	M	I	NA
Interest rates	04/2012	05/2012	M	I	NA
Consumer price index	04/2012	05/2012	Q	Q	Q
Revenue, expenditure, balance and composition of financing[3]—general government[4]	NA	NA	NA	NA	NA
Revenue, expenditure, balance and composition of financing[3]—central government	04/2012	05/2012	A	A	A
Stocks of central government and central government-guaranteed debt[5]	12/2011	05/2012	A	A	A
External current account balance	12/2011	05/2012	A	A	NA
Exports and imports of goods and services	12/2011	05/2012	A	A	NA
GDP/GNP	12/2011	05/2012	A	A	NA
Gross external debt	12/2011	05/2012	A	A	A
International investment position[6]	12/2011	05/2012	A	A	NA

[1]Tuvalu uses the Australian dollar as its legal tender.

[2] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

Tuvalu does not have a monetary authority. Foreign assets of National Bank of Tuvalu and the Consolidated Investment Fund constitute the official reserves of Tuvalu.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

INTERNATIONAL MONETARY FUND

TUVALU

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

July 6, 2012

Approved By
Masato Miyazaki and Thomas Dorsey (IMF), and Jeffrey D. Lewis and Sudhir Shetty (World Bank)

Prepared by staffs of the International Monetary Fund and The World Bank

The conclusion of the first joint IMF/World Bank Debt Sustainability Analysis is that Tuvalu is at high risk of debt distress. Under baseline assumptions debt ratios are broadly stable in the long run, but are sensitive to changes in underlying assumptions. Ensuring debt risks remain contained while the country's development needs are addressed will require donors to continue to provide assistance only in the form of grants. [1]

[1] This DSA has been produced in consultation with the Asian Development Bank (ADB). It is based on the common standard LIC DSA framework. Under the Country Policy and Institutional Assessment (CPIA) Tuvalu has been provisionally rated a weak performer, and the DSA uses the indicative threshold indicators on the external public debt for countries in this category: 30 percent for the ratio of the present value (PV) of debt to GDP; 100 percent for the ratio of PV of debt to exports; 200 percent for the ratio of PV of debt to revenue; 15 percent for the ratio of debt service to exports; and 18 percent for the ratio of debt service to revenue.

BACKGROUND

1. **This is the first Joint IMF/World Bank DSA for Tuvalu.** Tuvalu joined the Bank and Fund in 2010; an Article IV consultation concluded in February 2011 did not incorporate a DSA due to data limitations. The analysis below is based on the most updated data available to Bank and Fund staff as of June 2012. Underlying macroeconomic data and debt data were updated during the 2012 Article IV mission to Funafuti, based on discussions with the authorities, donors and the Pacific Financial Technical Assistance Center (PFTAC).

2. **A preliminary assessment tied to the 2010 IMF Article IV consultation concluded that Tuvalu was at high risk of debt distress.** External debt and debt service ratios breached many indicative thresholds under the baseline scenarios. Stress tests confirmed that Tuvalu's debt burden was highly vulnerable to deteriorating macroeconomic conditions or a weaker financing outlook. Overall, the DSA concluded that greater access to grants would be essential for Tuvalu to meet its development needs. Since 2010, the fiscal situation has improved somewhat as tax compliance has improved and spending has begun to be reined in, though the still-strong Australian dollar has widened trade imbalances.

3. **Tuvalu's small economy is highly dependent on external flows and vulnerable to shocks.** The smallest member of the Bank and Fund, Tuvalu's GDP in 2011 was only US$36 million. Almost all goods, and even many services, are imported; the country's main sources of foreign currency are donor assistance and earnings from Tuvaluans working abroad as seafarers; and the government budget is generally in deficit even in good times. The economy shrank after the global financial crisis and returned to growth only in 2011, while the strong Australian dollar has boosted imports.

4. **There are large external holdings of public assets, though these are not freely usable by the government.** The Tuvalu Trust Fund (TTF) was capitalized by donors in 1988 and by end-March 2012 had grown to 345 percent of GDP (A$122.9 million) through reinvestment of its own earnings and contributions by the government during surplus periods. The TTF is not fully sovereign: it can only be drawn down either with approval of its Board (where donors are represented) or when its market value exceeds a "maintained value" linked to Australian CPI. When it exceeds this value,

additional funds are deposited into the Consolidated Investment Fund (CIF), which the authorities may freely draw upon. As of mid-2012, the TTF remains around 3.6 percent below its maintained value, and the CIF holds A$6.1 million, including a A$4.0 million injection from Australia in 2012.

5. **With official borrowing halted since 2008, the main issue is Tuvalu's outstanding debt and new borrowings from unofficial sources.** Bilateral donors provide only grant assistance. Tuvalu's public and publicly guaranteed (PPG) debt stock has declined in the past two years, and amounted to A$17.3 million (50 percent of GDP) at end-2011. External PPG debt was A$14.9 million (36.7 percent of GDP in PV terms) at end-2011.The Asian Development Bank (accounting for 42 percent of the stock in PV terms) provided concessional loans until 2008; subsequent disbursements have been on a grant basis, as – on a provisional basis – was an initial World Bank disbursement in 2012. However, loans contracted at market rates by joint ventures -(JVs) signed in 2008 and 2010 with companies from Korea and Taiwan Province of China (TPOC) constitute a possible substantial contingent liability, and guarantees of domestic borrowing by both public and private enterprises have been made at market rates[2]. These loans account for half the debt stock in NPV terms, with the remainder owed to the European Investment Bank[3].

MACROECONOMIC FRAMEWORK

6. **Growth is expected to be close to historical averages.** Throughout the scenario, growth is estimated to average 1.2 percent, slightly below the average of the past ten years. Depressed seafarer employment, at levels that are likely to remain significantly below pre-crisis levels, is expected to have a negative impact on growth. With little scope for import substitution or export diversification, the trade balance will remain close to historic norms.

7. **The fiscal outlook is based on a continuation of current trends.** Taxes will stabilize at slightly above current levels, based on continued levels of compliance but with higher tax rates.

[2] An effectively defunct and wholly government-owned public enterprise called the National Fishing Corporation of Tuvalu (NAFICOT), is party to both JVs. NAFICOT owns 50 percent of the TPOC venture and 40 percent of the Korean one, and pays dividends to the government. Loans taken out by both JVs are on market terms. Tuvalu's share of the debts amounts to 28 percent of GDP.

[3]The EIB loan is a credit line to the Development Bank of Tuvalu, which is fully owned by the government. Overdrafts at the National Bank of Tuvalu, which the government uses for cash management but also for short-term financing, are not included in the debt stock.

License revenue will be boosted in 2012 in line with the new .tv domain and fishing license agreements as well as the depressed U.S. dollar, but will stabilize at this level thereafter. Recurrent grants are expected to average 14 percent of GDP over the medium and long term. Under the assumption that other assistance will be provided in the form of grants and no new joint ventures will be signed, the only new stream of borrowing assumed in the DSA is term IDA borrowing of A$1¾ million annually. Annual financing needs will thus be covered by concessional financing and use of half the available CIF balance, with the rest of the CIF, along the lines of previous practice, being reinvested.

8. **The limited financing envelope forces a consolidation, but expenditure will eventually expand again.** With CIF financing limited and no scope for domestic borrowing, expenditure is projected to fall by 13 percent of GDP to around 80 percent of GDP in the next few years, with capital expenditure bearing some of the burden. This will bring the deficit to around A$3½ million (around 10 percent of GDP). But as the TTF recovers fully and disbursements into the CIF rise, additional financing will eventually permit the government to raise spending[4]. For this reason, beginning around 2016, expenditure will rise modestly, to around 85 percent of GDP.

9. **The current account deficit is expected to improve somewhat.** Tuvalu has only eleven years of balance of payments data, three years of which have been affected by the global financial crisis. During this time the country's external assets have grown strongly. Income from these assets should continue to rise, while employment from seasonal schemes replaces some seafarer income. Imports are expected to normalize in 2012, post one-off construction projects, and return to their historical average in the medium term. The current account is projected to settle at around a 4 percent surplus, slightly above its eleven-year average of 2 percent. Reserves rise gradually over time.

10. **Risks to the baseline are largely on the downside.** A slowdown in global growth, particularly if accompanied by a sudden financing stop that damages global trade, would severely affect Tuvalu. On the fiscal side, weak revenue performance, from poor tax compliance or from a decline in fishing or telecommunications licensing proceeds, is a serious risk to the baseline outlook.

[4] The scenario assumes TTF nominal returns of 7 percent, slightly below historical levels and in line with the authorities' targeted asset returns.

Finally, continued low demand for seafarers or an inability to place workers in seasonal employment schemes would depress earnings from abroad, weakening the current account.

Macroeconomic Assumptions for the DSF

					Projections							
(in percent)	2008	2009	2010	2011	2012	2013	2014	2015	2016	2020	2025	2032
Baseline Scenario:												
Real GDP growth	7.6	-1.7	-2.9	1.1	1.2	1.3	1.2	1.2	1.2	1.2	1.3	1.5
CPI inflation	10.4	-0.3	-1.9	0.5	2.6	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Current account balance / GDP	-13.2	27.8	-3.8	-29.2	-8.5	-3.3	1.9	4.2	4.3	4.2	4.2	4.2
Revenue excluding grants/ GDP	55.3	59.6	52.0	56.2	59.6	59.6	59.6	59.6	56.4	56.4	56.4	56.4
Grants/ GDP	17.1	30.6	22.1	38.2	24.5	12.3	12.0	11.7	11.1	11.2	15.7	16.9
Expenditure/ GDP	75.9	93.3	104.1	93.3	79.8	82.0	80.6	81.2	81.2	81.2	85.2	85.2
Fiscal balance / GDP	-0.7	-3.1	-30.0	1.1	4.2	-10.1	-9.1	-10.0	-13.7	-13.6	-13.1	-11.9
Loan disbursements /GDP	0.0	0.0	0.0	0.0	0.0	4.1	4.1	4.6	5.4	4.6	4.2	3.4
Reform Scenario:												
Real GDP growth	7.6	-1.7	-2.9	1.1	1.2	2.0	2.0	1.9	1.9	1.9	2.0	2.2
CPI inflation	10.4	-0.3	-1.9	0.5	2.6	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Current account balance / GDP	-13.2	27.8	-3.8	-29.2	-8.5	7.0	9.8	9.9	8.4	6.4	6.4	6.4
Revenue excluding grants/ GDP	55.3	59.6	52.0	56.2	59.6	60.4	61.1	61.9	61.9	61.9	61.9	70.1
Grants/ GDP	17.1	30.6	22.1	38.2	24.5	23.9	22.7	21.5	20.4	14.2	11.4	6.0
Expenditure/ GDP	75.9	93.3	104.1	93.3	79.8	78.5	77.3	76.9	94.5	85.8	81.3	80.5
Fiscal balance / GDP	-0.7	-3.1	-30.0	1.1	4.2	5.7	6.6	6.5	-12.3	-9.8	-8.1	-4.3
Loan disbursements /GDP	0.0	0.0	0.0	0.0	0.0	4.0	3.9	4.3	4.8	3.4	2.7	1.4

EXTERNAL AND PUBLIC DEBT SUSTAINABILITY ANALYSIS

A. External Debt

11. **External debt breaches stock thresholds under the baseline scenario.** The ratios of the present value (PV) of debt to GDP and of debt to exports both begin at high levels due to recently contracted JV debt. Levels than fall as new concessional lending comes online and older ADB debt is paid off. As grace periods for concessional loans come to a close, both ratios rise (Figure 1). The export ratio remains above thresholds throughout the simulation period, while the GDP ratio rises above only as repayments come into view. The debt service to exports ratio similarly falls from its current high level to a more sustainable level, but then rises back toward unsustainable levels as loan repayments come online.

12. **Stress tests show the debt burden is particularly sensitive to growth and exchange rate assumptions.** The PV of public sector external debt closes the simulation at 36 percent of GDP, but a one-time 30 percent nominal depreciation raises this ratio to 51 percent. Under the historical

scenario, in which the current account deficit does not recover in the medium term and financing needs remain large, all stock ratios rise throughout the simulation period, with the PV of public external debt reaching 108 percent of GDP around 2027.

B. Public Debt

13. **Public debt ratios are relatively stable under the baseline.** As concessional lending comes online, the ratios of debt PV to GDP and to revenue both remain close to current levels even as grace periods come to a close (Figure 2). The ratio of debt service to revenue mostly falls for the first half of the simulation period, but then rises gradually in the second half as more payments come due. Historical scenarios for public debt are generally more benign than the baseline.

14. **These ratios are also fragile to shifts in underlying assumptions.** GDP growth below baseline assumptions would raise the public debt burden well above sustainable levels: under the baseline the PV of public debt in 2032 reaches only 38 percent of GDP, but scenario with permanently lower GDP growth pushes this ratio to 113 percent. Similar dynamics are observed for the ratio of PV of debt to revenue, By contrast, given that all long-run debt is on IDA terms, debt service indicators are not as strongly affected under these scenarios.

IMPLEMENTATION OF THE POLICY REFORM MATRIX

15. **The authorities have presented to donors a Policy Reform Matrix (PRM) which aims, *inter alia*, at strengthening macroeconomic management.** The PRM is intended to be a reform roadmap as well as a streamlined list of potential triggers for budget support disbursements by donors. Its main targets in the areas of macroeconomic management are better tax compliance, reorientation of expenditure toward priority areas in health and education, and improving the business environment to strengthen growth. IMF staff estimates that full implementation would raise growth and investment in Tuvalu modestly, while allowing for some expansion of spending as the fiscal envelope is widened by better tax collection and additional donor support. Overall, the deficit is contained below 15 percent of GDP, and the current account surplus stabilizes at around 6 percent of GDP. Significantly, neither under the baseline nor under the alternative scenario is there any borrowing beyond new IDA disbursements, as there are no additional prospective lenders.

16. **Debt dynamics under the reform scenario are somewhat more benign.** Faster GDP growth would bring the ratio of the PV of external public debt to GDP below sustainability thresholds and keep it on a gradual downward trend; the relationship with exports is similar (Figure 3). Debt service ratios display similar dynamics to the baseline, but levels are lower. Public debt, which remained almost stable under the baseline, displays a gradual downward trend under the reform scenario.

CONCLUSIONS

17. **Tuvalu's weak capacity to service debt means renewed loan disbursements are unlikely to lead to a sustainable outcome.** Even when the only new disbursements are those provided by the development partners on IDA terms, indicators of public and publicly guaranteed external debt stocks remain well above indicative thresholds, indicating high levels of debt distress. Tuvalu's revenue base (including licensing income) is relatively high, but its small export base and GDP mean that even small disbursements result in a long-term reduction in sustainability. While stock indicators do not rise strongly under the baseline scenario, Tuvalu's current fiscal situation is unsustainable, and maintaining its current level of debt service is unlikely to improve it even as it is able later in the simulation period to take advantage of its external asset holdings.

18. **Implementation of the PRM would bring debt sustainability somewhat closer.** While debt ratios remain fragile even under the PRM scenario, a stronger fiscal position and modestly faster GDP growth would make the current debt position more sustainable, and improve debt dynamics.

19. **Moreover, the most damaging risks – a slowdown in GDP and a nominal depreciation– are not low-probability events.** GDP growth in Tuvalu is highly volatile and may not return to historical levels without a significant effort to improve macroeconomic management, the business climate and human capital. Donor assistance can help growth and resilience, by building policymaking capacity and by supporting infrastructure investment. But a slowdown of the magnitude presented in this scenario, while not a baseline event, cannot be ruled out. Similarly, the current strength of the Australian dollar cannot be guaranteed: a return of the Australian dollar to levels seen only eight years ago would cause a dangerous increase in Tuvalu's debt ratios.

Table 1.: External Debt Sustainability Framework, Baseline Scenario, 2009-2032 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Projections									
				Average	Deviation							2012-2017			2018-2032
	2009	2010	2011			2012	2013	2014	2015	2016	2017	Average	2022	2032	Average
External debt (nominal) 1/	**53.0**	**49.1**	**41.7**			**36.1**	**35.8**	**36.1**	**36.8**	**38.5**	**40.7**		**49.7**	**63.2**	
o/w public and publicly guaranteed (PPG)	53.0	49.1	41.7			36.1	35.8	36.1	36.8	38.5	40.7		49.7	63.2	
Change in external debt	4.7	-3.9	-7.5			-5.6	-0.3	0.3	0.8	1.7	2.2		2.3	0.2	
Identified net debt-creating flows	-21.4	-3.8	23.7			8.1	2.9	-2.3	-4.6	-4.7	-4.6		-4.8	-5.2	
Non-interest current account deficit	**-29.4**	**2.7**	**27.7**	**-14.8**	**18.7**	**7.2**	**2.2**	**-2.9**	**-5.1**	**-5.0**	**-4.9**		**-4.6**	**-4.7**	-4.7
Deficit in balance of goods and services	109.6	119.3	139.3			109.1	103.4	100.5	100.3	100.3	100.3		100.3	100.3	
Exports	10.7	12.0	11.6			11.6	11.6	11.6	11.6	11.6	11.6		11.6	11.6	
Imports	120.3	131.3	150.9			120.7	115.0	112.2	112.0	112.0	112.0		112.0	112.0	
Net current transfers (negative = inflow)	-57.1	-53.9	-56.0	-45.1	8.0	-32.6	-31.7	-33.7	-35.6	-35.6	-35.6		-35.6	-35.6	-35.6
o/w official	-49.7	-46.8	-49.1			-26.1	-24.8	-26.8	-28.7	-28.7	-28.7		-28.7	-28.7	
Other current account flows (negative = net inflow)	-81.9	-62.7	-55.6			-69.3	-69.5	-69.7	-69.8	-69.7	-69.6		-69.3	-69.4	
Net FDI (negative = inflow)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**		**0.0**	**0.0**	0.0
Endogenous debt dynamics 2/	**8.0**	**-6.5**	**-4.0**			**0.8**	**0.7**	**0.6**	**0.4**	**0.3**	**0.2**		**-0.1**	**-0.4**	
Contribution from nominal interest rate	2.0	1.0	1.4			1.3	1.2	1.0	0.9	0.7	0.6		0.4	0.5	
Contribution from real GDP growth	0.9	1.3	-0.5			-0.5	-0.5	-0.4	-0.4	-0.4	-0.4		-0.5	-0.9	
Contribution from price and exchange rate changes	5.0	-8.8	-4.9			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**26.1**	**0.0**	**-31.2**			**-13.7**	**-3.1**	**2.6**	**5.4**	**6.3**	**6.9**		**7.1**	**5.4**	
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	36.7			31.4	29.1	27.4	25.9	25.2	25.4		26.8	35.6	
In percent of exports	...	...	316.9			269.6	249.8	235.2	223.0	216.9	218.7		230.8	306.4	
PV of PPG external debt	**...**	**...**	**36.7**			**31.4**	**29.1**	**27.4**	**25.9**	**25.2**	**25.4**		**26.8**	**35.6**	
In percent of exports	**...**	**...**	**316.9**			**269.6**	**249.8**	**235.2**	**223.0**	**216.9**	**218.7**		**230.8**	**306.4**	
In percent of government revenues	**...**	**...**	**65.3**			**52.6**	**48.8**	**45.9**	**43.5**	**44.8**	**45.1**		**47.6**	**63.2**	
Debt service-to-exports ratio (in percent)	**-15.2**	**79.9**	**75.7**			**49.9**	**45.3**	**40.1**	**39.2**	**33.7**	**22.7**		**11.3**	**14.3**	
PPG debt service-to-exports ratio (in percent)	**-15.2**	**79.9**	**75.7**			**49.9**	**45.3**	**40.1**	**39.2**	**33.7**	**22.7**		**11.3**	**14.3**	
PPG debt service-to-revenue ratio (in percent)	**-2.7**	**18.4**	**15.6**			**9.7**	**8.8**	**7.8**	**7.7**	**7.0**	**4.7**		**2.3**	**3.0**	
Total gross financing need (Millions of U.S. dollars)	-8.5	3.9	13.1			4.8	2.7	0.7	-0.2	-0.4	-0.8		-1.5	-1.8	
Non-interest current account deficit that stabilizes debt ratio	-34.1	6.5	35.2			12.9	2.5	-3.2	-5.9	-6.6	-7.1		-7.0	-4.9	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-1.7	-2.9	1.1	1.2	4.5	1.2	1.3	1.2	1.2	1.2	1.0	1.2	1.2	1.5	1.3
GDP deflator in US dollar terms (change in percent)	-9.4	19.9	11.1	9.6	9.7	0.5	-0.7	-0.9	-0.8	-0.6	1.5	-0.1	1.7	1.7	1.7
Effective interest rate (percent) 5/	3.7	2.1	3.2	2.6	0.8	3.2	3.2	2.8	2.4	2.0	1.6	2.6	0.9	0.8	0.9
Growth of exports of G&S (US dollar terms, in percent)	-16.8	30.8	8.8	13.7	16.4	2.1	0.6	0.3	0.4	0.6	2.5	1.1	2.9	3.2	3.0
Growth of imports of G&S (US dollar terms, in percent)	-21.7	27.1	29.2	10.3	25.1	-18.6	-4.2	-2.2	0.2	0.6	2.5	-3.6	2.9	3.2	3.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	52.3	52.3	52.3	52.3	52.3	52.3	52.3	52.3	52.3
Government revenues (excluding grants, in percent of GDP)	59.6	52.0	56.2			59.6	59.6	59.6	59.6	56.4	56.4		56.4	56.4	56.4
Aid flows (in Millions of US dollars) 7/	8.4	7.0	13.7			8.9	6.0	5.9	6.0	6.1	6.1		6.9	12.0	
o/w Grants	8.4	7.0	13.7			8.9	4.5	4.4	4.3	4.1	4.1		4.9	10.0	
o/w Concessional loans	0.0	0.0	0.0			0.0	1.5	1.5	1.7	2.0	2.0		2.0	2.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			24.5	14.4	14.1	14.1	13.9	13.6		13.6	18.7	16.3
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			99.9	88.2	87.9	86.5	84.4	84.4		86.2	92.0	88.7
Memorandum items:															
Nominal GDP (Millions of US dollars)	27.4	31.9	35.8			36.5	36.7	36.8	36.9	37.2	38.1		43.7	59.0	
Nominal dollar GDP growth	-11.0	16.4	12.3			1.8	0.6	0.3	0.4	0.6	2.5	1.0	2.9	3.2	3.0
PV of PPG external debt (in Millions of US dollars)			12.9			11.3	10.5	10.0	9.5	9.4	9.7		11.7	21.0	
(PVt-PVt-1)/GDPt-1 (in percent)						-4.5	-2.1	-1.6	-1.3	-0.3	0.9	-1.5	1.9	1.4	1.6
Gross workers' remittances (Millions of US dollars)	4.1	3.1	3.4			4.0	4.1	4.1	4.2	4.2	4.3		4.9	6.7	
PV of PPG external debt (in percent of GDP + remittances)	...	...	33.5			28.2	26.1	24.6	23.3	22.7	22.8		24.1	32.0	
PV of PPG external debt (in percent of exports + remittances)	...	...	173.6			138.2	127.6	119.7	113.1	110.0	110.8		117.0	155.3	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	41.5			25.6	23.2	20.4	19.9	17.1	11.5		5.7	7.3	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes (the hight voltility of the AUD)

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability. Median used for current account.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2.Tuvalu: Public Sector Debt Sustainability Framework, Baseline Scenario, 2009-2032
(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate					Projections				
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-17 Average	2022	2032	2018-32 Average
Public sector debt 1/	65.6	61.7	50.0			43.4	42.2	41.6	41.6	42.5	44.6		53.1	65.7	
o/w foreign-currency denominated	53.0	49.1	41.7			36.1	35.8	36.1	36.8	38.5	40.7		49.7	63.2	
Change in public sector debt	5.2	-3.9	-11.7			-6.5	-1.2	-0.6	-0.1	0.9	2.1		2.2	0.2	
Identified debt-creating flows	-1.8	59.6	10.8			3.4	15.3	15.9	18.6	22.8	23.1		22.7	19.8	
Primary deficit	1.2	28.6	-2.9	6.8	10.0	-5.8	8.8	7.9	9.0	13.0	13.4	7.7	13.2	11.5	12.7
Revenue and grants	90.2	74.0	94.5			84.1	71.9	71.5	71.2	67.5	67.2		67.6	73.3	
of which: grants	30.6	22.1	38.2			24.5	12.3	12.0	11.7	11.1	10.8		11.2	16.9	
Primary (noninterest) expenditure	91.4	102.7	91.5			78.3	80.7	79.5	80.2	80.4	80.6		80.8	84.8	
Automatic debt dynamics	-8.8	-3.7	0.8			0.3	0.9	0.8	0.7	0.1	-0.5		-1.0	-1.6	
Contribution from interest rate/growth differential	4.5	1.3	1.8			0.3	0.1	0.0	-0.1	-0.3	-0.5		-1.0	-1.6	
of which: contribution from average real interest rate	3.5	-0.7	2.5			0.9	0.7	0.5	0.3	0.2	-0.1		-0.4	-0.6	
of which: contribution from real GDP growth	1.1	2.0	-0.7			-0.6	-0.5	-0.5	-0.5	-0.5	-0.4		-0.6	-1.0	
Contribution from real exchange rate depreciation	-13.3	-5.0	-1.0			0.0	0.8	0.8	0.8	0.4	0.0		...	...	
Other identified debt-creating flows	5.8	34.6	13.0			9.0	5.6	7.1	8.9	9.8	10.2		10.5	9.9	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	5.8	34.6	13.0			9.0	5.6	7.1	8.9	9.8	10.2		10.5	9.9	
Residual, including asset changes 2/	7.0	-63.4	-22.5			-10.0	-16.5	-16.5	-18.6	-22.0	-21.0		-20.4	-19.7	
Other Sustainability Indicators															
PV of public sector debt	...	...	45.0			38.7	35.5	32.9	30.7	29.2	29.3		30.2	38.1	
o/w foreign-currency denominated	...	...	36.7			31.4	29.1	27.4	25.9	25.2	25.4		26.8	35.6	
o/w external	...	...	36.7			31.4	29.1	27.4	25.9	25.2	25.4		26.8	35.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	-0.1	38.5	5.9			0.9	14.8	13.3	14.2	17.5	16.1		14.5	13.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	47.7			46.1	49.4	46.0	43.1	43.3	43.6		44.7	52.0	
PV of public sector debt-to-revenue ratio (in percent)	…	…	80.1			65.0	59.6	55.3	51.5	51.8	52.0		53.6	67.7	
o/w external 4/	…	…	65.3			52.6	48.8	45.9	43.5	44.8	45.1		47.6	63.2	
Debt service-to-revenue and grants ratio (in percent) 5/	-1.5	13.3	9.4			7.9	8.4	7.5	7.3	6.7	3.9		1.9	2.3	
Debt service-to-revenue ratio (in percent) 5/	-2.2	19.0	15.7			11.2	10.2	9.0	8.7	8.0	4.7		2.3	3.0	
Primary deficit that stabilizes the debt-to-GDP ratio	-3.9	32.5	8.8			0.8	10.0	8.5	9.1	12.1	11.3		11.0	11.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	-1.7	-2.9	1.1	1.2	4.5	1.2	1.3	1.2	1.2	1.2	1.0	1.2	1.2	1.5	1.3
Average nominal interest rate on forex debt (in percent)	3.7	2.1	3.2	2.6	0.8	3.2	3.2	2.8	2.4	2.0	1.6	2.6	0.9	0.8	0.9
Average real interest rate on domestic debt (in percent)	4.6	-0.8	3.5	1.5	2.4	1.7	1.1	0.7	0.2	-0.5	-1.6	0.2	...	...	...
Real exchange rate depreciation (in percent, + indicates depreciation)	-25.7	-9.2	-2.0	-5.5	15.7	-0.1	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	-2.1	3.2	-1.0	1.9	2.2	1.3	1.5	1.5	1.5	1.5	1.7	1.5	1.7	1.7	1.7
Growth of real primary spending (deflated by GDP deflator, in percent)	0.2	0.1	-0.1	0.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	…	…	52.3	52.3	52.3	52.3	52.3	52.3	52.3	52.3	52.3	...

Sources: Country authorities; and staff estimates and projections.

1/ Public sector includes central government (excludes public enterprises)and public enterprise loan guarantees by the government. Gross debt is used.

2/ Residuals reflect the CIF drawdown and official grants received

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3.Tuvalu: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012-2032
(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
PV of debt-to GDP ratio								
Baseline	31	29	27	26	25	25	**27**	36
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	31	32	37	43	49	56	**86**	118
A2. New public sector loans on less favorable terms in 2012-2032 2	31	30	30	30	32	34	**43**	65
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	31	30	30	28	28	28	**29**	39
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	31	29	28	26	26	26	**27**	36
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	31	29	27	25	25	25	**26**	35
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	31	26	23	21	20	21	**22**	32
B5. Combination of B1-B4 using one-half standard deviation shocks	31	22	15	13	12	12	**13**	26
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	31	41	39	37	36	36	**38**	51
PV of debt-to-exports ratio								
Baseline	270	250	235	223	217	219	**231**	306
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	270	279	318	369	424	485	**738**	1016
A2. New public sector loans on less favorable terms in 2012-2032 2	270	259	257	259	271	288	**371**	556
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	270	247	233	221	216	218	**230**	306
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	270	257	253	240	236	238	**251**	330
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	270	247	233	221	216	218	**230**	306
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	270	224	194	181	175	177	**188**	278
B5. Combination of B1-B4 using one-half standard deviation shocks	270	189	122	108	102	103	**111**	212
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	270	247	233	221	216	218	**230**	306
PV of debt-to-revenue ratio								
Baseline	53	49	46	44	45	45	**48**	63
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	53	54	62	72	88	100	**152**	210
A2. New public sector loans on less favorable terms in 2012-2032 2	53	51	50	51	56	60	**77**	115
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	53	51	50	47	49	49	**52**	69
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	53	49	46	44	46	46	**49**	64
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	53	48	45	43	44	44	**47**	62
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	53	44	38	35	36	36	**39**	57
B5. Combination of B1-B4 using one-half standard deviation shocks	53	38	25	22	22	22	**24**	45
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	53	69	65	62	64	65	**68**	90

Table 3.Tuvalu: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012-2032 (continued)
(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
Debt service-to-exports ratio								
Baseline	50	45	40	39	34	23	**11**	14
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	50	41	34	31	25	18	**12**	25
A2. New public sector loans on less favorable terms in 2012-2032 2	50	45	41	40	36	26	**18**	29
A3. Alternative Scenario :[Costumize, enter title]	50	42	35	32	26	17	**5**	-1
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	50	45	40	39	34	23	**11**	14
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	50	47	43	42	36	24	**12**	15
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	50	45	40	39	34	23	**11**	14
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	50	45	40	39	33	22	**11**	12
B5. Combination of B1-B4 using one-half standard deviation shocks	50	43	36	34	29	19	**9**	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	50	45	40	39	34	23	**11**	14
Debt service-to-revenue ratio								
Baseline	10	9	8	8	7	5	**2**	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	10	8	7	6	5	4	**2**	5
A2. New public sector loans on less favorable terms in 2012-2032 2	10	9	8	8	7	5	**4**	6
A3. Alternative Scenario :[Costumize, enter title]	10	8	7	6	5	3	**1**	0
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	10	9	9	8	8	5	**3**	3
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	10	9	8	8	7	5	**2**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	10	9	8	8	7	5	**2**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	10	9	8	8	7	5	**2**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	10	9	7	7	6	4	**2**	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	10	13	11	11	10	7	**3**	4
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	50	50	50	50	50	50	**50**	50

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account
as a share of GDP is assumed to return to its baseline level after the shock
(implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 4.Tuvalu: Sensitivity Analysis for Key Indicators of Public Debt 2012-2032

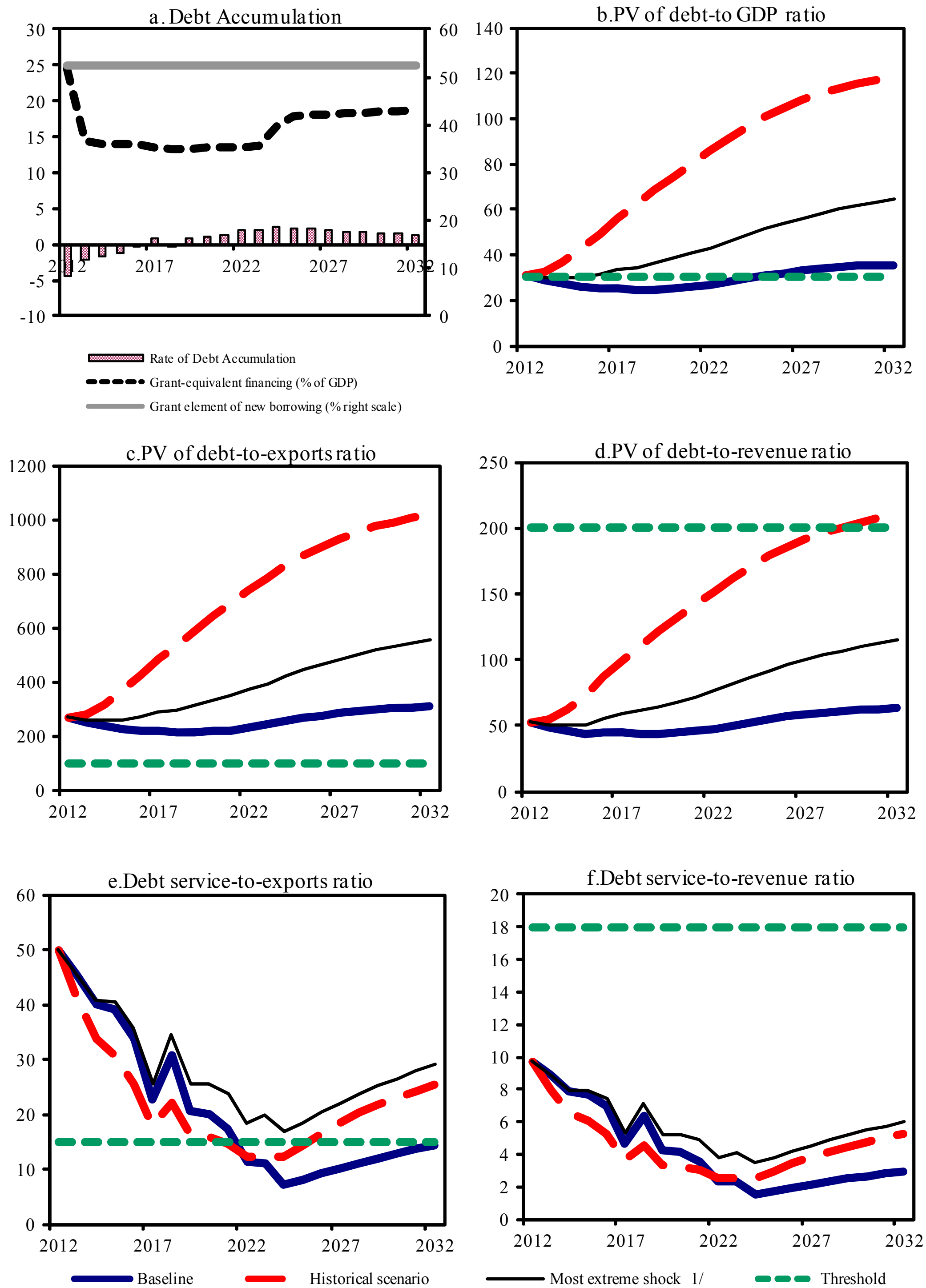
	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	39	36	33	31	29	29	30	38
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	39	35	31	28	23	20	4	-15
A2. Primary balance is unchanged from 2012	39	28	18	8	-3	-13	-62	-140
A3. Permanently lower GDP growth 1/	39	36	34	33	33	35	50	113
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	39	39	41	41	42	45	61	96
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	39	40	42	40	38	38	40	46
B3. Combination of B1-B2 using one half standard deviation shocks	39	38	38	37	37	38	46	68
B4. One-time 30 percent real depreciation in 2013	39	49	45	41	38	36	31	35
B5. 10 percent of GDP increase in other debt-creating flows in 2013	39	38	32	26	20	16	0	-11
PV of Debt-to-Revenue Ratio 2/								
Baseline	46	49	46	43	43	44	45	52
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	46	48	44	39	35	30	6	-20
A2. Primary balance is unchanged from 2012	46	39	26	12	-4	-19	-92	-192
A3. Permanently lower GDP growth 1/	46	50	48	47	49	52	73	147
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	46	53	56	57	62	67	89	128
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	46	55	58	56	57	57	59	63
B3. Combination of B1-B2 using one half standard deviation shocks	46	52	52	52	54	57	68	91
B4. One-time 30 percent real depreciation in 2013	46	68	62	57	56	54	47	48
B5. 10 percent of GDP increase in other debt-creating flows in 2013	46	53	45	36	30	25	1	-15
Debt Service-to-Revenue Ratio 2/								
Baseline	8	8	8	7	7	4	2	2
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	8	8	8	7	7	4	1	0
A2. Primary balance is unchanged from 2012	8	8	7	7	6	3	0	-6
A3. Permanently lower GDP growth 1/	8	8	8	8	7	4	2	5
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	8	9	8	8	7	5	3	5
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	8	8	8	8	7	4	2	3
B3. Combination of B1-B2 using one half standard deviation shocks	8	9	8	8	7	4	2	4
B4. One-time 30 percent real depreciation in 2013	8	10	10	10	9	6	3	4
B5. 10 percent of GDP increase in other debt-creating flows in 2013	8	8	8	8	7	5	3	7

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

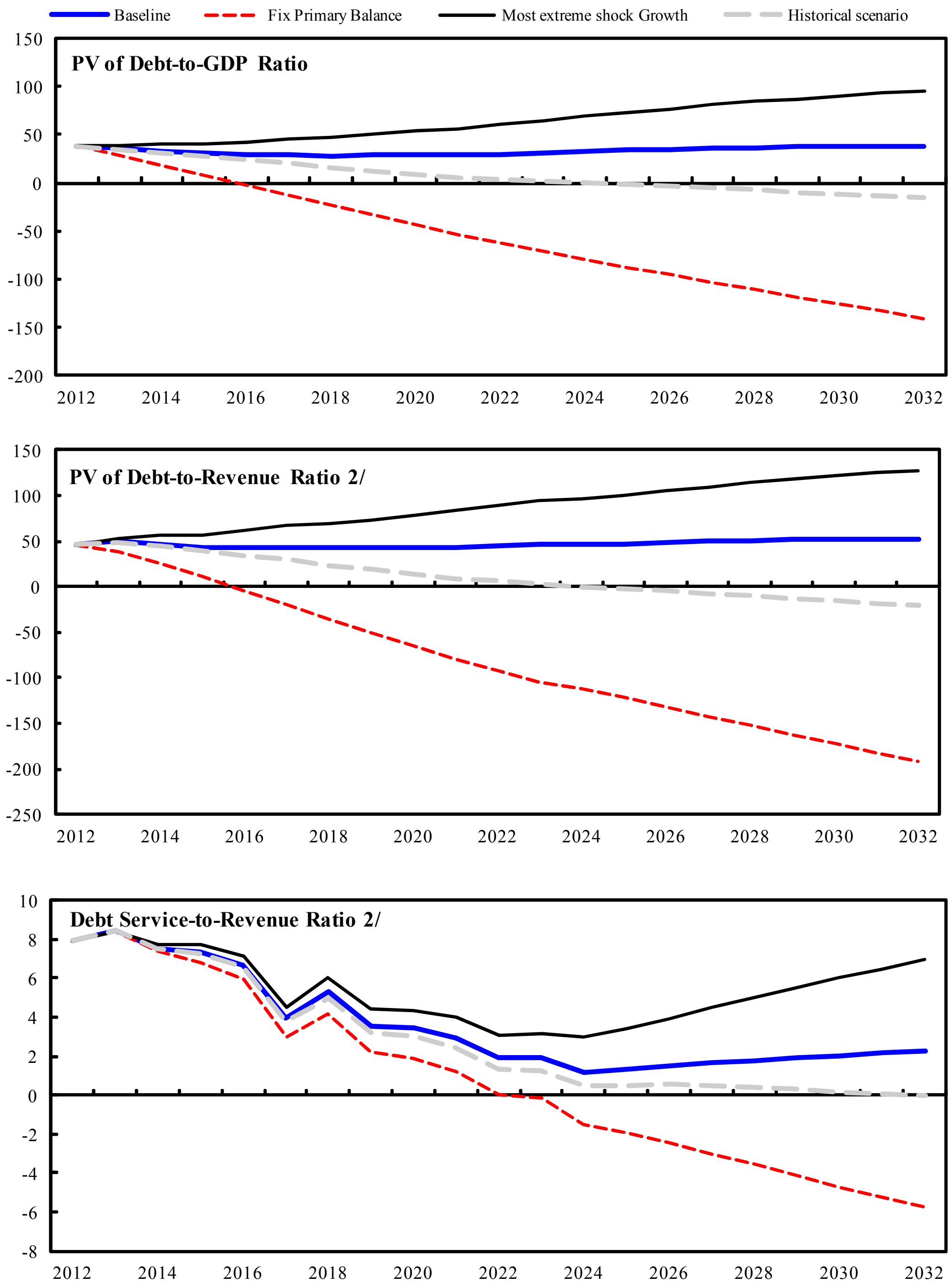
2/ Revenues are defined inclusive of grants.

Figure 1. Tuvalu: Indicators of Public and Publicly Guaranteed External Debt under Baseline and Alternative Scenarios, 2012-2032 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2022. In figure b. it corresponds to a Terms shock; in c. to a Terms shock; in d. to a Terms shock; in e. to a Terms shock and in figure f. to a One-time depreciation shock.

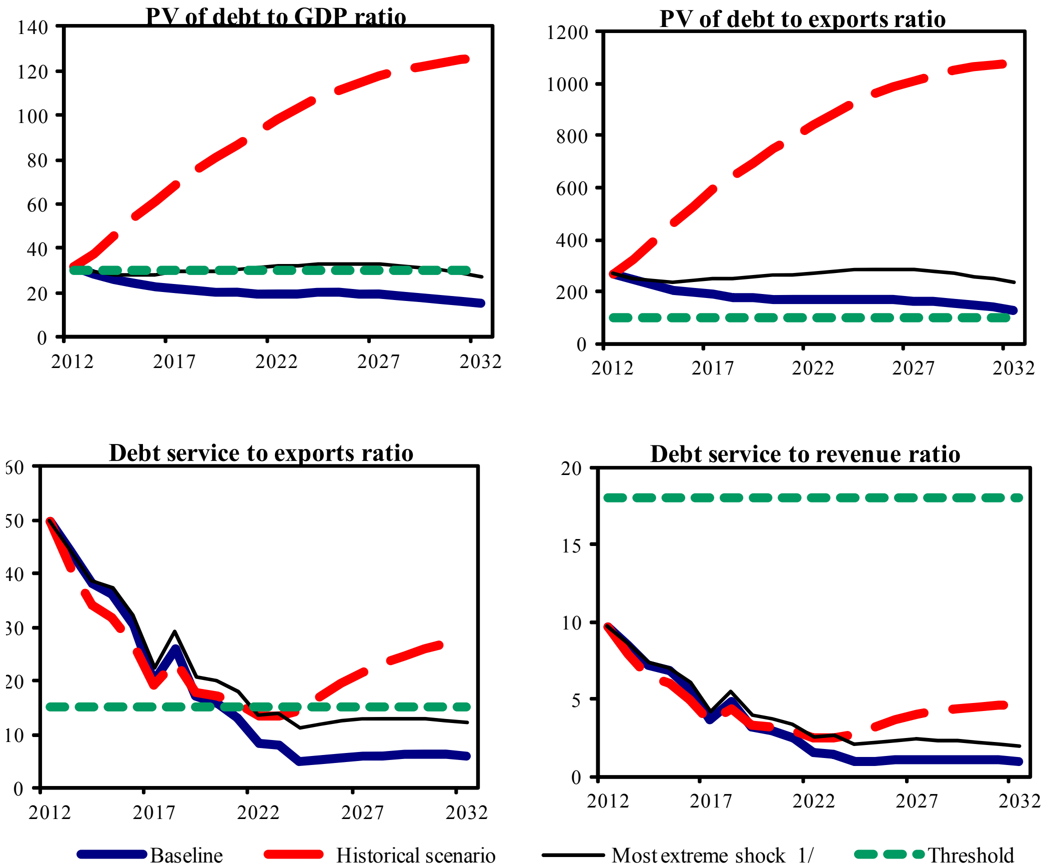
Figure 2.Tuvalu: Indicators of Public Debt under Baseline and Alternative Scenarios, 2012-2032 1/



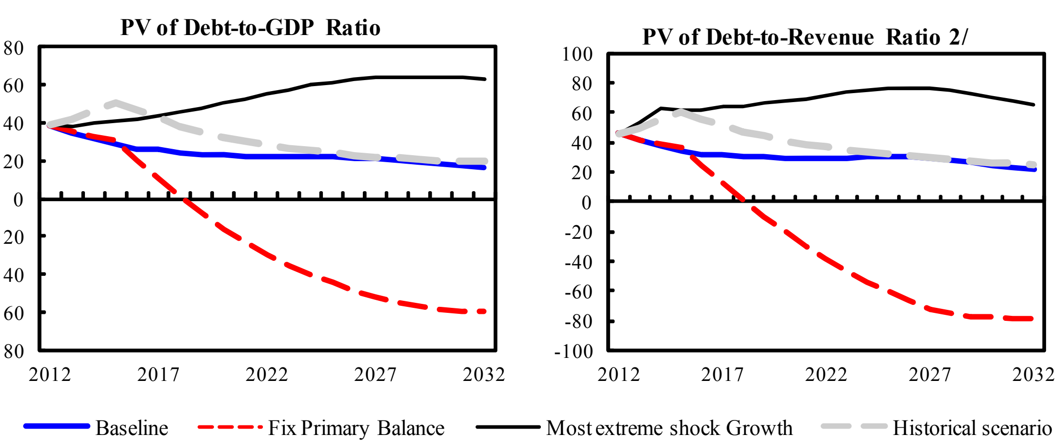
Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2022.
2/ Revenues are defined inclusive of grants.

Figure 3. Tuvalu: Indicators of Debt under Reform Scenario and Alternative Scenarios, 2012-2032 1/

Indicators of Public and Publicly Guaranteed External Debt



Indicators of Public Debt



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022. In figure b. it corresponds to a Terms shock; in c. to a Terms shock; in d. to a Terms shock; in e. to a Terms shock and in figure f. to a Terms shock

2/ Revenues are defined inclusive of grants.

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IMF Executive Board Concludes 2012 Article IV Consultation with Tuvalu

On August, 5 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tuvalu.[1]

Background

A slow recovery is underway in Tuvalu, but there are important risks. GDP grew in 2011 for the first time since the global financial crisis, led by the private retail sector and education spending. We expect growth to rise slowly from 1.1 percent last year to 1.2 percent this year as the services sector continues to grow. Falling prices for imported goods such as clothing pulled inflation down to 0.5 percent in 2011, but the prices of domestically produced goods and services are also broadly stable. However, falling numbers of Tuvaluan seafarers, and the corresponding drop in their remittances, are hurting household incomes at a time when a strong Australian dollar is increasing imports. The possibility that seafarer income both does not recover and is not replaced by opportunities such as seasonal employment schemes is the biggest risk to long-term sustainable growth.

Even beyond employment, Tuvalu remains exposed to the difficult global environment. Strong performance at the Tuvalu Trust Fund (TTF) has brought closer the point where it will begin to recapitalize the Consolidated Investment Fund (CIF). But a reversal could hurt the TTF, depriving the government of necessary support. Proceeds from licensing and joint ventures

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

have improved the government's revenue prospects, but further strengthening of the Australian dollar could negate these gains. On the other hand, a rapid weakening of the dollar could cause prices of imported goods to rise quickly. In the current fragile environment, this would present serious difficulties for Tuvaluan households.

A large fiscal expansion in 2009-10 is now slowly being unwound. Expenditure rose quickly during and after the Global Financial Crisis, nearly exhausting Tuvalu's financing buffer, the CIF. The deficit before grants rose to around half of GDP in 2010, but in 2012 is expected to fall to only 10 percent, as tax compliance among private companies has improved and costs related to various educational and medical programs have been trimmed.

The current account deficit is widening, though reserves are also rising. In 2011, the trade deficit reached 58 percent of GDP, while remitted wages, the largest source of foreign exchange, fell to only 8 percent of GDP. Income from Tuvalu's large asset holdings abroad has so far cushioned the blow, as has donor support, and the rising level of reserves.

A program to improve the management of public enterprises has shown some successes, with improved payment culture in utilities and improved risk management at the country's two banks. But more work needs to be done, particularly in compliance with taxes and employee social contributions.

Executive Board Assessment

Executive Directors welcomed the resumption of economic growth in Tuvalu, but noted downside risks stemming from continued exposure to external shocks and debt distress, in the context of limited availability of policy levers. Against this background, Directors encouraged the authorities to re-build fiscal buffers and accelerate structural reforms to boost medium-term growth prospects.

Directors commended the authorities for taking measures to lower the 2012 budget deficit, but urged further fiscal adjustment within a multi-year budget framework. They supported an increase in the value-added tax next year, while stressing the importance of improving tax compliance and ensuring that the new investment strategy of the Tuvalu Trust Fund does not add undue risk. Directors also encouraged the authorities to reduce subsidies and contain non-essential spending without compromising development goals.

Directors welcomed the adoption of a Policy Reform Matrix with focus on governance, social programs, and macroeconomic stability. They commended plans to increase the participation of the private sector in economic activity, and urged faster progress in operating public enterprises on commercial terms. Directors called for policies to improve labor skills and seasonal employment overseas. Directors also stressed the financial sector's crucial role in fostering growth. They noted the high level of non-performing loans in the banking system, and welcomed efforts by the National Bank of Tuvalu and the Development Bank of Tuvalu to improve credit quality.

Directors encouraged the authorities to improve the availability and quality of economic statistics, and welcomed IMF technical assistance provided for this purpose.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2012 Article IV Consultation with Tuvalu is also available.

Tuvalu: Selected Social and Economic Indicators, 2008–2013

	2008	2009	2010	2011 Proj.	2012 Proj.	2013 Proj.
			Percent change			
Real sector						
Real GDP growth	7.6	-1.7	-2.9	1.1	1.2	1.3
Consumer prices (period average)	10.4	-0.3	-1.9	0.5	2.6	2.7
			(In percent of GDP)			
Government finance 2/						
Revenue	72.4	90.2	74.0	94.5	84.1	71.9
of which Taxes	16.8	16.2	16.2	18.9	19.3	19.3
of which Grants	17.1	30.6	22.1	38.2	24.5	12.3
Total Expenditure	75.9	93.3	104.1	93.3	79.8	82.0
Expense	67.9	77.7	87.1	78.5	75.6	76.5
Net Acquisition of Nonfinancial Assets	5.1	15.6	17.0	14.9	4.3	5.5
Net Lending/Borrowing	-0.7	-3.1	-30.0	1.1	4.2	-10.1
Tuvalu Trust Fund 3/	262.8	275.8	310.0	331.7	354.7	364.0
Consolidated Investment Fund 3/	34.1	44.2	20.8	9.0	11.2	5.6
Balance of payments						
Current account balance	-4.7	9.6	-1.3	-10.1	-3.0	-1.2
(In percent of GDP)	-13.2	27.8	-3.8	-29.2	-8.5	-3.3
Trade balance	-18.3	-16.0	-18.6	-19.5	-18.0	-16.5
Exports	0.6	0.6	0.5	0.6	0.7	0.7
Imports	19.0	16.6	19.1	20.2	18.7	17.2
Services balance	-26.8	-21.9	-22.7	-28.9	-20.8	-21.3
Income balance	24.9	27.8	21.4	18.8	24.2	25.0
Current transfers (net)	15.5	19.8	18.7	19.4	11.6	11.6
of which: remittances, employee compensation	6.2	5.2	3.3	3.3	3.9	4.1
of which: government	12.7	17.2	16.2	17.0	9.3	9.1
Gross official reserves 5/	30.0	29.9	26.0	23.9	23.1	23.8
(In months of imports of goods and services)	-8.6	-7.9	-6.0	-6.7	-6.6	-6.8
Debt indicators						
Gross external public debt	17.4	18.3	17.0	14.5	12.8	13.1
(In percent of GDP)	48.3	53.0	49.1	41.7	36.1	35.8
Debt Service	0.9	0.6	0.5	0.4	0.6	0.6
(In percent of exports of goods and services)	21.4	15.4	11.2	10.7	14.5	15.1
Exchange rates						
Australian dollars per U.S. dollar						
Period average 6/	1.2	1.3	1.1	1.0	0.9	0.9
End-period 6/	1.5	1.1	1.0	1.0	0.9	0.9
Nominal effective exchange rate (2005=100)	102.5	98.1	111.6	119.3	…	…
Real effective exchange rate (2005=100)	103.5	100.7	115.2	123.2	…	…
Nominal GDP (In millions of Australian dollars)	36.0	34.6	34.7	34.7	35.6	36.6
Nominal GNI (In millions of Australian dollars)	58.7	60.8	55.5	58.9	62.1	65.5

Sources: Tuvalu authorities, PFTAC, Asian Development Bank, UNDP, CIA World Factbook, and IMF staff estimates.

1/ Tuvalu uses the Australian dollar as its currency. It has no central bank operations.

2/ Data for 2011 are Tuvalu authorities and staff estimates.

3/ Data for 2010 are provisional estimates of Tuvalu authorities.

4/ Rates for personal and business loans.

5/ Defined as sum of foreign assets of the National Bank of Tuvalu, the Consolidated Investment Fund, and SDR holdings. Excludes the Tuvalu Trust Fund. Data for 2010 are as of October.

6/ Data for 2012 are as of end-May.

Statement by Christopher Legg, Executive Director for Tuvalu and Christopher Becker, Advisor to Executive Director August 3, 2012

Tuvalu became the 187th member of the Fund in 2010 and this is the second Article IV consultation between Staff and the authorities since that time. The authorities found the frank, constructive discussions and the commitment of the mission team very helpful, and look forward to enduring engagements with the Fund and other International Financial Institutions.

The main challenges facing Tuvalu concern the development needs of the country while ensuring the sustainability of both its natural and donor-provided resources. Fund surveillance and technical assistance play a key role in maximizing the benefits from limited endowments, and also help to catalyze contribution to the country's development goals by other International Financial Institutions (World Bank, Asian Development Bank) and the broader donor community.

With a population of only around 11,000 people and annual Gross National Income of just US$50 million, this small atoll group of islands is particularly vulnerable due to its geographic isolation, lack of fertile land, susceptibility to the impacts of climate change, and inability to reap economies of scale in the provision of public goods and services.

1. Macroeconomic conditions

The global financial crisis spilled over into Tuvalu as slower economic activity and trade in goods translated into less demand for Tuvaluan seafarers. The associated slowdown in remittances and economic activity resulted in a worsening fiscal position which is now being addressed by the austerity actions of the incumbent authorities. Financial contagion manifested itself through the adverse impact on the principal and income from the sovereign wealth fund and is forcing the authorities to forego much needed investment in human capital and social projects. Exchange rate appreciation has allowed inflation to remain low and steady but has also eroded the local currency value of US dollar denominated receipts from the sale of fishing rights and remittances. There is little capacity for Tuvalu to build policy buffers to absorb future economic shocks given the extremity of its economic situation on a number of measures. As a result, in the foreseeable future the country is likely to remain almost completely reliant on support from the international community and its major donors for funds to respond to either real (including environmental), or financial shocks.

2. Monetary and exchange rate policy

Tuvalu uses the Australian dollar as legal tender and has no central bank. As a result, it has no independent monetary policy flexibility, no exchange rate flexibility separate from the Australian dollar, and domestic interest rates are set based on social and development objectives by the only two banks that operate in Tuvalu. Both of these banks are government-owned. Scope to absorb external shocks or decouple from developments in Australia are therefore limited on the monetary side.

For example, while the boom in commodity prices has seen Australia's terms of trade rise to 140 year highs and led to significant exchange rate appreciation, the net benefit for the Tuvaluan economy, with no mineral resources, is clearly questionable. While imports have become significantly cheaper (and there is no export sector to speak of), the local currency value of US dollar-denominated remittances from seafarers and proceeds from fishing licenses is also commensurately lower. The recent strength in the exchange rate has helped keep inflation low but this positive influence could reverse quickly if the outlook for commodity prices were to deteriorate substantially. Furthermore, the fall in the price of imports has translated into a widening of the current account deficit and the associated depletion of foreign currency assets.

However, while noting these disadvantages, the use of the Australian dollar remains the most appropriate exchange rate arrangement. The issue of extremely small scale (in all aspects) makes the establishment of a modern banking system, financial markets, a central bank, let alone an independent currency, prohibitively expensive and therefore implausible. Given that Australia is one of the largest countries in the region, its leading role as a donor, and the lack of viable alternatives, dollarization is the least-cost option for Tuvalu.

3. Fiscal policy

Macroeconomic management and the absorption of shocks therefore largely rely on fiscal policy.

In 1988, donors capitalized an investment fund from which the income in excess of a stable real principal is used to supplement donor assistance to fund persistent budget deficits. Following a number of years of below-average returns and larger than usual deficits, these resources (over and above the principal) are almost exhausted. An important policy therefore involves broadening the tax base and improving compliance in order to finance spending on social projects. The progress made to consolidate in the most recent budget has been difficult and unpopular but clearly highlights the authorities' commitment to setting the fiscal stance on a more sustainable footing. Budget support from Australia has also helped to alleviate the pressure.

The high risk of debt distress is a particular concern considering the multifaceted vulnerabilities confronted by the country. Grants are the only viable form of financing projects at the current juncture, as even joint ventures with foreign private sector firms in fishing could quickly become unsustainable if financed at commercial loan rates.

4. Structural policies

The government has an explicitly formulated development strategy to address governance, social development, education, human resources, macroeconomic growth and stability, natural resources and infrastructure. This plan is a useful tool for coordinating the prioritization of projects and engaging effectively with donors. An example of difficult choices that have to be made is the recent elimination of government-funded scholarships. Short-term budget pressures have led to the elimination of such subsidies but this comes at the obvious longer-term cost to the development of human capital.

The government's involvement in the economy is extensive and the private sector remains small, accounting for only around ¼ of economic activity. Reform of public enterprises is therefore recognized by the authorities as an area where efficiency gains would be beneficial. Sound governance and professional, independent management of enterprises such as the electricity provider could limit the amount of leakage from the public balance sheet and thus reduce the need for cuts in important spending on social projects. Nonetheless, in a country this small almost all major service providers fulfill key social functions and are therefore part of the policy mechanisms through which the government is able to manage economic outcomes. The prospects for full commercialization of these enterprises are therefore limited.

An important policy to assist with the absorption of adverse shocks has been to diversify the sources of income for Tuvaluans working abroad. Aside from the natural endowment of resources that can be extracted from the country's extensive maritime zone, income from Tuvaluan seafarers on international vessels has been the other major 'industry' and source of income. The local currency value of this US dollar-denominated income has been negatively impacted by the appreciation of the exchange rate and the slowdown in international shipping. Efforts to create new and more diverse work opportunities abroad are therefore important. Increasingly workers are branching out to take up seasonal harvesting work opportunities in New Zealand, and more recently Australia. This diversification has helped to offset part of the decline in remittances from seafarers and is expected to expand further in the future.

5. Other issues

Capacity problems are a major issue in almost all aspects of the economy in a microstate such as Tuvalu. For example, there is a need to improve the quality of statistics to better inform the policy making process. The authorities have ambitions to expand the statistics department by 30 percent (or one more person) to deliver better quality data but the funds and skills are lacking. Currently, a single person compiles both the National Accounts and the Balance of Payments, while the other two people in the department compile the remaining statistics and deal with administration. PFTAC and the large donor countries have been important in assisting capacity building, but there is scope for further development.

The government is facing major constraints in terms of the economies of scale in the provision of public goods and services across such a small population and commensurately limited tax base. While the most basic health services are provided domestically, most of the more complicated procedures are carried out in Fiji. Containing the costs of these services to the government has been addressed through several measures. The system by which patients are referred to hospitals abroad has become more closely scrutinized, patient accommodation while abroad has been reconsidered, the entitlement for relatives to accompany patients is now more restrictive, and patients bear part of the costs that are incurred.

These changes not only make a positive contribution to the sustainability of the budget, but they also highlight the complications of interpreting income per capita in an extremely small state such as Tuvalu. The country generates sufficient income from the sale of fishing licenses, remittances, and the donor provided wealth fund to rank relatively highly in terms of annual income per capita (US$4,760) because the total income numerator is shared across a very small population denominator. Nonetheless, it finds itself in a situation where total income is so small that it proves prohibitively expensive for the government to provide adequate health services domestically. If a substantial part of that higher income per capita therefore has to be allocated toward expensive medical services in another country, the remaining disposable per capita amount available for consumption and saving is significantly lower. The return airfare from Funafuti to Suva alone is almost ¼ of the average Tuvaluan's annual income. In this simple illustration it is easy to recognize that assessment of welfare based on income per capita alone can be misleading. This is especially the case in countries where vulnerabilities are relatively pronounced.