

# Global and Regional Spillovers to Pacific Island Countries



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**Apia, March 23, 2012**

# At the 2011 Annual Meetings: The Agenda

## Deliverables

- Pacific Islands Conference early this year in the region ✓
- Research Agenda:
  1. Spillovers from global & regional economies to the PICs (Sheridan, Tumbarello, Wu, 2012) ✓
  2. Managing mineral revenues (Feridhanusetyawan, 2011) ✓
  3. Commodity Prices and Exchange Rate Pass-through (Peiris, 2012) ✓
  4. Sources of Growth (Yang, 2012) ✓

# Plan of the presentation

Global and Regional Outlook

Pacific Islands: Growth Spillovers

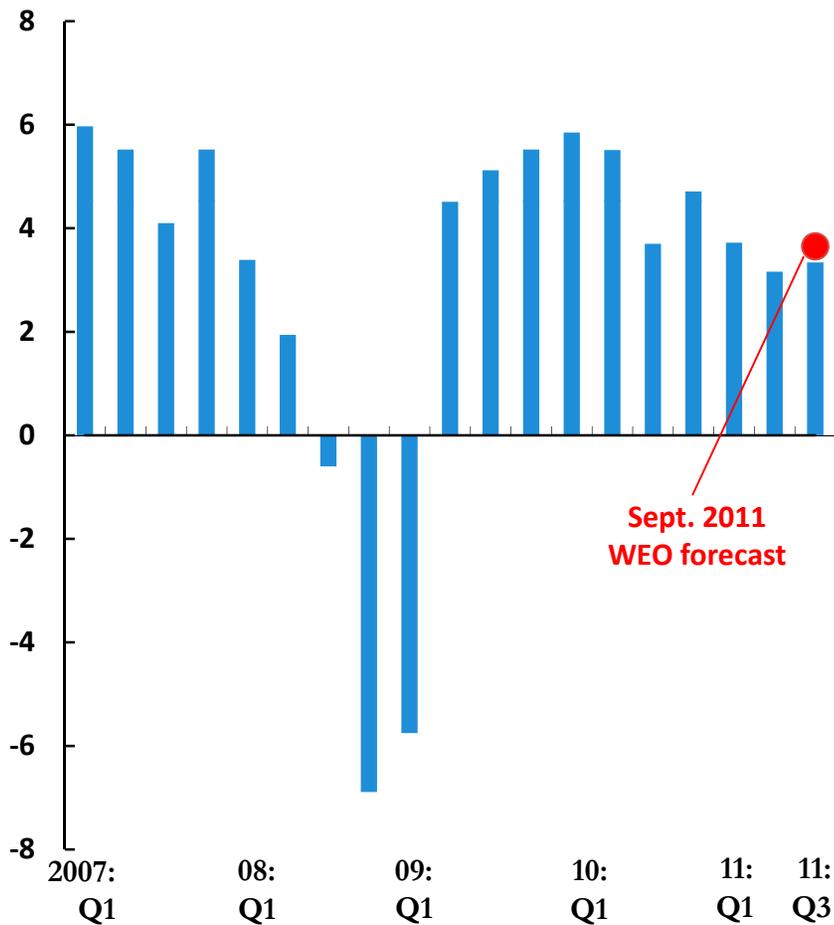
What Implications for Policies

# Global and Regional Outlook

# Global activity was robust in the third quarter of 2011...

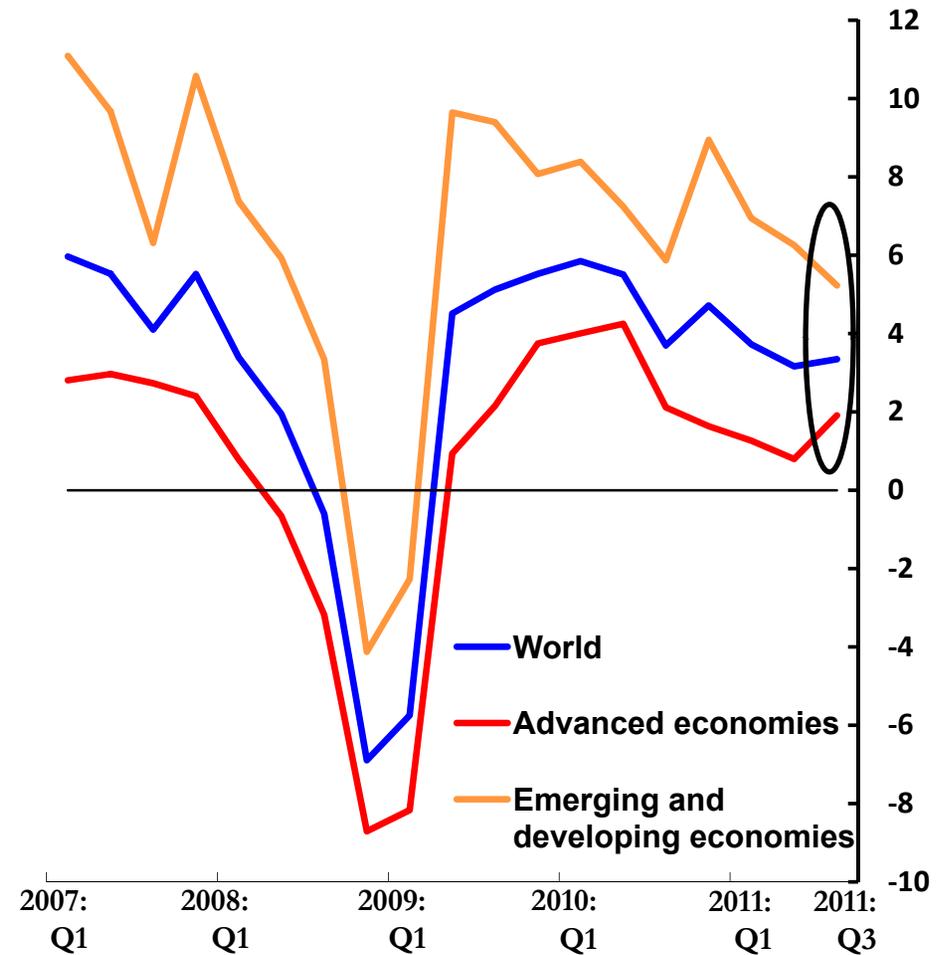
## Quarterly World Growth

(percent; quarter over quarter, annualized)



## Global GDP Growth

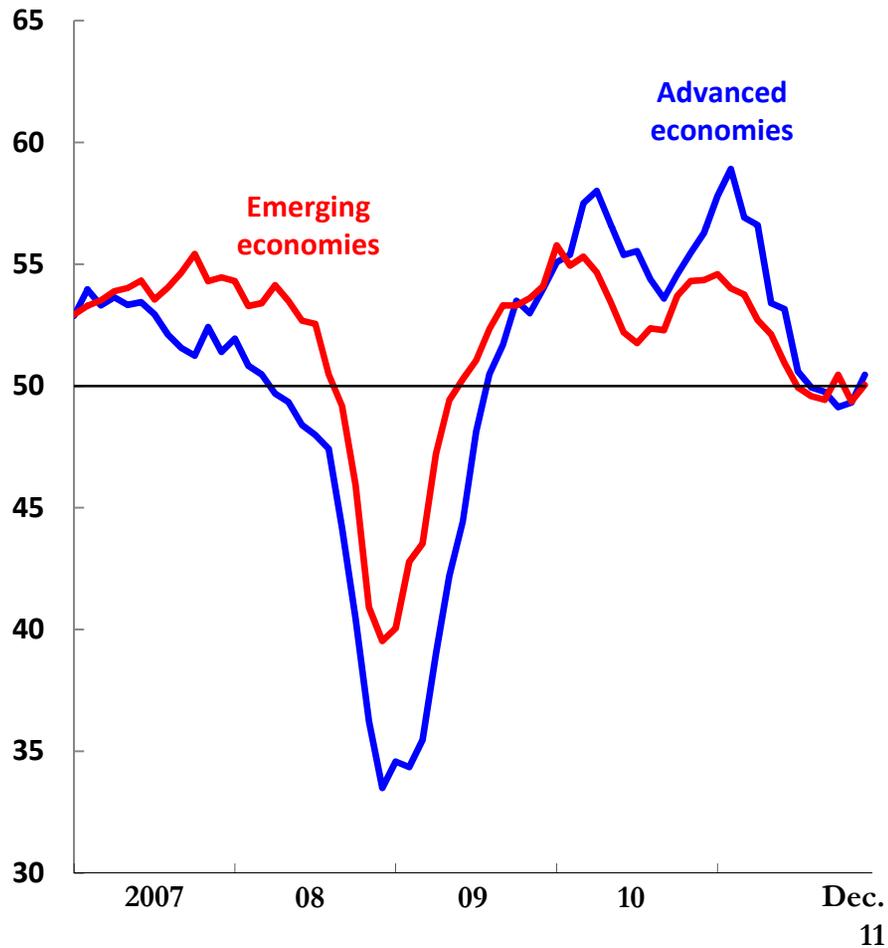
(percent; quarter over quarter, annualized)



... but things took a turn for the worse in the fourth quarter ...

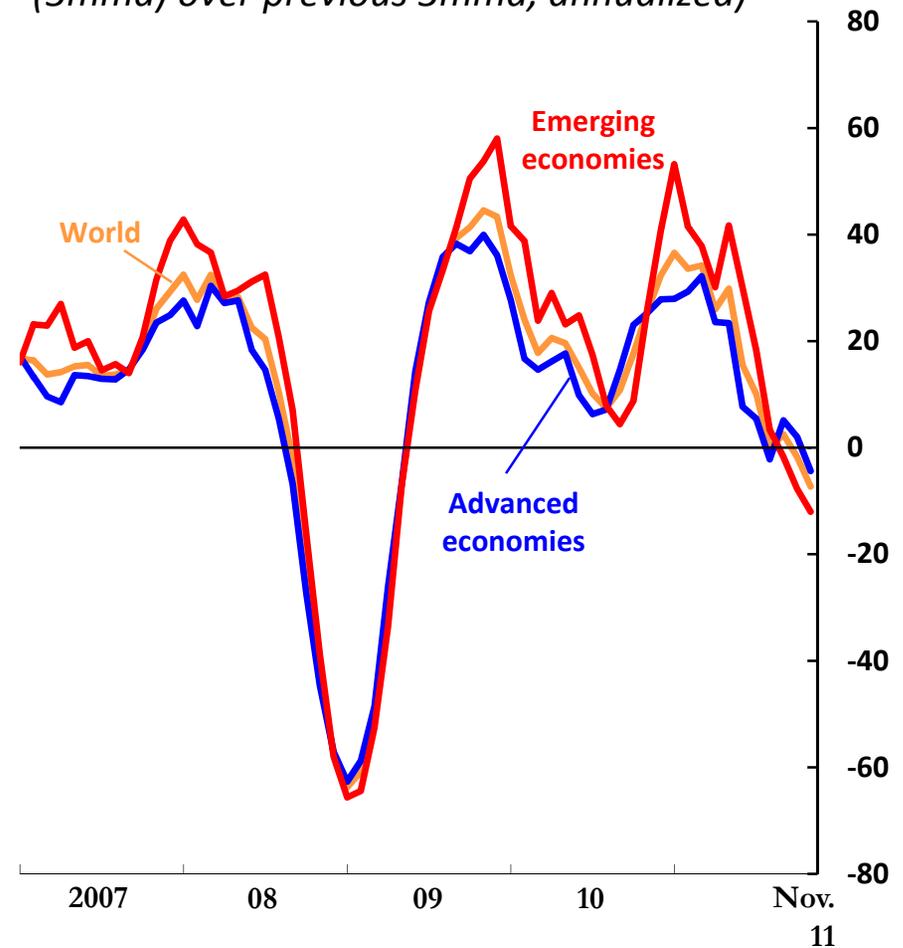
### Manufacturing Purchasing Managers' Index (PMI)

(index; figures above 50 denote expansion)



### Merchandise Exports

(percent; three-month moving average (3mma) over previous 3mma, annualized)

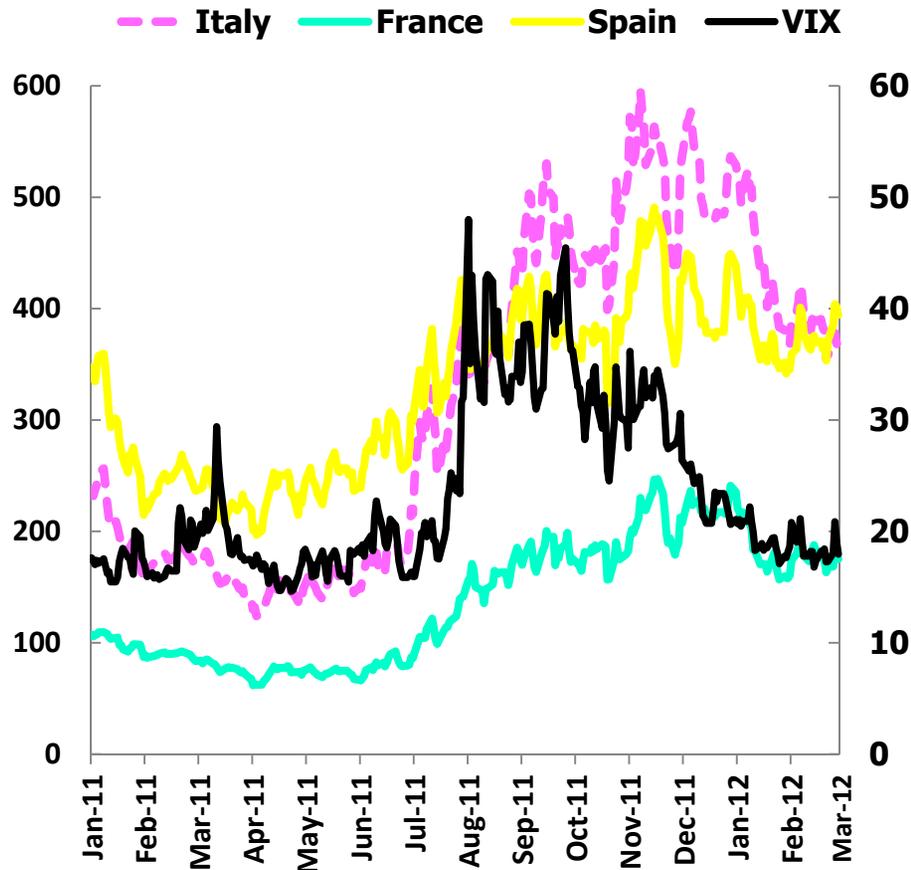


# Global financial conditions have improved recently

## Better signals from economic data, especially in the U.S.

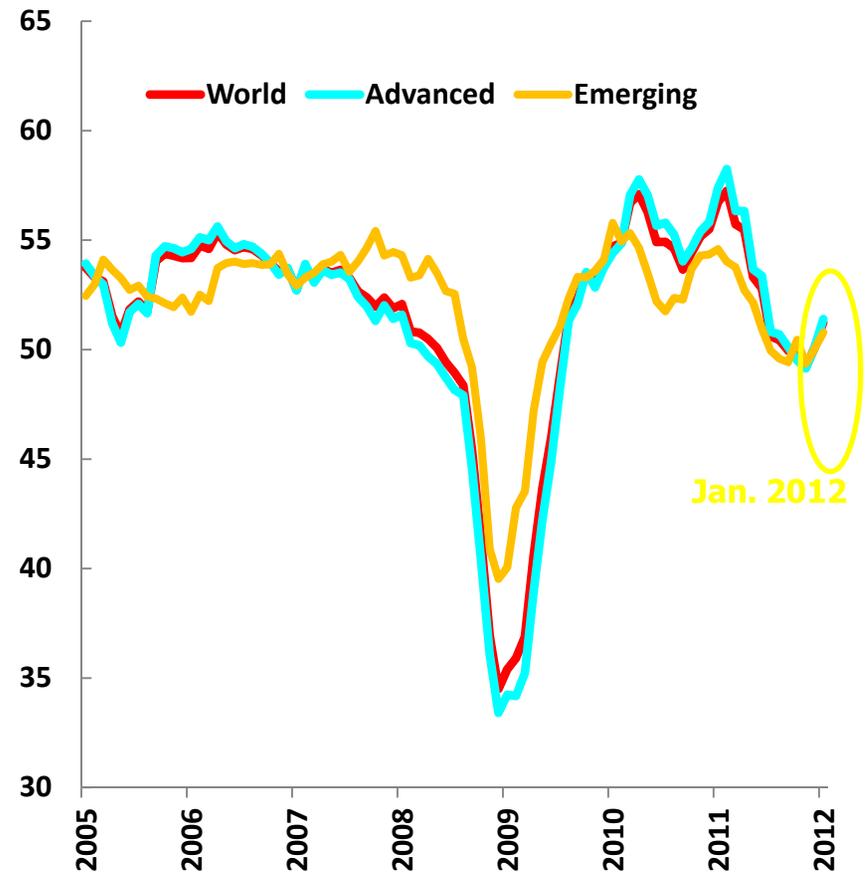
### Sovereign CDS Spreads and VIX

(CDS Spreads in basis points, 5-year senior debt, ViX is in percentage points)



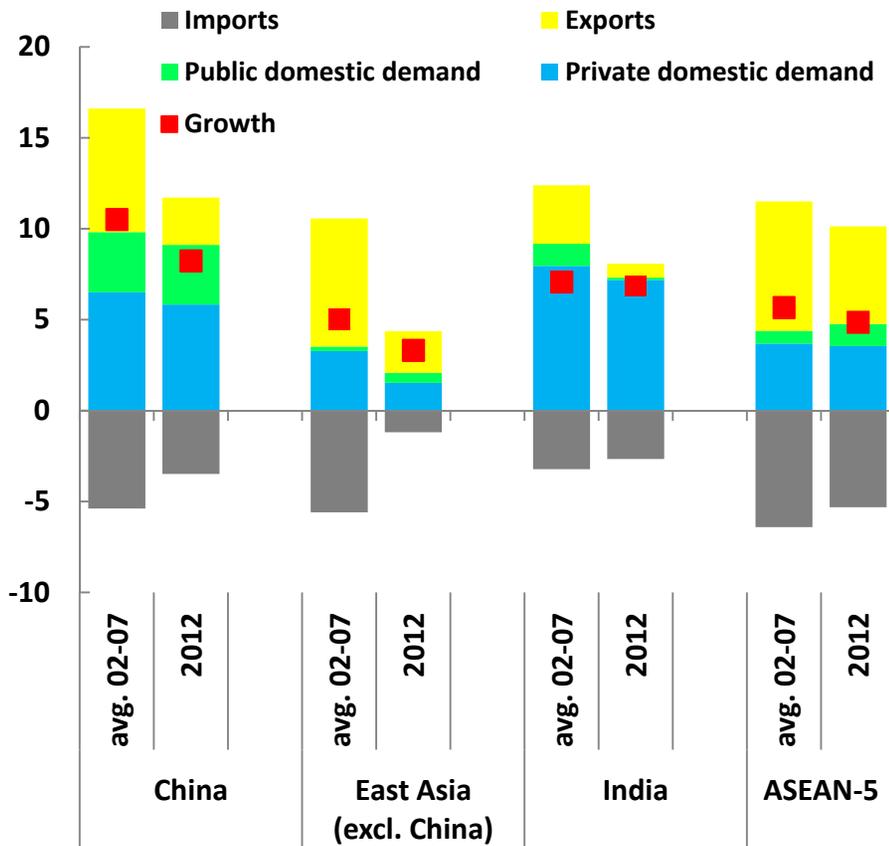
### Purchasing Managers' Index (PMI)

(index)

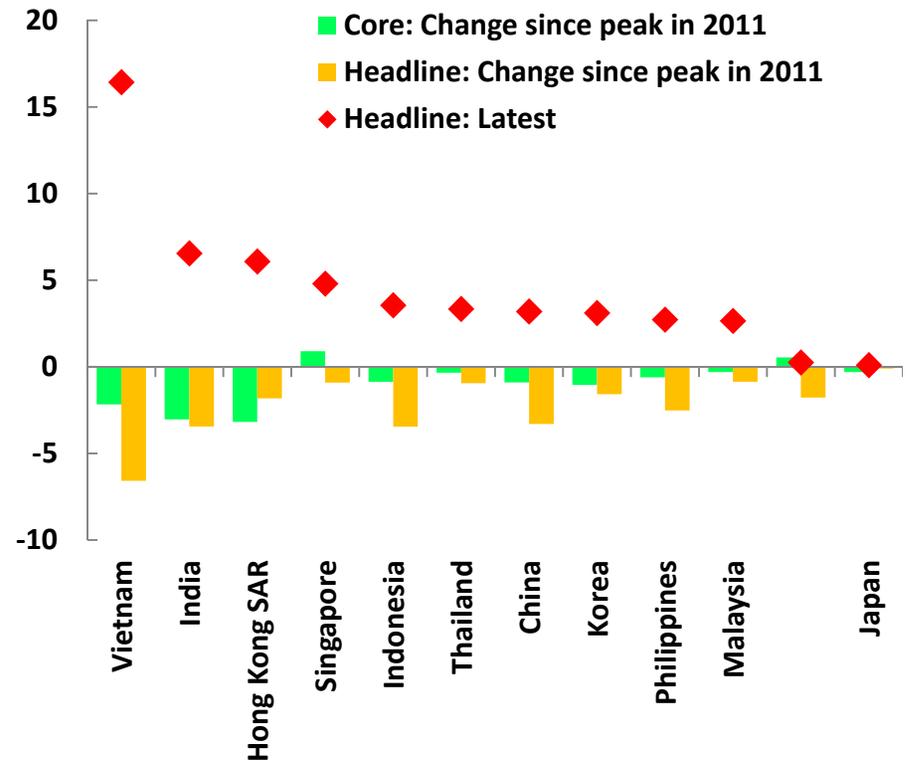


# In Asia, only a modest slowdown is expected thanks to resilient domestic demand, and core inflation remains sticky

**Contributions to Projected Growth  
(year-on-year, in percentage points)**

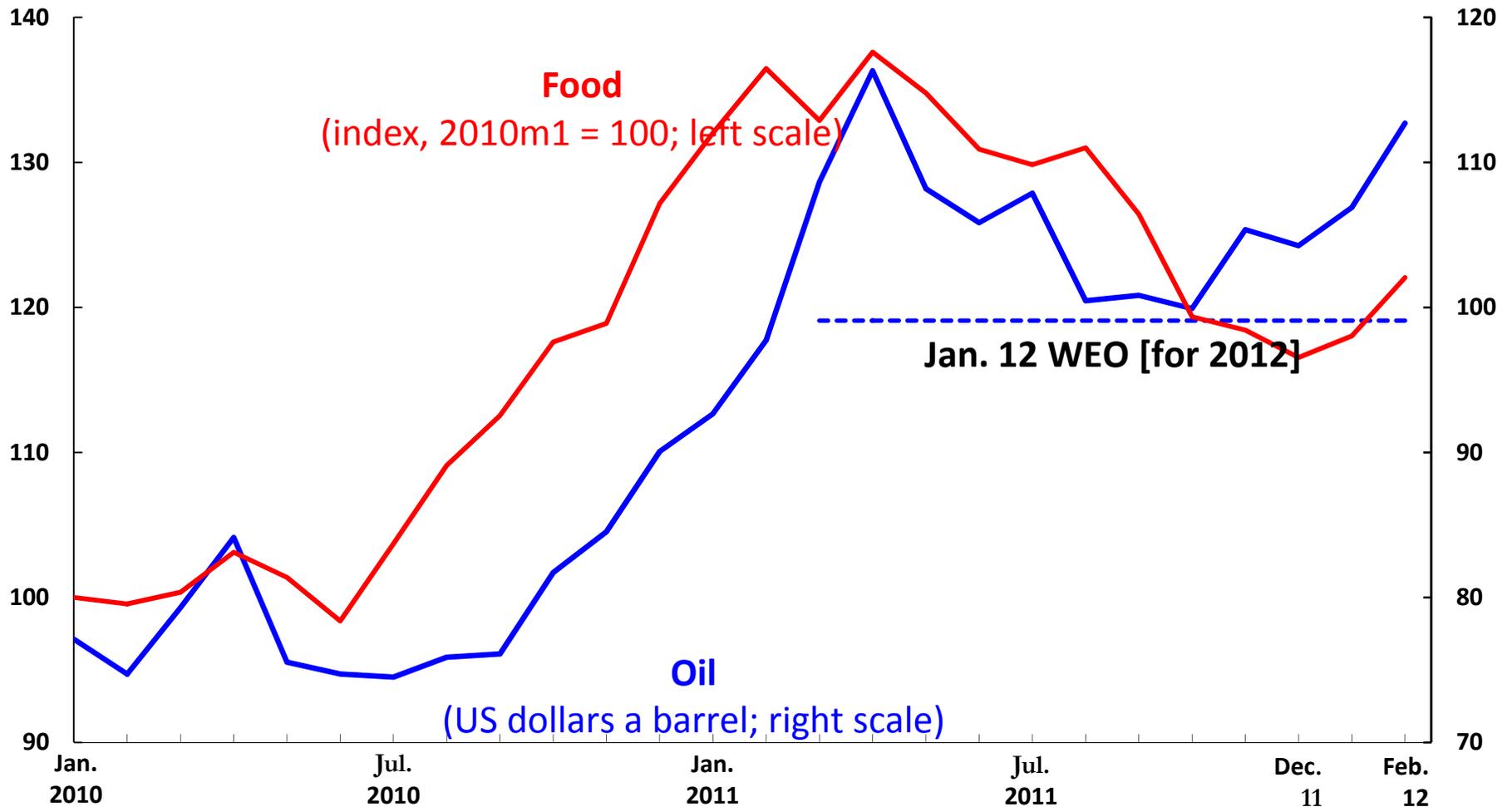


**Core and Headline Inflation  
(In percentage points)**



# Oil prices remain—and are expected to remain— at relatively high levels

## Food and Oil Prices

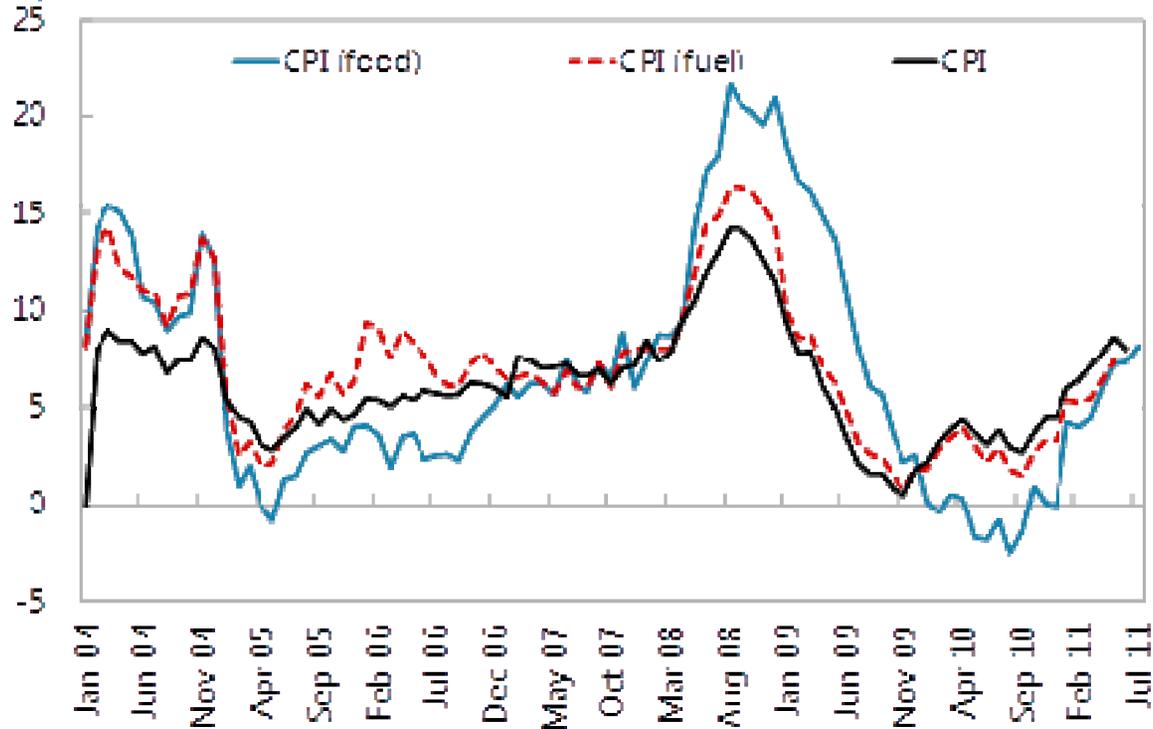


# Pacific Islands

# Inflation has been following global commodity prices

## PICs: Fuel, Food and Headline Inflation

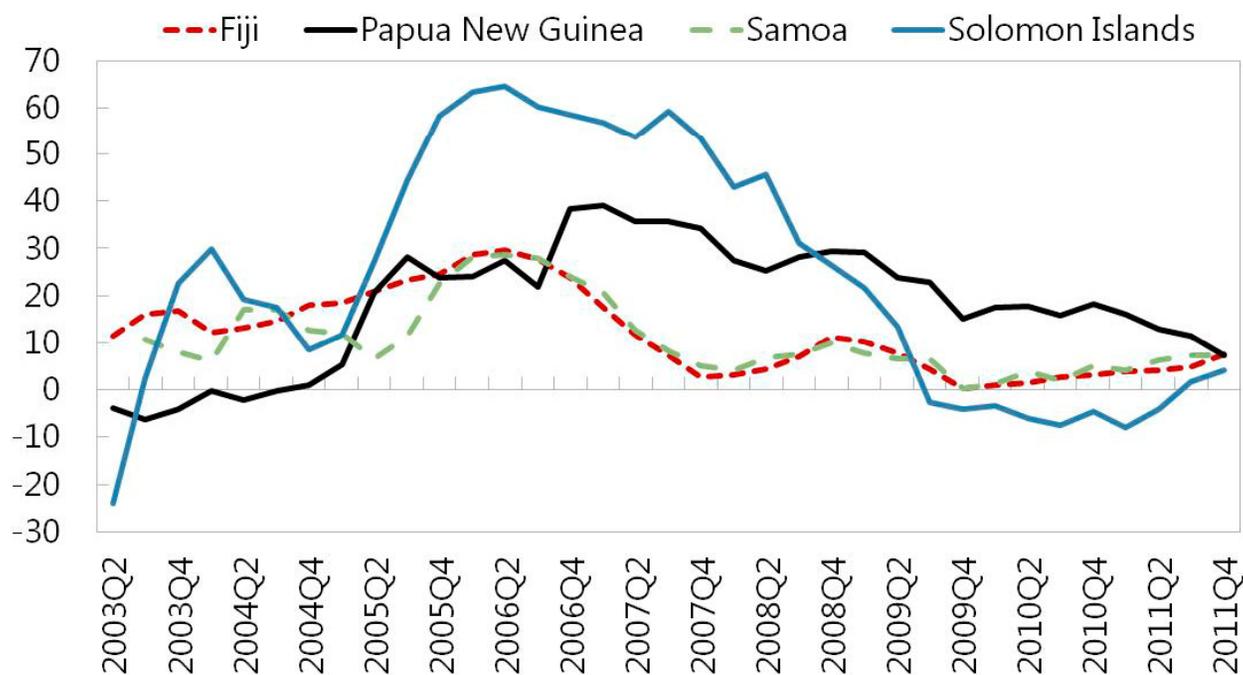
(In percent)



# Credit is started to picking up, slowly...

## PICs: Credit to Private Sector

(Year-over-year percent change)

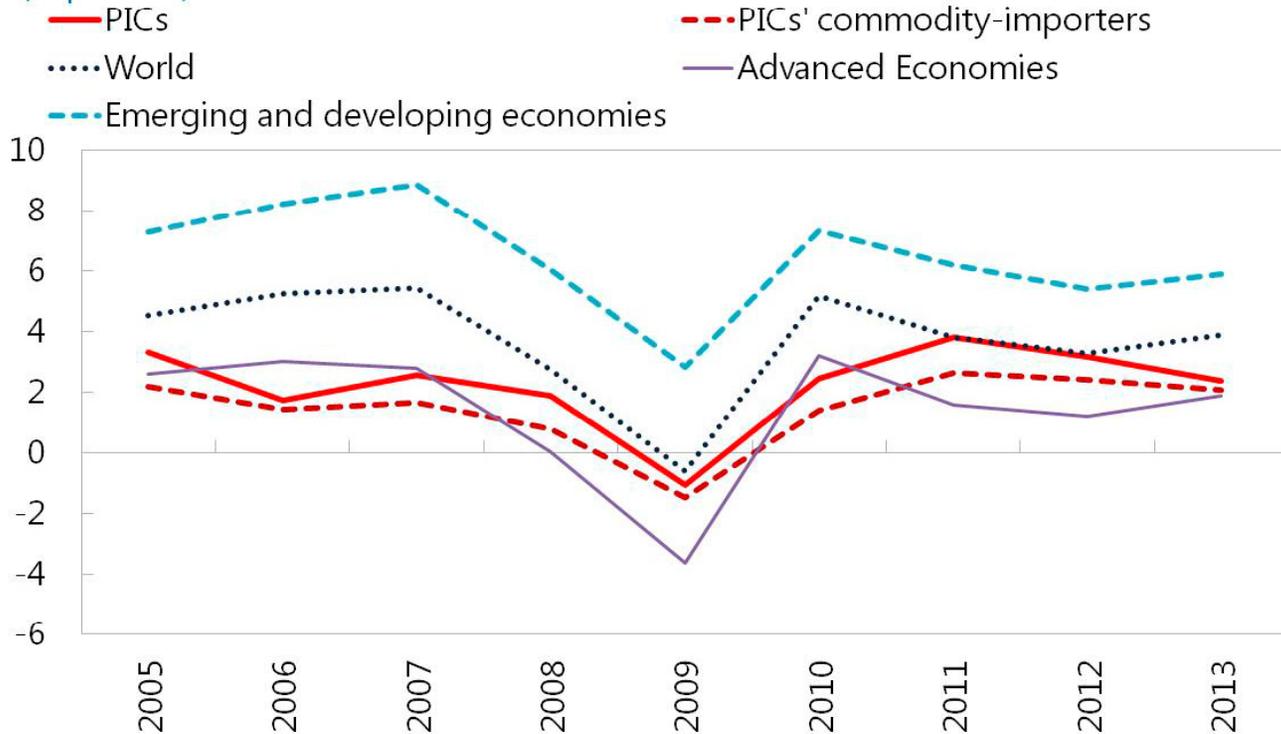


Sources: Country authorities and IMF staff calculations. The latest data for Samoa is as of October 2011.

# The recovery is still underway but growth remains relative low...

## PICs: Real GDP Growth

(In percent)

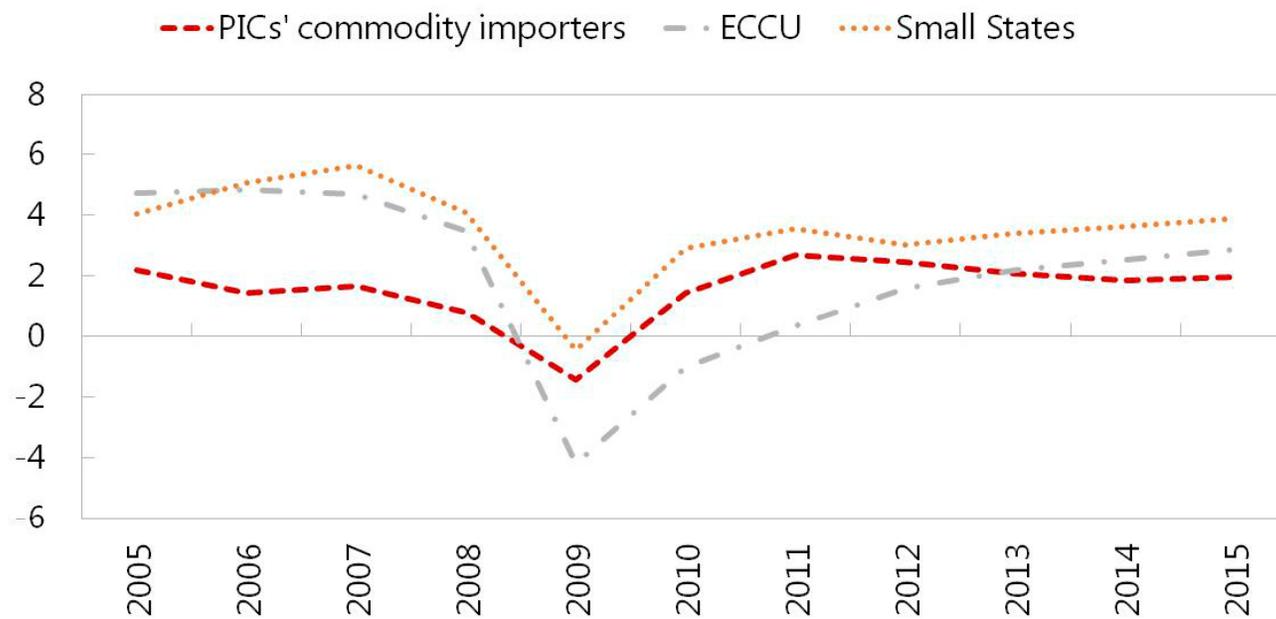


Sources: Country authorities; IMF, WEO database; and staff calculations.

# ... especially in commodity importers

## PICs: Real GDP Growth

(In percent)



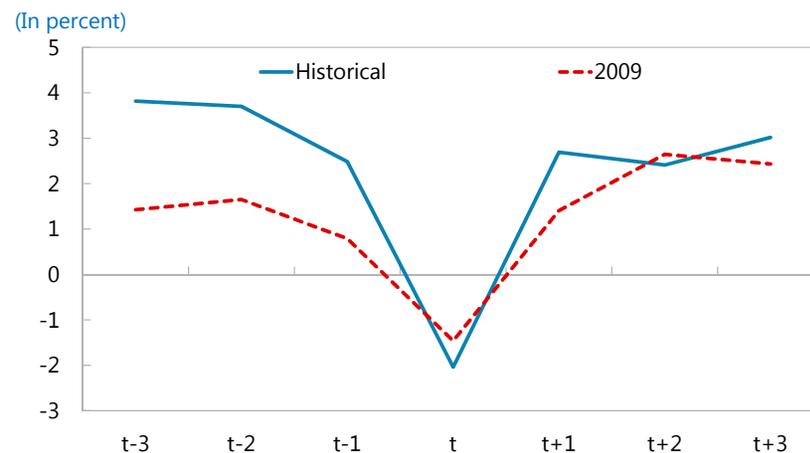
Sources: Country authorities and IMF staff calculations.

Note: ECCU include Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent.

# The recovery: commodity importers are struggling

- Milder recession in 2009, yet slower recovery for commodity importers

**PICs Commodity Importers: Real GDP Growth around Downturns<sup>1</sup>**



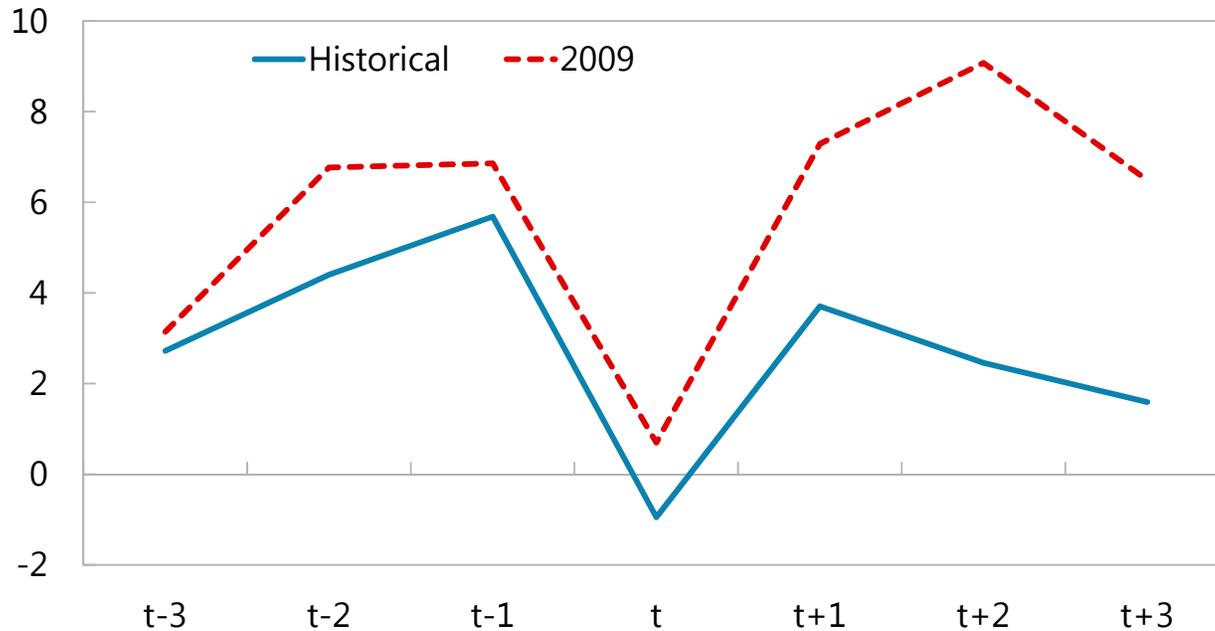
Source: IMF staff calculations.

<sup>1</sup> Historical is average of four downturns.

# A different story for commodity exporters

## PICs Commodity Exporters: Real GDP Growth around Downturns<sup>1</sup>

(In percent)



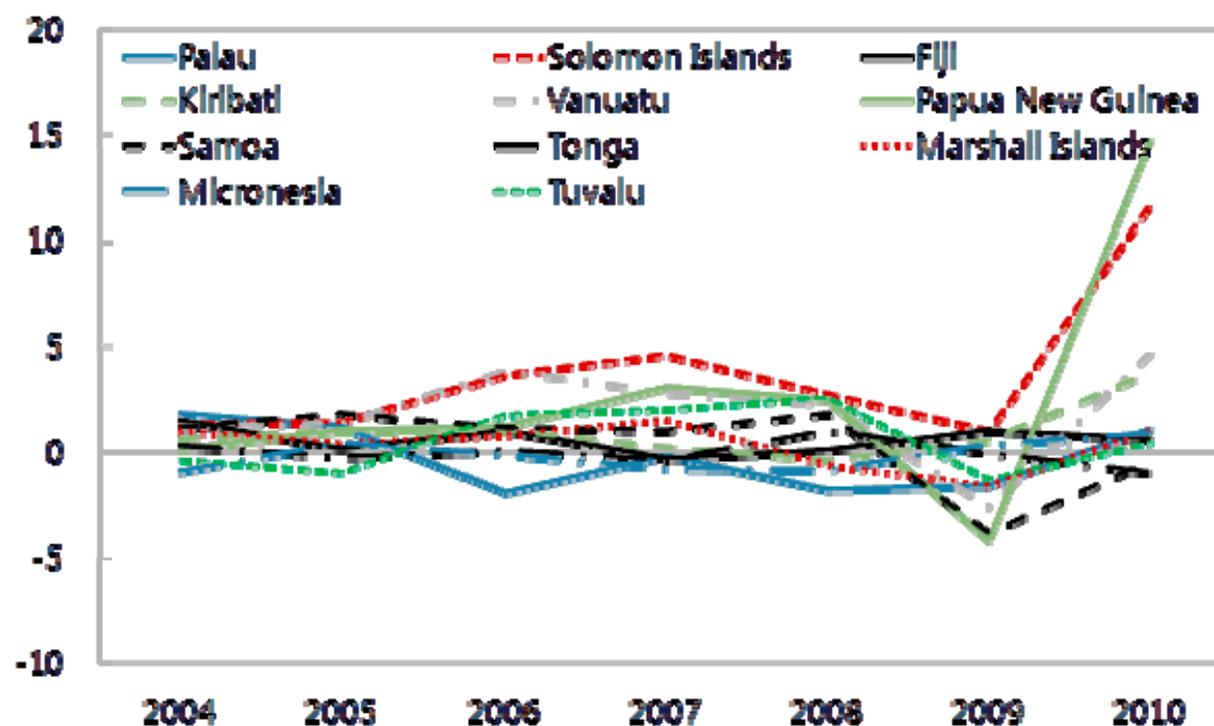
Source: IMF staff calculations.

<sup>1</sup> Historical is average of four downturns.

# Relative Growth Performance among PICs have changed

## PICs: Relative Growth Performance

(Real GDP growth relative to regional median, in percent)



Sources: IMF staff calculations.

# Analysis: Growth (and Channels of) Spillovers

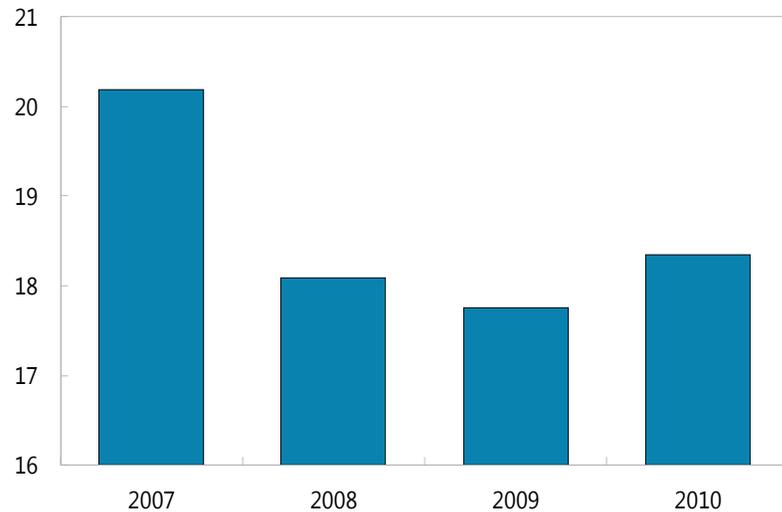
- Stylized facts
- Econometric models (VAR and VECM)
- What role of policies?

# Stylized facts: Channels of Spillovers

- Remittances (Samoa, Tonga, Tuvalu, Fiji)
- Tourism (Palau, Samoa, Vanuatu, Fiji)
- Trade flows
- Terms of trade via commodities
- Financial: mainly through trust funds

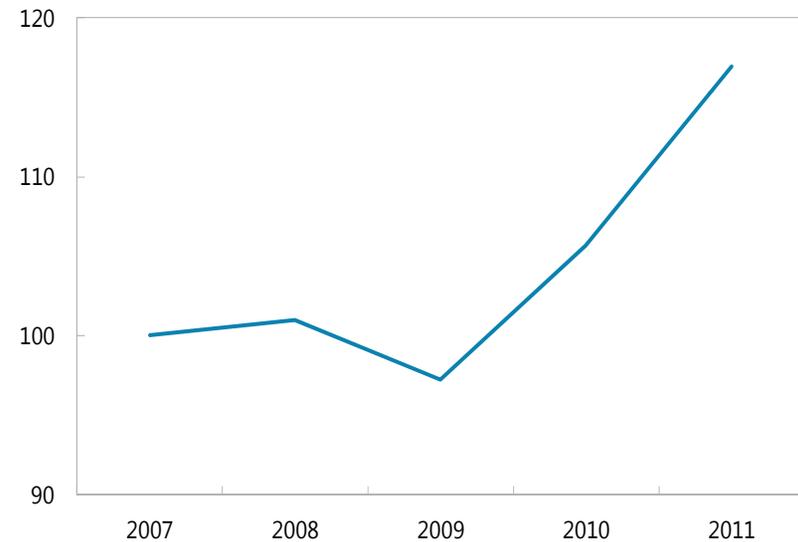
# During the crisis: remittances and tourist arrivals dropped

**Remittances**  
(In percent of GDP)



Sources: Country authorities; and Fund staff calculations.

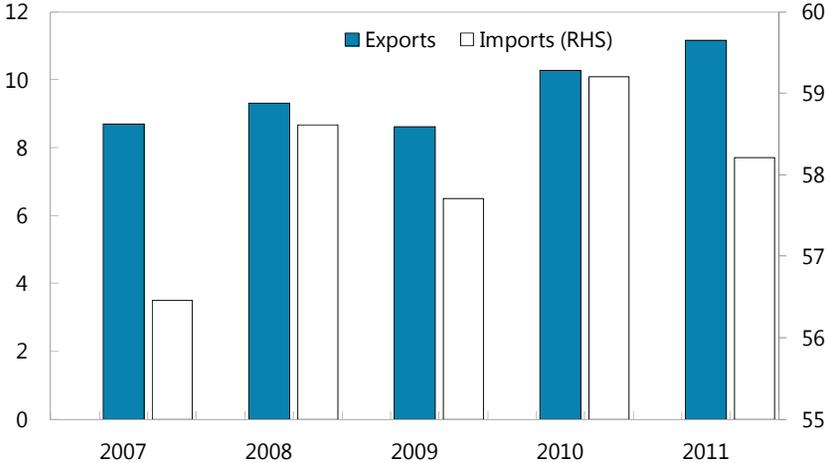
**Tourists arrivals**  
(2007=100)



# Trade dropped as well as the value of the trust funds

## Exports and Imports

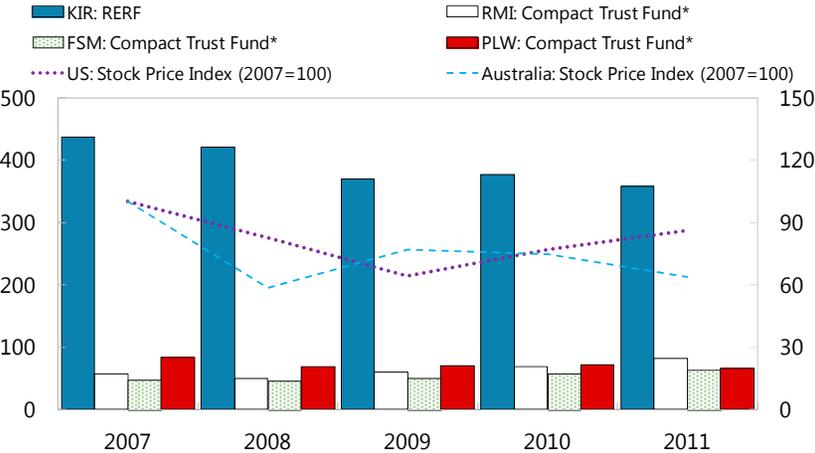
(In percent of GDP)



Sources: Country authorities; and Fund staff calculations.

## PICs: Sovereign Investment Fund Balances

(In percent of GDP)

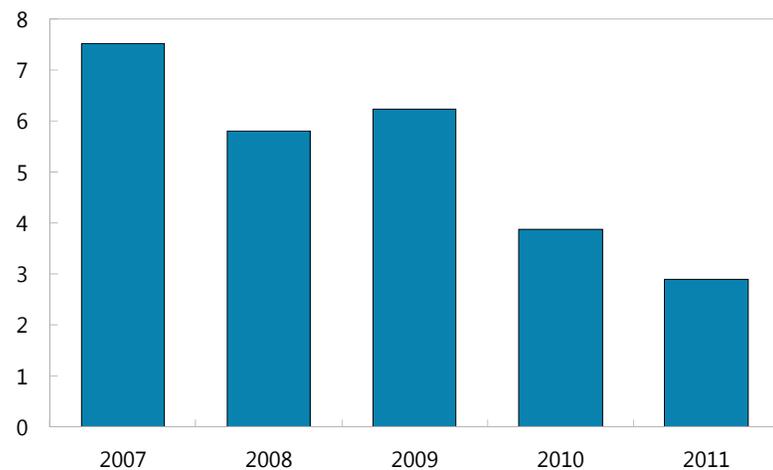


Sources: Country authorities; and Fund staff calculations.  
\* Fiscal year.

# Aid provided countercyclical support

## FDI

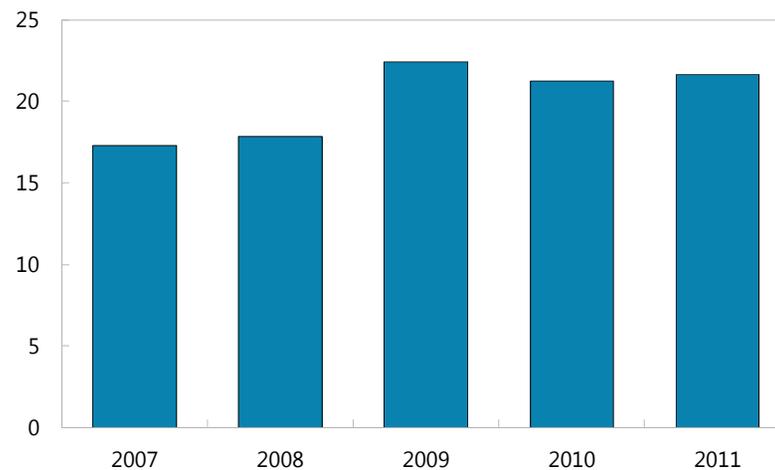
(In percent of GDP)



Sources: Country authorities; and Fund staff calculations.

## Grants

(In percent of GDP)

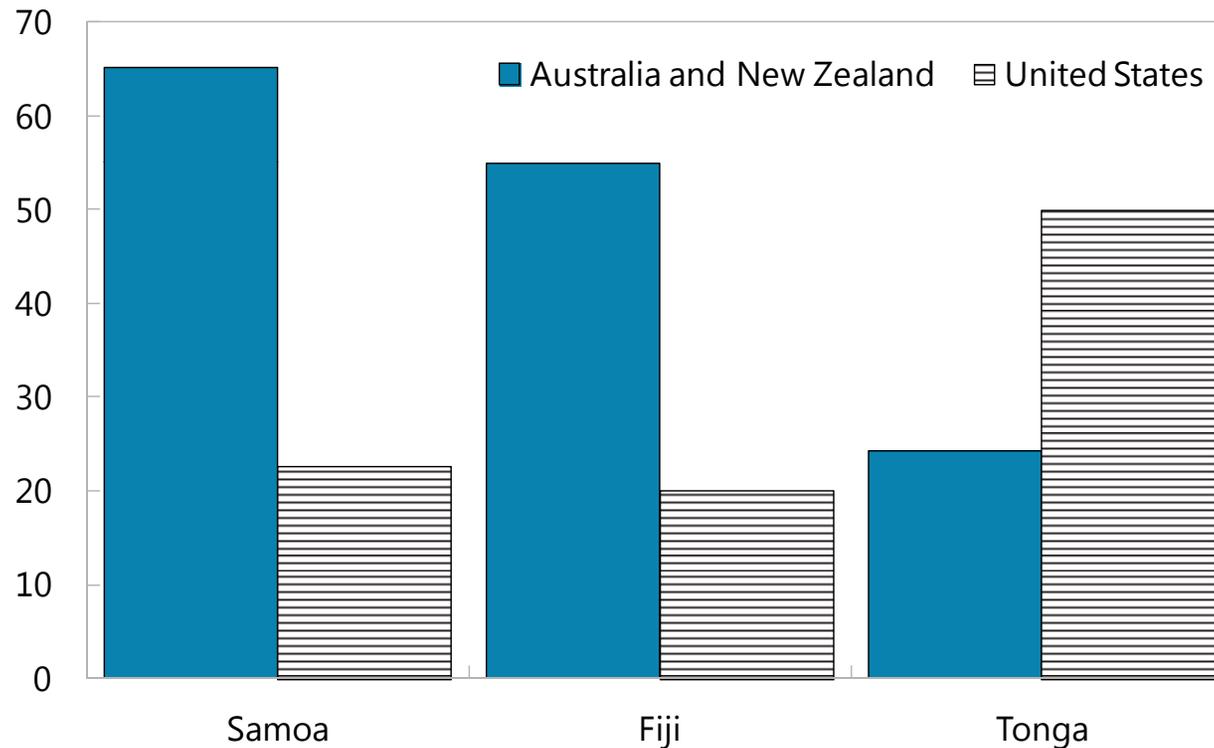


Sources: Country authorities; and Fund staff calculations.

# Links with Australia are strong including through remittances...

## PICs: Remittances by Country of Origin

(In percent of total remittances)

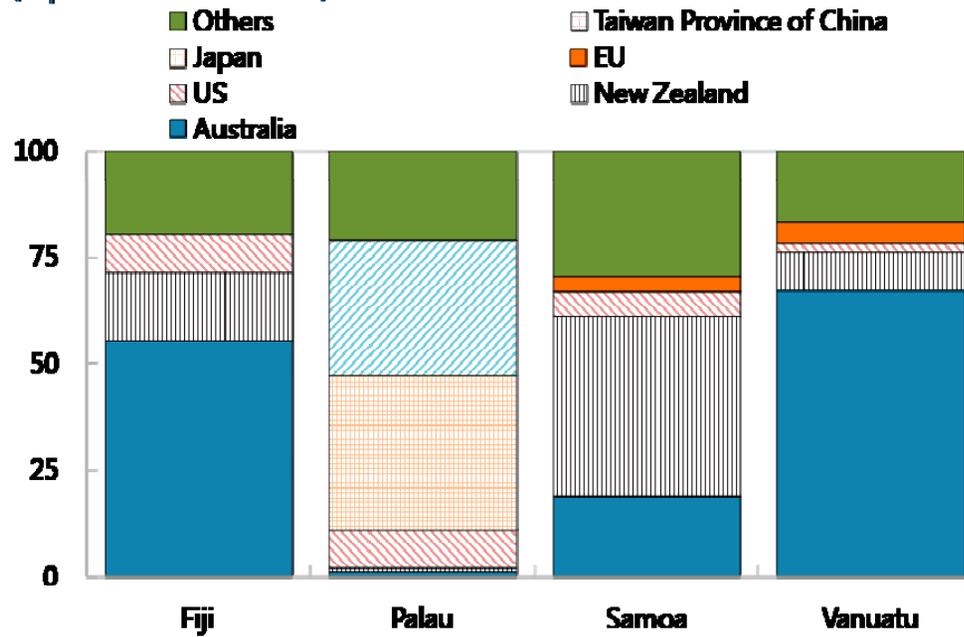


Sources: Country authorities; and IMF staff calculations.

# ... and tourism...

## PICs: Tourists by Country of Residence

(In percent of total arrivals)

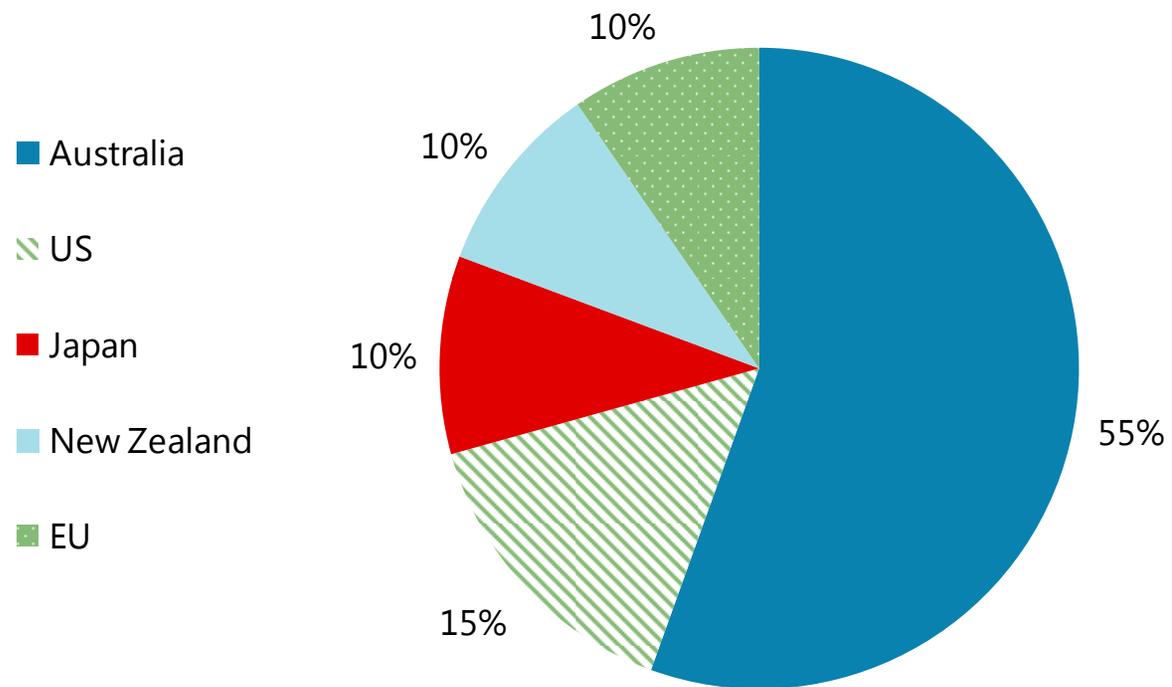


Sources: Country authorities; and IMF staff calculations.

# ... aid...

## PICs: Official Development Aid by OECD Donors

(In percent of total aid, 2010)

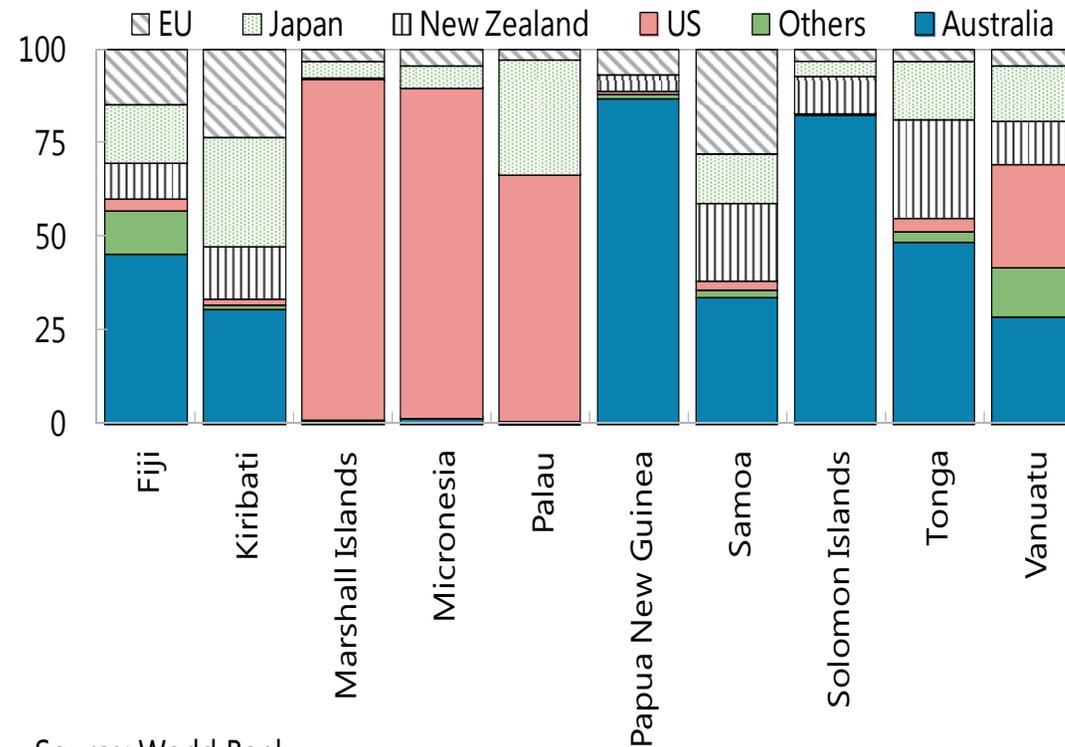


Source: OECD.

# The United States provides aid to PIC compact countries

## PICs: Official Development Assistance by Donors

(In percent of total aid, 2010)

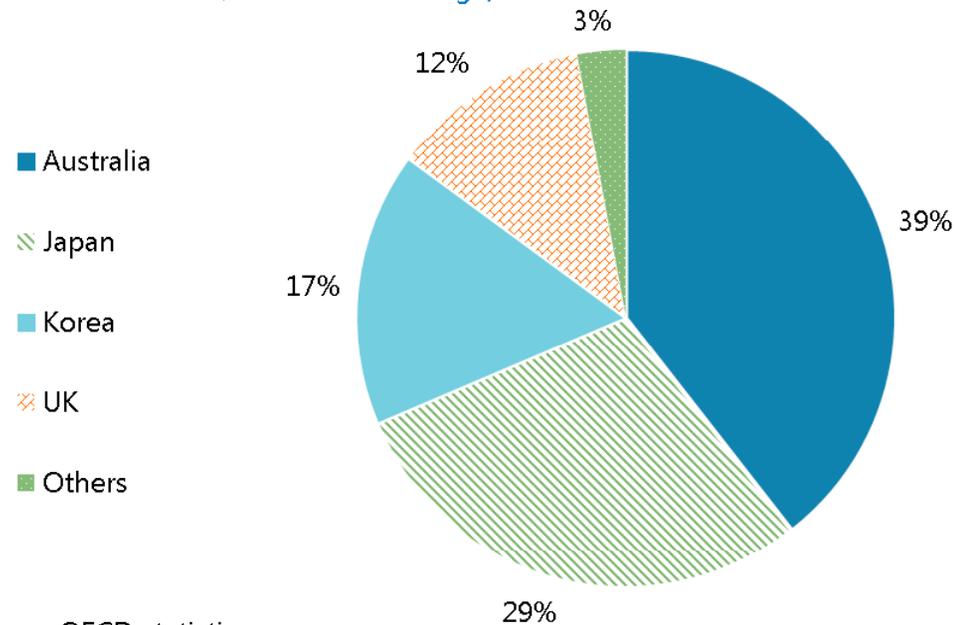


Source: World Bank.

# Australia is the largest provider of FDI among OECD countries

## PICs: FDI by OECD Countries <sup>1</sup>

(In percent of total FDI, 2005-2010 average)



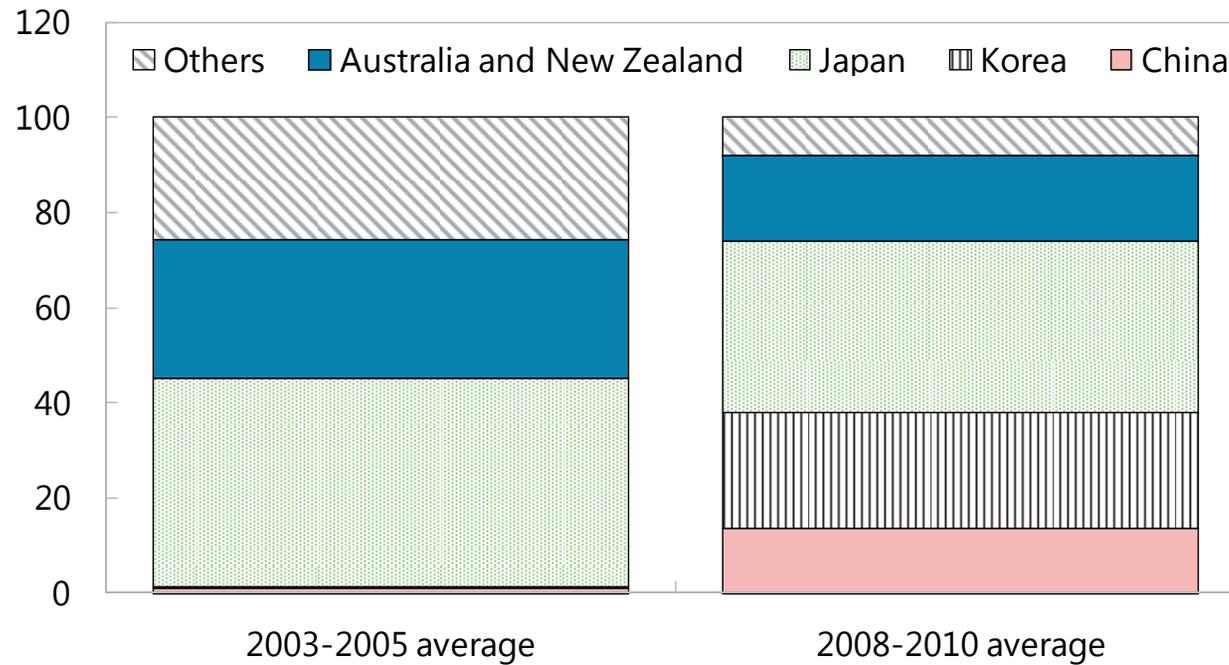
Source: OECD statistics.

<sup>1</sup> Excludes Norway and Denmark.

# Emerging Asia in playing an increasing role through FDI...

## PICs: FDI by Country of Origin <sup>1</sup>

(In percent of total FDI)



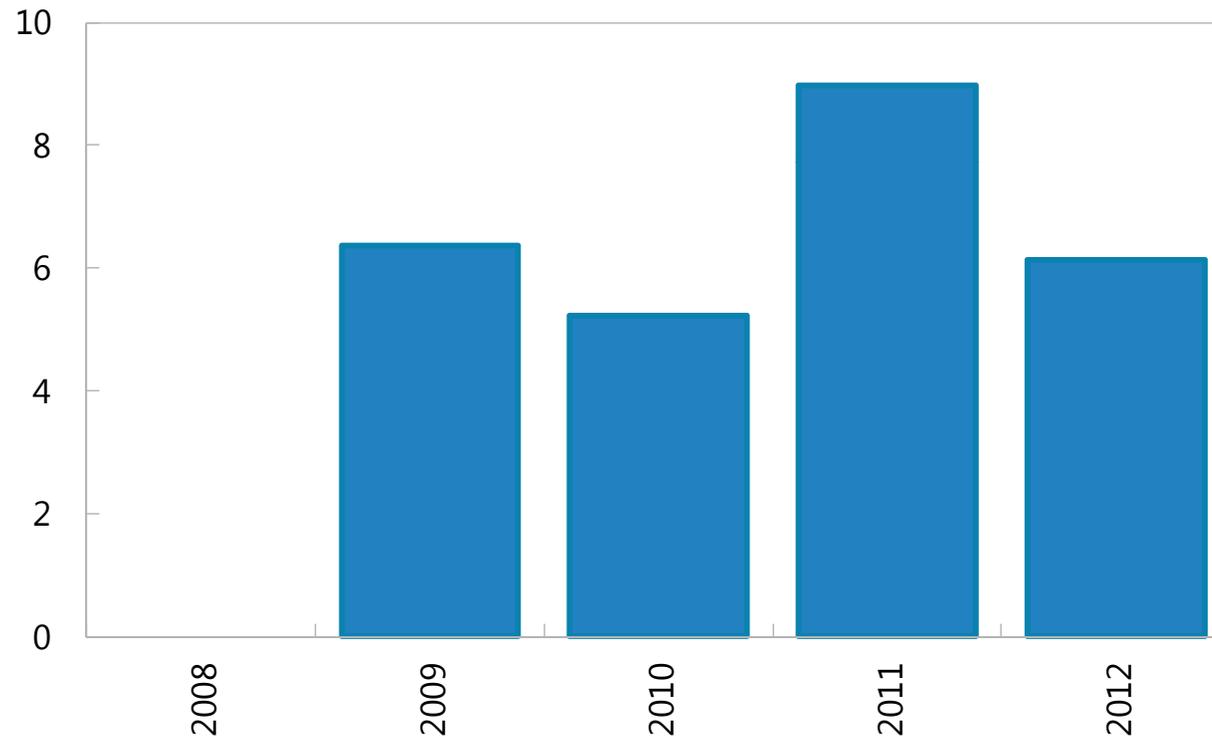
Sources: OECD and UNCTAD.

<sup>1</sup> Includes Australia, China, Korea, Japan, France, Germany, Italy, Luxembourg, Netherlands, New Zealand, Sweden, United Kingdom, and United States.

# ... external financing...

## Tonga: Loan Disbursements from China

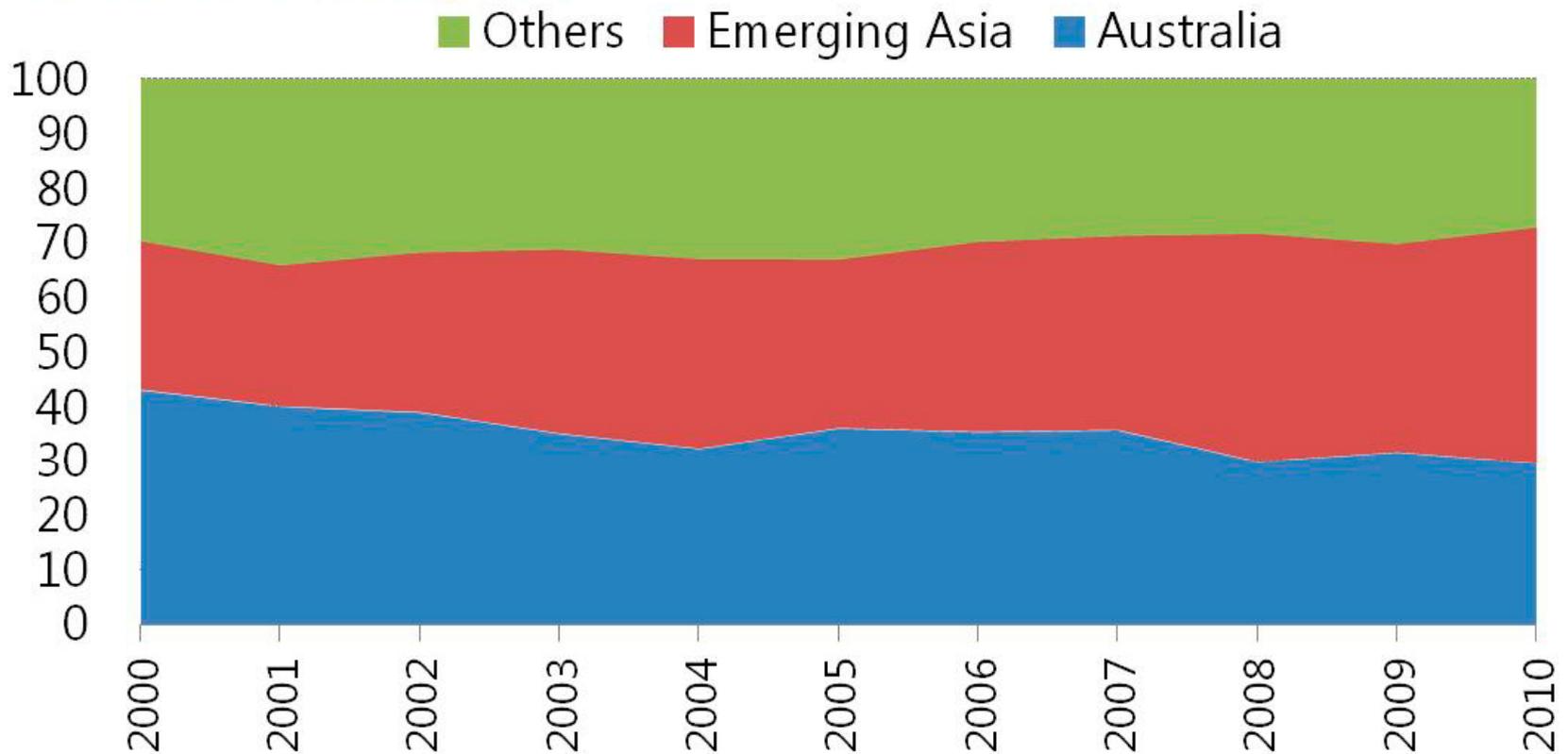
(In percent of GDP)



Source: Country authorities.

... and trade especially on the import side in some PICs...

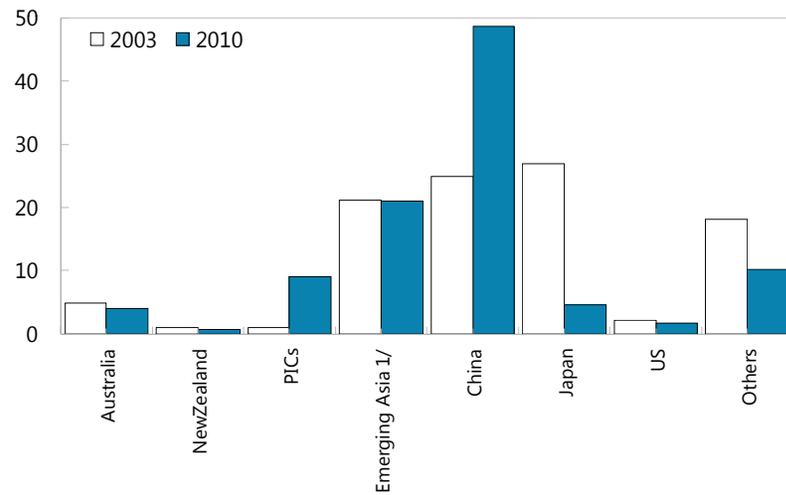
### PICs: Total Imports



# ...in Solomon Islands...

## Solomon Islands: Exports by Destination

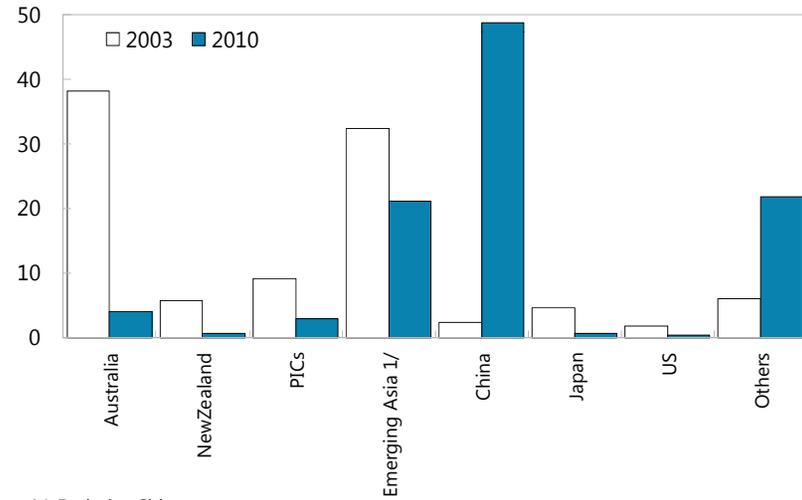
(In percent of total)



1/ Excludes China.

## Solomon Islands: Imports by Country of Origin

(In percent of total)

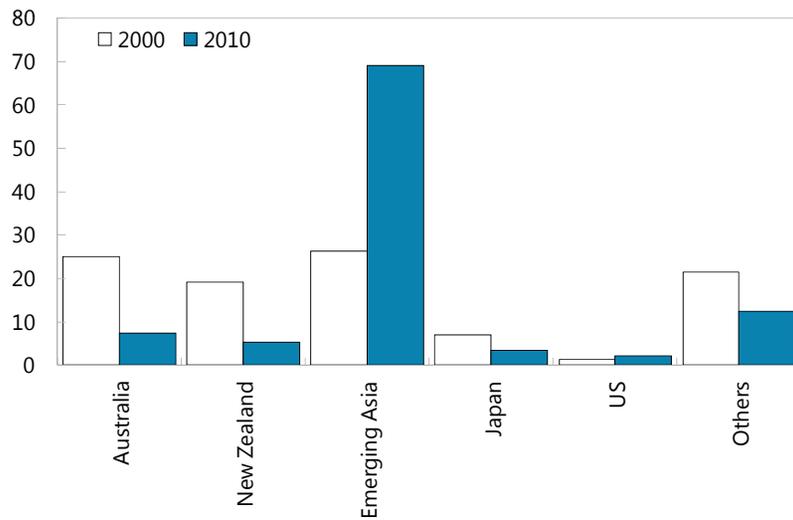


1/ Excludes China.

# ...Vanuatu and Fiji

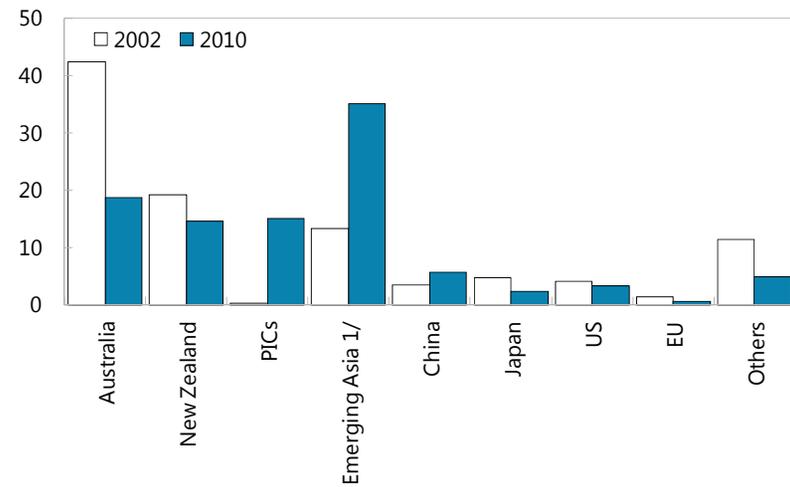
## Vanuatu: Imports by Country of Origin

(In percent of total)



## Fiji: Imports by Country of Origin

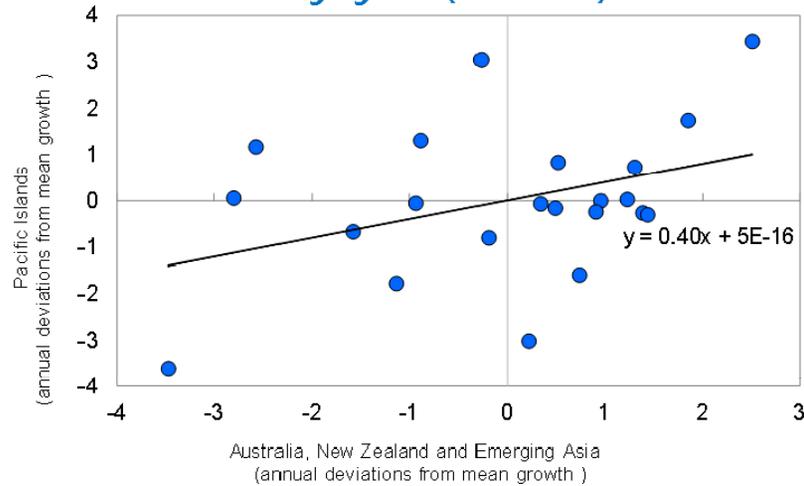
(In percent of total)



1/ Excludes China.

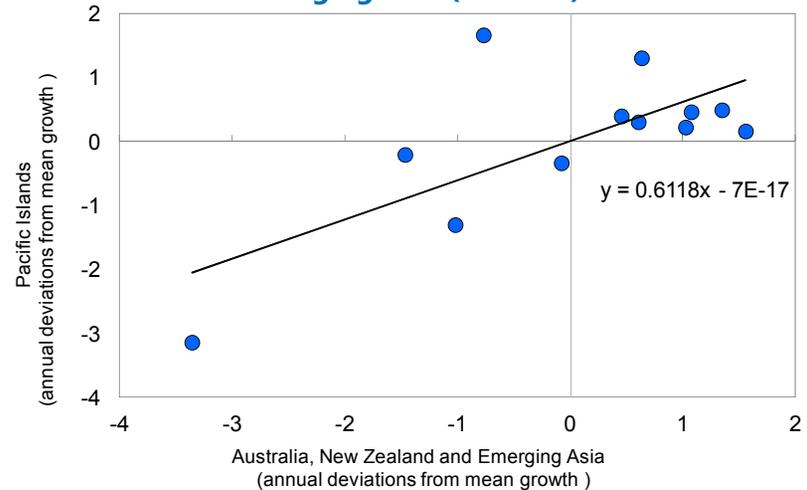
# Regional integration has increased over last ten years

**PICs: Correlation of Real GDP Growth with Australia, New Zealand and Emerging Asia (1990-2011)**



Sources: Country authorities; and IMF staff calculations.

**PICs: Correlation of Real GDP Growth with Australia, New Zealand and Emerging Asia (2000-11)**



Sources: Country authorities; and IMF staff calculations.

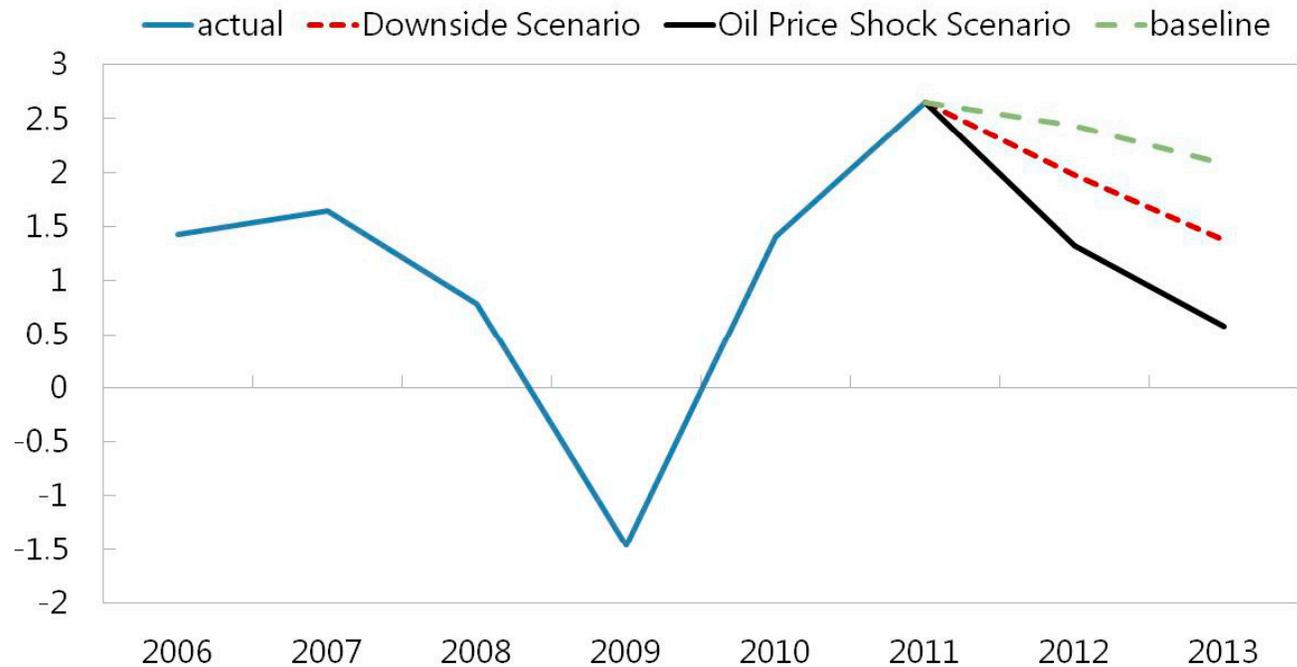
# Econometric Analysis on Spillovers

- Vector Error Correction Model (based on Sheridan, Tumbarello, Wu)
  - \* Baseline: Global and Regional Growth spillovers (short run and long run)
  - \* Downside: 1) Global Slowdown  
2) Supply-Side Commodity price Shock
- OLS model using VECM results as input to simulate the impact of a downside scenario on the banking sector

# Spillovers: Impact on Growth: commodity importers

## PICs: Real GDP Growth for commodity importers

(in percent)

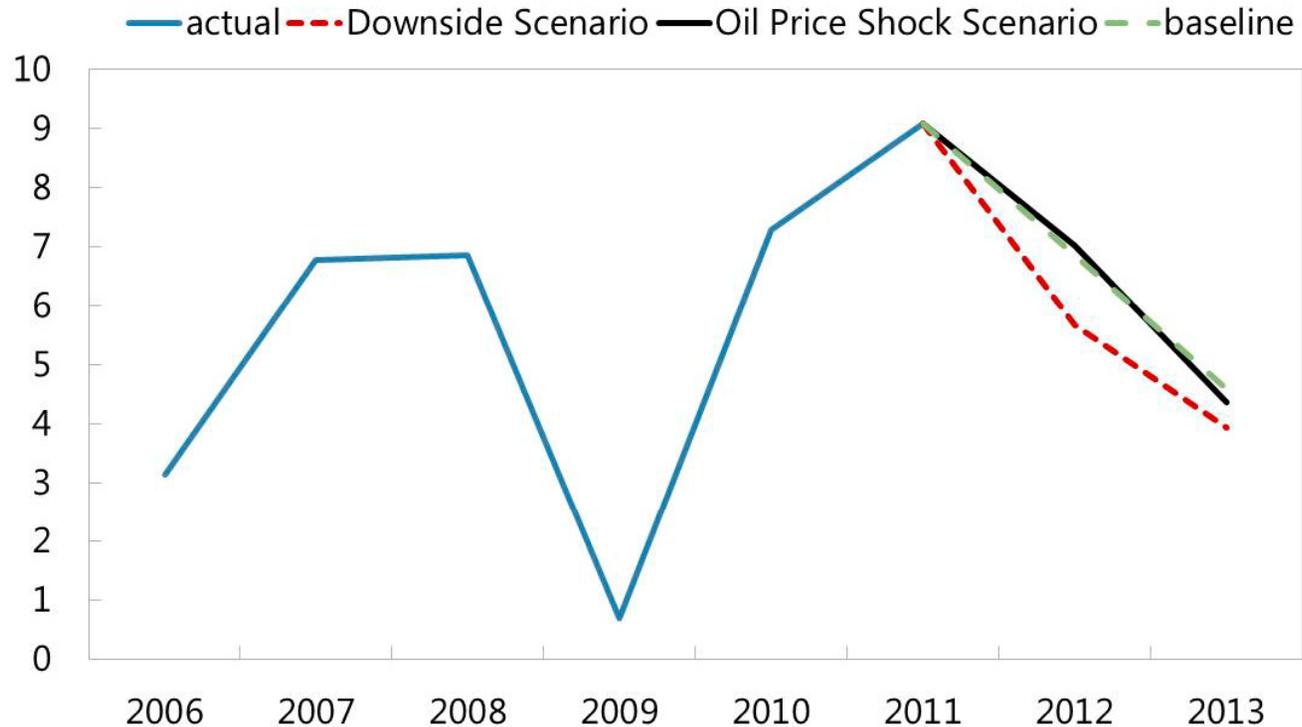


Source: IMF staff estimates.

# Spillovers: Impact on Growth commodity exporters

## PICs: Real GDP Growth for Commodity Exporters

(In percent)

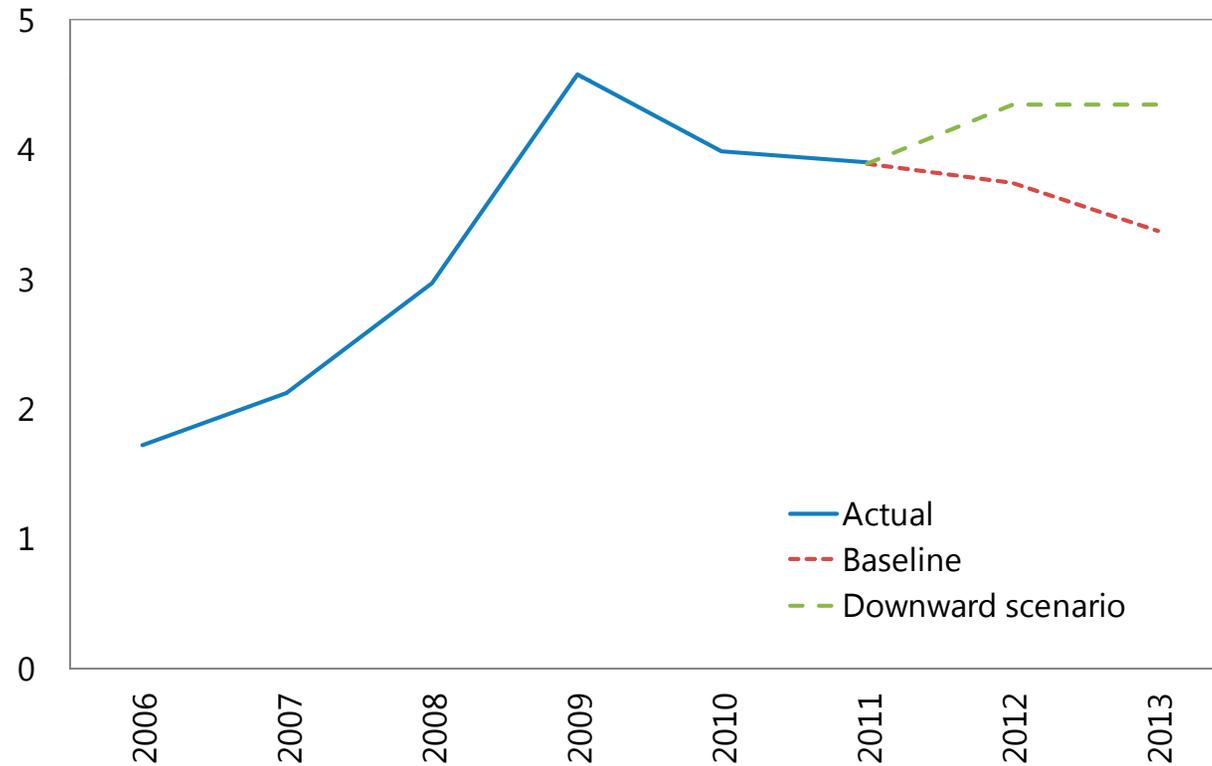


Source: IMF staff estimates.

# Spillovers to the Financial Sector

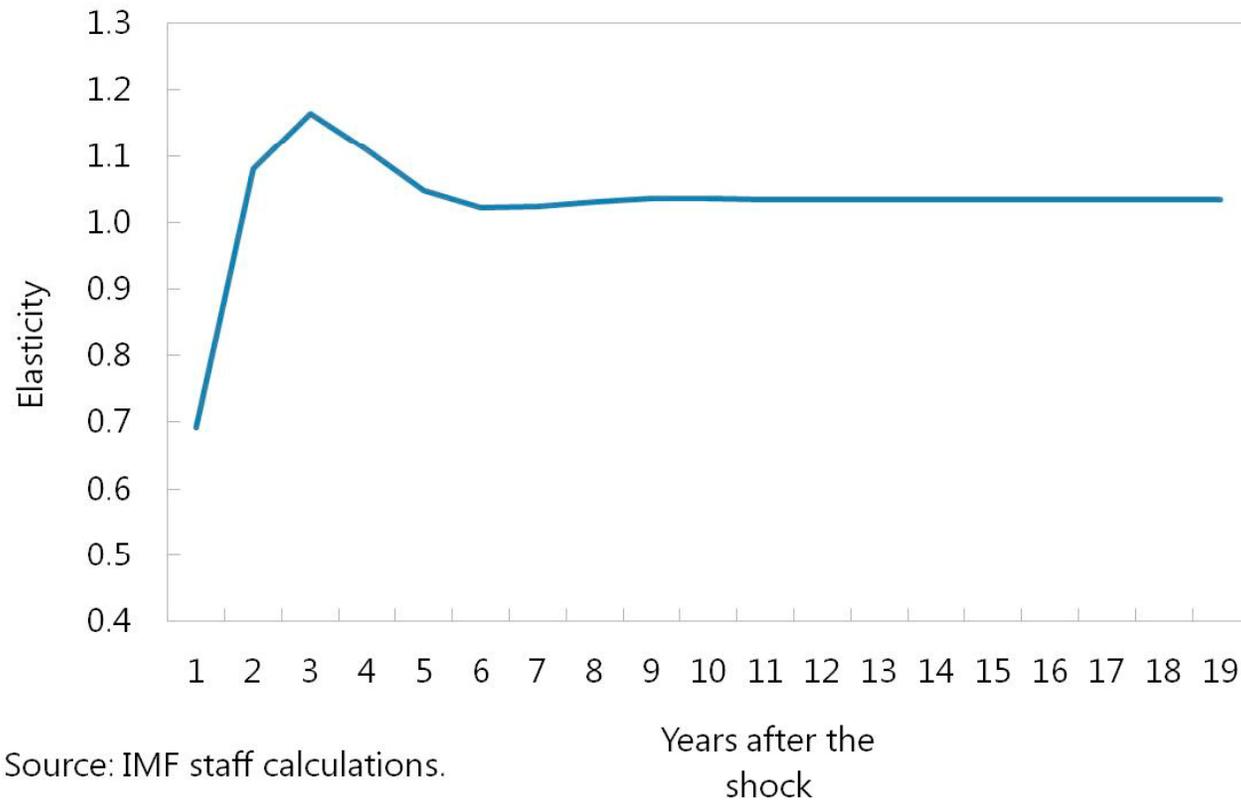
## PICs: Ratio of Provisions to Loans

(In percent)



# Elasticity of PIC GDP to Regional GDP

**Response of PIC GDP to Changes of Australia GDP**  
(In response to one percent shock)



# Main results from VECM

- Regional integration has increased
- Spillovers from Europe limited
- Australia is by far the main source of direct and indirect spillovers (in the long and short run)
- Emerging Asia matters in the short run
- Downside: commodity price shocks more relevant
- Spillovers to the financial sector → more provisioning
- Policies can play a role in enhancing resilience

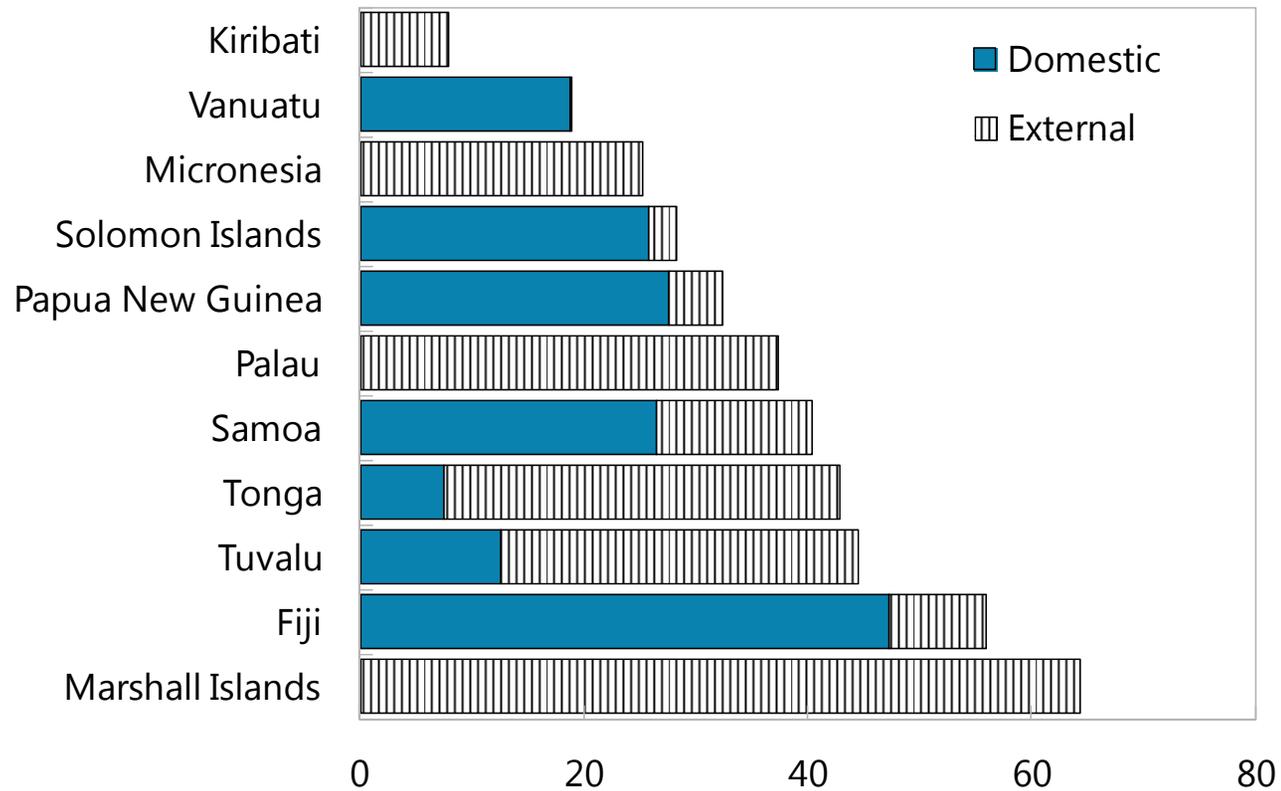
# WHAT ROLE FOR POLICIES

Rebuilding buffers to increase resilience

# Fiscal space is limited in PICs with high public debt narrowing the scope for countercyclical policies

## Public Debt, 2010

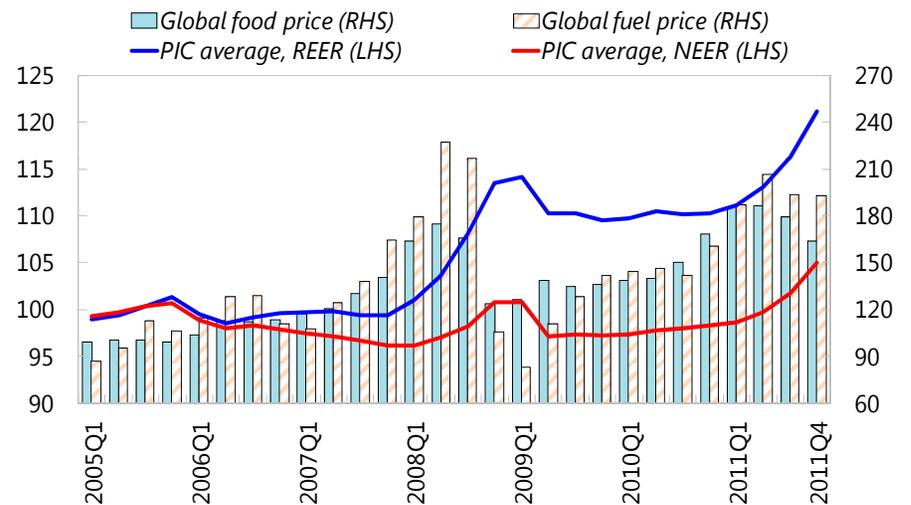
(In percent of GDP)



# Monetary and Exchange Rate Policies

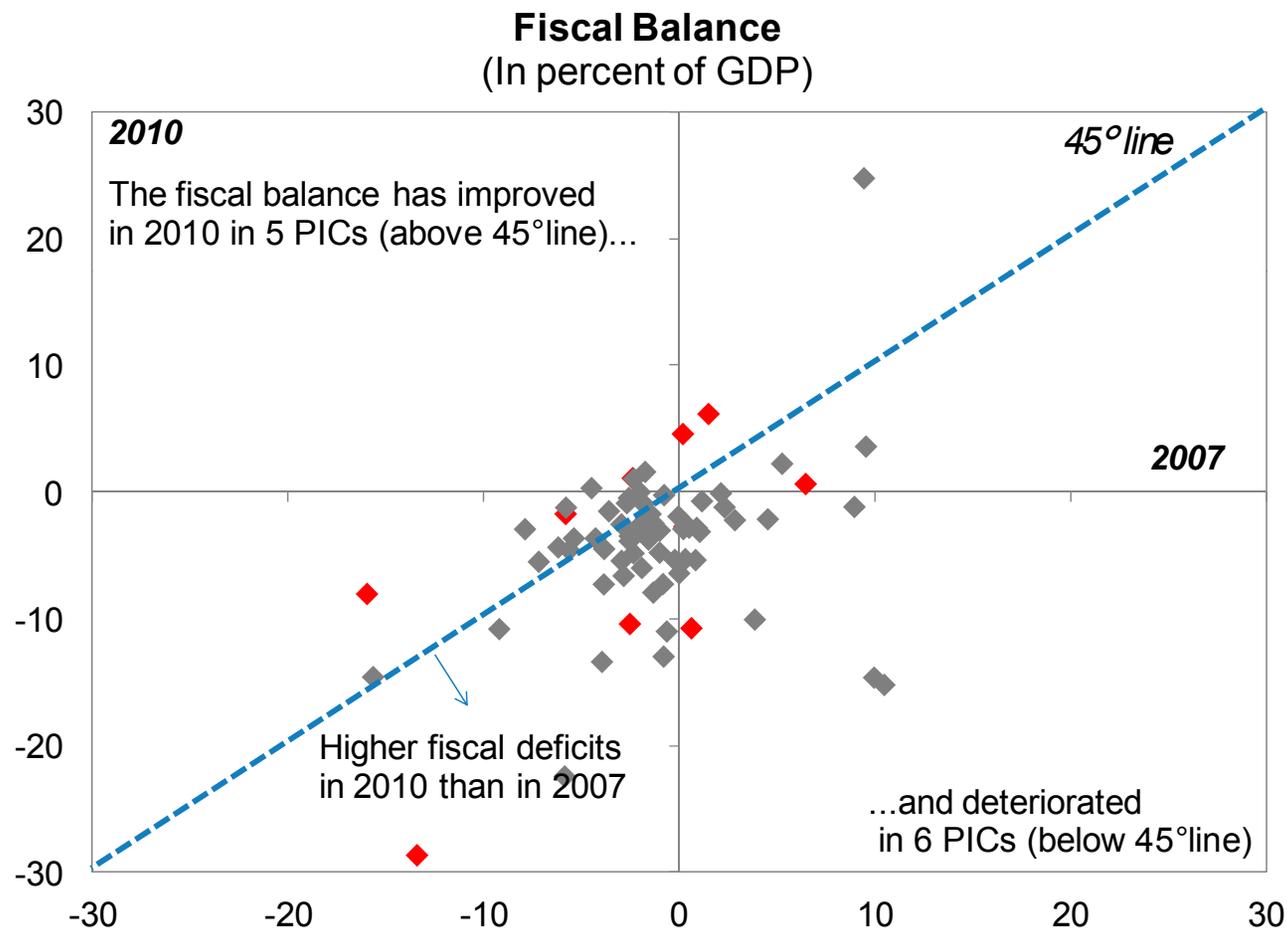
- In some PICs monetary transmission mechanism is weak: excessive liquidity
- Some PICs are dollarized
- Exchange rate has lately appreciated

**PICs: Effective Exchange Rates 1/**  
(Index, 2005=100)

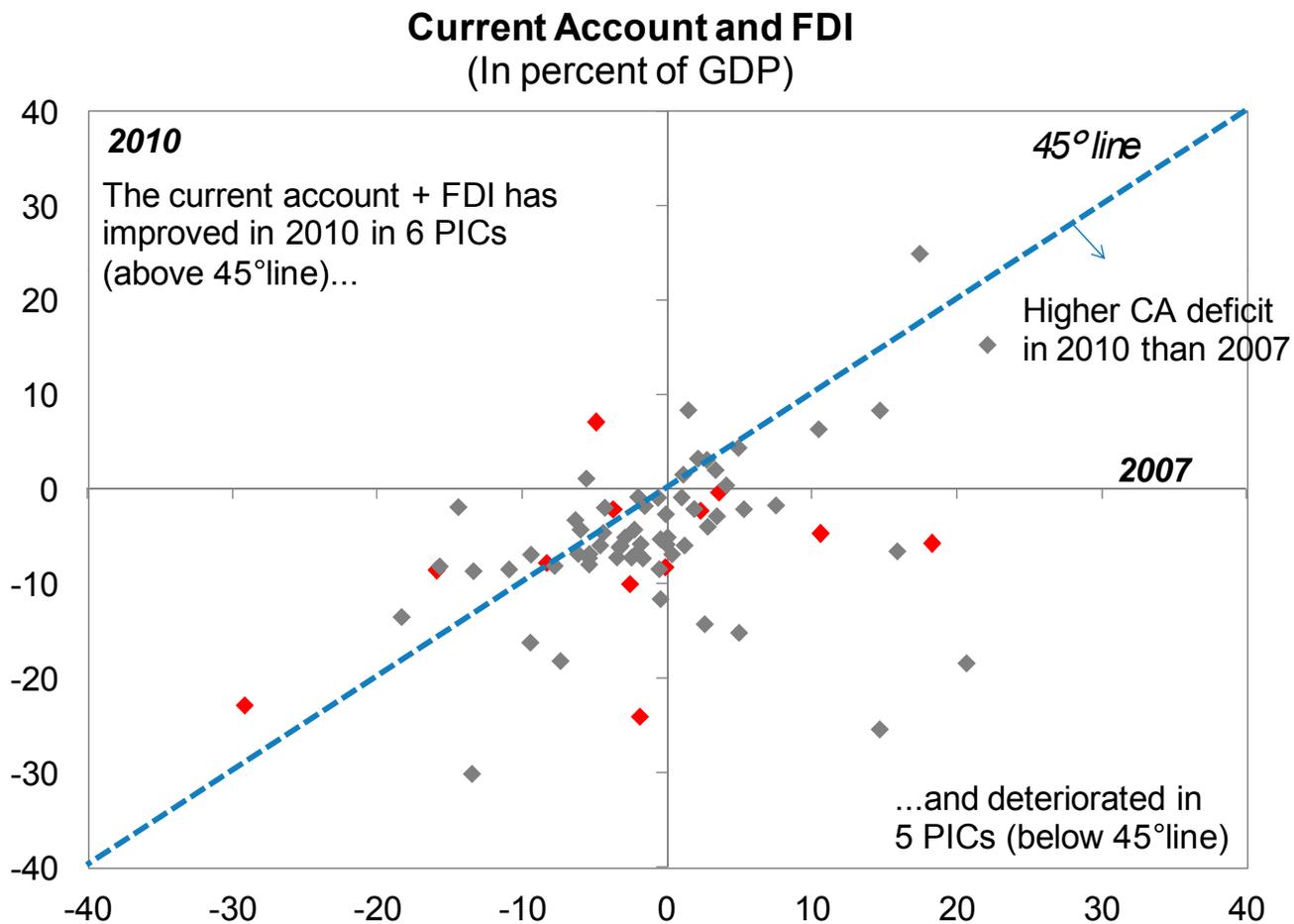


1/ PICs include Marshall Islands, Papua New Guinea, Samoa, Solomon Islands, Tonga, and Vanuatu.

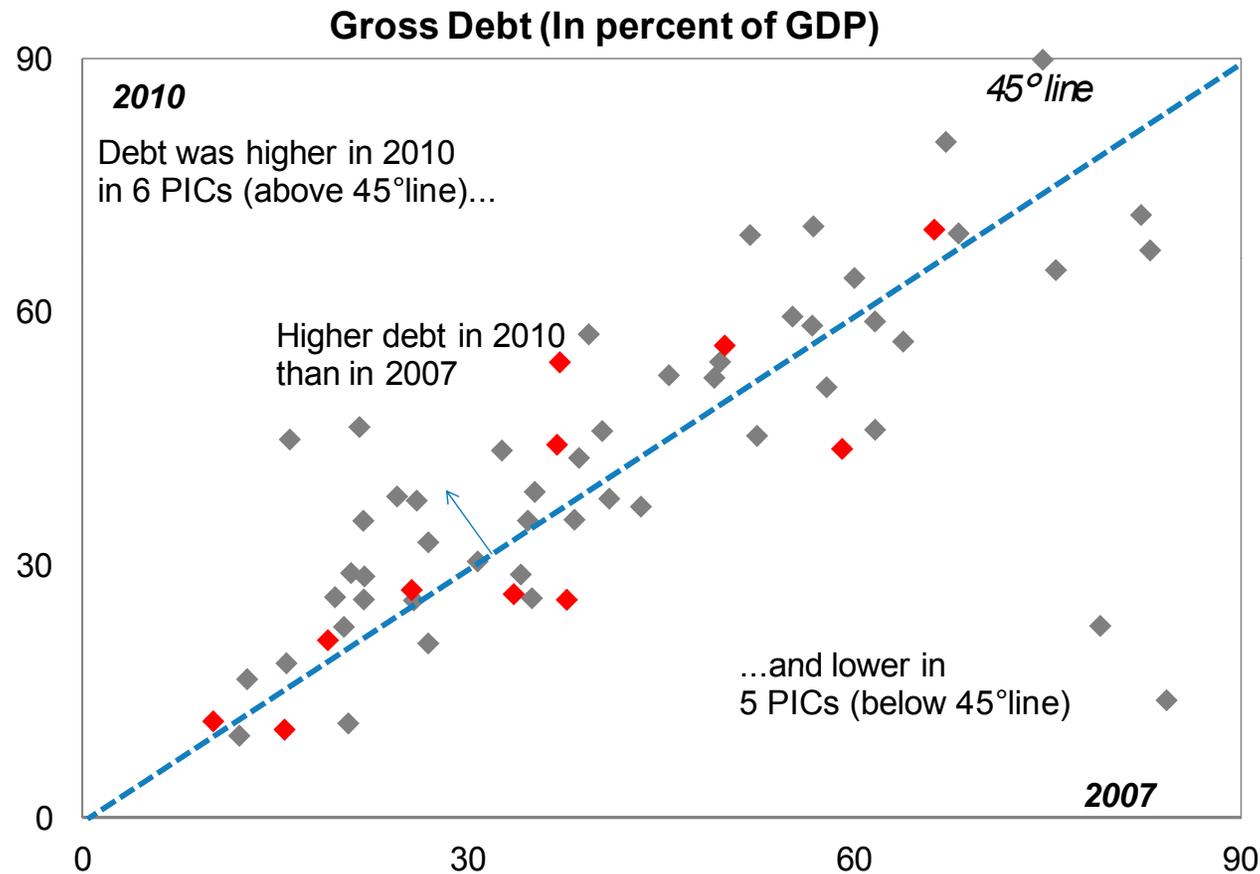
# Some PICs are in a weaker position than the pre-crisis years, especially with regard to fiscal...



# ...and current account balances

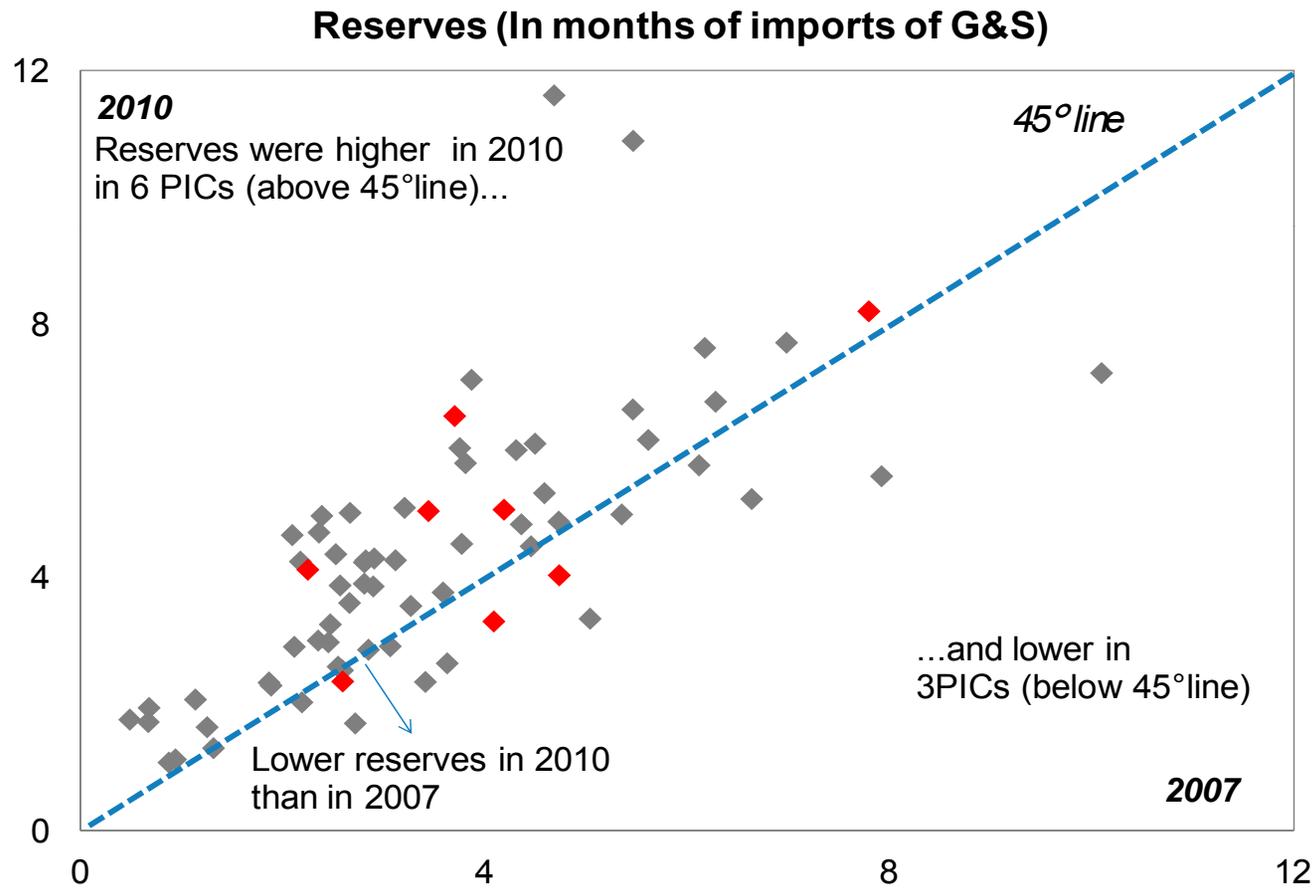


# But debt has declined especially in the commodity exporters

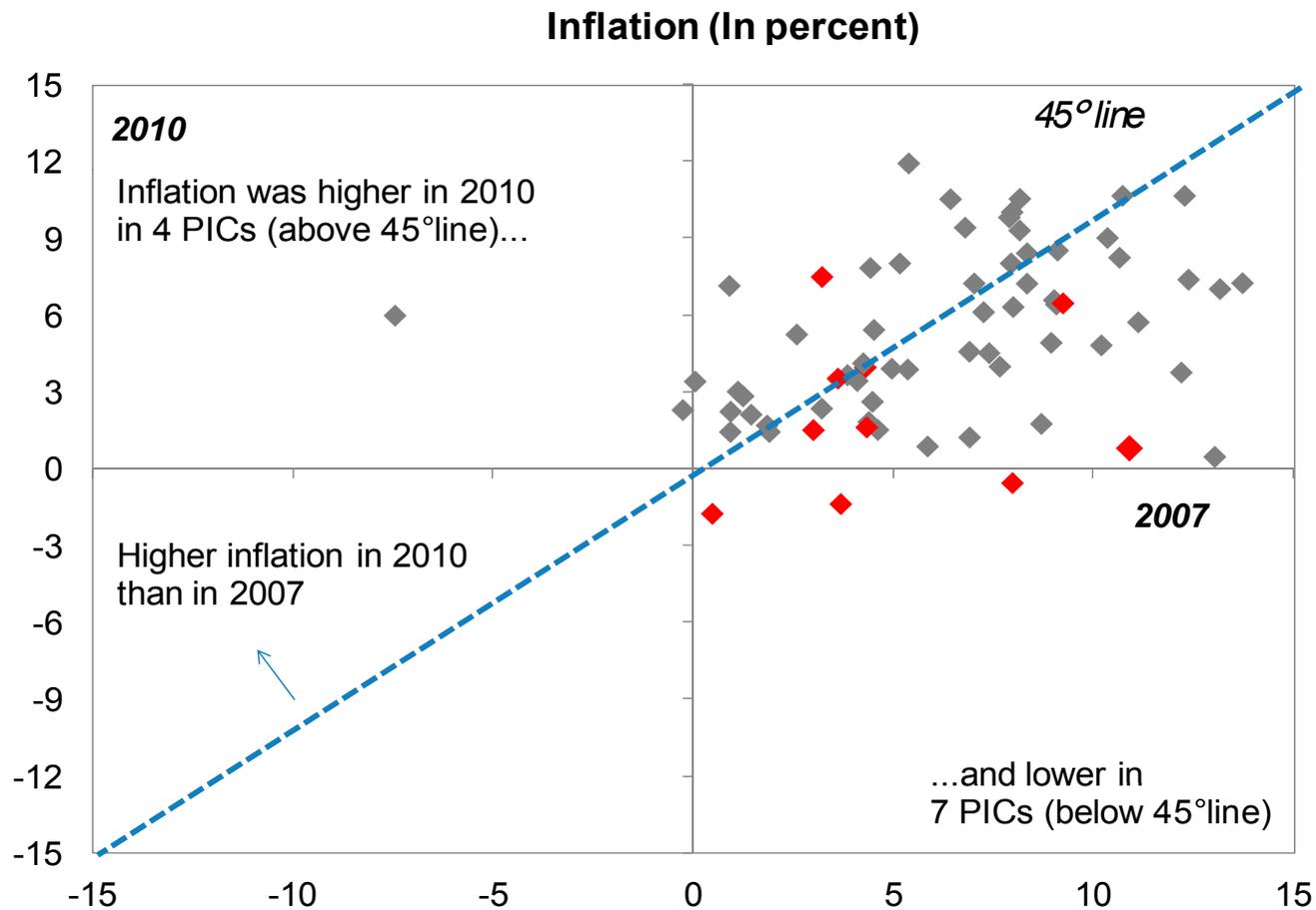


# ...reserve buffers have been rebuilt in several PICs...

## PICs...



# ...and inflation has remained moderate in some PICs compared to pre-crisis years



# Some conclusions

- Rising regional linkages offer greater insurance against risks generated by non-regional advanced-economies
- Policies can play a role in enhancing resilience to shocks and stabilize the business cycle
- PICs should continue to rebuild policy buffers and implement growth-oriented structural reforms to ensure inclusive growth