



PACIFIC ISLANDS FORUM SECRETARIAT

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FORUM ECONOMIC OFFICIALS MEETING

8 August 2023

FORUM ECONOMIC MINISTERS MEETING

9-10 August 2023

AGENDA ITEM 4: REGIONAL UPDATE ON ECONOMIC STATE OF PLAY & OUTLOOK

Purpose

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This paper provides an update to the Forum Economic Ministers Meeting (FEMM) on the economic state of play and outlook for the region based on the key economic indicators of: (i) real Gross Domestic Product (GDP) growth rate, (ii) inflation rates, and (iii) debt to GDP ratios. The details on a country basis are contained in *Annex 1*.

The paper also highlights broadly, the economic impact of the war in Ukraine and the risks associated with climate change induced shocks.

Summary

In terms of output levels, most Pacific countries are projected to reach their pre-pandemic GDP by 2024, except for Palau, Samoa, and Solomon Islands. Real GDP growth rates in Forum Island Countries (FIC) have rebounded from their lowest of -5.5 % in 2020 to about 5 % in 2023. Real GDP for the region is forecasted to decline to about 3.2 % in 2024.

Inflation is expected to remain elevated in 2023, threatening the livelihoods of poor and vulnerable people. Inflation hovered at around the 3% mark between 2019 - 2021 for most Forum Island Countries. However, inflation has increased to about 6 % in 2022, partly due to the war in Ukraine.

Key contributing factors to the elevated inflation rates include the weakening consumer and investor sentiments in several countries, the higher global interest rates and economic uncertainties due to the war in Ukraine pushing up financing costs, the impact on supply chain disruptions and energy prices.

Some of the poorest countries in the world are being forced into a choice between servicing their debt or serving their people. In 2022, the United Nations (UN) estimates that the global public debt reached a record US\$92 trillion dollars. Developing countries shoulder a disproportionate amount, especially across smaller Island economies.

Debt distress levels in the Pacific remains high but is expected to decline in most Pacific countries

as fiscal pressures ease and governments implement fiscal consolidation plans.

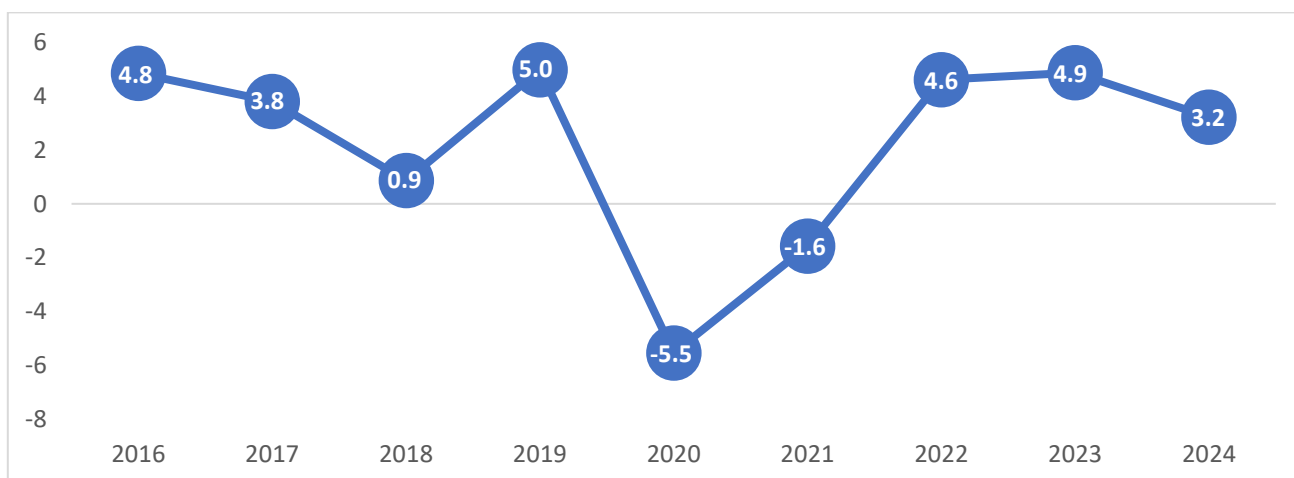
Given the region's vulnerability to disasters, climate change is a persistent major underlying risk. The United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) identifies 5 FIC in its top 10 climate-induced disaster-prone countries. These include Vanuatu, Tonga, Palau, Federated States of Micronesia (FSM) and Fiji.

A. Problem Statement/Context

Real GDP Growth Rates

Until the onset of the COVID-19 pandemic, real GDP growth rates for FIC were around 4% between 2016 - 2019, with a high of 5% growth in 2019 and falling to its lowest of -5.5% in 2020. Since then, real GDP growth rates in FIC have rebounded to about 5% in 2023. Real GDP is forecasted to decline to about 3.2% in 2024. This is shown below in Figure 1.

Figure 1: Real GDP Growth for Pacific Island Countries



Source: UNESCAP, 2023

2. According to the World Bank Pacific Economic Update (2023), the following analysis are made:

(i) For tourism-based economies, the earlier border reopening and connectivity to regional source markets, the faster the recovery. Country-specific factors also determine the recovery path. Fiji will reach pre-COVID-19 output levels by 2023, with Vanuatu reaching the milestone a year later due to the impact of the twin cyclones (see Table 1 for country specific real GDP growth rates).

(ii) In Samoa, GDP may not return pre-pandemic levels until 2025 due to the spillovers from the 2019 measles outbreak, prolonged border closure and a relatively weaker tourism base. Solomon Islands is not expected to reach its pre-pandemic GDP level until 2025 due to a low base after a series of adverse shocks, including civil unrest in November 2021 and declines in logging and agriculture productivity.

(iii) In contrast, some countries where fishing license revenue is a dominant contributor to income, such as Kiribati and RMI, surpassed pre-pandemic levels.

Table 1: Pacific Real GDP Growth Projections

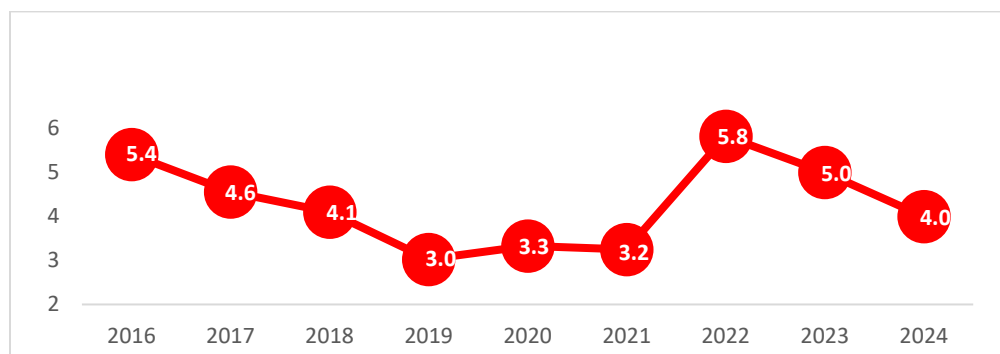
	2022 (Est.)	2023 (Est.)	2024	2025	2026
Fiji	18.6	7.7	4.0	3.3	2.7
FSM	0.6	3.2	2.4	1.0	0.7
Kiribati	1.2	2.5	2.4	2.3	2.1
Nauru	2.3	0.8	2.0	2.5	2.5
Palau	0.4	10.3	8.4	4.2	3.2
RMI	1.7	1.9	2.2	2.2	2.5
Samoa	0.0	5.5	4.2	3.0	2.5
Solomon Islands	-4.1	2.5	2.4	3.0	2.9
Tonga	-0.9	2.9	2.7	2.5	1.8
Tuvalu	0.7	3.9	3.5	2.4	2.2
Vanuatu	1.9	1.5	2.6	3.9	3.1
Tourism-based economy average	5.2	6.2	4.8	3.6	2.9
Non-tourism-based economy average	0.2	2.5	2.5	2.3	2.1
Overall Pacific Average	2.0	3.9	3.3	2.7	2.4

Source: IMF and World Bank staff estimates

Inflation

3. The onset of COVID-19 pandemic has significantly reduced global demand and supply of goods and services. Inflation hovered around the 3 % mark between 2019 - 2021 for most FIC. This is shown in Figure 2 below:

Figure 2: Inflation levels in Pacific Island countries, 2016-2024



Source: UNESCAP, 2023

4. However, inflation has increased to 5.8% in 2022, due to the impacts of the war in Ukraine. This is also reflected in the Asia-Pacific headline inflation, rising to 7.3% in March of 2022. To cope with rising inflation, many central banks have increased policy rates in their own economies.

5. Tighter monetary policy stances, however, dampens household consumptions and the ability of people and firms to service their debt obligations.

6. Inflation has been revised upwards since March 2023 projections to 6.0% in 2023. Supply chain disruptions and spillovers from the Russia's invasion of Ukraine continued to exert pressure on food and fuel prices (see Table 2 for selected country consumer price inflation projections).

Table 2: Pacific Consumer Price Inflation projections (annual average)

	2019	2020	2021	2022	2023	2024
Fiji	-0.8	-2.5	2.6	3.3	1.6	2.4
FSM	1.7	0.9	2.6	5.4	4.1	1.8
Kiribati	-1.6	2.4	1.6	5.3	8.6	4.5
Nauru	1.7	1.0	2.2	2.9	4.3	4.4
Palau	0.9	0.2	2.1	9.6	6.9	3.5
RMI	-0.5	-1.0	2.3	5.3	3.4	3.5
Samoa	1.0	-1.6	3.1	11.0	10.0	7.0
Solomon Islands	1.9	2.9	0.0	5.5	4.8	3.7
Tonga	1.3	0.1	2.9	9.7	8.6	3.9
Tuvalu	3.5	1.9	6.2	11.5	5.9	3.7
Vanuatu	2.6	5.0	2.4	4.6	8.3	5.6
Tourism-based economy average	0.9	0.3	2.6	7.1	6.7	4.6
Non-tourism-based economy average	1.2	1.2	2.5	6.5	5.7	3.7
Overall Pacific Average	1.1	0.9	2.5	6.7	6.0	4.0

Source: IMF and World Bank

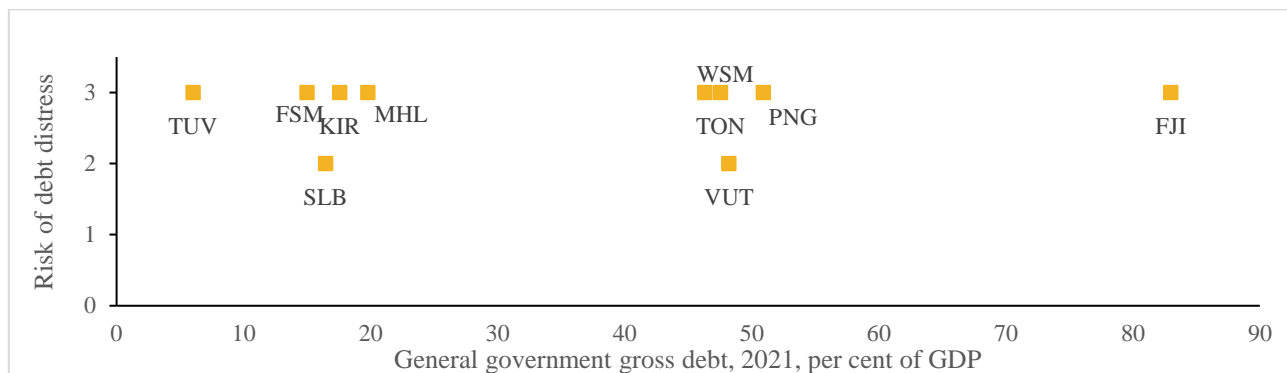
Debt distress

7. Some of the poorest countries in the world are being forced into a choice between servicing their debt or serving their people. In 2022, the United Nations (UN) estimates that global public debt reached a record US\$92 trillion dollars. Developing countries shoulder a disproportionate amount, exacerbating the interconnected crises of food, energy, and finance.

8. In 2022, based on data obtained from the IMF for ten (10) FIC, two (2) key observations on overall debt distress levels are observed as follows (see Figure 3):

- i) only Solomon Islands and Vanuatu were considered as being at moderate risk of debt distress; while
- ii) the rest (Fiji, FSM, Kiribati, Marshall Islands, Papua New Guinea, Samoa, Tonga and Tuvalu) are assessed as being at high risk of debt distress.

Figure 3: Overall debt distress in 10 Pacific Island Countries



Source: UNESCAP, 2023

9. Public debt level in tourism-based economies is relatively high compared to others in the region, reflecting the negative impact of the pandemic on these economies and the cost of fiscal response. Fiji and Palau continue to hold the largest share of public debt in the region with an average of over 85 percent of GDP in 2022. Tuvalu has the least public debt at 7 percent of GDP.

10. In line with fiscal consolidation efforts, public debt is projected to decline during 2023-2024 across the Pacific (except in Solomon Islands and FSM).

Impact of war in Ukraine

11. The multifaceted socio-economic impacts of the ongoing war in Ukraine poses a further shock to the world economy, including FIC. According to the UNESCAP¹, there are (3) main trends emerging:

- i) *Early indicators are pointing to notable adverse macroeconomic impacts of the war in Ukraine on the region* - the surging global energy and food prices are pushing up consumer inflation, which will disproportionately hurt poorer households;
- ii) *Countries in special situations, are deemed more exposed to the war in Ukraine than others* – in the Pacific, these include Kiribati, Samoa, Solomon Islands and Vanuatu whom, because their economic structure and conditions are more exposed to higher energy and food prices, smaller external financial inflows, rising financing costs and/or sudden shifts in business sentiments; and
- iii) *Policymakers can consider various policy measures to reduce the immediate impact of the war in Ukraine and increase resilience to future economic and price shocks*. To cushion the impact of rising food prices, governments may consider stepping up the provision of subsidies and ensure that existing government assistance, social protection mechanisms and development programmes benefit those in need. This would require, however, strong fiscal positions, which had already deteriorated in many Pacific economies in the aftermath of the

¹ UNESCAP Policy Brief, 2022, The war in Ukraine: Impacts, exposure and policy issues in Asia and the Pacific, Bangkok, Thailand

pandemic. To boost fiscal space and to maintain public debt sustainability, various fiscal and financing policy options should be explored urgently.

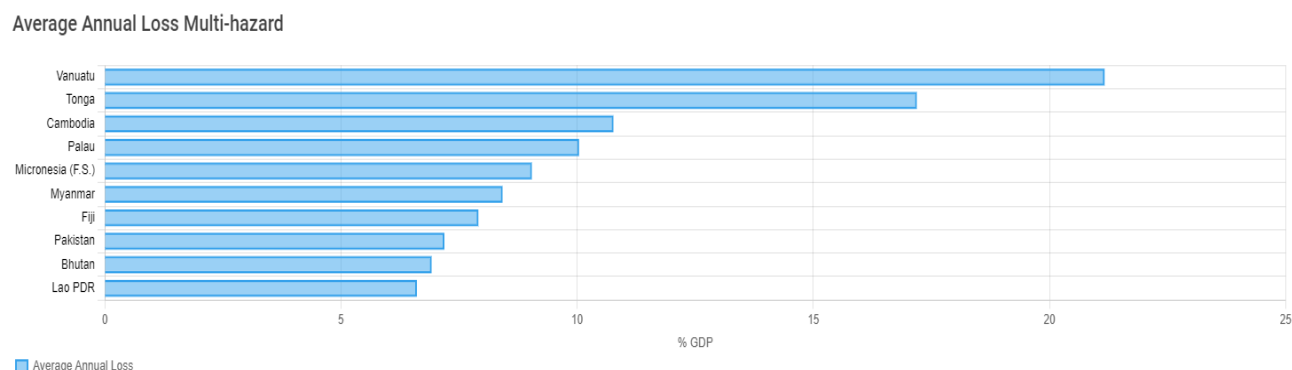
The Impact of Climate Change Shocks on Inflation and Growth

12. *The increasing frequency and severity* of climate-related disasters affect economic development, worsen external balances, threaten financial system stability, significantly affect government bond yields, increase the probability of debt defaults and poor sovereign credit ratings especially in developing countries.

13. A study by the IMF² indicate that climate-induced disasters have differential and opposing effects on inflation and growth through multiple channels, such as: (i) increasing or lowering agricultural production and food prices; (ii) dampening economic activity and lowering labor productivity; (iii) reducing wealth and income and thereby consumption and investment; (iv) affecting transportation infrastructure and distribution costs.

14. In addition, the ESCAP identifies 5 FICs in its top 10 list of countries at high risk from disasters and climate change. These include, from the highest risk, Vanuatu, Tonga, Palau, FSM and Fiji, as shown in Figure 4 below.

Figure 4: Top 10 Average Annual Loss Multi-hazard



Source: UNESCAP Disaster Risk portal

15. In terms of the average annual loss due to hazards and climate change for FIC, it is estimated that average annual loss as a percentage of GDP is as follows:

- Vanuatu - 21.7 %
- Tonga - 17.19 %
- Palau - 10.04 %
- FSM - 9.04 %
- Fiji - 7.91 %

16. This means, many of the regions economies are in a constant cycle of response and recovery making the region's climate financing needs substantial, estimated at 6.5 % - 9.0 % of GDP or almost

² Cevik, S & Jalles JT, 2023, Eye of the Storm: The Impact of Climate Shocks on Inflation and Growth, IMF Working Paper

US\$1 billion annually³. Unfortunately, current estimated financing of around US\$220 million⁴ annually for FIC has fallen far short of the financing requirement and couples with accessibility, implementation efforts for mitigation and adaptation have been uneven across the Pacific.

B. Linkages to 2050 Strategy for the Blue Pacific Continent

17. The *2050 Strategy for the Blue Pacific Continent* (2050 Strategy) identifies seven thematic areas including one on resources and economic development and another focused on climate change and disasters.

18. The resources and economic development thematic area highlights the importance of accelerating the region's economic priorities and aspirations. To support these aspirations, the proposed Pacific Roadmap for Economic Development (PRED) attempts to articulate the key regional economic priorities and their associated collective actions that aims to grow and diversify the economic base of FIC, strengthen and improve their financial and fiscal resilience and harness the full potential of their blue and green economies.

19. The 2050 Strategy also recognises the multifaceted impacts of climate change and disasters on Pacific peoples, the statehood of FIC and their economies. Climate induced disasters negatively affect the financial and fiscal resilience of FIC and therefore timely access to climate finance and disaster risk finance to support adaptation and mitigation is a priority.

20. To be effective in accessing and managing existing and new sources of financing, key prerequisites include expanding the available climate finance landscape and options, the ability to mobilise private sector finance, robust Public Financial Management (PFM) systems at national level, prioritising capacity building and supplementation, and consolidating individual country efforts towards a regional approach. The establishment and capitalisation of the Pacific Resilience Facility (PRF) would be a game changer for the region in this regard.

Pacific Islands Forum Secretariat
1 August 2023

³ IMF. 2021. Unlocking Access to Climate Finance for Pacific Island Countries.
<https://www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2021/09/23/Unlocking-Access-to-Climate-Finance-for-Pacific-Islands-Countries464709>

⁴ Consolidated figure from PIFS climate finance assessment reports completed in 11 PICs.

Annex 1: Key Indicators for some Forum Island Countries

Cook Islands	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	4.8	-5.2	-29.1	10.5	11.2	11.0
Inflation	0.0	0.7	2.2	4.2	7.7	7.7
Debt to GDP ratio						

* Projected

Fiji	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	0.5	-17.2	-5.1	15.6	6.0	3.8
Inflation	1.8	-2.6	0.2	4.8	4.2	3.6
Debt to GDP ratio	48.8	63.1	83.0	91.3	91.1	91.5

Kiribati	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	2.3	-0.5	1.5	1.8	2.3	3.0
Inflation	-1.8	2.3	1.0	5.0	3.7	3.3
Debt to GDP ratio	20.1	19.0	17.6	25.2	32.8	39.0

Marshall Islands	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	5.3	-2.2	-2.5	1.5	2.2	2.5
Inflation	0.1	-0.8	1.0	3.5	5.5	3.0
Debt to GDP ratio	24.8	21.6	19.8	20.8	21.6	24.3

Micronesia (Federated States of)	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	1.2	-3.8	-1.2	2.2	4.1	4.0
Inflation	-2.6	-2.9	2.0	8.8	4.1	3.0
Debt to GDP ratio	17.8	18.3	15.0	14.2	13.3	17.4

Nauru	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	1.0	0.7	1.6	1.2	2.2	2.4
Inflation	4.3	-6.6	1.2	2.3	2.5	2.5
Debt to GDP ratio	62.8	61.4	27.1	27.3	25.0	22.9

Palau	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	0.3	-9.7	-17.1	-1.0	4.3	3.0
Inflation	0.6	0.7	0.5	10.2	5.0	3.0

Debt to GDP ratio

Papua New Guinea	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	6.5	-3.5	-0.2	3.5	4.9	3.0
Inflation	3.6	4.9	4.5	6.0	5.0	4.0
Debt to GDP ratio	40.2	47.1	50.9	49.9	49.3	50.9

Samoa	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	2.3	-3.1	-7.1	-6.0	2.0	2.5
Inflation	2.2	1.5	-3.0	8.8	10.6	8.0
Debt to GDP ratio	44.3	43.2	46.3	46.4	45.1	46.6

Solomon Islands	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	1.2	-3.4	-0.5	-4.2	3.0	2.4
Inflation	1.6	3.0	-0.2	4.0	4.0	3.5
Debt to GDP ratio	7.9	13.7	16.5	19.2	21.7	24.6

Tonga	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	0.7	0.5	-2.7	-2.2	2.5	3.2
Inflation	4.0	0.2	1.4	8.5	9.4	4.5
Debt to GDP ratio	41.3	43.6	47.5	47.4	45.3	44.3

Tuvalu	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	6.3	1.0	1.5	2.5	2.7	3.2
Inflation	3.5	1.6	6.7	7.6	3.3	3.0
Debt to GDP ratio	11.5	7.3	6.0	4.8	3.8	3.3

Vanuatu	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024*
Real GDP Growth	2.8	-5.0	1.0	2.0	4.0	4.4
Inflation	2.8	5.3	2.3	4.8	3.2	2.5
Debt to GDP ratio	45.1	47.5	48.2	50.4	51.0	51.3

Source: UNESCAP, 2023