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Pacific Islands Monitor

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Recent Developments and Short-Term Outlook

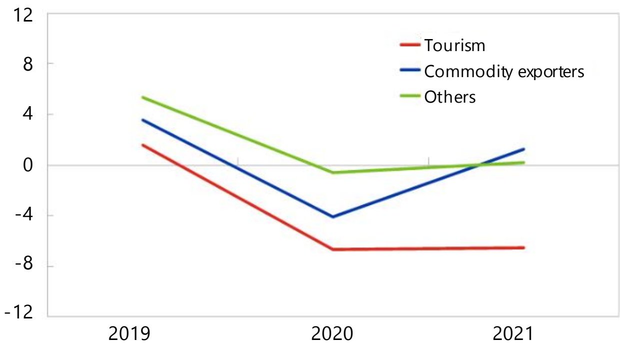
The COVID-19 pandemic continues to weigh heavily on the Pacific Island Countries (PICs) but not uniformly. Many PICs remain COVID free, but the effects of the pandemic and local containment measures have strained their economies. The region's output declined by 3.7 percent on average in 2020 and is expected to decline by an additional 2.4 percent in 2021[1]. Output losses have varied—largely as a function of dependence on tourism and commodity exports, the stringency of local lockdowns, and the size and efficacy of policy support.

Economic contractions have been most pronounced in tourism-dependent economies. The sudden stop of tourism inflows in March 2020 immediately impacted such economic activities as restaurants and hotel services, transportation, and other business activities. As a group, the unweighted average real GDP of Pacific Islands with a reliance on tourism (Fiji, Palau, Samoa, Tonga, and Vanuatu) contracted by 6.6 percent in 2020 and is expected to decline by a further 6.5 percent in 2021. Countries with a heavy reliance on commodity exports (Papua New Guinea and Solomon Islands) also experienced large contractions in GDP during 2020, due in part to the decline in external demand for their products. However, these countries are expected to benefit from the global recovery and increase in commodity prices in 2021.

A range of other factors have also differentiated the impact of the pandemic across the Pacific Islands. These include (i) the stringency of containment measures; (ii) the magnitude of economic slowdowns in main trading partners; (iii) increased economic uncertainty and dampening effects on consumption and investment; (iv) disruptions in seasonal worker programs and global supply chains; and (v) a halt in the arrival of foreign experts and associated impact on execution of infrastructure projects. A recent surge in commodity prices is also affecting the PICs given their heavy dependence on imported goods (particularly foods). Average end-2021 inflation is estimated to have increased by 3.0 percent in 2021 from 0.3 percent in 2020. This recent surge in inflation is expected to be transitory but uncertainty remains high.

PICs: Short Term Output Loss

(Average Real GDP Growth)



Note: Tourism economies include Fiji, Palau, Samoa, Tonga, and Vanuatu; commodity economies include Papua New Guinea and Solomon Islands; and mixed economies include Kiribati, Marshall Islands, Micronesia, Nauru and Tuvalu.

Sources: World Economic Outlook and IMF Staff calculations

COVID-19 Stringency Index

(0-100, September 2021)

Source: Oxford COVID-19 Government Response Tracker

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

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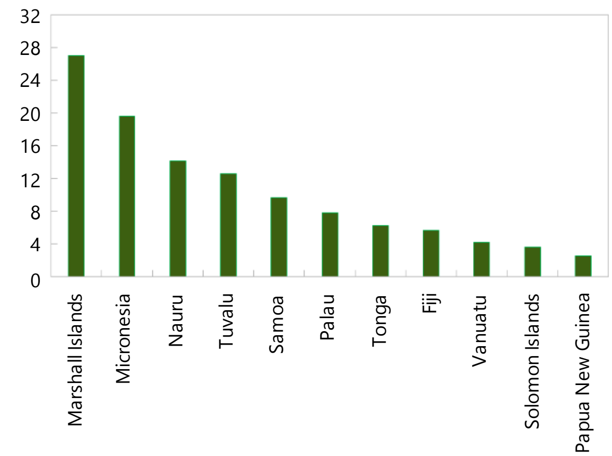
[1] For countries following Fiscal Year (FY) budget, such as Marshall Islands, Micronesia, Palau, and Tonga, all numbers referrer to their FY outturns or projections.

Economic contraction, loss of tourism revenues, and counter-cyclical fiscal measures generally widened fiscal deficits in 2021. The erosion in the tax base due to economic contractions combined with lower revenues from tourism activities and commodity exports led to a deterioration in the fiscal positions in most Pacific Islands. Higher public spending to mitigate the impact of the COVID-19 pandemic outbreak also contributed to fiscal gaps. The additional fiscal measures in response to the pandemic since January 2020 is estimated at about US$1,066 million. Development partners increased their grants to support response plans in the PICs. Nevertheless, the unweighted average fiscal balance among the PICs shifted from a surplus of 3.9 percent of GDP in 2019, to a surplus of 1.4 percent of GDP in 2020 and an estimated deficit of 3.5 percent of GDP in 2021. Fiji and Palau—two tourism-dependent economies—are expected to record the largest fiscal deficits in 2021. Higher fiscal deficits are reflected in higher public debt, with the regional average rising by 5 percentage points to reach about 39 percent of GDP in 2021.

PICs: Fiscal Measures in Response to COVID-19

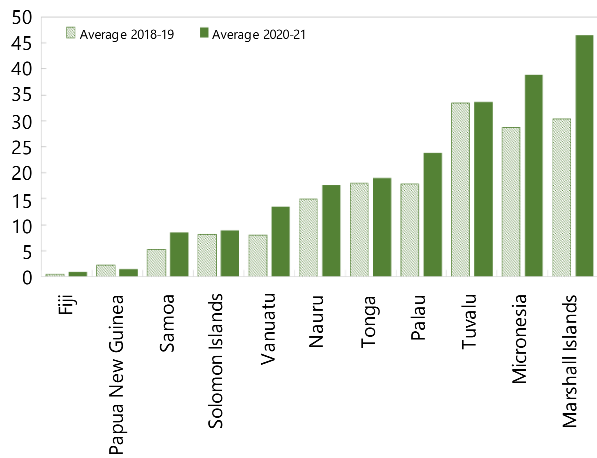
(In percent of GDP)



Sources: Country authorities and IMF staff estimates
Note: Fiscal measures include above the line measures and liquidity support between January 2020 and June 2021.

PICs: Grants

(In percent of GDP)



Sources: Country authorities and IMF estimates.

External balances are also projected to deteriorate further in 2021—with the regional average driven largely by developments in tourism-dependent economies. The average current account deficit is estimated at 5.3 of GDP in 2021 from a smaller deficit of 1.0 percent of GDP in 2020 and a surplus of 1.2 percent of GDP in 2019. The deterioration is driven largely by tourism-dependent economies that are expected to record an average current account deficit of about 20 percent of GDP in 2021. The lesser degree of stress on balance of payments for many PICs is due largely to a combination of three factors: (i) donor support in the form of concessional loans and grants; (ii) remittances have been resilient notwithstanding the global recession[2]; and (iii) weak aggregate demand reduced imports, improving trade balances. As a result, foreign exchange reserves have remained relatively robust in many PICs.

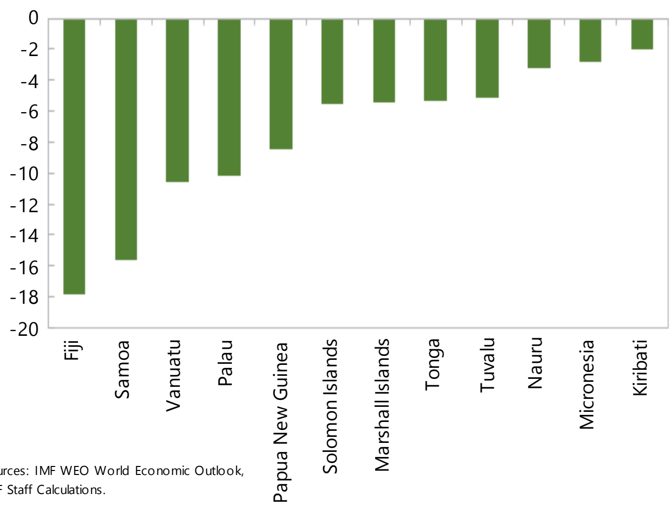
[2] See Kpodar et al. (2021), ''Defying the Odds: Remittances During the Covid-19 Pandemic'', IMF WP/21/186.

Medium-Term Outlook

While the winding down of the pandemic will ease pressure across the Pacific Islands, the outlook is likely to be marked by divergent paths to economic recovery. Average real GDP growth among the Pacific Islands is expected to rise to about 4.0 percent in 2022 before moderating to about 3 percent in the medium-term as base effects diminish. Vaccine supply and distribution, as well as evolution of the external environment and domestic policy support, will determine the pace of recoveries across Pacific Islands. For commodity exporters, global demand for commodities as well as the evolution of their prices will be key. For tourism-reliant countries, the key variables will be the timing of border reopening—including in tourism source markets—and the pace of recovery in international tourism.

PICs: Medium Term Output Loss (2020-24)

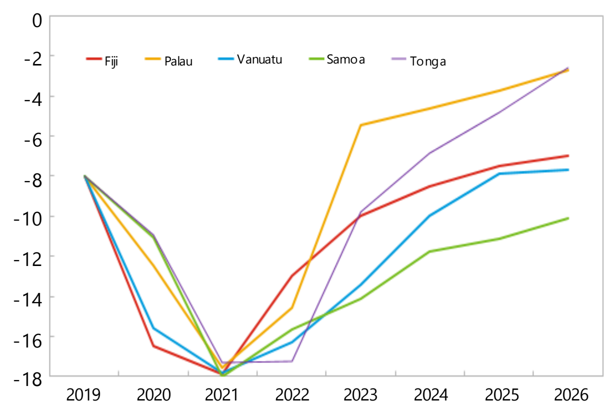
(Current projection relative to pre-COVID forecast, in percentage points)



Sources: IMF WEO World Economic Outlook, IMF Staff Calculations.

PICs: Projected Recovery in Tourism

(In percent of GDP)



Sources: IMF Staff Estimates.

Fiscal positions are on average expected to remain in deficit in the medium-term. The average fiscal deficit among PICs is projected at about 4 percent of GDP over the medium-term. Revenues are expected to gradually improve in many Pacific Islands as borders reopen and economic activity ramps up to pre-pandemic levels. However, government spending is expected to remain high as COVID-related support policies are expected to continue until the recovery is firmly underway. As a result, improvement in fiscal positions and public debt is expected to lag the general economic recovery.

External balances are expected to strengthen gradually over the medium term. The average current account balance is projected to improve from a deficit of about 4 percent of GDP in 2022 to a deficit of about 3 percent in the medium-term. Imports are expected to increase in the medium-term as: (i) economic growth rebounds; (ii) borders gradually reopen inducing less disruption in global trade; and (iii) commodity prices increase, leading to higher import bills for most of the PICs[3]. Remittances are also expected to revert to their pre-pandemic levels as tourism receipts steadily improve. Foreign exchange coverage ratios are expected to gradually converge towards their pre-pandemic levels.

[3] Most PICs are net importers of commodity goods.

Challenges

Uncertainty around the speed and depth of recovery is high. The pandemic has exerted a severe social toll. Unemployment has surged in many PICs, and poverty levels have increased despite financial support provided to the most vulnerable. It is estimated that the pandemic is pushing many people into extreme poverty[4]. A strong and inclusive recovery could help reverse the situation but risks to the outlook are high. Extended border closures due to a COVID-19 resurgence could undermine or prolong the recovery and push more people into poverty. There is also a need for continued policy support to address scarring and mitigate some long-lasting effects of the pandemic such as increases in inequality. But fiscal space has already been diminished severely. Setbacks in vaccine rollout, and the ongoing risk of new COVID variants also pose risks to the recovery. In this context, continued international support and financing will be critical in the near term.

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

	Actuals and Latest Projections					Difference from April 2021 World Economic Outlook				Difference from Pre-Pandemic January 2020 World Economic Outlook			
	2019	**2020**	**2021**	**2022**	**2023-26**	**2020**	**2021**	**2022**	**2023-26**	**2020**	**2021**	**2022**	**2023-26**
Tourism Dependent	**1.6**	**-6.6**	**-6.5**	**5.6**	**4.1**	**1.8**	**-3.9**	**-0.1**	**0.5**	**-9.8**	**-9.2**	**3.1**	**2.9**
Fiji	-0.4	-15.7	-4.0	6.2	5.6	3.3	-9.0	-2.8	2.2	-18.7	-7.2	3.0	4.0
Palau	-0.7	-8.7	-19.7	14.9	5.8	1.6	-8.8	4.5	0.8	-10.5	-21.9	12.9	4.8
Samoa	4.4	-2.6	-8.1	1.0	3.4	0.6	-0.3	-0.7	0.6	-7.0	-10.3	-1.2	2.2
Tonga	0.7	0.7	-2.0	2.9	2.6	1.1	0.4	0.4	0.1	-3.0	-4.9	0.5	1.6
Vanuatu	3.9	-6.8	1.2	3.0	3.3	2.4	-1.9	-1.6	0.1	-9.9	-1.6	0.2	1.8
Commodity Dependent	**3.5**	**-4.1**	**1.2**	**4.2**	**3.2**	**0.0**	**-1.3**	**-0.2**	**0.2**	**-6.8**	**-1.4**	**1.3**	**1.6**
Papua New Guinea	5.9	-3.9	1.2	4.0	2.9	0.0	-2.3	-0.2	0.3	-6.5	-1.3	1.0	1.2
Solomon Islands	1.2	-4.3	1.2	4.4	3.4	0.0	-0.3	-0.1	0.1	-7.2	-1.5	1.7	2.0
Others	**5.4**	**-0.6**	**0.2**	**2.2**	**2.0**	**0.2**	**0.1**	**-0.4**	**0.1**	**-2.7**	**-1.8**	**0.2**	**1.1**
Kiribati	3.9	-0.5	1.8	2.5	2.1	0.0	0.0	0.0	0.0	-2.8	-0.3	0.6	1.1
Marshall Islands	6.8	-2.4	-1.5	3.5	2.0	0.9	0.0	0.0	0.0	-4.7	-3.5	1.7	1.3
Micronesia	1.2	-1.8	-3.2	0.6	1.6	-0.2	0.5	-2.2	0.7	-2.6	-4.0	0.0	1.3
Nauru	1.0	0.7	1.6	0.9	0.6	0.0	0.0	0.0	0.0	0.0	0.3	-0.7	-0.4
Tuvalu	13.9	1.0	2.5	3.5	3.9	0.5	0.1	0.0	-0.1	-3.4	-1.7	-0.6	2.2
PICs (unweighted avg.)	**3.5**	**-3.7**	**-2.4**	**3.9**	**3.1**	**0.8**	**-1.8**	**-0.2**	**0.3**	**-6.4**	**-4.8**	**1.6**	**1.9**

APD Pacific Island Countries: Current Account Balance
(In percent of GDP)

	2019	**2020**	**2021**	**2022**	**2023-26**
Tourism Dependent	**1.6**	**-6.6**	**-6.5**	**5.6**	**4.1**
Fiji	-0.4	-15.7	-4.0	6.2	5.6
Palau	-0.7	-8.7	-19.7	14.9	5.8
Samoa	4.4	-2.6	-8.1	1.0	3.4
Tonga	0.7	0.7	-2.0	2.9	2.6
Vanuatu	3.9	-6.8	1.2	3.0	3.3
Commodity Dependent	**3.5**	**-4.1**	**1.2**	**4.2**	**3.2**
Papua New Guinea	5.9	-3.9	1.2	4.0	2.9
Solomon Islands	1.2	-4.3	1.2	4.4	3.4
Others	**5.4**	**-0.6**	**0.2**	**2.2**	**2.0**
Kiribati	3.9	-0.5	1.8	2.5	2.1
Marshall Islands	6.8	-2.4	-1.5	3.5	2.0
Micronesia	1.2	-1.8	-3.2	0.6	1.6
Nauru	1.0	0.7	1.6	0.9	0.6
Tuvalu	13.9	1.0	2.5	3.5	3.9
PICs (unweighted avg.)	**3.5**	**-3.7**	**-2.4**	**3.9**	**3.1**

APD Pacific Island Countries: Fiscal Account Balance
(In percent of GDP)

	2020	**2021**	**2022**	**2023-26**
Tourism Dependent	**-9.8**	**-9.2**	**3.1**	**2.9**
Fiji	-18.7	-7.2	3.0	4.0
Palau	-10.5	-21.9	12.9	4.8
Samoa	-7.0	-10.3	-1.2	2.2
Tonga	-3.0	-4.9	0.5	1.6
Vanuatu	-9.9	-1.6	0.2	1.8
Commodity Dependent	**-6.8**	**-1.4**	**1.3**	**1.6**
Papua New Guinea	-6.5	-1.3	1.0	1.2
Solomon Islands	-7.2	-1.5	1.7	2.0
Others	**-2.7**	**-1.8**	**0.2**	**1.1**
Kiribati	-2.8	-0.3	0.6	1.1
Marshall Islands	-4.7	-3.5	1.7	1.3
Micronesia	-2.6	-4.0	0.0	1.3
Nauru	0.0	0.3	-0.7	-0.4
Tuvalu	-3.4	-1.7	-0.6	2.2
PICs (unweighted avg.)	**-6.4**	**-4.8**	**1.6**	**1.9**

[4] Summer A., Ortiz-Juarez E., and Hoy C. (2020), ''Precarity and the pandemic'', United Nations University World Institute for Development Economics Research Working Paper 2020/77 and Hoy C. (2020), ''Poverty and the pandemic in the Pacific'', Development Policy Centre Blog.

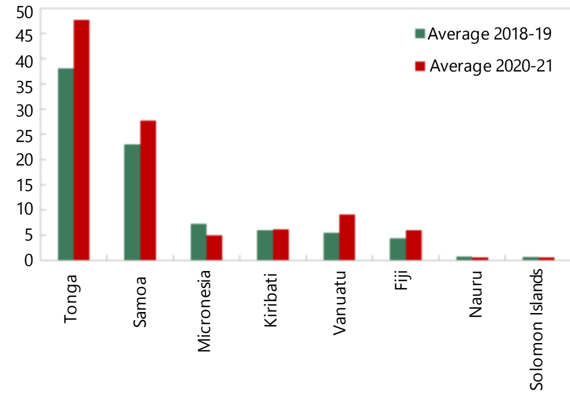
The effects of the pandemic have exacerbated some pre-existing vulnerabilities in the Pacific Islands. Key among these include:

- **Higher public debt**. The pandemic has led to a significant rise in public debt among some PICs—putting additional pressure on fiscal and debt management frameworks, and constraining space for needed investments (including for climate change adaptation and resilient infrastructure). This highlights the need for credible medium-term fiscal strategies and continued efforts to bolster debt management capacity.
- **Climate change**. PICs are among the most vulnerable countries worldwide to the effects of climate change. Continued external shocks from climate-related events is a continued drag on economic growth in most PICs as well as a threat to fiscal and external buffers. However, many of the islands now have significantly less fiscal space to respond to natural disasters, and even less room to take on new loans to finance climate adaptation and resilience. Finding ways to sustainably finance these investments is a high priority for PICs.
- **Contingent liabilities.** Corporate balance sheets have been under duress during the pandemic. This is particularly the case for state-owned enterprises (SOEs—including national airlines)—in some cases engendering expanded public support or government guarantees (including national airlines). Robust and transparent oversight will be needed both to deal with losses already accumulated, as well as to ensure that national airlines and other SOEs are well managed going forward.
- **Corresponding banking relationship (CBRs)**. Loss of CBRs threaten foreign exchange inflows such as remittances, bank profitability, as well as government revenue in some cases. The loss of CBRs, in the Pacific and globally, reflects assessments by many banks that revenues from this business line are outweighed by the costs of monitoring compliance and the potential penalties.

Figure 1. PICs: Recent Developments

Remittances are resilient despite global recession.

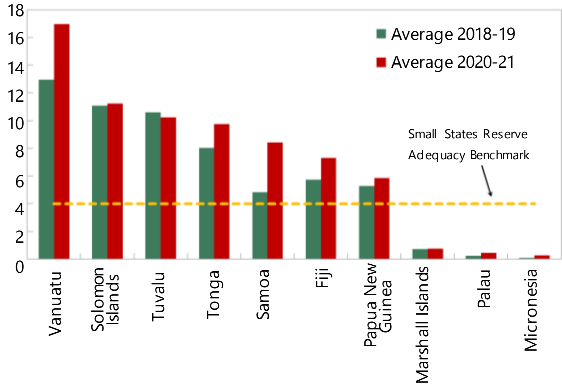
Inward Remittances
(In percent of GDP)



Sources: WEO; and IMF staff estimates

Strong remittances combined with large official financial inflows are boosting reserves[1]. The IMF's 2021 SDR allocation is going to further boost reserves.

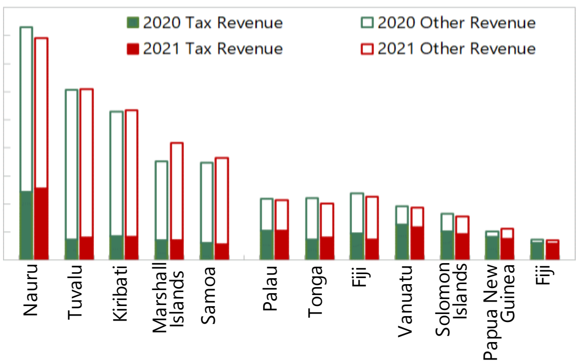
Official Reserves
(In months of imports)



Sources: World Economic Outlook; and IMF staff estimates.

Government revenue, especially tax revenue, is projected to be lower in 2021 than in 2020 for many PICs.

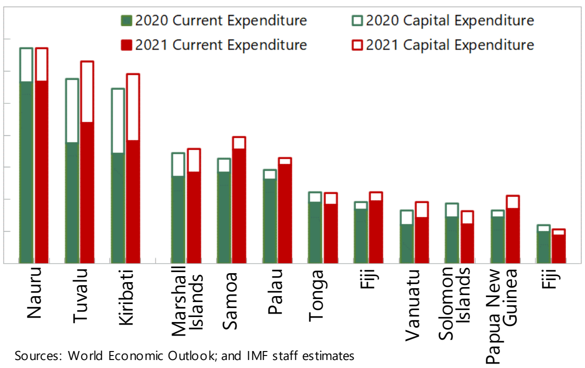
Government Revenue: Tax and Other Revenue
(In percent of GDP)



Source: World Economic Outlook; and IMF staff estimates.

Government expenditure is projected to remain high.

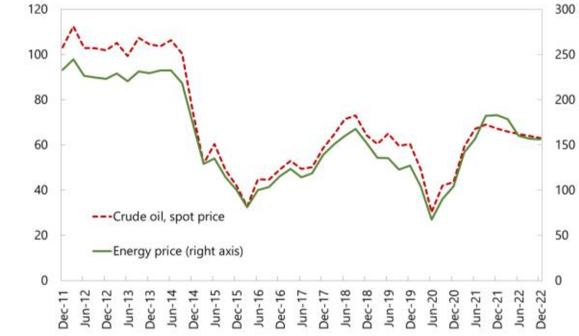
Government Spending: Current and Capital Expenditure
(in percent of GDP)



Sources: World Economic Outlook; and IMF staff estimates

Recent surge in commodity prices affected many PICs.

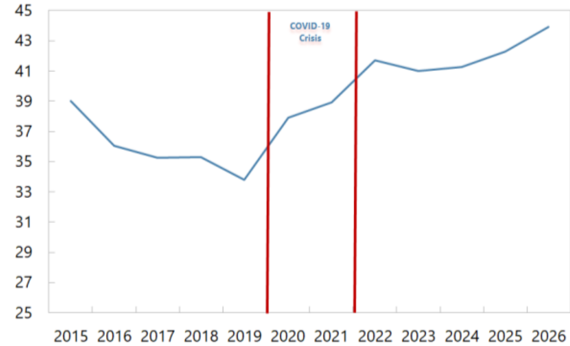
Energy Prices
(In USD) (Index, 2005 = 100)



Sources: World Economic Outlook.

Public debt is rising as a result of weak fiscal positions and rising below the line operations.

Average Public Debt, 2015-26
(In percent of GDP)



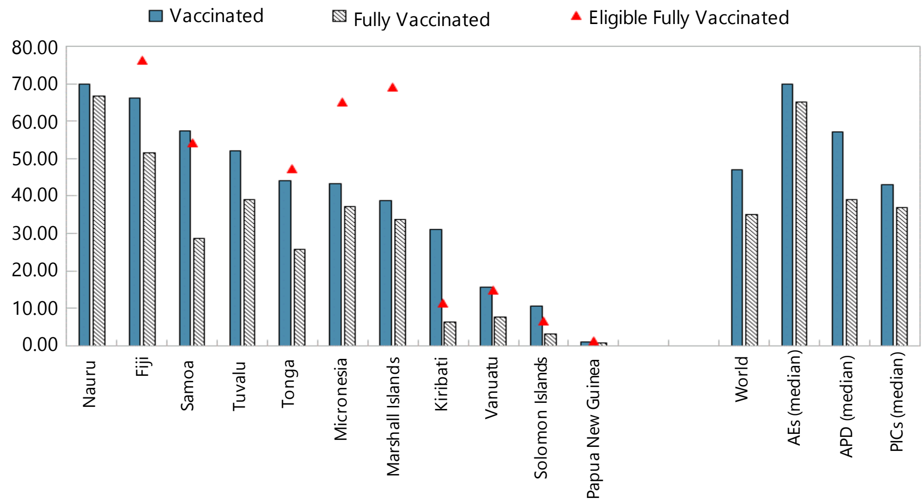
Sources: World Economic Outlook; and IMF staff estimates.

[1] Marshall Islands and Micronesia have neither central bank nor foreign exchange reserves. Government deposits serve to absorb short-term liquidity shocks.

Progress on vaccination has varied across Pacific Islands. Vaccine rollout was generally slow to pick up speed, but this is in line with the slower pace observed in the Asia and Pacific region. Fiji and Nauru have already fully vaccinated 40 percent of their total population. Marshall Islands, Micronesia, Samoa, Tonga and Tuvalu are on track with almost 40 percent or more of the population having received at least one dose of a COVID-19 vaccine as of end-September. The remaining Pacific Islands are facing a range of challenges slowing vaccine rollout. Smaller, concentrated populations might make coordination of vaccine campaigns easier, while more dispersed geography increases difficulty. Most PICs, however, have secured at least half of the vaccines needed to vaccinate 60 percent of the population. Support from the COVAX initiative has been critical in securing vaccine supplies, as have bilateral donations from Australia, New Zealand, the U.S., India, and others.

Vaccination Progress in the Pacific

(In percent of the total population)



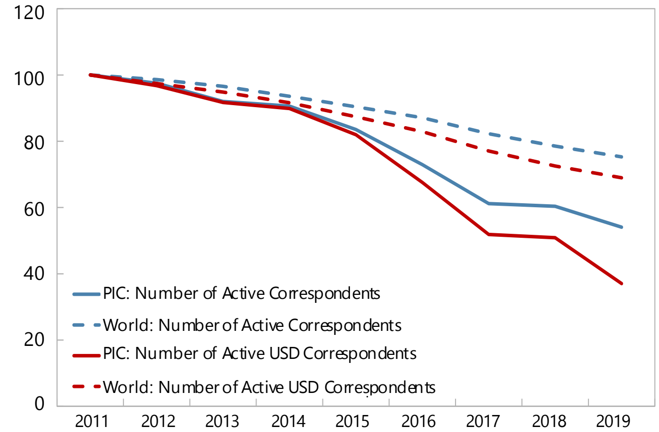
Continued multilateral and bilateral support will be critical to accelerating the vaccination effort and managing the interim stage while vaccine access is limited. The vaccine spillover effects quantified in the APD 2021 October Regional Economic Outlook[5] imply that no country can fully recover until all countries have broad access to vaccines. Closing the vaccination divide is a policy priority for the global recovery. IMF staff has proposed a plan to vaccinate at least 40 percent of the population in every country by end-2021 and 70 percent by mid-2022, alongside ensuring adequate diagnostics and therapeutics.

[5] ''Navigating Waves of New Variants: Pandemic Resurgences Slows the Recovery'', Regional Economic Outlook: Asia and Pacific, International Monetary Fund, October 2021.

The number of correspondent banking relationships (CBRs) in the Pacific has declined more significantly than in most other regions. CBRs have been under pressure globally for the past decade, as banks reassess the risks (e.g., tougher global AML/CFT enforcement) relative to the profitability of this business. The number of CBRs in the Pacific has fallen by nearly 50 percent since 2011 with US dollar CBRs falling by more than 60 percent. This has led to a concentration of remaining CBRs in just a few banks--increasing the vulnerability of some PICs to a complete loss of CBRs.

Number of Active Correspondents

(Index 2011 = 100)



Sources: BIS and IMF staff calculations.

The decline in CBRs could have severe macroeconomic consequences for the Pacific. It could potentially impact the transfer of remittances—a critical financial lifeline for many of the islands. Remittances account for nearly 40 percent of GDP in Tonga—one of the highest ratios in the world—and other countries (including Samoa and Vanuatu) are also highly dependent on remittances. Many remittances are sent through money transfer operators (MTOs), which are particularly vulnerable to the loss of CBRs. Losing CBRs could also hinder import and export activities, especially in the case of US dollar accounts. For example, the withdrawal of CBRs in Solomon Islands in 2018 threatened to disrupt the export of logs—Solomon Island's principal commodity export. Continued CBR loss could also affect banks' profitability, as currency trading is a source of banks' income. For example, the recent loss of business export clearing service of US dollar could impact one of Vanuatu banks' profitability.

CBR issues in the Pacific are commonly associated with AML/CFT related concerns. Financial integrity risks have often been cited by banks as one of the main reasons for the termination of CBRs, including citizenship for investment programs, offshore financial services, logging practices, and concerns about corruption, tax transparency, and financial management.

Addressing the risk from the loss or potential loss of CBRs can be a macro-critical issue for some Pacific Islands. The IMF's assistance in this area has been largely through the provision of technical assistance and facilitating dialogue among key stakeholders. Regional central banks are collaborating together with Australian and New Zealand counterparts to develop a regional Know Your Customer (KYC) utility. Some tailored solutions have been implemented to reduce the impact of potential disruption of CBRs. For example, with the assistance from the IFC, the Tonga Development Bank (TDB) launched a voucher system with New Zealand in 2017.[6] More recent work in progress is focused on the possibility of developing safe payment corridors to protect remittance flows.

[6] A voucher can be purchased online in New Zealand and redeemed/cashed at TDB branches in Tonga. The TDB uses the liquidity obtained from Tongan importers to distribute to the beneficiaries of vouchers in Tonga, and correspondingly use the liquidity obtained from selling vouchers to distribute to the New Zealand counterparties of the Tongan importers.

International financial institutions are supporting the Pacific Islands to weather the pandemic. To date, the IMF has approved financing request to four PICs (Papua New Guinea, Samoa, Solomon Islands, and Tonga) amounting US$424.1 million through the Rapid Credit Facility (RCF) and the Rapid Financing Instrument (RFI). Solomon Islands has also benefited from debt relief under the Catastrophe Containment and Relief Trust. Four PICs benefited from the Debt Service Suspension Initiative (DSSI) established by the G20, Paris Club, and the IMF and World Bank. It is estimated that the four countries could save up some US$462.3 million from the DSSI by end-2021

Pacific Island Participation in DSSI

Potential DSSI Savings (May 2020 – December 2021)

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

Source: World Bank Staff Calculations

The IMF's Board of Governors has also approved a general allocation of Special Drawing Rights (SDRs) to provide additional liquidity to member countries, including the PICs. PICs have collectively received US$638.5 million under the 2021 SDR allocation. The SDR allocation aims to help countries with weak foreign exchange reserves reduce their reliance on more expensive domestic or external debt and bolster their capacity to meet urgent needs (e.g., to pay for vaccines and support vulnerable groups).

IMF's 2021 SDR Allocations to PICs

Country	Millions of SDRs	Millions of US$	Percent of GDP
Fiji	94.3	133.8	3.0
Kiribati	10.7	15.2	7.7
Marshall Islands	4.7	6.7	2.7
Micronesia	6.9	9.8	2.4
Nauru	2.7	3.8	3.3
Palau	4.7	6.7	2.6
Papua New Guinea	252.3	357.9	1.5
Samoa	15.5	22.0	2.7
Solomon Islands	19.9	28.2	1.8
Tonga	13.2	18.7	3.8
Tuvalu	2.4	3.4	6.2
Vanuatu	22.8	32.3	3.5
Total	450.1	638.5	1.9

Source: IMF Staff Calculations

The IMF is studying options for voluntary channeling of SDRs from members with external positions to support more vulnerable countries such as the Pacific Islands.

Fiji

The IMF Fiji team completed the virtual 2021 Article IV mission on October 8, 2021. Fiji has been hard hit by the pandemic and the sudden stop of tourism receipts. The authorities moved early in 2020 to close borders and undertake measures to provide public support. Real GDP contracted by 15.7 percent in 2020, and the overall budget deficit rose to 13.7 percent of GDP in the fiscal year ending in July 2021. A second wave hit Fiji starting in April with a severe outbreak of the COVID-19 Delta variant—which brought a new round of local restrictions and an associated dampening of economic activity. However, an aggressive public vaccination program facilitated by vaccine donations from Australia, New Zealand and India has lifted Fiji's vaccination rate rapidly. More than 95 percent of eligible Fijians (those over 18) have received their first dose and 80 percent were fully vaccinated as of early October. Passing these milestones, the government announced an easing of local curfew and business restrictions. The government has also announced that Fiji's borders will be reopened to fully vaccinated travelers from a select group of countries, including Australia, New Zealand, the U.S., UK, Japan, and other Pacific Islands. Tourists from these markets will have no quarantine requirement from November 11th, ahead of an official reopening date of December 1st, when the first Fiji Airways tourist flights will recommence. With a steady ramping up of tourism, staff project real GDP growth to rise to 6 percent in 2022, and to 8 percent in 2023. Policies should aim to continue support in the near term as Fiji reopens and emerges from the pandemic but shift to addressing macroeconomic imbalances as the recovery takes hold. More details about the mission findings can be accessed at: https://www.imf.org/en/News/Articles/2021/10/07/pr21289-fiji-imf-staff-completes-2021-article-iv-mission

Palau

The IMF Palau team completed the virtual 2021 Article IV mission on October 7, 2021. The team met the Minister of Finance; the Minister of Human Resource, Culture, Tourism and Development; the Minister of Public Infrastructure and Industries; other government officials; representatives of the private sector and state-owned enterprises, and development partners. While strict and preemptive containment measures have helped prevent local community spreads of COVID-19 to date, they have severely impacted the tourism-dependent economy. The authorities have adopted a comprehensive policy response with measures that appropriately aimed at strengthening healthcare and mitigating the economic and social hardship of the pandemic. The economic outlook remains challenging. After a contraction of 9.7 percent in FY2020, real GDP is projected to further decline by 17.1 percent in FY2021, before rebounding by 9.4 percent in FY2022 alongside a gradual recovery in tourist arrivals. Considering the challenging near-term outlook, pandemic relief measures should be extended until the recovery is firmly entrenched as envisaged in the FY2022 budget. The negative effect of the pandemic on the economy and the cost of the fiscal response have opened a fiscal financing need covered by disbursed and planned concessional financing from the Asian Development Bank, leading to a rapid increase in public debt. The recent approval of a comprehensive tax reform is welcome. In addition to potential revenue gains, the tax reform should improve the efficiency of the tax system and support growth. The tax reform will also contribute to the needed fiscal consolidation in the medium term to lower public debt ratios, improve the external position, and accommodate higher spending to address climate change and other infrastructure needs. More details about the mission findings can be accessed at: https://www.imf.org/en/News/Articles/2021/10/08/pr21292-palau-imf-staff-completes-2021-article-iv-mission

Papua New Guinea (PNG)

The COVID-19 pandemic induced severe economic and social costs for PNG in 2020. In response, the IMF disbursed a Rapid Credit Facility of 100 percent of quota in June 2020. The resurgence of the disease in early 2021 and the renewed containment measures have slowed economic activity. While PNG has rolled out vaccines, only 0.7 percent of the population has been fully vaccinated as of end September 2021, among the lowest globally. A vaccine centered strategy to achieving herd immunity is proving difficult to pursue due to limited supply, weak healthcare capacity and stubborn vaccine hesitancy. The authorities are focusing on the *niupela pasin* (new normal) measures, including mask up and physical distancing, to reduce the risk of COVID-19. A Staff Monitored Program (SMP)—approved in February 2020, just before the COVID-19 pandemic struck—expired on June 30, 2021. PNG made progress in their reform agenda, including implementation of key aspects of revenue reforms, cash forecasting, and facilitating a safeguards assessment. The authorities are committed to continuing with SMP reforms, focusing on strengthening public finances, foreign exchange and monetary operations, and governance, including the review of the Central Bank Act. PNG will hold general elections in June 2022.

Samoa

While a domestic outbreak has been successfully avoided so far, the COVID-19 pandemic and its economic effects remain a driving force in Samoa's economic performance in 2021. Given the continued closure of Samoa's international borders and the central nature of tourism to the economy, economic activity remains sluggish, and the current account has deteriorated. Real GDP contracted -8.1 percent in FY2021 (ending in June) after a decline of -2.6 percent in FY2020, and with the persistence of the pandemic a slow recovery is projected for FY2022. While the loss of tourism inflows was partially offset by higher private remittances, there was a current account deficit of -15.7 percent of GDP in FY2021, after a surplus in FY2020. Nevertheless, gross reserves increased by US$66 million, helped by official grant inflows and Samoa's participation in the DSSI. The fiscal balance remained in surplus, helped by resilient tax revenues. However, the slow execution of investment projects has weighed on growth, and an acceleration could help boost economic activity. Samoa is the subject of the Fund's first pilot Climate Macroeconomic Assessment Program (CMAP—the successor to the Climate Change Policy Assessment). The CMAP will analyze links between resilience building and long-term growth, climate financing needs, distributional effects of climate policy, and long-term decarbonization plans. Work is underway, with the report to be finalized by the end of the year. For more details, please find the press release and the staff report:
Samoa : 2021 Article IV Consultation-Press Release and Staff Report (imf.org)

Tuvalu

The 2021 Article IV consultation was completed in July, after a virtual mission. At the onset of the COVID-19 pandemic, the Tuvaluan government swiftly implemented containment measures to prevent the emergence of COVID19 in Tuvalu. The measures, however, halted infrastructure investment and shut down the already-limited tourism sector. In response, the authorities approved a large fiscal package of AUD 23.3 million (30 percent of GDP) to support population and private businesses, procure necessary medical supplies, and maintain quarantine facilities. The package, financed by buoyant fishing revenues and grants from development partners, also helped preserve growth at estimated 1 percent in 2020. The outlook for 2021 remains positive, with growth projected at 2.5 percent, thanks to higher current spending and gradual resumption of infrastructure projects.

Long-term outlook is nevertheless challenging, due to uncertain donor commitments, impact of natural disasters and climate change, and potential for plateauing of fishing revenues and dotTV fees. Tuvalu is assessed to be at high risk of debt distress, due to the increasing risks of natural disasters, elevated current spending, limited revenue base, and high dependence on donor grants. Once the recovery takes hold, a gradual fiscal consolidation will be needed to preserve fiscal buffers and help fund climate adaptation and infrastructure maintenance needs. Development of effective prudential regulation and supervision of the financial system, continued implementation of structural reforms, and strengthening the capacity of domestic institutions remain key. As of September 20, Tuvalu remained COVID-free, with 42 percent of the population vaccinated, and enough doses available to vaccinate the entire population.

For more details, please find the staff report:
Tuvalu: 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Tuvalu

Vanuatu
The 2021 Article IV consultation was completed in September 2021. The COVID-19 pandemic and major natural disasters hit the Vanuatu economy severely in 2020. Due to the authorities' decisive measures, Vanuatu has had no domestic transmission of COVID-19. However, the border closure dealt a heavy blow to tourism. Infrastructure projects have also been delayed. In addition, Tropical Cyclone Harold and a volcanic eruption in Tanna Island caused extensive damage the first half of 2020. Notwithstanding the authorities' policy responses, the reduction in travel receipts led to severe economic contraction. Strong receipts of the Economic Citizenship Programs (ECP) and donor support have helped mitigate the impact of the pandemic on fiscal and external balances.
After a severe contraction in 2020, real GDP growth is expected to rise to 1.2 percent in 2021. Risks to the outlook are substantial and tilted to the downside. A worsening of the pandemic requiring longer border closure would adversely impact economic activity. ECP revenues could fall sharply amid growing concerns on AML/CFT risks to ECP under the recent loss of the key correspondent banking relationship. Further deterioration of banks' asset quality could erode the soundness of Vanuatu's financial system. Lack of transparency and effective supervision framework for state-owned enterprises could negatively affect the business environment and fiscal management. Issues concerning AML/CFT, and EU blacklisting related to tax transparency could accelerate de-risking by foreign firms and impede foreign direct investment (FDI). An ever-present downside risk relates to further natural disasters. For more details, please find the staff report:
Vanuatu: 2021 Article IV Consultation -Press Release; Staff Report; and Statement by the Executive Director for Vanuatu (imf.org)

By Leni Hunter, Resident Representative for Pacific Island Countries

IMF Res Rep Office team: Bula vinaka, Kaselehlia, Mauri, Ekamwir-omo, Alii, Halo, Lakwe, Talofa, Halo olaketa, Malo e lelei, Fakatalofa atu, Hello and Kia orāna,

We hope this finds everyone safe and well. In Fiji, the restrictions put in place in April to contain a tragic outbreak of the delta variant have started to be lifted. The virus has taken a heavy toll, but progress on vaccinations is enabling activity to return. The Res rep office team has been fortunate to be able to work from home and look forward to a partial return to the office in the near future.

Our team has been in contact with many of you through virtual surveillance missions so far this year: Seruwaia joined the Vanuatu team and participated in the Article IV in June, Devendra continues to work with the PNG team and has met frequently with the authorities, Munesh has joined the Solomon Islands and Samoa teams and is working on upcoming missions. I have joined several missions this year and have been very grateful for the kind assistance in organizing meetings. In addition, I was also able to again join the FEMM as an observer and participate in other PIFS meetings. Earlier in the year I coauthored a paper on national airlines with Vybhavi Balasundharan and PFTAC colleagues Paul Seeds and Iulai Lavea, which I hope will be of use in evaluating and managing fiscal risks.

Clockwise from top left : Leni, Munesh, Deven, Seru, Peter, Pule.

Port Vila.

Before the onset of the pandemic, I was fortunate to have been able to visit nearly all the countries covered by our office – it was a privilege to do so, and we look forward to being able to meet again in person as things normalize. Best regards from all of us in the Res Rep Office.

By David Kloeden, PFTAC Coordinator

With a surge in COVID cases in Fiji from April, PFTAC operations reverted to Work from Home (WFH) arrangements after six months of relatively normal office-based operations albeit without travel. Given Fiji's successful vaccination rollout, expectations are high for a return to normality in the near future. Capacity Development (CD) delivery plans for the 2022 fiscal year (FY22) that runs through April 2022 anticipated an optimistic restart of in-person engagement gradually from early 2022 depending upon when individual member countries reopen to travel. In the meantime, FY22 CD continues to be delivered remotely as it had successfully pivoted to throughout FY21.

The FY21 PFTAC Annual Report[7] published in June detailed an impressive volume of CD delivery at around 72 percent of pre-COVID-19 plans, but with substantial budget savings. Over the year, a significant proportion of CD missions and training events pivoted to urgent topics and issues to help member countries react and respond to new COVID-19 realities. Most countries adapted well to the changed circumstances, including a few that received more CD than originally planned, while some members faced connectivity challenges and preferred deferring activities until a resumption of travel. Innovative approaches were trialed, including hybrid events for in-person participation in Suva and other locations using campus and network facilities of the University of the South Pacific (USP). Gender and other cross-cutting themes, particularly relating to climate change received heightened attention.

Under the recently launched Debt Management program financed by the Government of Japan Mrs. Briar Ferguson was appointed Resident Advisor at PFTAC in late March. A New Zealand national, Briar was selected from a pool of highly experienced experts to assist PFTAC member countries to strengthen public debt management capacity. She joins PFTAC from the United Kingdom where she spent five years delivering technical assistance to Commonwealth members as a Public Debt Management Advisor at the Commonwealth Secretariat. Prior to this she had a decade with the New Zealand Debt Management Office in market facing and risk management roles. Briar holds a Masters in Applied Finance and brings with her a breadth of experience from both practitioner and advisory perspectives.

The 2021 PFTAC Steering Committee (SC) meetings were convened virtually over two sessions on June 29 and July 2 respectively. The July 2 session was specifically dedicated to issues relating to the sixth phase of PFTAC operations that was originally due to commence in 2022. The meetings were strongly attended with at least 89 participants representing 10 of the 16 PFTAC member countries, all seven Phase V donors, a wide range of IMF officials, and representatives of 11 observer organizations. Deputy Governor Esala Masitabua from the Reserve Bank of Fiji (RBF) chaired both sessions on behalf of the Fijian authorities as PFTAC host and the 2021 meetings.

The SC endorsed an extension of Phase V beyond the intended April 2022 end-date. Given abnormal FY2021 COVID-19 savings, plus earlier savings and cost efficiencies, a sizable balance of unspent funds will be on-hand on April 30, 2022 that is ample to finance at least a six-month extension,

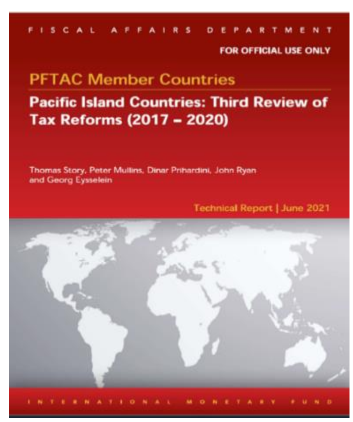
[7] https://www.pftac.org/content/dam/PFTAC/Documents/Reports/Annual%20Reports/FY2021-PFTAC-Annual%20Report_Final.pdf

and most likely a full year subject to the projected FY2022 outturn. The precise extension duration will be determined by November 2021 when a clearer picture of the FY2022 outturn has emerged. **The SC meeting also endorsed an ambitious FY2022 budget and workplan** (available on the PFTAC website[8] along with FY2021 outturn workplans).

The July 2 second day of SC discussions focused entirely on Phase VI. To maximize input and to provide structure in the consideration of Phase V achievements and potential Phase VI priorities, five Virtual Working Groups (VWG) were formed that met at least three times from April, each with membership of 3 – 4 member countries, 1 – 2 donors, and any relevant regional organization or partner. The PFTAC resident advisors helped facilitate the VWGs that covered: (1) Public Financial Management; (2) Revenue Policy and Administration; (3) Financial Sector Supervision; (4) Macroeconomic Statistics; and (5) Macroeconomic Programming and Debt Management. Beforehand, each group circulated a summary note with an IMF respondent commenting on each presentation followed by SC discussion. These are very useful inputs for the next steps in moving towards Phase VI, beginning with an IMF Interdepartmental Working Group to develop a Phase VI strategy note for IMF management approval followed by preparation of a draft Program Document targeted for discussion at the late- 2021 virtual SC meeting.

PFTAC's midterm external evaluation of Phase V is now complete. Covering the period November 2016 – April 2019, the evaluation assessed the performance of 74 of PFTAC's 91 projects in six programs and identified a number of areas for further performance improvement to help guide the future direction of the center. The evaluation highlighted a number of key findings, including: the close alignment of programs and objectives to member countries' national priorities; the high quality of the center's TA and training offered on a cost-effective basis; the effectiveness of programs, notably GFS, PFM, and Macroeconomics; improved coordination with other development partners; and development of regional networks. The recommendations cover a broad range of areas, from strengthening member country engagement in PFTAC governance, support to develop regional expertise, to improving the use of Results Based Management (RBM) to support country prioritization. An implementation plan is being prepared for those recommendations supported for action to be considered at the end-2021 SC meeting.

A review of Tax Reforms in Pacific Countries was completed under the leadership of the Fiscal Affairs Department in early 2021 to consider developments over the four years since the last review in 2017, including the scaling up of the Revenue program and the significant impact of the COVID-19 crisis in 2020. The findings of the 2021 review that were presented at the SC meeting are particularly timely in helping define the priorities and resource requirements for Phase VI of PFTAC operations. The review focused on five case study countries, namely Fiji, Kiribati, Samoa, Solomon Islands, and Tonga, with a lighter review of the other 11 PFTAC member countries. This is consistent with the focus of the 2017 review.



[8] https://www.pftac.org/content/PFTAC/en1/baselinewp.html

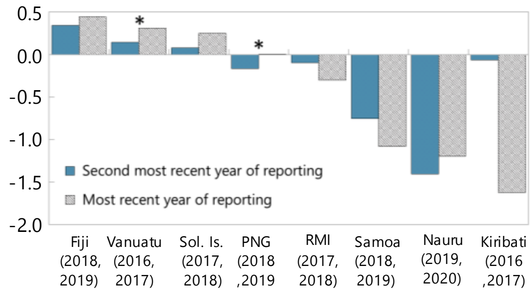
Pacific Island Airlines — Flying on Empty?

by Vybhavi Balasundharam, Leni Hunter, Iulai Lavea and Paul Seeds

With virtually no international travel since March 2020, national airlines in the Pacific face mounting financial difficulties. For Pacific Island Countries (PICs) this shock is particularly severe given the weak financial condition of national carriers prior to the pandemic, the reliance of these countries on airline connectivity to support tourism, and limited fiscal space to provide ongoing or future financial support to these airlines (also discussed in the April 2021 *Pacific Islands Monitor*). Recovery from this crisis presents an opportunity to overhaul governance and oversight of national airlines to mitigate future risks.

Figure 1: National Airlines' Profit and Loss

(In percent of GDP of year of financial reporting)

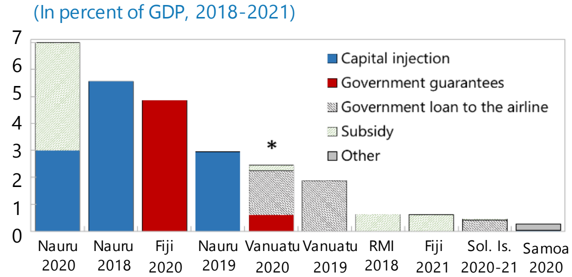


Sources: Financial statements, IMF WEO April 2021. Asterisk denotes media reports used for Vanuatu and PNG, in absence of recently published financial statements. Note: Reporting years in brackets. Excludes government subsidy/CSO payments.

Financial losses and weak profitability have been long-standing concerns for several Pacific airlines. Only Fiji Airways has made consistent profits over the past six years. In a recently published [IMF Working Paper](), we found that the majority of the national airlines in PICs had at least a moderate overall risk rating prior to the pandemic. Many have already been through one or more restructurings and remain extremely vulnerable to external shocks.

Figure 2: Government Support and Transfers to National Airlines

(In percent of GDP, 2018-2021)



Sources: IMF Staff estimates, budget documents, financial statements. Note: Calendar years Asterisk denotes media reports used for Vanuatu 2020. Some government support may not be fully captured or may not yet be implemented (Fiji 2021 subsidy). Samoa "other" is compensation part payment for Faqali airport land use.

Governments have been directly exposed to local airlines by virtue of state ownership and were often providing financial support even before the pandemic. Government support has been large relative to GDP in several cases, diverting resources from other development needs. However, governments have struggled to monitor and contain the risks from national airlines, reflecting inadequate governance frameworks, lack of oversight capacity, and lack of transparency from the airlines that undermines the ability to assess potential risks. The pandemic has forced governments to increase support of national airlines. Tourism is unlikely to reach pre-COVID-19 levels prior to 2023. Given these conditions, airlines will struggle to improve financial performance in the near term. And for some, their continued losses represent significant quasi-fiscal liabilities. Enhancing oversight and strengthening governance has become more urgent than ever to mitigate risk to government balance sheets.

Greater transparency and accountability in the running of national carriers and rigorous oversight will be critical in the difficult months ahead. Transactions between the government and the national airline should be disclosed in the annual budget and in quarterly budget reports. Audited financial statements of the airlines need to be published in a timelier manner. Most PICs have an independent oversight unit to monitor and mitigate risks from all state-owned enterprises, including national airlines. Sufficient capacity in these units, along with comprehensive governance laws and effective enforcement are key to effective oversight.

How Tourism Diversion Could Boost PICs' COVID-19 Recovery

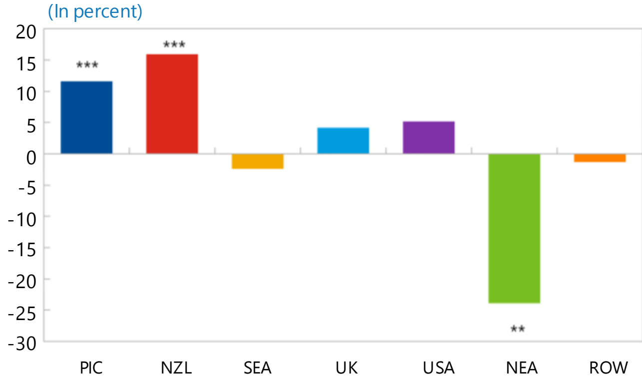
By Vybhavi Balasundharam and Robin Koepke

International tourism in the Pacific Island Countries (PICs) has been at a standstill for the past 18 months, but rising vaccination rates and other health measures could soon allow for some gradual reopening.[9] In a recently published IMF Working Paper, we argue that tourism diversion effects could accelerate PICs' recovery if they can establish themselves as more attractive travel destinations than competitor countries (such as Indonesia, Thailand, and other Asian tourism hubs).

We study the response of outbound travel from Australia (the primary source country for PICs in the South Pacific) during previous global shocks like the SARS epidemic and September 11 attacks, in addition to more localized external shocks like the Bali Bombings and Indian Ocean Tsunami. We find that PICs have generally been insulated from external shocks and tend to gain from the diversion of visitors away from more affected countries. For example, the number of departures to PICs only fell slightly during the SARS epidemic, despite a significant fall in total departures from Australia, corresponding to a substantial increase in share of departures to PICs (Figure 1). The SARS experience also illustrates the importance of a strong health infrastructure and accessibility, as New Zealand witnessed stronger diversion gains compared to the PICs.

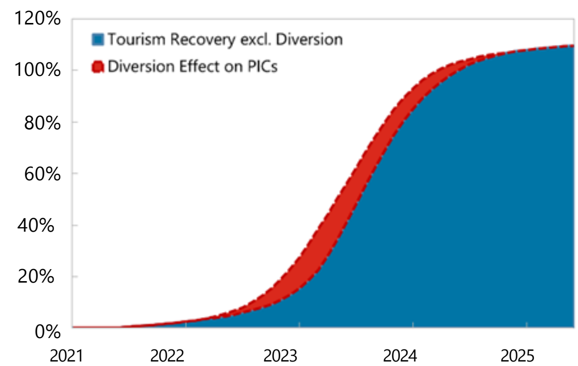
Our results suggest that PICs could have a strong tourism recovery if they continue to manage the pandemic well, reach high vaccination rates, and reinforce their health infrastructure (Figure 2). This is also consistent with the recent experience in Cook Islands, where up to 60 percent of the peak arrivals were observed in July 2021 during the travel bubble with New Zealand. Targeted policies could amplify such gains, for example through more reliable and frequent airlinks, and digital media marketing campaigns (like that of Maldives). Additional policy measures could help turn temporary diversion effects into longer-term gains, including improvements to the tourism infrastructure and labor resources, and policies to promote digitalization and environmental sustainability.

Figure 1: Change in shares of departures during SARS epidemic
(In percent)



Sources: IMF Staff estimates.

Figure 2: Illustrative Path of Tourism Recovery in PICs
(Visitors in percent of 2019 level)



Sources: IMF Staff estimates.

[9] Fiji plans to reopen its borders around November/December. Palau has resumed its travel bubble with Taiwan Province of China in August. Indonesia and Thailand are planning to open their borders to tourists in October.

Unlocking Access to Climate Finance

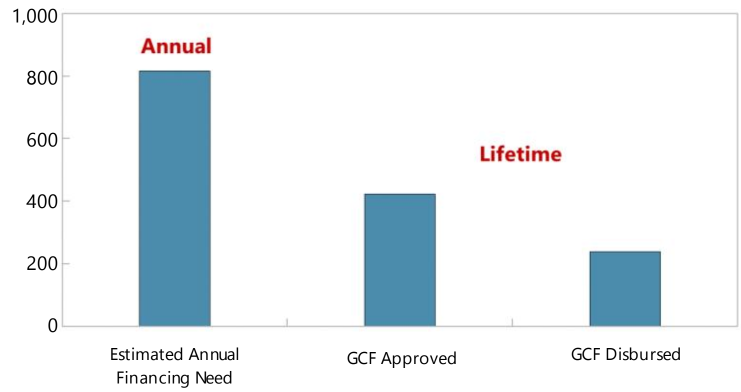
By Manal Fouad, Natalija Novta, Gemma Preston, Todd Schneider, and Sureni Weerathunga

PICs – among the most exposed to climate hazards – have an urgent need to invest in climate adaptation. IMF staff estimates that the Pacific region needs almost $1 billion every year over the next 10 years to upgrade and retrofit public sector infrastructure and coastal protection systems. However, access to climate finance has so far disappointed. A recent IMF departmental paper titled "Unlocking Access to Climate Finance for Pacific Island Countries" examines the successes and challenges faced by PICs in accessing climate finance, drawing lessons and recommendations.

The paper makes three key findings. First, it emphasizes that without additional grant-based access to climate finance, meeting the cost of climate adaptation in the PICs will be extremely challenging (Figure 1). Second, analysis shows that access to GCF funds through international accredited entities (such as the ADB, UNDP, or the WB) has so far been the most fruitful pathway, with faster approvals and larger projects. Third, while national direct-access accreditation to the GCF remains a strong preference for PICs, the track record in the region so far has been poor. In some countries, the speed at which PFM capacity needed for direct access can be developed is inconsistent with the speed at which PICs need to adapt to climate change.

The paper formulates several recommendations for the PICs, climate funds, and the IMF, respectively. The PICs should strategically decide which projects are best financed through bilateral channels, and which are better suited for climate funds, through international or direct access. Where resource constraints allow, PICs should establish dedicated climate units, preferably within Ministries of Finance, to coordinate the financing of priority climate projects. Finally, PICs should continue to build PFM capacity, with a focus on strong audit, robust control frameworks, and strengthened public investment practices, that are at the center of GCF accreditation requirements.

Figure 1: GCF Financing vs Estimated Annual Adaptation Needs
(In millions of US Dollars)



Sources: Green Climate Fund, IMF (2021) and IMF staff calculations.
Note : GCF data as of May 2021.

Recognizing the shrinking window of opportunity to address the climate crisis, climate funds should consider further streamlining accreditation requirements for small and fragile countries and increasing reliance on ex-post monitoring. The IMF will further integrate analysis of climate issues into macroeconomic surveillance, in line with the IMF's Climate Strategy, and continue to provide capacity development support to countries to build stronger PFM and public investment management practices.

Recent and Upcoming Events on Pacific Island Countries

Recent Events

CDOT/PFTAC: Workshop on Balance of Payments: Methodology and Compilation Challenges. *April 19 – 23, 2021*

PFTAC: Virtual Workshop on Managing Tax Debt and Tax Return Compliance. *April 19 – 23, 2021*

PFTAC/FAD: Virtual Workshop on Public Investment Management. *April 27 – May 6, 2021*

PFTAC Virtual Annual Steering Committee Meeting. *June 29 and July 2, 2021*

Pacific Forum Economic Officials Meeting (FEOM). *July 6 – 7, 2021*

Pacific Forum Economic Ministers Meeting (FEMM). *July 13 – 14, 2021*

STI/PFTAC: Webinar on GDP Forecasting. *July 21 -23, 2021*

PFTAC: Virtual Workshop on Taxpayer Services and Communication. *August 17 – 26, 2021*

ADB/Platform for Collaboration on Tax (PCT) with PFTAC: Workshop on Medium-Term Revenue Strategies (MTRS) for small states in Asia and the Pacific. *August 25 – 26, 2021*

IMF/WB 2021 Annual Meetings
Virtual Conference for Pacific Island Authorities with Deputy Managing Director Bo Li
October 12, 2021

Upcoming Events

STI/PFTAC: Webinar on Inflation Forecasting. *October 27 -29, 2021*

PFTAC: Virtual Workshop on State Owned Enterprise (SOE) and Fiscal Risks. *October 19 -22, 2021*

PFTAC: Virtual Workshop on Fundamentals of Debt Reporting and Monitoring. *October 25 -29, 2021*