SOUTH PACIFIC ISLANDS

Table 1	2020
Population, million	
Samoa	0.20
Tonga	0.10
Vanuatu	0.30
GDP, US$, billion	
Samoa	0.85
Tonga	0.48
Vanuatu	0.92
GDP per capita, current US$	
Samoa	4316
Tonga	4621
Vanuatu	3052

Sources: WDI, World Bank staff estimates.

The economies of Samoa, Tonga, and Vanuatu have been impacted by a range of natural disasters and adverse shocks over the past year. Ongoing strict international travel restrictions related to COVID-19 have had severe effects on tourism-related activity and employment. In addition, Tropical Cyclone Harold struck Tonga and Vanuatu in April 2020. Governments need to maintain macroeconomic sustainability while enhancing health system capacity for COVID-19 vaccine rollout, continuing reconstruction activities and prioritizing measures that lay the foundation for the economic recovery.

Key conditions and challenges

For each of these small South Pacific nations, natural disasters and external shocks pose a constant threat to livelihoods, economic growth, and fiscal sustainability. Enhancing resilience to external shocks is crucial to support long-run growth and achieve sustainable improvements in living standards and poverty reduction. The economic outlook hinges on how quickly and effectively the three nations can obtain and roll out a COVID-19 vaccine, thus allowing for strict international border restrictions to be relaxed. A domestic outbreak of COVID-19 would have severe ramifications, but economic activity will be constrained for as long as international travel restrictions remain in place. Based on current projections for vaccine roll out and the recovery in international travel, economic activity across the three countries may remain depressed for another six to 12 months. This creates significant potential for scarring effects in the longer term—particularly in the tourism sector—as lost firms and jobs create adverse structural changes to the economy that are not reversed when aggregate demand recovers. The economic shocks and slow recovery also greatly increase the risk of poverty for much of the population, particularly as households deplete savings and assets to cope with lost incomes.

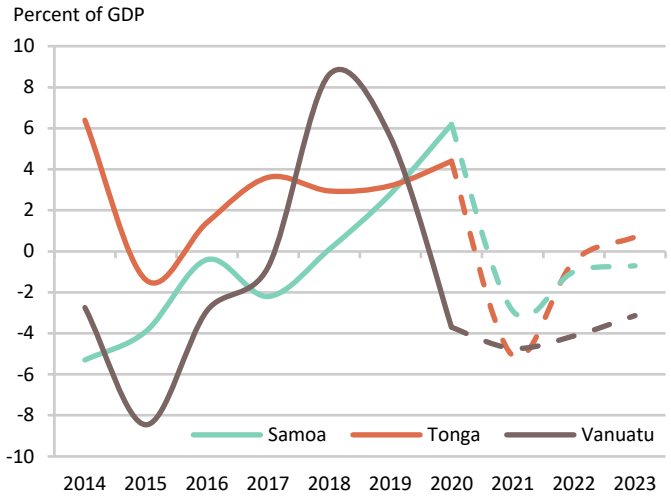
The main immediate challenges are to continue to enhance health sector preparedness and remain free of COVID-19. Over the coming months and years, the key challenge will be to catalyze a sustainable and inclusive economic recovery, and at the same time maintain macroeconomic sustainability in the face of several competing pressures. With limited fiscal space and low capacity to carry debt, governments need to prioritize strategic measures that lay the foundation for the economic recovery, while also supporting livelihoods for the Bottom 40 percent of households. In Tonga and Vanuatu, governments should carefully prioritize cyclone reconstruction and development spending, mindful of budget and local capacity constraints.

Recent developments

Leading indicators suggest that the economic contraction in the South Pacific countries may be less severe than previously projected. Nevertheless, the combined effects of the dual crises represent a major economic shock to Tonga and Vanuatu.

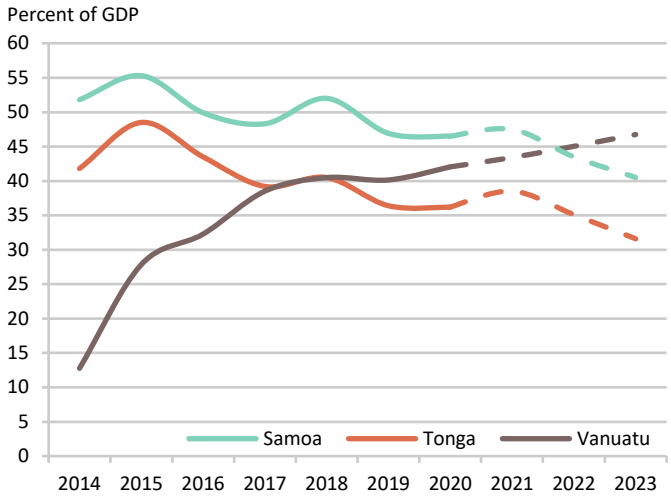
In **Samoa,** travel restrictions imposed in March 2020 resulted in a substantial reduction in tourism activity in late FY20 (July 2019 – June 2020). Economic activity was also adversely affected by declines in construction activity and goods exports, although remittances remained resilient. These impacts resulted in the economy contracting by 3.5 percent in FY20, compared with the prior forecast of 4 percent growth. Of the 7.5 percentage point drop, 5 percentage points is attributable to the

FIGURE 1 South Pacific Islands / Overall fiscal balance



Sources: National sources and World Bank projections.

FIGURE 2 South Pacific Islands / Public and publicly guaranteed external debt



Sources: National sources and World Bank projections.

decline in tourism, 2 percentage points to the impact of the measles that struck the country in December 2019, and 1.5 percentage points to other COVID-19 impacts. These impacts were partially offset by support from fiscal stimulus which is estimated to have contributed 1 percentage point to growth. The fiscal surplus increased as additional donor grants to support crisis response more than offset falls in domestic revenues and additional spending.

In **Tonga,** the dual shocks of COVID-19 and Tropical Cyclone (TC) Harold are estimated to have caused the economy to contract by 1.5 percent in FY20 due primarily to the sharp slowdown in the tourism, hospitality, retail, and construction sectors. These twin shocks increased the risk of falling into poverty for many households, from a combination of increased unemployment and loss or damage of assets. The sharp economic slowdown put pressure on both the fiscal accounts and balance of payments. However, these pressures were more than offset by substantial additional development partners grants to support crisis recovery.

In **Vanuatu,** GDP is estimated to have shrunk by 10 percent in 2020 due to the impacts of COVID-19 and TC Harold. International tourism continues to be at a standstill. As a result, tourism-related employment dropped by an estimated 64 percent. The fiscal deficit for 2020 is estimated at 3.7 percent of GDP, with additional COVID-19 and TC Harold-related spending somewhat offset by higher than expected revenues from the country's Economic Citizenship Program (ECP). On the external accounts, lower remittances and tourism inflows are offset by increased aid flows and receipts from the ECP.

Outlook

The near-term outlook for all three countries remains dependent on the duration of COVID-19 related travel restrictions, and whether the countries continues to remain free of the virus. Current projections assume that travel restrictions begin to ease in early 2022. There remain downside risks to the economic outlook to the extent that the recovery from COVID-19 and TC Harold is slower than expected.

In **Samoa,** GDP is expected to contract by a further 7.7 percent in FY21, before recovering in FY22 and FY23. Lower international tourism would cause GDP to contract by a further 9.5 percent in FY21. Additional negative effects on the construction sector, goods exports, remittances and commercial activity would also have a contractionary impact. These effects would be partially offset by the effects of government stimulus packages, the efforts of the tourism industry to reorient toward domestic tourism and hospitality, and the reallocation of hospitality workers and assets toward other productive activities, including agriculture. Fiscal deficits averaging 1.5 percent of GDP are projected over the period FY21 to FY23.

In **Tonga**, GDP is expected to contract by a further 3 percent in FY21, before recovering to average 2.5 percent in FY22 and FY23 due to the gradual increase in tourist arrivals, combined with a recovery in agriculture production and construction activity. A fiscal deficit of over 5 percent of GDP is projected for FY21, due to lower domestic revenues and increased spending for health sector preparedness, cyclone recovery and economic and social stimulus measures. Nonetheless, the fiscal accounts are projected to return to surplus over the projection period as domestic revenues recover and stimulus spending is unwound.

In **Vanuatu,** GDP is projected to grow by 4 percent in 2021. The economic effects of the stimulus package, increased construction activity and growing domestic tourism demand are expected to lift the economy. Due to increased recovery and infrastructure spending a fiscal deficit of 5 percent is projected in 2021. Continued border restrictions are estimated to negatively impact the current account in 2021. The fiscal and external accounts are expected to remain negative in the later years of the projection period. As economic growth is estimated to slow down in 2022 and 2023, public debt is projected to increase.

TABLE 2 South Pacific Islands / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices						
Samoa	-2.2	3.5	-3.5	-7.7	5.6	4.9
Tonga	0.3	0.7	-1.5	-3.0	2.3	2.8
Vanuatu	2.8	3.0	-10.0	4.0	3.9	3.3

Note : Financial years for Samoa and Tonga are Jul - Jun, for Vanuatu is Jan - Dec. e= estimate, f=forecast
Source: World Bank and IMF.