Central Pacific Islands

**Recent developments**

In Kiribati, economic growth is volatile and mainly determined by aid-related construction activity and government spending. Revised figures indicate GDP growth of just 0.9 percent in 2017 before accelerating to 2.3 percent in 2018, driven by the construction sector and government consumption (2019 data is not yet available). Inflation has been low in recent years and dipped into negative territory in 2019 (-1.8 percent) on the back of lower food and beverage prices. Fishing license fees, investment income from its sovereign wealth fund – the Revenue Equalisation Reserve Fund (RERF) – and aid transfers contributed to a current account surplus of 39 percent of GDP in 2018, despite a large trade deficit (77 percent of GDP). High fisheries revenues in recent years have fueled a major fiscal expansion. The largest new initiative is an international expansion of the state-owned airline fleet at a cost of circa A$120m (47 percent of GDP) over 2018-2020. Other recent measures include an increase to the copra (coconut) subsidy which supports livelihoods on the outer islands, an extension of fee-free primary education, a 30 percent pay rise for civil servants, and an outer islands infrastructure program. In the 2019 budget, the government introduced a new disability allowance and funding for pre-school teacher salaries, which may help to make early childhood education more accessible for the poor. Overall, Kiribati achieved a fiscal surplus of 4 percent of GDP in 2018, but is likely to have registered a small deficit in 2019 (based on the revised budget estimates), owing to a one-off payment towards the airline fleet expansion and delays in budget support payments.

After doubling in size in the early part of the decade, the economy of Nauru has seen slower and more volatile growth in recent years, in line with fluctuations in activity associated with Australia’s Regional Processing Centre (RPC) for asylum-seekers, phosphate mining, and fishing. After contracting in FY17 (year ended June), the economy rebounded in FY18, with growth of 5.7 percent attributable to strong fishing activity, preparations for the Pacific Islands Forum (hosted by Nauru in September 2018), and higher-than-expected RPC-related activity. But growth is estimated to have slowed in FY19 to around 1 per cent, due to a slowdown in phosphate mining and a reduction in refugee and asylum-seeker numbers.

Government revenue has increased by around 50 percentage points of GDP since FY2015 due to RPC-related revenues and fishing license fees, as well as the implementation of employment and services taxes and improvements in tax administration. Government spending has also increased rapidly, particularly on the wage bill and on RPC-related expenditures. Nevertheless, a surplus of 16.1 percent of GDP has been estimated for FY19, broadly in line with the average surplus of 20 percent of GDP realized over the last five years. These surpluses have been used to contribute to the Nauru Trust Fund (which now has assets equivalent to
about two thirds of GDP, but is not accessible until 2033), as well as build government deposits (including cash buffers) and reduce arrears.

Tuvalu’s macro-economic performance over the past few years has been favorable due to strong fishing license fees and increased capital investment in several large infrastructure and housing projects. The country looks set to record a sixth consecutive year of growth in 2019 with real GDP growth estimated at 4.1 percent, marginally below the 2018 level of 4.3 percent. Inflation climbed to 4.4 percent in 2017 due to higher food and transportation costs but is estimated to have fallen back to 4 percent in 2018-2019, with the increase in public wages, dictated by the need to compensate increased living costs and retain staff in the public administration, offset by moderation in food and fuel prices. Tuvalu has a very narrow domestic economic base and external grants are a critical source of budget financing. The banking sector is fragile, and credit provides only modest support to growth.

In recent years Tuvalu maintained fiscal surpluses despite high expenditure thanks to revenue from fishing license fees and the “.tv” domain, and grants, which together account for three quarters of domestic revenues. In 2018 a windfall gain, from a near doubling of fishing license fees, resulted in a sizeable fiscal surplus (including grants) equivalent to 24 percent of GDP. Post-grant surpluses in recent years have been used to replenish the Consolidated Investment Fund (CIF) and, more recently, to capitalize the Tuvalu Trust Fund (TTF) and the newly established Tuvalu Survival Fund (TSF). The combined value of the TTF, TSF and CIF was around 370 percent of GDP at end-2019. The current account continued to post a surplus, 5 percent of GDP, with the deficit in goods and services offset by income inflows, and reserve coverage remains adequate; an estimated 10 months of imports at end-2019.

### Outlook

In Kiribati, the near-term outlook is tilted to the downside: economic disruption from COVID-19 may result in delays to construction activity and affect the valuation of sovereign wealth fund (RERF) assets in the short term. The impact on the fiscal position should be limited, however, provided that the Pacific tuna fishing industry is not strongly impacted by COVID-19 related travel restrictions. Over the medium term, growth is expected to recover to around 2 percent as construction activity and visitor arrivals recover. Meanwhile, the next stage of the airline project is expected to result in large one-off budget deficit in 2020, although this can be afforded from Kiribati’s cash reserve buffer. The economy of Nauru is expected to contract by around 2 percent in FY2020, due to the effects of COVID-19 on construction activity and international arrivals, with a state of emergency declared in March and international flights severely curtailed. Only modest growth of between 1 and 2 percent per annum is expected over the medium term. Growth remains dependent on the uncertain outlook for the RPC, the execution of infrastructure projects (which may suffer to the extent there are COVID-19 related constraints on the availability of labor or materials), and fishing license revenues. Port construction work is likely to continue to support overall economic activity over the next two to three years. The central case is for the fiscal surplus to decline significantly over the medium term in line with a projected decline in RPC-related revenues.

In Tuvalu, the short-term outlook is subject to downside risks due the adverse impact of the COVID-19 outbreak. The medium-term outlook is broadly positive with GDP growth projected to average 4 percent in 2021-22, following the implementation of infrastructure projects. Inflation is expected to moderate to around 3 percent as oil price pressures ease. Over the medium-term however limited administrative capacity, lack of competitiveness and inefficient state-owned enterprises will act as constraints and growth is projected to slow to an annual average of around 2 percent. The government projects a moderate fiscal surplus for 2020 but going forward fiscal deficits averaging 5 percent of GDP over the medium term and 7 percent in the long term could likely emerge as fishing revenues moderate due to a waning El Nino cycle and as development grant allocations decline.

### Risks and challenges

Kiribati is heavily reliant on volatile fishing license revenues and investment returns from the RERF to meet its substantial long-term development financing and climate adaptation needs. Going forward, it will be important for Kiribati to continue its efforts to strengthen the sustainable management of these critical resource endowments. Nauru faces significant challenges in maintaining growth and ensuring fiscal and debt sustainability. While fishing license fees have provided a welcome (albeit volatile) revenue stream in recent years, the biggest challenge is to diversify the economy further given that neither phosphate mining nor the RPC are sustainable drivers of growth in the long run. Tuvalu is also subject to significant downside risks and challenges stemming from a combination of factors including the country’s geographic remoteness, a narrow economic base dependent primarily on inherently volatile fishing revenues and international aid, near total dependency on imports of food and fuel, a fragile and under-regulated banking system and elevated vulnerability to external shocks. Tuvalu is one of the most climate-change challenged countries in the world and the required climate-related adaptation measures impose long-term fiscal costs.

### TABLE 2

<table>
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<tr>
<th>Central Pacific Islands</th>
<th>Macro poverty outlook baseline scenario</th>
<th>(annual percent change unless indicated otherwise)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth, at constant market prices</td>
<td></td>
<td></td>
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<tr>
<td>Nauru</td>
<td>2.8</td>
<td>10.4</td>
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<tr>
<td>Tuvalu</td>
<td>9.1</td>
<td>3.0</td>
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Sources: Country authorities and World Bank and IMF staff estimates. 2017 estimates are not yet available for Kiribati. Nauru data are based on the fiscal year ended June; Kiribati and Tuvalu are calendar years. Notes: p = projection.

The cut-off date for information in this MPO was March 30, 2020.