CENTRAL PACIFIC ISLANDS

Table 1	2020
Population, million	
Kiribati	0.12
Nauru	0.01
Tuvalu	0.01
GDP, US$, billion	
Kiribati	0.19
Nauru	0.12
Tuvalu	0.05
GDP per capita, current US$	
Kiribati	1678
Nauru	9516
Tuvalu	4104

Sources: WDI, World Bank staff estimates.

The Central Pacific countries – Kiribati, Nauru and Tuvalu – have been less severely affected by the pandemic than their tourism-dependent neighbors, thanks to their relative economic isolation and the dominance of the public sector in their economies. Looking forward, Kiribati faces sustainability challenges from rapid expenditure growth, while Nauru will need to adjust to a projected sharp decline in public revenues. All three countries face long-run challenges to growth and poverty reduction from their narrow economic base and vulnerability to climate change.

Key conditions and challenges

Kiribati has been spared from severe economic impacts due to the pandemic, and the key economic challenge currently is to improve the sustainability and effectiveness of public spending. Kiribati has experienced a fourfold increase in public revenues from the fishing sector in the past decade, and now receives fishing license revenues worth 66 percent of GDP on average per year. These new revenues present an unprecedented opportunity to address the country's severe infrastructure deficit, reduce poverty and promote climate resilience. However, Kiribati's small public service faces significant capacity challenges in effectively delivering high-quality spending on this expanded scale. Moreover, after successive years of spending increases, aggregate spending levels have now caught up to and surpassed Kiribati's expanded revenue envelope, seriously threatening fiscal sustainability.

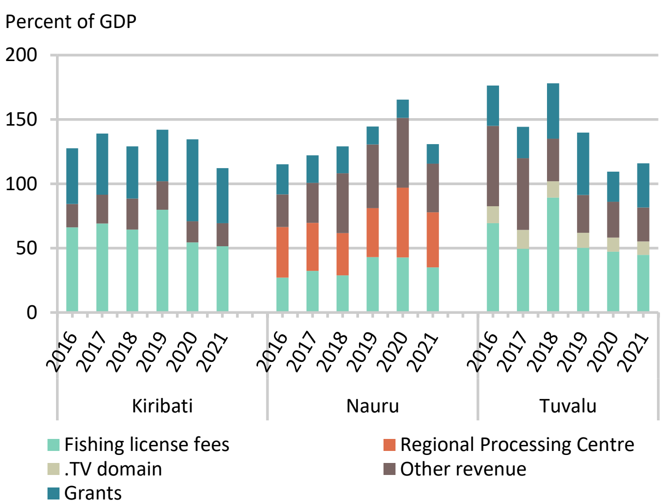
Nauru is also undergoing a significant economic transition. Public revenues and growth have been highly dependent on activity associated with Australia's Regional Processing Centre (RPC) for asylum-seekers, phosphate mining and fishing. However, the country's phosphate resources have now been fully exploited, and the RPC is also expected to wind down in 2021. Nauru now faces the challenge of adjusting to reduced budget revenues and finding new sources of growth over the medium term. In the short term, the impacts of COVID-19 have been relatively limited, thanks to the swift imposition of border controls and the economy's limited exposure to global economic conditions.

Tuvalu is one of world's smallest, remote and most climate challenged countries. It has near total dependence on imports for food and fuel and vulnerability to climate change present significant challenges to macroeconomic performance. Fishing licenses account for around 40 percent of Government revenue. Support from international partners and the Tuvalu's sovereign wealth funds are important cushions for meeting shortfalls in the Government's budget. The Government Financial Reserves (GFR), including the Consolidated Investment Fund, Tuvalu Development Fund and Survival Fund, is valued at 105 percent of GDP. The Tuvalu Trust Fund, an international donor trust fund established in 1987, represents 260 percent of GDP. An estimated 26 percent of the population lives below the national poverty line. The narrow economic base, the financial impact of climate change events and cost of climate-related adaptation projects pose significant macro-economic challenges. Tuvalu also confronts escalating fiscal costs of meeting the health care needs of an aging population and epidemic of non-communicable diseases.

Recent developments

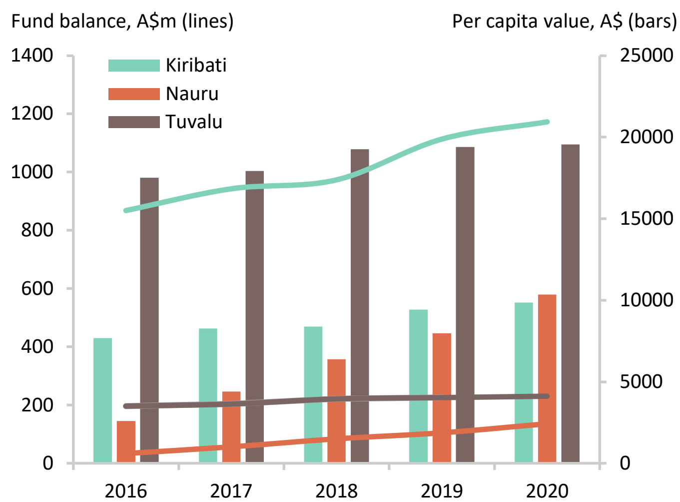
Kiribati's economy is expected to have contracted by about 2 percent in 2020. On

FIGURE 1 Central Pacific Islands / Sources of revenue – projections to 2021



Sources: Country authorities, and World Bank and IMF staff estimates and projections. Nauru data are June years; Kiribati and Tuvalu are calendar years.

FIGURE 2 Central Pacific Islands / Sovereign wealth fund balances



Sources: Country authorities, and World Bank and IMF staff estimates and projections. Notes: Nauru data are June years; Kiribati and Tuvalu are calendar years. The Nauru Trust Fund was established in 2016.

the supply side, border closures have hampered donor-financed project activity and also caused some disruptions to cargo imports. Restaurant-grade fresh tuna exports have also been affected by a lack of international air freight capacity and weak international demand. Lack of expatriate demand has severely impacted on hotels and restaurants, while quarantine measures have also affected demand for fisheries transshipment services. The authorities estimate that about 2 percent of the labor force has been affected by border closures, including temporary workers abroad.

Preliminary estimates suggest a fiscal deficit of around 5 percent of GDP in 2020. The fiscal impact of COVID-19 has been relatively limited, with only slightly lower than expected revenue performance and strong donor support for health spending. Meanwhile, the authorities implemented a more than 20 percent increase in recurrent spending that was unrelated to the pandemic, with the launch of a new unemployment benefit and an expansion of the old age pension. The new benefit schemes are expected to have a major poverty reduction impact, given that more than three quarters of Kiribati's adult population are eligible to receive support.

In **Nauru**, the growth forecast has been revised upwards to 0.7 percent for FY20, due to stronger than expected activity related to the RPC and a 17 percent increase in spending compared with FY19. This has helped to offset negative impacts of the pandemic from border closures, including supply-chain disruptions of construction activity and the departure of expatriates.

The government's initial fiscal response to COVID-19 amounted to 5.5 percent of GDP in FY20. It focused on health measures and financial support to the state-owned Nauru Airlines (to ensure maintenance of critical services) as well as other SOEs. Despite strong expenditure growth, Nauru achieved a fiscal surplus of 17 percent of GDP in FY20 due to much higher than expected revenues from the RPC and fishing licenses. Large fiscal surpluses in recent years have been used to build the Nauru Trust Fund (currently at 70 percent of GDP) and government deposits (around a third of GDP).

In **Tuvalu,** early and effective response to the COVID-19 pandemic prevented adverse public health outcomes and it is one of only a very few countries in the world with no reported cases. The global economic lockdown impacted travel and trade, but fishing license revenues remained resilient. The economy is expected to contract by 0.5 percent in 2020, moderate in comparison to other countries in the region, but a marked downturn from average annual growth of 4.7 percent in 2015 -2019. In March 2020, Parliament approved a supplementary COVID-19 budget (equivalent to 30 percent of 2019 GDP) and an economic recovery package in May 2020 to provide temporary economic support. The latter included a universal cash payout to every citizen. Together they pushed the fiscal deficit to an estimated 31.3 percent of GDP financed primarily with external budget support grants.

Outlook

In **Kiribati**, a bounce back in growth of around 3 percent is expected in 2021 despite the ongoing border closure, thanks to consumer demand stimulus from the new social benefits and a public sector pay rise. Over the medium term, however, there are significant risks to macroeconomic stability stemming from the fiscal sector. The recently passed 2021 budget includes new recurrent spending of 8 percent of GDP, with an additional 5 percent of GDP in new spending projected from 2022 onwards. The deficit is expected to reach nearly 20 percent of GDP in 2021 and will be financed with a drawdown from the sovereign wealth fund. With the deficit expected to remain elevated over the coming years, Kiribati will quickly erode its available cash reserves and the sustainability of the sovereign wealth fund could also be put at risk.

In **Nauru,** modest growth of around 1 percent is expected over the medium term, with the expected closure of the RPC expected to weigh heavily on the outlook. A major port construction project is expected to help offset the winddown in RPC-related activity, although the execution of this and other infrastructure projects may be subject to ongoing delays due to supply chain disruptions. A balanced budget is expected in FY21, with fisheries revenues expected to recover from a relatively weak performance in the first half of the year. However, given the projected sharp decline in RPC-related revenues over the medium term, the large fiscal surpluses seen in recent years are unlikely to persist.

In **Tuvalu** growth is expected to recover to around 3.0 percent in 2021, assuming the reopening of international borders and easing of travel restrictions in the year. The 2021 budget presented as a balanced budget as support from international partners remains strong. The public debt-to-GDP ratio is low (estimated at 16 percent of GDP in 2019), including both direct Government obligations and implicit contingent liabilities. Debt management policies remain prudent. The major risks to the outlook are unpredictability of the COVID-19 pandemic and prolonged shut down of the global economy; volatility in revenue flows; an abrupt reduction in budget support from development partners; and the ever-present threat of climate related natural disasters.

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

	2017	2018	2019	2020f	2021f	2022f
Real GDP growth, at constant market prices						
Kiribati	0.9	3.8	3.9	-1.9	3.0	2.6
Nauru	-5.5	5.7	1.0	0.7	1.3	0.9
Tuvalu	3.2	4.3	4.1	-0.5	3.0	4.0

Sources: Country authorities and World Bank and IMF staff estimates.
Notes: f = forecast.
Nauru values correspond to their fiscal year ending June 30; Kiribati and Tuvalu are calendar years.