

The Pacific Economic Monitor provides an update of developments and policy issues in the Pacific economies.

Contents

Highlights	1
A view from neighboring economies	3
The state of the Pacific	9
Risks and scenarios	24
Economic management	29
Data	32

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Highlights

A view from neighboring economies

- Major neighboring economies—Australia, New Zealand and the United States—will experience recession in 2009. Their labor markets are continuing to deteriorate. Unemployment has risen to 8.9% in the United States, 5.4% in Australia, and 5.0% in New Zealand.
- The external slowdown is reducing tourism activity in the Pacific and the flow of remittances to the region.
- Tourism departures from Australia to the Pacific weakened in early 2009. Departures for the Pacific from New Zealand had noticeably weakened earlier. Departures from the United States and Asia for the Pacific were also down over 2008.

The state of the Pacific

- The Pacific saw historic economic growth in 2008. Overall growth of 5.1% was led by the commodity-intensive economies of Papua New Guinea, Solomon Islands, and Timor-Leste. Overall growth is projected to slow to 3.1% in 2009.
- The contraction in gross domestic product (GDP) forecast for 2009 in the Fiji Islands and Samoa is likely to be larger than originally expected. Conditions are deteriorating rapidly in Solomon Islands. Vanuatu is now expected to perform better than originally forecast.
- Inflation is easing across the region, mainly because of lower world fuel prices. The devaluation of the Fiji Islands dollar will, however, add to inflationary pressures in the Fiji Islands.

Risks and scenarios

- A key downside risk for the commodity-intensive Pacific economies is a larger than expected decline in world demand and commodity prices.
- The tourism-intensive economies of the Pacific are exposed to the continued deterioration in international tourism now forecast for 2009.

Economic management

- The response to the global economic crisis is best tailored to the individual circumstances of each Pacific economy. A proactive, targeted, and coherent policy response is called for.
- Poor revenue outcomes are raising the imperative to act early to trim low-priority expenditure. Increased revenue effort will also be required. Additional fiscal resources may also be needed. Options include external grants, where made available, and borrowing, where it is affordable.

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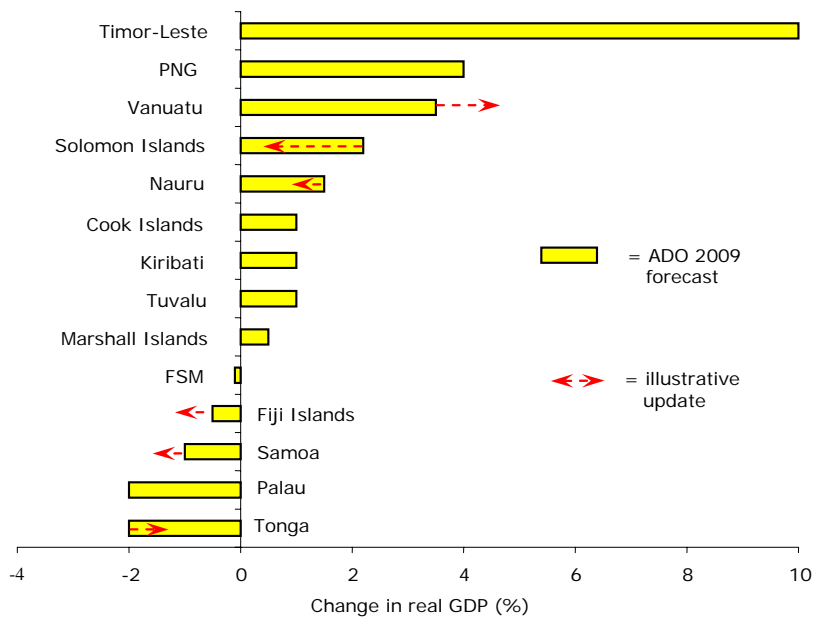
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Abbreviations

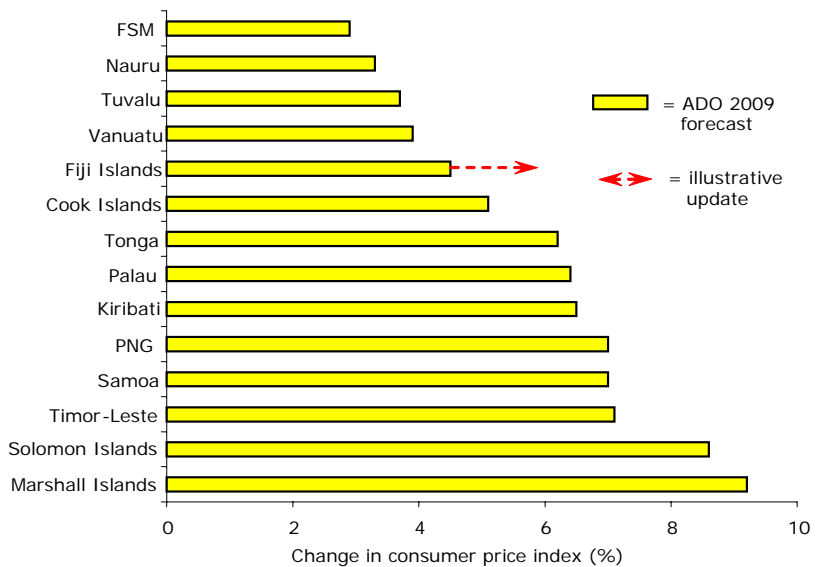
- ADB Asian Development Bank
- ADO Asia Development Outlook
- ABS Australian Bureau of Statistics
- cpi consumer price index
- fas free along side
- fob free on board
- FSM Federated States of Micronesia
- FY fiscal year
- GDP gross domestic product
- lhs left hand side
- m.a. moving average
- NZ New Zealand
- PNG Papua New Guinea
- rhs right hand side
- US United States
- y-o-y year on year

Latest Asian Development Bank forecasts for 2009

Real GDP growth



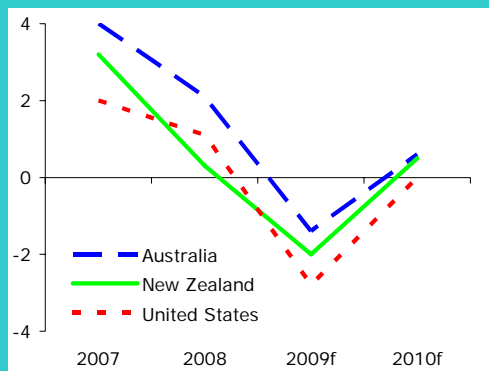
Inflation



ADO=Asian Development Outlook, FSM=Federated States of Micronesia,
GDP=gross domestic product, PNG=Papua New Guinea
Note: Forecasts for the Cook Islands, Marshall Islands, FSM, Nauru, Palau,
Samoa, and Tonga are for their fiscal years.
Source: ADB. 2009. *Asian Development Outlook 2009*. Manila (March) and
ADB staff estimates.

Developments overseas

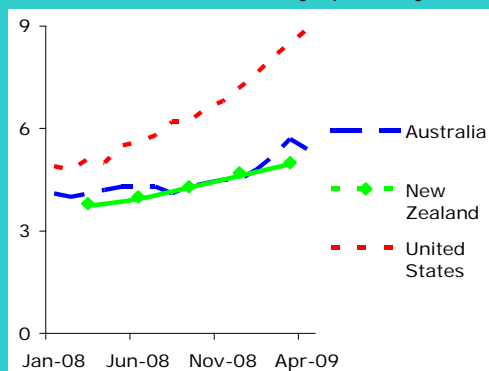
GDP growth (%, annual)



f=forecast

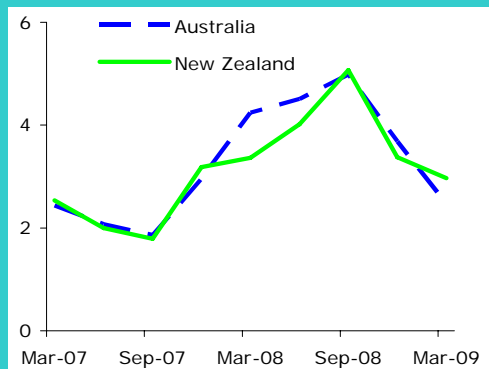
Source: International Monetary Fund. 2009. World Economic Outlook, April.

Unemployment in key economies (% of labor force, monthly/quarterly)



Sources: Australian Bureau of Statistics (ABS), Reserve Bank of New Zealand, and US Bureau of Labor Statistics.

Inflation (y-o-y % change in CPI, quarterly)



CPI=consumer price index

Sources: ABS and Reserve Bank of New Zealand.

Gross domestic product

- Major neighboring economies will be in recession in 2009: a 2.8% contraction is forecast for the United States (US), 1.4% for Australia, and 2.0% for New Zealand.

Unemployment

- The US labor market has been deteriorating since early 2008. The unemployment rate reached 8.9% in April 2009.
- The US lost 149,000 jobs in manufacturing and 110,000 construction jobs in April 2009. Manufacturing overtime hours, a leading indicator of labor demand, fell to an average of around 2.7 hours per week from about 4 hours in January 2008.
- New Zealand's unemployment rate reached a 6-year high of 5.0% in the first quarter of 2009. Unemployment began to rise sharply in Australia in late 2008. Australia's unemployment rate reached 5.7% in March 2009 before falling slightly to 5.4% in April.

Inflation

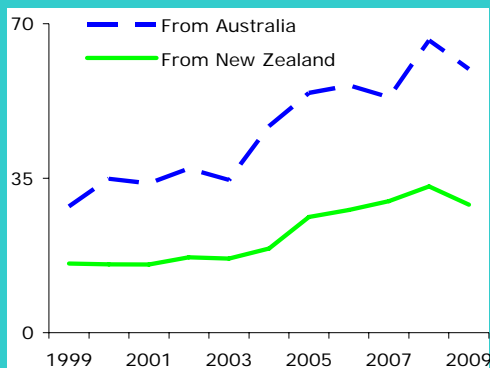
- Inflation is easing internationally as demand pressures decrease and prices of oil and commodities retreat from their historic highs of 2008.
- Inflation (year-on-year) in Australia and New Zealand both peaked at around 5.0%. Both have since declined to 2.5% and 3.0%, respectively, as of March quarter 2009. US inflation was -0.4% by March 2009, down from the high of 5.6% in July 2008.
- Latest forecasts from the International Monetary Fund for 2009 are for a slight deflation of -0.9% for the US, and low inflation of 1.6% in Australia and 1.3% in New Zealand (*World Economic Outlook*, April 2009).

Stock markets

- Stock markets in key neighboring economies continued their decline in 2009, reaching record lows in March 2009 but posting modest gains thereafter. Stock indices in the US and Australia are still down by a third and New Zealand's by a fifth compared to a year ago.

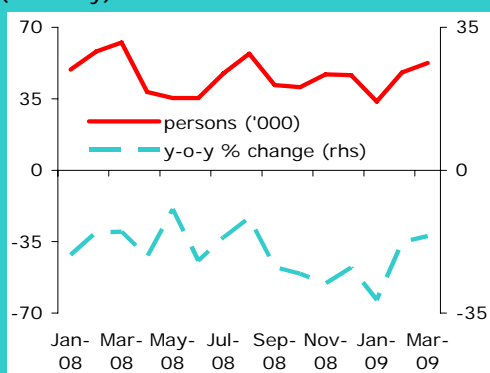
Tourism and trade

Departures for the Pacific (‘000 persons, March quarter totals)



Sources: ABS and New Zealand Ministry of Tourism.

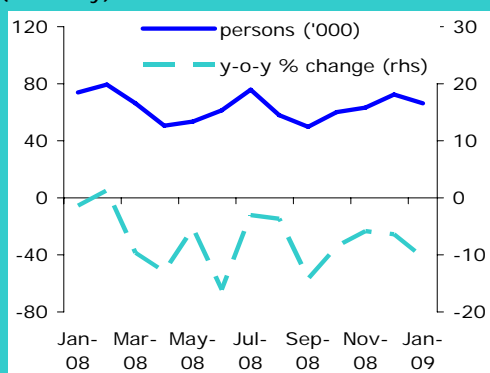
Japanese departures for Oceania (monthly)



y-on-y=year-on-year

Sources: Japan Tourism Marketing Co.

US departures for Oceania (monthly)



y-on-y=year-on-year

Sources: US Office of Travel and Tourism Industries.

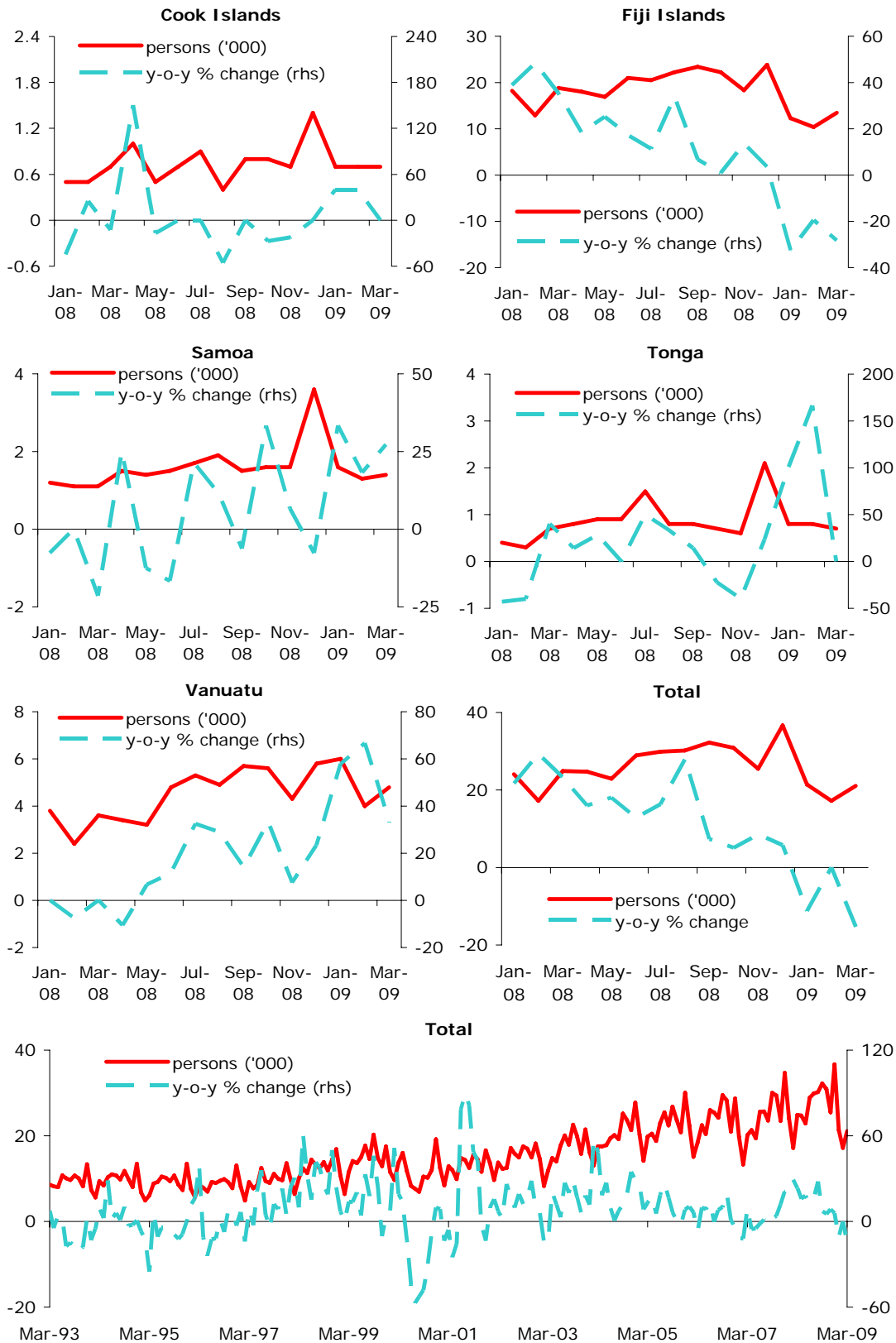
Tourist departures to the Pacific—Oceania

- The sustained growth in tourism from Australia and New Zealand that has helped expand the region's economies this decade is over. Arrivals from these primary source countries are now declining. This will contribute to a slowdown of growth in the Pacific region in 2009. Tourism-dependent economies face the prospect of an economic contraction.
- The decline in departures from Australia has affected the Fiji Islands the most. Flooding and political developments have added to the weak demand from a slowing Australian economy.
- The apparent diversion of tourists from the Fiji Islands to other major Pacific destinations is providing some economic relief for these other economies. Vanuatu in particular is appearing to benefit from a switch in destinations by Australian tourists. However, this relief is likely to be temporary, as the Fiji Islands is expected to win back tourists later in 2009.
- New Zealand tourism to the Pacific started to weaken in late 2008. Departures to Fiji, Tonga, and Vanuatu are down compared to last year. This decline has been partially offset by higher tourism numbers for the Cook Islands and Samoa.
- Tourism from Asia and the US to Oceania was generally weak throughout 2008. This downturn is expected to continue into 2009 given the international slowdown. Japanese departures for Australia and New Zealand declined by around 20% in 2008, and were still down by about 16%, year-on-year, as of March 2009. Departures from the US to Oceania also declined by about 7% last year, and early numbers for 2009 confirm a continuing decline of around 10%.

Exports of goods to (imports by) the Pacific

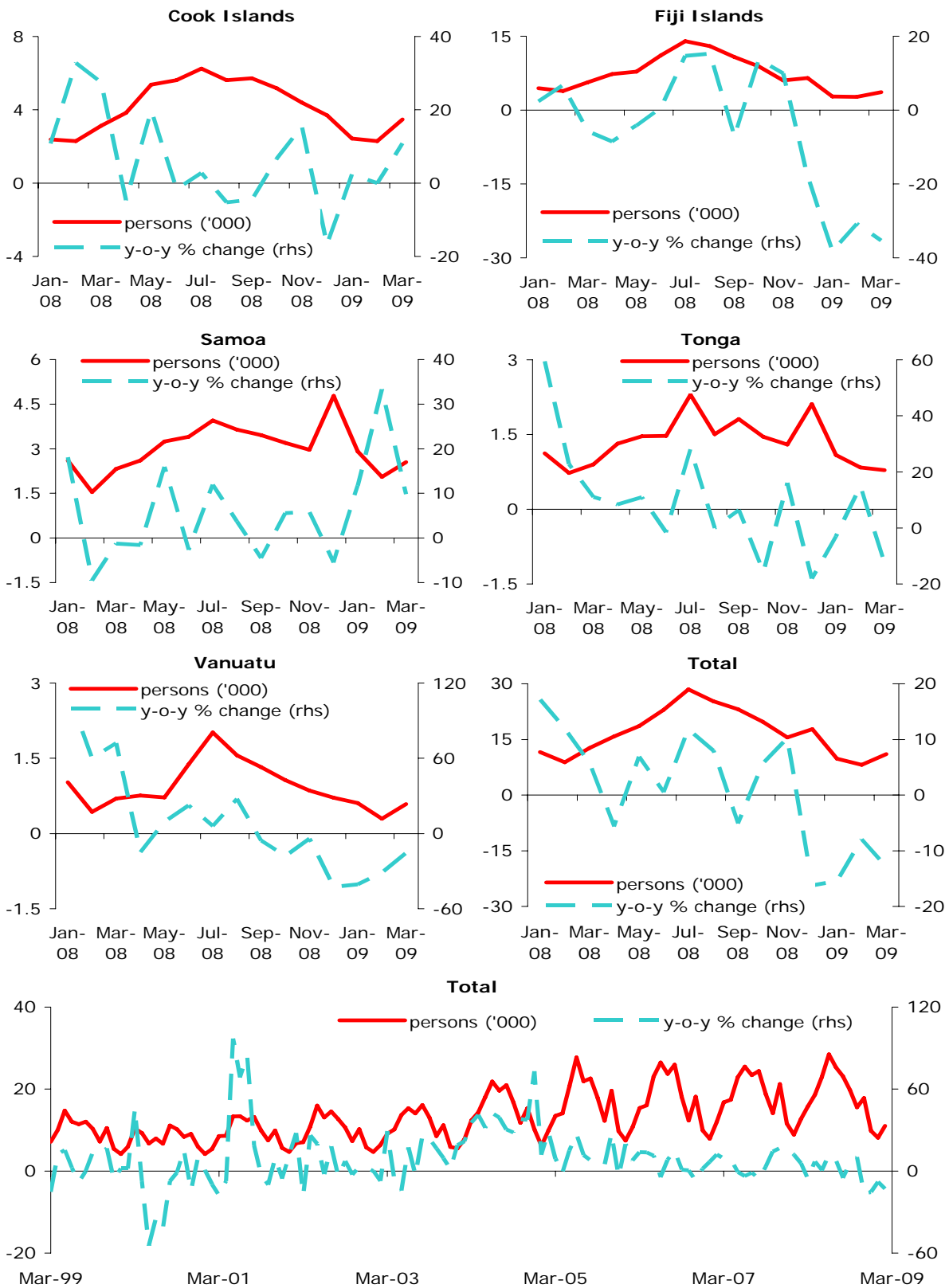
- The value of imports (nominal) is declining in most of the larger Pacific economies. While partly due to the effect of lower fuel prices, the decline also points to lower domestic demand. Notably, the value of imports from each country's major trading partner (fuel is normally from a minor trading partner for these countries) is now trending down in the tourism- and remittance-dependent economies.

Departures from Australia to the Pacific (monthly)



rhs=right hand side, y-on-y=year-on-year
Source: ABS.

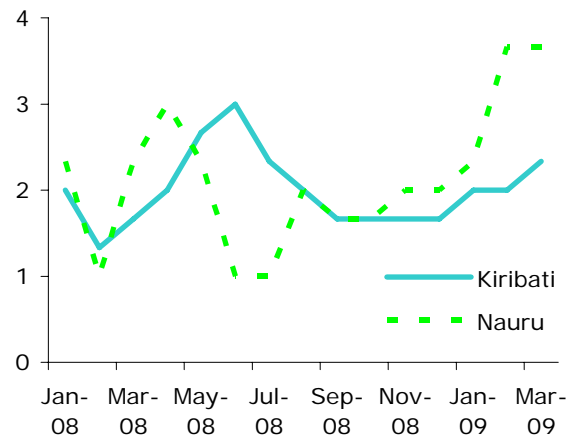
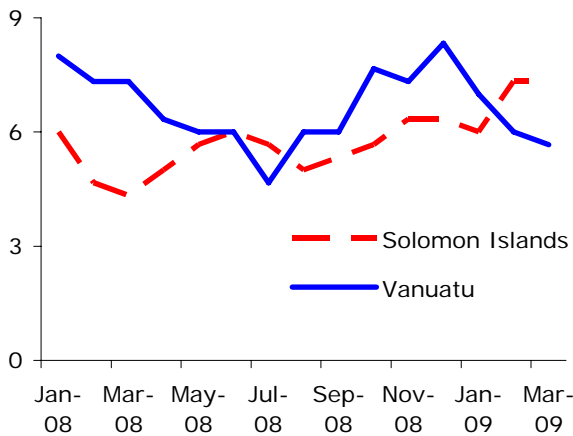
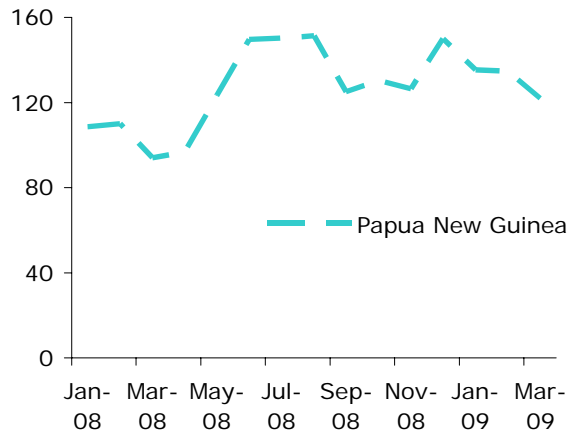
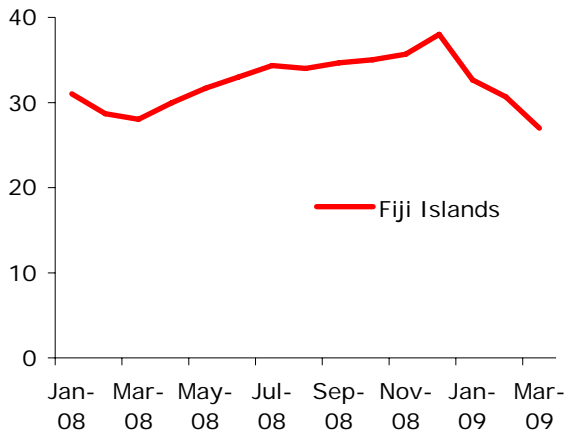
Departures from New Zealand to the Pacific (monthly)



rhs = right hand side, y-on-y=year-on-year
 Source: New Zealand Ministry of Tourism.

Merchandise exports from Australia

(A\$ million, fob; 3-month moving average)

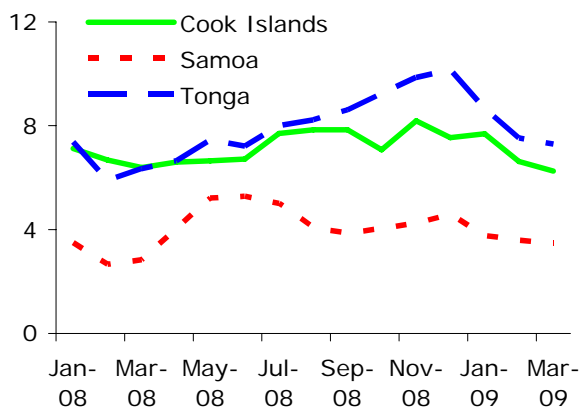


fob=free on board
Source: ABS.

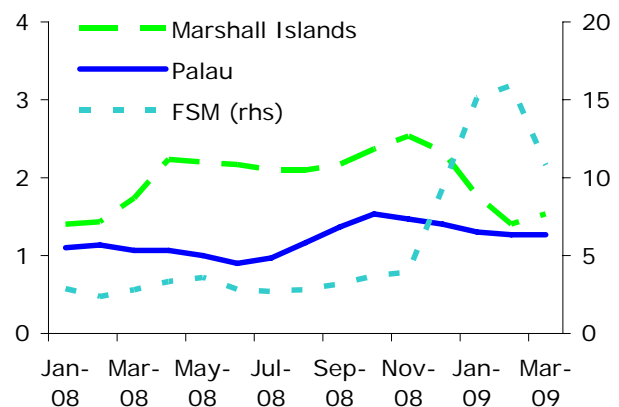
Merchandise exports from New Zealand and the United States

(3-month moving average)

From New Zealand
(NZ\$ million, fob)

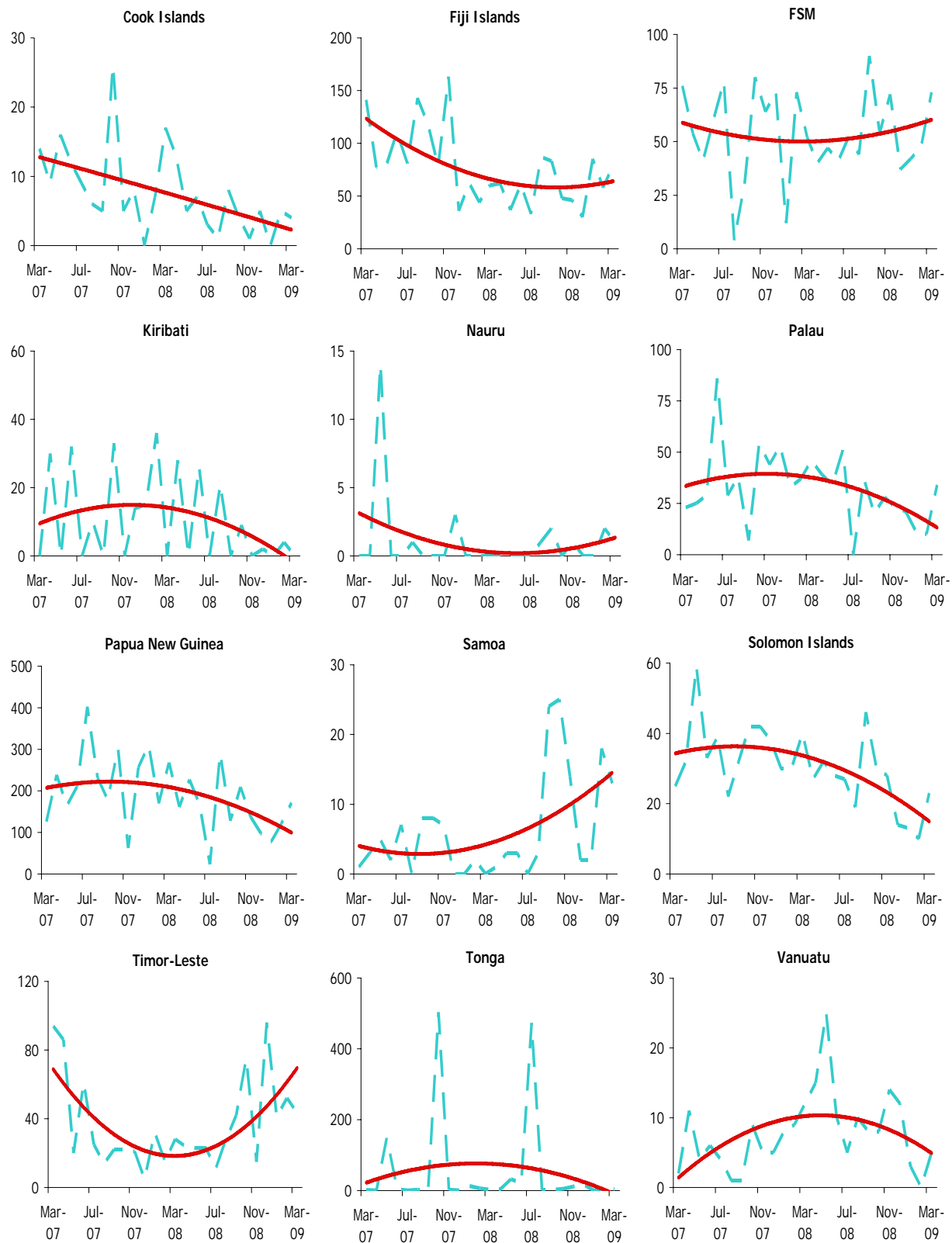


From US
(US\$ million, fas)



fas=free along side, fob=free on board, rhs=right hand side
Sources: Statistics New Zealand, and US Census Bureau.

Motor vehicle imports from Japan
(number with trend, monthly)

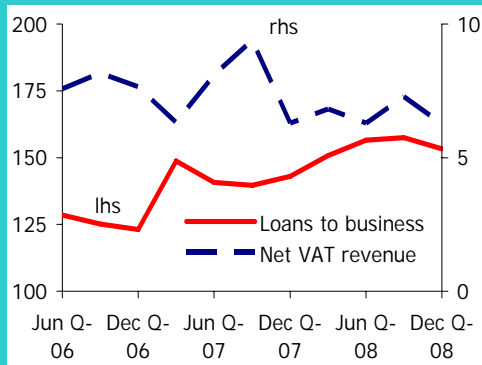


Source: Japan e-Stats website.

Cook Islands

Key indicators

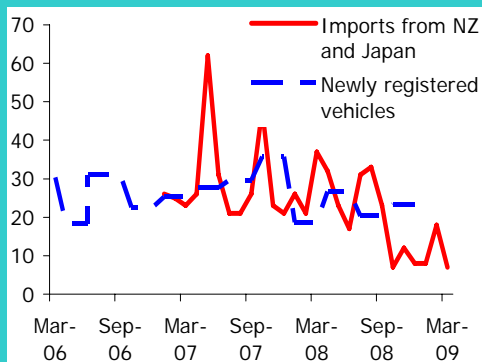
(NZ\$m, quarterly)



lhs=left hand side, Q=quarter, rhs=right hand side, VAT=value added tax
Source: Cook Island Statistics Office.

Motor vehicles

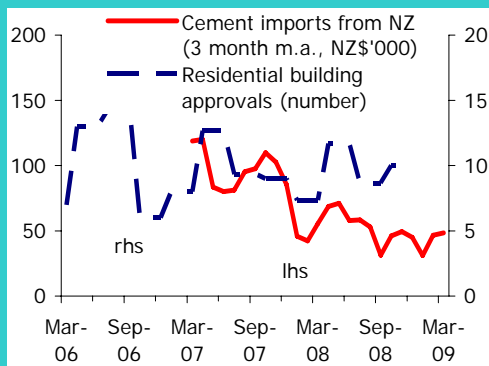
(number, monthly)



Note: Registrations are the monthly average per quarter. NZ=New Zealand
Sources: Cook Island Statistics Office, Japan e-Stats website, and Statistics New Zealand.

Building activity

(monthly)



lhs=left hand side, m.a.=moving average, NZ=New Zealand, rhs=right hand side
Note: Approvals are the monthly average per quarter.
Sources: Cook Island Statistics Office and Statistics New Zealand.

Key developments

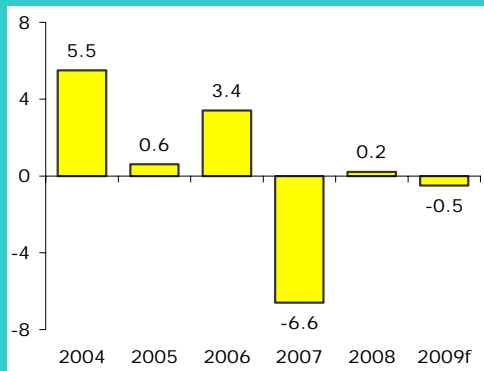
- Economic growth was weak in 2008, continuing the poor performance of recent years. Real GDP grew by an estimated 1.1% in 2008, following growth of 1.4% in 2007 and only 0.7% in 2006.
- Visitor arrivals were down by 3.1% in 2008, with a large decline from high-spending segments of the market such as the US, Canada, and Europe. High fuel prices and the loss of one of two international freight-shipping services also contributed to a weak economy.
- Key imports have slowed in early 2009, an outcome consistent with a weak economy. Motor vehicle imports from Japan and New Zealand are falling, as are cement imports. Imports of basic food items are mixed; wheat flour and poultry are on the decline, while imports of rice and soft drinks are holding steady.
- Growth is projected to remain low at 1.0% in 2009. The positive, albeit low, growth forecast in the face of external deterioration is attributable to special events and public construction projects planned for 2009. Increasing visitor arrivals in early 2009 give some hope of a better outcome than originally forecast. Another positive development is the issuance of building approval in December 2008 for a major commercial project.
- Higher government expenditures and a stagnation in revenue will lift the budget deficit in FY2008–09. A deficit of 8.1% of GDP is expected compared to 0.8% in FY2007–08.
- Inflation had eased to 8.8% by March quarter 2009 largely due to lower fuel prices. Inflation is forecast to decline to 5.1% in 2009.

Key issues

- The economy is highly exposed to the global economic crisis given its dependence on tourism. The government has acted early to avoid an economic contraction. While the resultant budget deficit is affordable given low debt levels, the fiscal stimulus is large by international standards. Extra care is needed to ensure value-for-money from new expenditures, particularly subsidies provided to the private sector and major new capital projects. Alongside the fiscal stimulus, the government should continue efforts to strengthen budget processes and create a leaner, more efficient public sector.

Fiji Islands

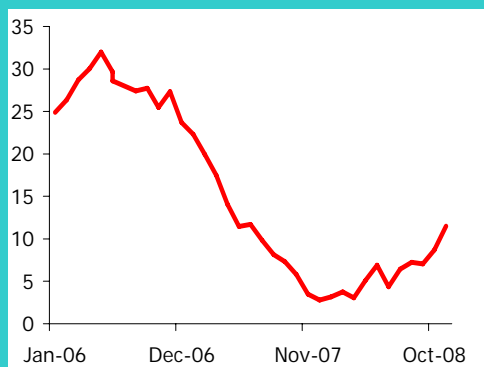
GDP growth (%, annual)



f=forecast

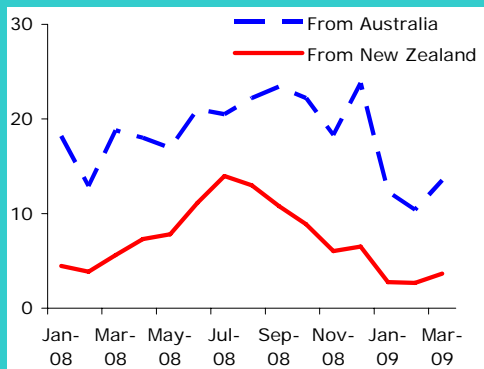
Sources: Reserve Bank of Fiji and ADB. 2009. *Asian Development Outlook 2009*.

Private sector credit growth (%, year-on-year, monthly)



Source: Reserve Bank of Fiji.

Resident departures to Fiji ('000 persons, monthly)



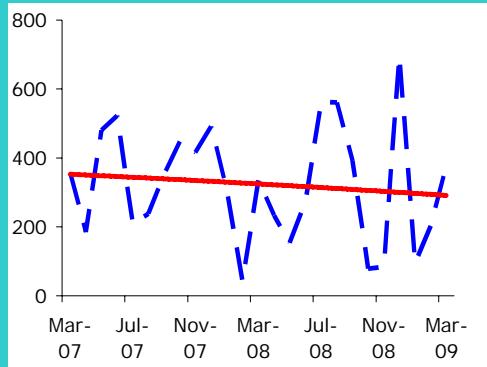
Sources: ABS and New Zealand Ministry of Tourism.

Key developments

- The economic decline of 2007 was halted in 2008 by improved performances of key sectors such as copra production, gold mining, mineral water production, electricity, and building and construction. Price discounting helped to recover visitor arrivals over the year.
- Global economic conditions and the January floods have led to a substantial downgrade in the official growth outlook. Forecasts made by the Reserve Bank of Fiji in late 2008 projected growth of about 2.4% for 2009. In April the forecast was revised to about 0.3%. The ADB forecast released in March projected a contraction of 0.5% in 2009.
- Subsequent political events, including the abrogation of the Constitution, have added to the downside risks for the economy in 2009.
- Economic data confirm a significant economic decline in early 2009. In March 2009, resident departures from Australia and New Zealand to Fiji were lower by about 28% and 35%, respectively, compared with the same month in 2008. Copra production and electricity generation also fell (on an annual basis) during the first two months of 2009, although positive results were noted by the end of April. Cement imports have been flat because it is also produced locally. Imports of key staples such as frozen chicken from New Zealand have been trending down since late last year, although this has picked up again as of March 2009. Automobile imports from Australia and Japan have also been subdued recently, and total new car sales have fallen by 9.9% in 2009, cumulative to April.
- The 2009 budget adopted an expansionary fiscal stance. The deficit is budgeted to double to about 3% of GDP, with planned additional spending on agriculture development and rural infrastructure improvements. With the dual objectives of increasing economic growth while also favoring the poor, the 2009 budget will provide a stimulus to the economy. Tax revenues in the March Quarter of 2009 have fallen below budget estimates, with lower income tax and custom duty collections due to decreased economic activity. This may push the actual fiscal deficit beyond 5% of GDP in 2009.

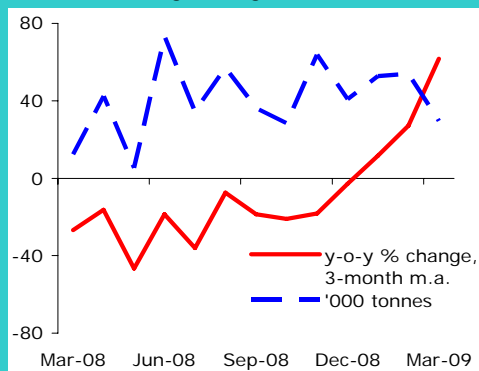
Fiji Islands

Cement imports from Australia (tonnes with trend, monthly)



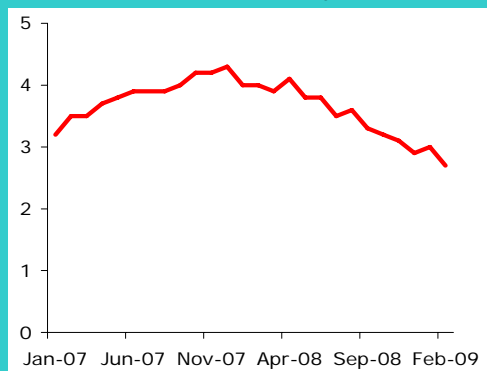
Source: ABS.

Petroleum imports from Singapore (3-month moving average)



m.a.=moving average, y-on-y=year-on-year
Source: International Enterprise Singapore.

Foreign exchange reserves (months of imports, monthly)



Source: Reserve Bank of Fiji.

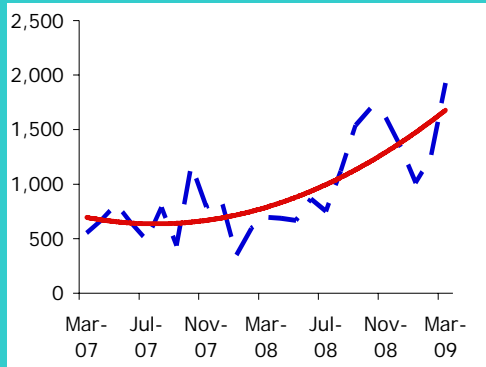
- Monetary policy has also become more expansionary. The reserve bank reduced its lending rates to commercial banks in January 2009 to ease tightness in liquidity. New regulations announced in April contain the unusual step of fixing commercial bank lending rates and interest rate margins. Commercial bank lending rates were fixed at the levels as of the end of December 2008 and a 4% ceiling on interest spreads was set, effectively raising deposit rates. Commercial banks are also required to establish microfinance units.
- The Fiji dollar was devalued by 20% in April. This was undertaken in part to adjust for a recent appreciation against the Australian and New Zealand dollars. This has the potential to lift the performance of the tourism and export sectors over time, if complementary policies are in place. However, these positives will take some time to be realized. The immediate effect will be a rise in inflation. As of April inflation was -0.3% (year-on-year), but is now projected to reach as high as 10% over 2009.
- External accounts remain under pressure as import payments outstrip export revenues. As of early 2009, import volumes of petroleum products from Singapore were rising, partially offsetting the benefits of the recent fall in prices. Domestic exports fell by 26.5% in the first 2 months of the year, compared to a 3.6% growth rate in the same period in 2008, underpinned by lower receipts from sugar, mineral water, garments, and fish.

Key issues

- Foreign exchange reserves are under considerable pressure, falling to a low level equivalent to only 2.7 months of merchandise imports by February 2009. Weak external demand remains a concern and will put pressure on the balance of payments and foreign reserves.
- Offsetting fiscal measures have been implemented to make funds available for flood relief and rehabilitation efforts, as well as to control overall spending. Such measures must be developed within a strategic framework to ensure that key public services are not disrupted. Fast-tracking of state-owned enterprise reform offers good prospects to help improve the government's fiscal position and, at the same time, encourage private enterprise to provide a broader basis for recovery.

FSM (Federated States of Micronesia)

Food imports from the US
(US\$'000 fas with trend, monthly)

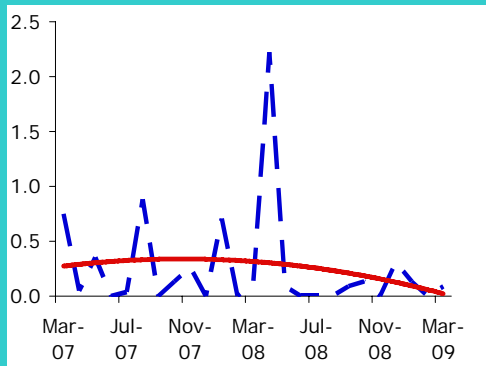


fas=free along side
Source: US Census Bureau.

- The FSM economy contracted by an estimated 1.0% in FY2008 and a contraction of around 0.1% was originally projected for FY2009. Using food imports from the US as a gauge of economic activity, domestic demand may be picking up slightly early this year.
- The fiscal position is unsustainable. While the fiscal deficit was reduced to 3% of GDP in FY2008 (through additional grants from the People's Republic of China (PRC) and severe public sector spending cuts in Chuuk and Kosrae), budget management is still a major concern. An increased revenue effort is a priority. Overcoming delays in public works funded by the US is central to correcting a long-standing problem: at least \$100 million, the equivalent of 40% of GDP, in grants allocated over FY2004–2008 remain

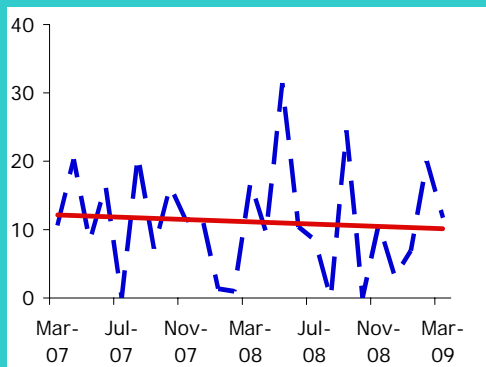
Kiribati

Cement imports from Australia
(tonnes with trend, monthly)



Source: ABS.

Beef imports from Australia
(tonnes with trend, monthly)



Source: ABS.

Key developments

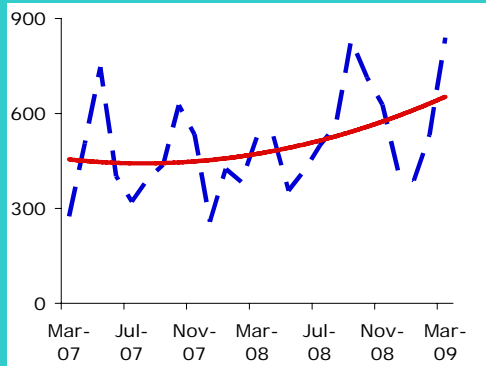
- The economy grew by 0.6% in 2008, driven by high levels of government spending. The fiscal deficit reached 13% of GDP in 2008, partly due to subsidies for imported fuel.
- Demand for imports from Australia grew to A\$7 million in the March quarter of 2009 compared to A\$5 million in the same period in 2008. Whether this upward trend is temporary remains to be seen. Imports of some consumer staples such as wheat flour and poultry meat are holding up, while beef imports are falling. Import of cement is likewise falling after a surge in 2008 linked to major public works projects.

Key issues

- Kiribati has substantial public savings invested in offshore equity markets. As world stock markets plunged, so did the value of the stocks held in the Revenue Equalization Reserve Fund (the RERF). Kiribati is yet to make the reductions in public spending needed to compensate for the decline in the market value and expected income from the RERF. While the absence of adjustment has the positive effect of helping support demand and economic activity for now, it will come at a price. The RERF was accumulated with much effort to secure economic sustainability. Without corrective action, it will be set on a path to depletion.

Marshall Islands, Republic of

Food imports from the US
(US\$'000 fas with trend, monthly)

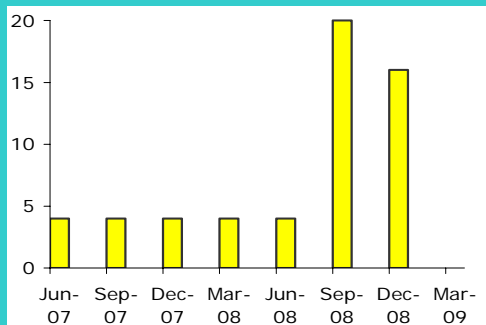


fas=free along side
Source: US Census Bureau.

- A grant-financed increase in public expenditures supported GDP growth of around 1.5% in FY2008. Increased copra production also supported economic activity; production responded to high international prices to exceed 7,000 tons for only the third time in 50 years. Food imports from the US are now exhibiting a slight upward trend, suggesting some improvement in domestic demand. A slight expansion is forecast for 2009.
- Inflation has subsided considerably. After posting the highest inflation rate in the Pacific last year (a high of 29.4% in the September quarter), inflation was only 5.6% in the March quarter of 2009 (year-on-year).
- Achieving fiscal sustainability must be addressed. Strong measures are required to cut spending and to develop local revenue sources.

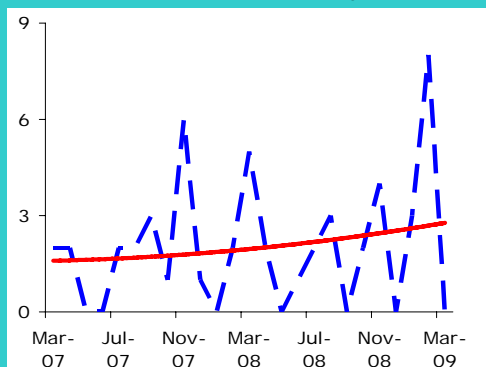
Nauru

Australian imports from Nauru
(% of 2007 GDP, quarterly)



Note: Mostly consists of phosphate.
Source: ABS.

Australian exports to Nauru
(A\$ million with trend, monthly)



Source: ABS.

Key developments

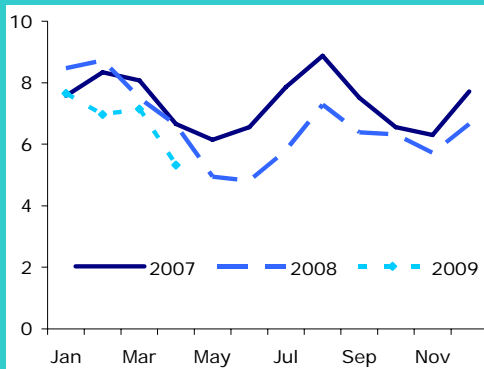
- The economy expanded by an estimated 1.0% in FY2008. Phosphate exports were the main driver of growth, with both higher export volumes and phosphate prices achieved. The gains on phosphate helped offset the impact of the closing of the refugee processing centre in early 2008.
- Australian exports to Nauru have trended up in recent years as phosphate mining has resumed and the economy has returned to positive growth. Import demand has been firm in recent months. GDP growth for 2009 is forecast at 1.5%.
- However, Nauru faces considerable downside risk. The March 2009 quarter was the first quarter since the resumption of phosphate mining where Australia did not record any phosphate exports from Nauru. This was the result of damage to mooring buoys. The mooring buoys are still to be fully repaired, and international demand for phosphate is now in decline.

Key issues

- Nauru's long-term economic future depends on making good use of phosphate income, principally by reducing the indebtedness that will hinder the emergence of a normal economy.

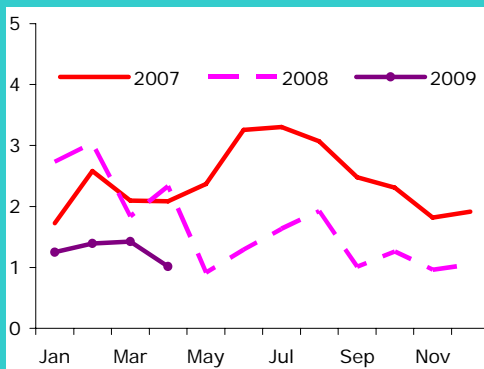
Palau

Total Visitor arrivals ('000 persons, monthly)



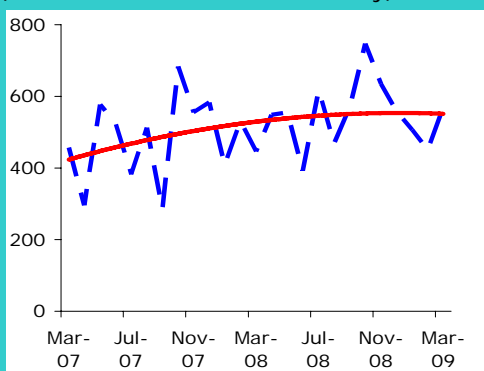
Source: Palau Visitors Authority.

Visitor arrivals from Taipei, China ('000 persons, monthly)



Source: Palau Visitors Authority.

Food imports from the US (US\$'000 fas with trend, monthly)



fas=free along side
Source: US Census Bureau.

Key developments

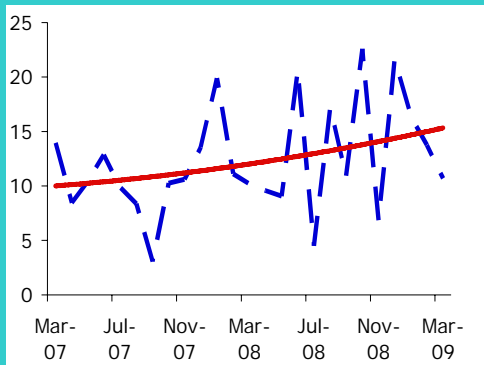
- The economy contracted by about 1% in 2008, driven by a 10.1% drop in tourist arrivals. An operator of chartered flights from Taipei, China, the second-largest source of visitors, closed down in May 2008 resulting in a marked reduction in tourist arrivals (relative to prior-year levels) in succeeding months.
- The economy is forecast to contract further in 2009 and 2010. Slowdowns in nearby Asian economies will further deepen problems in the tourism sector. As of April 2009, total arrivals were down 19.5%, with arrivals from Taipei, China, dropping by 56.5% over the same month of 2008. Lower infrastructure spending (from recent highs) and delays in planned private investment in tourism facilities are expected to contribute to the slowdown.
- The slowdown is evident in imports. Food imports from the US leveled off in early 2009, indicative of slowing demand. Japanese car imports have been on a clear downward trend over 2008 (partly due to a strong yen), although some recovery was recorded in March 2009.
- Inflation is easing after peaking in the September quarter of 2008. Year-on-year inflation declined to 8.6% in the March quarter of 2009 from a high of 16.8% in 2008. The easing in inflation was driven by a fall in fuel and transportation costs.

Key issues

- Current arrangements for US financial assistance under the Compact of Free Association were to end in the fiscal year ending 30 September 2009. However, these arrangements have been extended by another 12 months, providing temporary relief for a budget position that has become increasingly tight.
- Fiscal sustainability is threatened by high expenditure levels, the uncertainty of future financial support from the US, and the decline in the market value of the Compact of Free Association Trust Fund. The market value of the trust fund's value fell by about 28% in 2008 due to global stock market turmoil. There is a pressing need for reductions in public spending to stabilize the long-term fiscal position and lessen the drawdowns on the diminished trust fund assets.

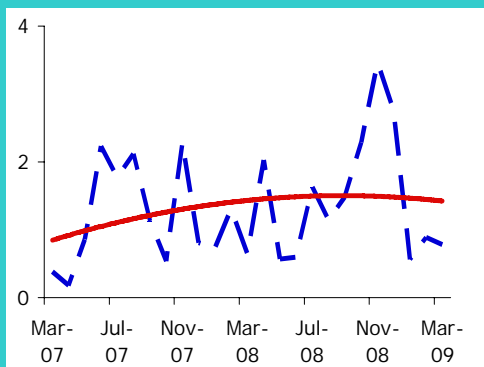
Papua New Guinea

Diesel imports from Singapore ('000 tonnes with trend, monthly)



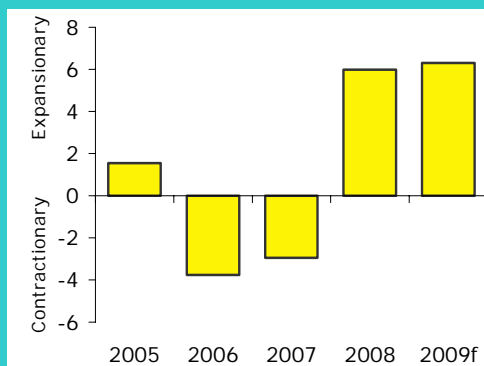
Source: International Enterprise Singapore.

Cement imports from Australia ('000 tonnes with trend, monthly)



Source: ABS.

Fiscal impulse (% of GDP, annual)



f=forecast

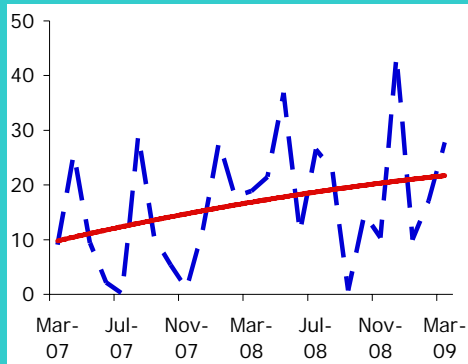
Source: ADB staff estimates derived from Papua New Guinea Ministry of Finance data.

Key developments

- Growth is easing as export earnings are eroded by the collapse in international commodity prices. Buoyed by a prolonged period of favorable terms of trade, real GDP growth reached 7.0% in 2008. Growth of only 4.0% is forecast for 2009 and 3.5% for 2010. The decline in export revenues and domestic growth is leading to a rapid erosion of the government's revenue position. Weak commodity prices resulted in a revenue shortfall of 3.2% of GDP in the last quarter of 2008.
- The quantity of imported diesel products, an indicator of economic activity, has continued to trend upwards. The rate of increase has slowed, however, since the latter part of 2008. Cement imports are at high levels but appear to be easing following the 2008 peak in construction activity (cement is also produced locally). Imports of commercial freight vehicles, an indicator of transport activity, have been trending down since late 2008.
- The import of electricity generator sets had been on a sustained upward trajectory throughout the commodity boom period but started to level off in mid-2008. The purchase of imported motor vehicles has also started to decline since mid-2008. As a luxury good, it is more sensitive to adverse income shocks. The strength of the yen would also have increased the cost of Japanese imports and added to a softening in demand. Demand for staple goods such as meat products has shown little signs of slowing down.
- An expansive fiscal policy is partially offsetting the decline in international commodity prices. The fiscal balance is expected to deteriorate from a surplus of 3.4% of GDP in 2008 to a deficit of -2.9% in 2009, which represents a fiscal impulse of 6.3% of GDP. The non-mineral budget deficit (the budget balance excluding mining and oil revenue) remains high.
- During the commodity boom years, mineral revenues had largely been saved in trust fund accounts and public debt was reduced. The government has already begun to draw down rapidly on these savings due to the weaker-than-anticipated revenue performance.

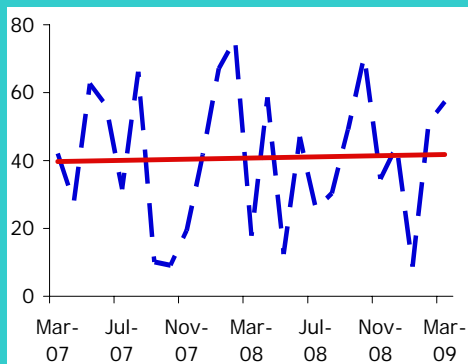
Papua New Guinea

Steel imports from Australia (tonnes with trend, monthly)



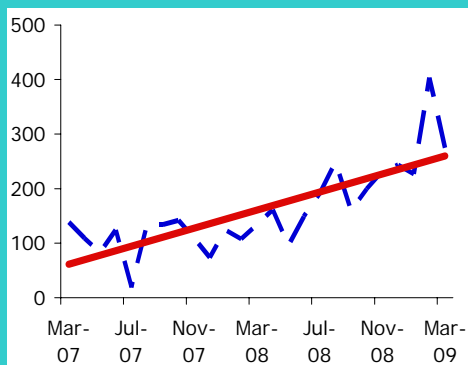
Source: ABS.

Electricity generator set imports from Australia (tonnes with trend, monthly)



Source: ABS.

Chicken imports from Australia (tonnes with trend, monthly)



Source: ABS.

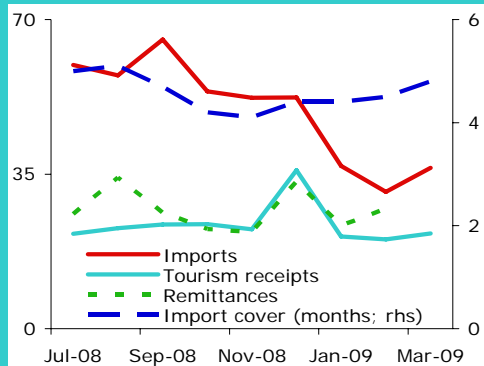
- The Bank of Papua New Guinea (PNG) has adopted an accommodative monetary policy stance. Declining commodity prices will reduce imported inflation but the large fiscal stimulus may fuel domestic inflation. The magnitude and pace of government expenditures and their impact on banking system liquidity is of particular concern. Credit growth has remained strong, growing by 33.9% in the 12 months to from February 2009 compared to 34.9% in the previous corresponding period. The Bank of PNG has recognized the need for improved policy coordination and quicker response to the large fiscal expansion.
- The external position is starting to weaken. The favorable terms of trade had generated sustained current account surpluses. The current account position is however changing because of the fall in international commodity prices. The current account is expected to move into deficit as the trade deficit widens due to lower export revenue in the face of continuing high import demand. Official reserve levels had peaked at US\$2.7 billion in early August 2008 but declined to just over \$2.0 billion by the end of January 2009 as depreciation pressures on the kina were resisted. The Bank of PNG has since allowed the kina to depreciate against the US dollar, which will help offset the impact of lower commodity prices on export incomes.

Key issues

- Papua New Guinea is still in a relatively favorable position, but there is less room to maneuver because revenue shortfalls have led to rapid drawdowns in trust fund savings and the strong kina policy has reduced holdings of international reserves.
- Loosening the fiscal policy stance in 2009 is an appropriate response but there are concerns over the pace and quality of public spending. Fiscal discipline is needed to ensure that accumulated mineral windfalls will be safeguarded and directed toward improving infrastructure and basic service delivery, as outlined in its medium-term development strategy.
- Coordinating the monetary and fiscal responses and exchange rate policy, is critical to ensuring an internally consistent and effective counter-cyclical policy mix.

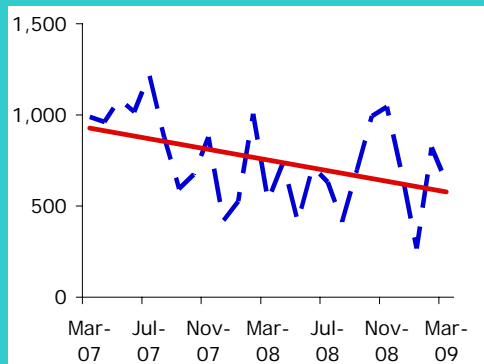
Samoa

Key economic indicators (tala million in real terms, quarterly)



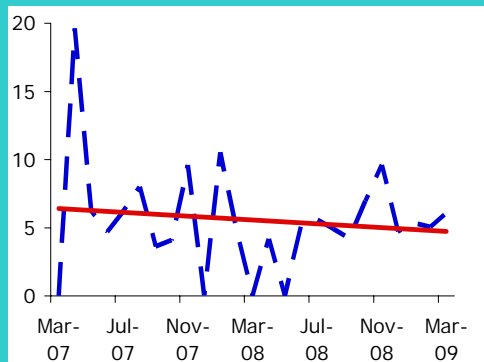
rhs=right hand side
Note: Real values derived using consumer price index.
Source: Central Bank of Samoa.

Food imports from the US (US\$'000 fas with trend, monthly)



fas=free-along-side
Source: US Census Bureau.

Petroleum imports from Singapore ('000 tonnes with trend, monthly)



Source: International Enterprise Singapore.

Key developments

- Driven partly by large job cuts at its largest private sector employer, Yazaki, the Samoan economy contracted by 3.4% in FY2008. The downturn became even more pronounced over the first half of FY2009, with economic activity falling by an estimated 7.6%. The closure of a large fish cannery in neighboring American Samoa, which had employed around 1,500 Samoans, is adding to the economic stress.
- Key economic aggregates (deflated by the consumer price index) reflect the deteriorating economy. Merchandise imports have been falling sharply over the first three quarters of FY2009, while tourism receipts and private remittance inflows were relatively flat. These trends imply falling local demand.
- Trends in commodity imports from major trading partners also show softening demand. Imports of cement from New Zealand and food, machinery, and transport equipment from the US, are declining. Imports of petroleum products from Singapore appear to have leveled off.
- The economic data for March provide some positive news. Tourism earnings were 27% higher compared to the same month last year, and early estimates suggest an increase in remittances. However, import values were still down by 22% for the month, and by 17% over the March quarter in nominal terms (relative to last year).
- Inflation eased to 12.4% in March 2009 (from more than 18% in late 2008) due to falling food and fuel prices. The coverage of foreign reserves has improved slightly to 4.8 months of imports. The lower inflation and adequate reserves allowed the Central Bank of Samoa to ease monetary policy slightly by cutting its lending rate to commercial banks from 7.8% to 5.0% in February 2009.

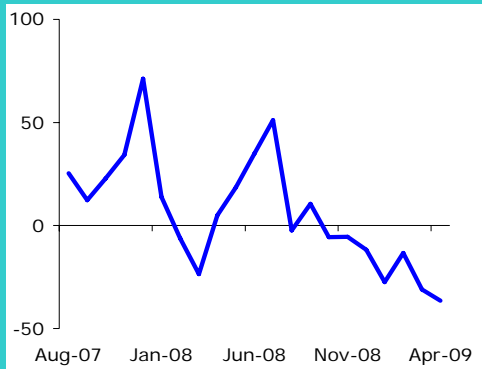
Key issues

- The government has signaled its intention to respond to the economic downturn with a substantial fiscal expansion. With the government's revenue position weakening, the affordable increase in government expenditure is unclear. Protecting essential government expenditures will be critical.

Solomon Islands

Logging volumes

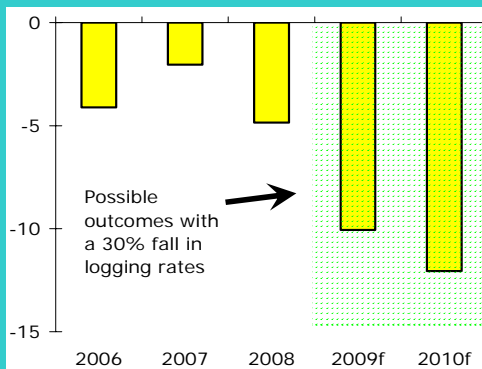
(y-o-y % change, 3-month m.a.)



m.a.=moving average, y-on-y=year-on-year
Source: Central Bank of Solomon Islands.

Current account balance

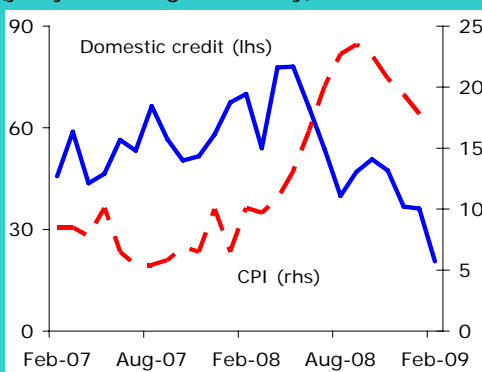
(% of GDP, annual)



Source: ADB. 2009. Draft Solomon Islands Economic Report.

Domestic credit and CPI

(y-o-y % change, monthly)



CPI=consumer prices index, lhs=left hand side, rhs=right hand side

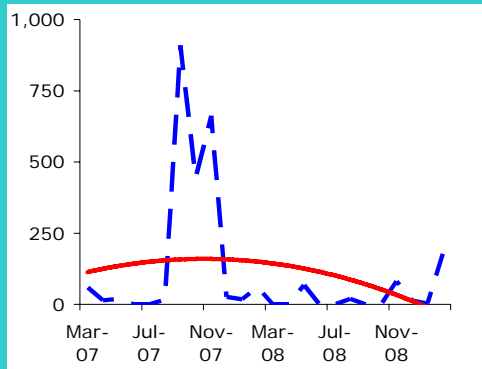
Source: Central Bank of Solomon Islands.

Key developments

- Economic growth remained relatively high at 6.4% in 2008, supported by momentum built up by logging revenues from the global commodity boom and expansionary fiscal policy. The Asian Development Outlook (ADO) growth forecast was 2.2% for 2009 and further moderation to 1.7% in 2010, mainly due to weaker logging exports. However, data on logging from early 2009 indicate that logging exports may be weakening more rapidly than previously expected. From November 2008 to February 2009, logging volumes fell by 22.5% compared with the same period in 2007–2008.
- A 30% decline in logging in 2009 has been projected to reduce GDP growth to zero, decrease per capita income, and result in the current account deficit ballooning to around 10% of GDP in 2009.
- The Central Bank’s governor recently warned that the country must be prepared for the worst if the global financial crisis continues and predicted drops in the levels of exports, foreign reserves, government revenue, employment, and incomes.
- The fiscal deficit is expected to widen as revenues fall. The deficit reached 5.6% of GDP in 2008, due to high development and recurrent spending. A deficit equivalent to 3.6% of GDP is expected in 2009 as the wage and salary bill balloons. This would exceed available cash reserves.
- There are early indications that 2009 revenues will be less than forecast, resulting in an even larger deficit. Actual revenue for the first quarter of 2009 (around SI\$316 million) was down by about 11% compared to a forecast of SI\$357 million. The government has implemented administrative measures to reduce government spending.
- Import demand is still strong but may be slowing. High government expenditures are helping to sustain import demand. Although overall import demand remains robust, there are signs of a softening of demand in certain discretionary items such as motor vehicles from Japan. Oil imports have recovered recently as the prices have trended down.

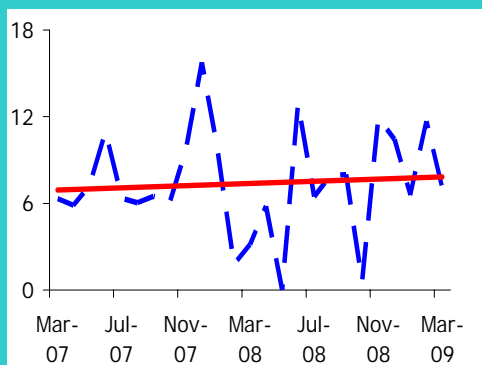
Solomon Islands

Cement imports from Australia (tonnes with trend, monthly)



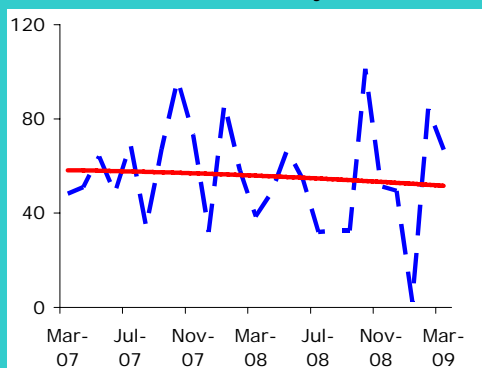
Source: ABS.

Petroleum imports from Singapore ('000 tonnes with trend, monthly)



Source: International Enterprise Singapore.

Chicken imports from Australia (tonnes with trend, monthly)



Source: ABS.

- International reserves are under considerable pressure. As of April 2009, reserves had fallen to around 2.5 months of import cover as logging exports declined, which is well below Central Bank's target of at least four months. The outlook is for further declines in the level of reserves during 2009 and 2010.
- Inflation should ease, albeit slowly, as economic activity slows. High excess liquidity in the banking sector and strong growth in domestic credit have contributed to the high inflation and import outcomes in Solomon Islands in recent years. Recently, however, growth in domestic credit has slowed markedly, falling to around 20% in February 2009, the slowest growth in more than 2 years.

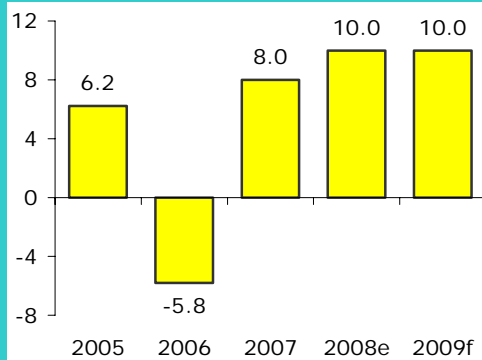
Key issues

- The impact of the global economic crisis on demand for timber exports in 2009, the probable indefinite postponement of gold mining, and the approaching depletion of commercially viable forests will cause lower growth in 2009–2013, place pressure on the government budget, and seriously diminish foreign reserves.
- A potential balance of payments crisis in 2009–2010 will demand a coordinated macroeconomic policy response. In the short term, the government will have to contemplate: (i) the removal of waste and low priority expenditures; (ii) tight restraint on the remaining recurrent expenditures; (iii) more effort to raise revenue; (iv) tighter monetary policy; and (v) securing external grants.
- Resolution of such a crisis is likely to require short-term external assistance while intensifying efforts to lay stronger foundations for medium- to long-term economic growth. Grant-funded infrastructure can play a key role in supporting growth and employment given the decline in exports and the need to reduce government spending. Infrastructure projects should be brought forward where possible, especially those that are labor-intensive.

Timor-Leste

Real GDP growth

(Non-oil, excluding UN; % annual change)

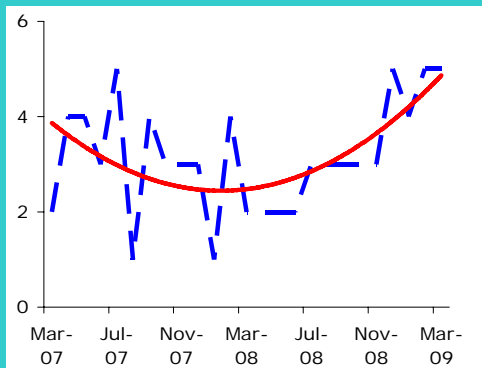


UN=United Nations

Source: Asian Development Outlook database.

Merchandise imports from Australia

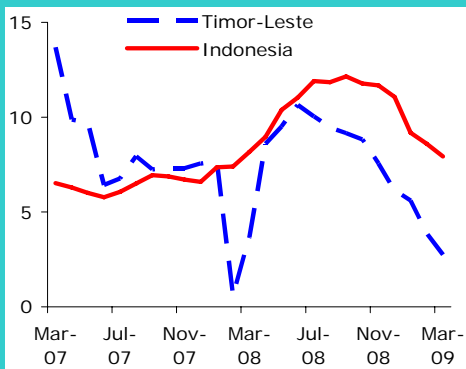
(A\$ million with trend, monthly)



Source: ABS.

Inflation

(y-o-y % change in CPI, monthly)



CPI=consumer price index

Sources: Timor-Leste National Statistics Directorate and Bank Indonesia.

Key developments

- A substantial expansion in public spending combined with a rebound in agricultural production lifted economic growth to an estimated 10% in 2008. The agricultural sector, which accounts for about 85% of total employment, recovered from a weather-related slump during the previous year. Growth is expected to remain high in the medium term, as revenues from offshore petroleum production are funding large increases in government expenditure.
- Buoyant domestic demand is evident in a significant increase in imports. Merchandise imports rose from \$68.6 million in the first half of 2007 to \$89.9 million in the first half of 2008. Import flows from neighboring Australia have been on an upward swing since the second half of 2008, and this has continued into early 2009.
- Inflation is easing after peaking in mid-2008 amid soaring oil and commodity prices. After reaching 10.6% in June 2008 (year-on-year), inflation had eased to 2.7% by March 2009. Higher food prices accounted for around half of inflation in 2008 (food accounts for 58% of the CPI) even after increased subsidies for imported rice. The decline in prices mirrors trends in Indonesia, Timor-Leste's primary trading partner.

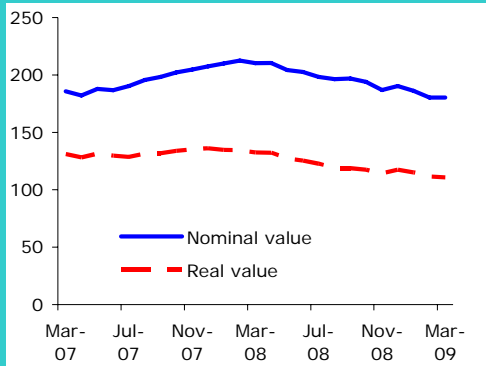
Key issues

- Timor-Leste is successfully offsetting the impacts of the global economic crisis by drawing on the revenue bonanza that preceded the crisis. Timor-Leste now has one of the most expansionary fiscal stances internationally. The resultant fiscal stimulus is affordable provided it is short-lived and expenditure is then quickly reined in.
- The quality of expenditures is central. Part of the fiscal expansion has been allocated to potentially low-priority expenditures. Moreover, long-standing capacity constraints remain and will make it difficult to achieve implementation timetables. These factors suggest that a lower rate of fiscal expansion is called for. It also remains important for government spending to target development priorities, notably basic services delivery and rural development, to arrest further increases in poverty.

Tonga

Remittances

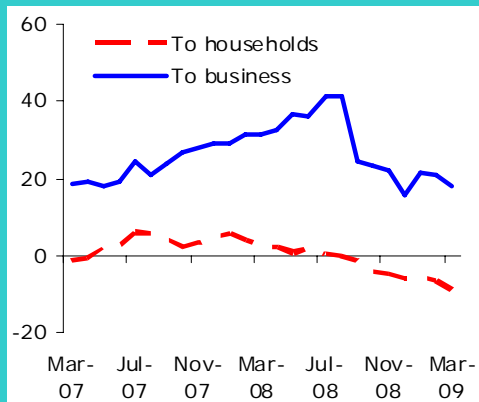
(Pa'anga, previous 12 months, monthly)



Note: Real values derived using consumer price index.
Source: National Reserve Bank of Tonga.

Private sector credit

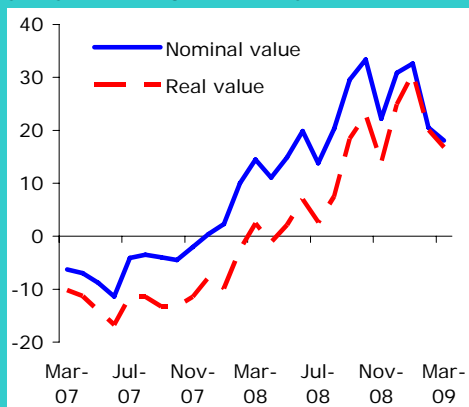
(y-o-y % change, monthly)



Source: National Reserve Bank of Tonga.

Value of imports

(y-o-y % change, monthly)



Note: Real values derived using consumer price index.
Source: National Reserve Bank of Tonga.

Key developments

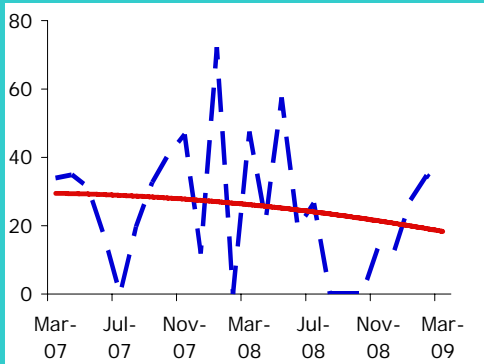
- Remittances, the major source of foreign exchange receipts, remain on a downward trend. Credit to the business sector is now growing at a much lower rate and credit to households is in decline. This primarily reflects a tightening of credit standards by the banks.
- Tourism arrivals were higher than expected in early 2009. However, tourism receipts are in decline, with the nominal value down 3.9% on a year-on-year basis in March.
- The overall weakening in the economy expected during 2009 is reflected in slower growth in the value of imports. The need to pay for higher-cost fuel deferred the turnaround in the value of imports, but the underlying decline in aggregate demand is apparent.
- Foreign reserves were rebuilt in late 2008 as the cost of fuel declined and the banking sector brought funds onshore. At 4.7 months of import cover, they are on the low side, but they remain above the target level set by the National Reserve Bank of Tonga.
- Inflation is easing rapidly. From its peak of 12.6% in May 2008, inflation had dropped to 2.5% by March 2009 (year-on-year). Further falls are expected from the weaker New Zealand dollar.
- The economy was originally forecast to contract by 2% in 2009. Prospects appear to be improving, with reconstruction work financed with the help of China Eximbank moving closer to fruition. The extent to which it contributes to domestic economic activity will depend on the domestic content of the construction work. However, a positive stimulus is assured, one that will have minimal pressure on foreign reserves given the external financial backing. Prospects are also strengthened by ongoing demand in Australia and New Zealand for seasonal workers.

Key issues

- Relatively low reserve levels and public debt levels that are already too high will limit the options available for countering the effects of the global economic crisis. The immediate priority is to safeguard expenditures for essential services. This is under pressure from a weaker outlook for government revenue and the cost of pay increases for public servants, which have now increased by around 80% on average, in nominal terms, since 2005).

Tuvalu

Chicken imports from Australia (tonnes with trend, monthly)

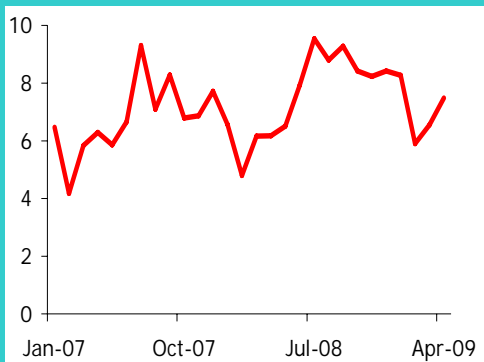


Source: ABS.

- The economy grew by 1.5% in 2008 on the back of a 9.8% increase in government spending. Growth is expected to remain subdued at 1% in 2009. Imports of chicken, beef, and wheat flour are on a downward trend, suggesting economic activity may be weaker than originally expected.
- Tuvalu contained its fiscal deficit to 5.4% of GDP in 2008, down from 14.3% in 2007. Larger-than-expected revenue from fishing license fees in the December quarter of 2008 were important in raising overall government revenue.
- The budget priority is to encourage a more effective and efficient use of its resources, including allocating more of its budget toward capital spending and away from high-cost recurrent items, such as overseas medical expenses.

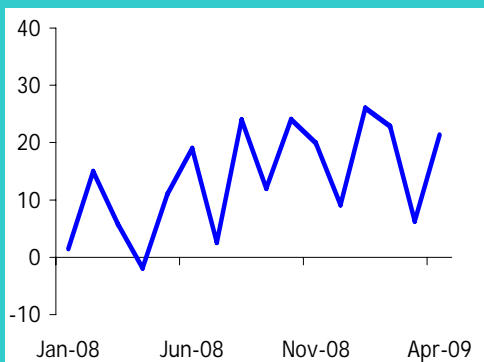
Vanuatu

Visitor arrivals ('000 persons, monthly)



Source: Vanuatu Statistics Office, Tourism and Migration.

Visitor Arrivals (y-o-y % change, monthly)



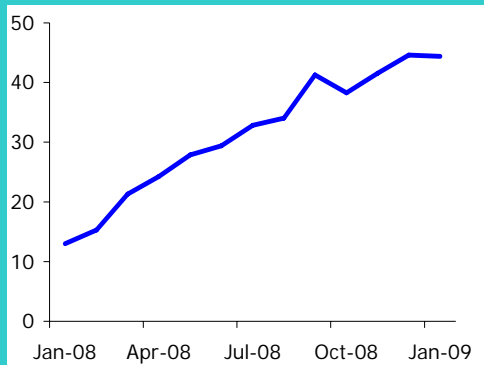
Source: Vanuatu Statistics Office, Tourism and Migration.

Key developments

- Economic conditions remain robust, principally because the tourism sector is holding up despite the global recession. Tourism and property development drove GDP growth of 6.3% in 2008. Visitor arrivals over the first 4 months of 2009 were 19.0% above the level of the same period of 2008. This is despite an overall decline in tourist departures to the Pacific. The entry of new international air services and increased foreign investment are key factors behind Vanuatu's growth. Vanuatu also appears to be benefiting from the problems in the Fiji Islands.
- Growth in private sector credit has started to level off as banks have become more cautious in their lending activities. However, credit growth remains very strong, rising by 44.4% in the 12 months to April 2009. The entry of a new commercial bank has contributed to the high growth in credit. There was a subsequent liquidity shortage in the second half of 2008, resulting in the reserve bank reducing the statutory reserve deposit level twice: from 10% to 8%, and then to 5%. The Vanuatu National Provident Fund also has a substantial impact on liquidity, contributing around 40% of the liquidity in the market. The significance of the fund and the high rates it demands (10% for 2 years) reduces the effectiveness of monetary policy.

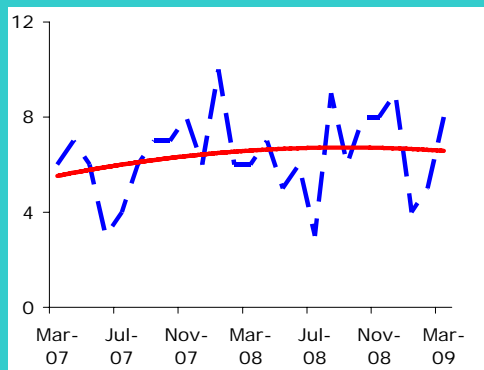
Vanuatu

Credit to the private sector (y-o-y % change, monthly)



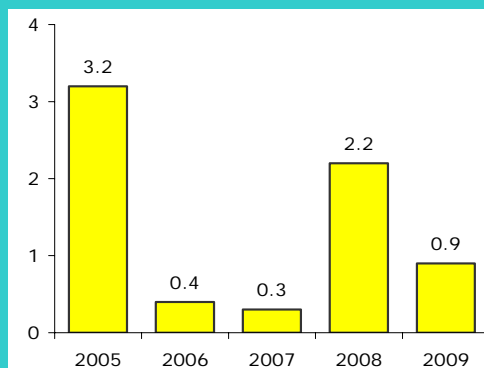
Source: Reserve Bank of Vanuatu

Australian exports to Vanuatu (A\$ million with trend, monthly)



Source: ABS.

Budget balance (% of GDP, annual)



Source: Vanuatu Government Budget Papers 2009.

- While inflation in Vanuatu was the lowest in the region in 2008, it exceeded the reserve bank's 0%–4% target band. Inflation peaked at 6.0% on a year-on-year basis in the September quarter before falling slightly to 5.8% in the December quarter.
- Robust import demand is putting pressure on reserves. During 2008 the trade deficit widened as strong growth in imports more than offset modest gains in exports. Reserves are declining, and new estimates have brought down earlier projected numbers. The monthly import cover was the equivalent of 5.4 months in February, down from 5.8 months in December. However, this is still well above the bank's minimum target level of 4 months.
- Import growth may have slowed in early 2009, with data on exports from Australia showing a flattening trend. A key issue for 2009 is whether the tourism sector will remain buoyant or be weighed down by the slowing Australian and New Zealand economies and the eventual recovery of tourism in Fiji.
- Steady progress has been made in strengthening the government's fiscal position in recent years. Since 2003, the fiscal deficit has never exceeded 1.5% of GDP, and small fiscal surpluses were recorded in 2004–2008. Another small fiscal surplus of 0.9% of GDP has been budgeted for 2009, down slightly from 2.2% in 2008. Improvements in tax administration have made an important contribution to the improved fiscal position, leading to a rise in domestic revenues from 18.7% of GDP in 2003 to 29.2% in 2008.

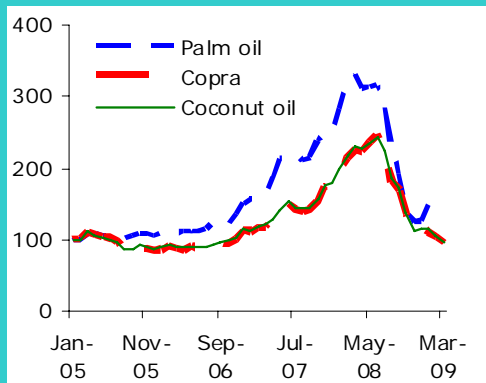
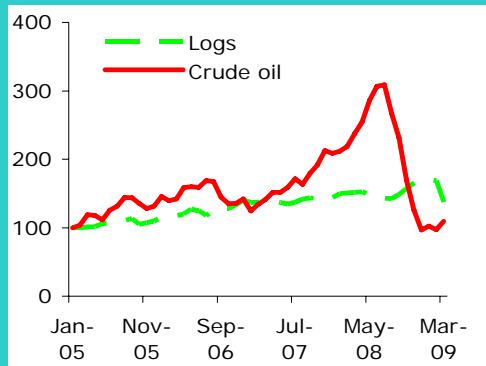
Key issues

- Amendments to the Employment Act were passed in late 2008, resulting in extremely generous employment provisions for those with formal employment. These amendments have not yet been gazetted but, if introduced, will substantially increase employment costs and is likely to curb the creation of much needed formal sector jobs.
- The Vanuatu Agricultural Development Bank became operational in September 2008. It is recommended that the bank be placed under the jurisdiction of the reserve bank so that it operates on commercial principles and remains free of political interference.

Commodity exports

Commodity prices

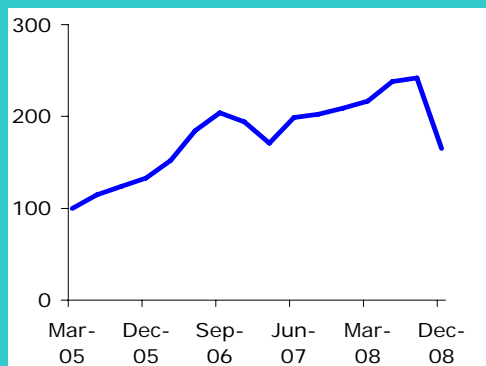
(Index: January 2005=100)



Source: International Monetary Fund International Financial Statistics online database.

PNG Export Price Index

(Index: March 2005 Quarter = 100)



Source: Bank of Papua New Guinea December 2009 Quarterly Economic Bulletin. Index rebased by ADB staff.

Key risks

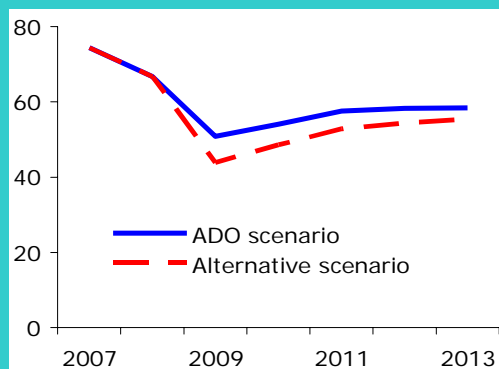
- Countries exporting natural resources and agricultural products have benefited from the commodity price boom in 2007 and 2008. Now these countries are confronted with deterioration of their terms of trade as international commodity prices plummet and global demand weakens. Export earnings will decline, affecting government revenue and the incomes of producers of these commodities. The fiscal and current account positions will deteriorate over time. Foreign exchange reserves will decline.
- Countries exporting oil and minerals have been hardest hit, with oil prices falling more than 60% from a peak in mid-2008. Global demand slump is also adversely affecting the prices of key Pacific exports such as coffee, cocoa, palm oil, coconut oil, and copra. The ability of these countries to combat the effects of the global economic crisis through countercyclical macroeconomic policies will depend on the extent to which they were able to consolidate gains generated during the commodity price boom.
- PNG and Solomon Islands are particularly vulnerable to deterioration in the terms of trade. Given their heavy dependence on primary product exports, the decline in commodity prices and the ensuing deterioration in global demand will have a serious impact on growth rates in 2009 and in the medium term. In PNG, the kina export price index declined by 32% in the last quarter of 2008 compared with the September quarter. In Solomon Islands, the price of logs, which generate almost 70% of export earnings, have been relatively stable, though some easing is apparent in early 2009.
- There remains much uncertainty in the external environment. The world economy and hence international commodity prices are generally expected to improve in 2010, but this remains uncertain. Risks to the outlook for PNG and Solomon Islands are high and mainly on the downside. Plausible scenarios for these two economies are considered below.

Commodity exports

PNG: Key aggregates

Export earnings

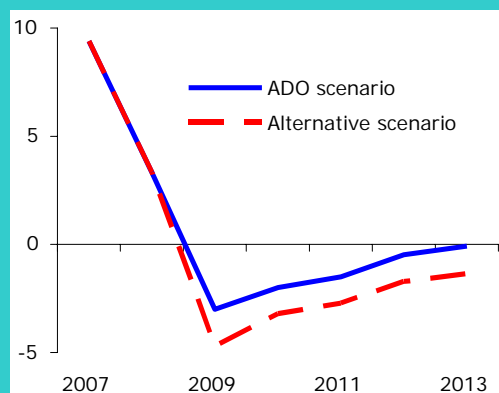
(% of GDP)



ADO=Asian Development Outlook
Source: ADB staff estimates.

Fiscal balance

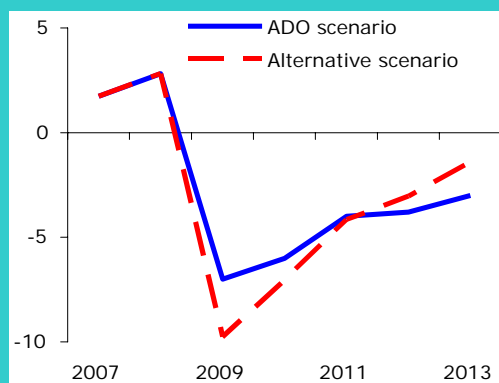
(% of GDP; includes trust fund account)



ADO=Asian Development Outlook
Source: ADB staff estimates.

Current account

(% of GDP)



ADO=Asian Development Outlook
Source: ADB staff estimates.

Scenario: Papua New Guinea

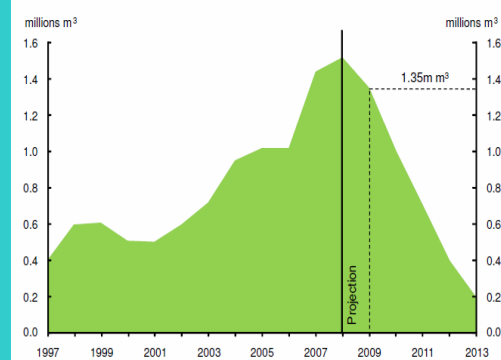
- PNG is highly vulnerable to movements in commodity prices owing to their importance to both export and government revenues. Mineral and agricultural products account for more than 95% of the country's merchandise exports. The risk of further deterioration in the global economy means the country remains vulnerable to additional weakening in the terms of trade.
- Two scenarios were considered to assess PNG's vulnerability to decline in commodity prices: (1) a baseline scenario assumes a 30% decline in the export commodity price index consistent with the 2009 ADO forecasts, and (2) an alternative scenario assumes a 40% decline in the export commodity price index. The growth projections do not incorporate the Liquefied Natural Gas project.
- Under both scenarios, the fiscal position will turn into a deficit due to falling oil revenues, with revenue shortfalls being financed through drawdowns from trust funds. The current account will also become a deficit in the short run due to the global crisis and continued strong import demand driven largely by expansionary fiscal policies.
- Under the alternative scenario, as compared to the baseline scenario, reduced export earnings would reduce government revenues and widen the fiscal deficit from 3.0% to 4.7% of GDP. The current account would also widen from 7.0% to 9.8%, as public expenditures would be expected to remain elevated, with the support from withdrawals from trust fund accounts.
- The impact of lower export earnings on government revenues is already evident. The 2008 fiscal balance was 2.2% of GDP—lower than had originally been anticipated. A smaller surplus was mainly the result of lower-than-forecasted revenues, which was attributed to low international commodity prices and a strong appreciation in the kina against the US dollar. The government has begun to draw down rapidly on trust fund savings to partially meet revenue shortfalls.

Commodity exports

Solomon Islands: Key aggregates

Logging volumes

(million cubic meters; official projections)

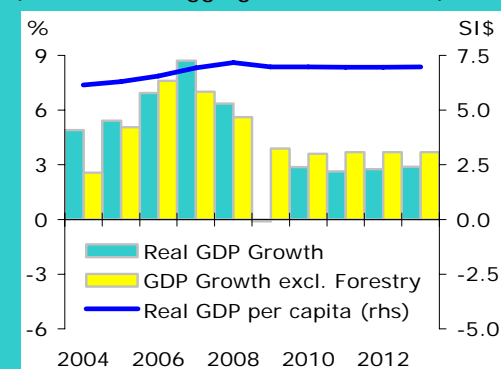


m³=cubic metres

Source: ADB. 2009. Solomon Islands Economic Report. Draft.

GDP growth

(with a 30% logging decline in 2009)

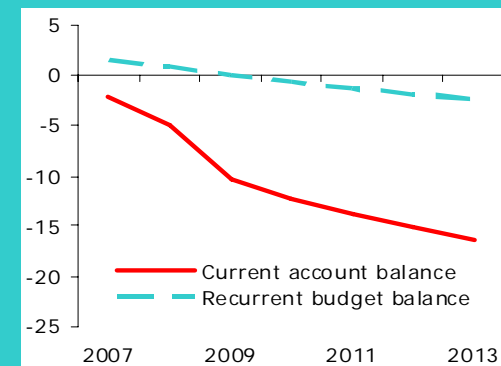


excl.=excluding, GDP=gross domestic product, rhs=right hand side

Source: ADB. 2009. Solomon Islands Economic Report. Draft.

Key balances

(% of GDP)



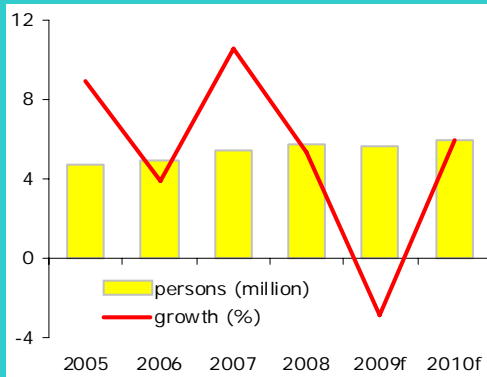
Source: ADB. 2009. Solomon Islands Economic Report. Draft.

Scenario: Solomon Islands

- Forestry accounted for a quarter of economic growth, two thirds of export earnings, and 16% of recurrent government revenues in 2007. In 2008, the sector's share to GDP was 12% and to formal employment, 10%.
- Growth in Solomon Islands has been driven by unsustainably high logging rates. The government budget has already forecast a modest drop in logging from more than 1.5 million cubic meters in 2008 to 1.35 million cubic meters in 2009 due to declining stocks. However, evidence of a more rapid demand-driven decline in logging exports is now emerging.
- The forthcoming ADB *Solomon Islands Economic Report* models the effect of a decline in logging. The model assumes the following: (1) a 30% decline in logging in 2009 and 5%–10% annual rate of decline thereafter; (2) 2.5%–4% annual growth of real GDP in other sectors; (3) Gold Ridge Mining Ltd. does not commence operations in the medium term and no other sizeable mining projects come on stream; and (4) budget and external grants are maintained at 2009 levels.
- The model shows that economic activity is stagnant, real per capita income falls, and the current account deficit reaches around 10% of GDP in 2009. Real per capita income stagnates for the next 4 years, with a 3% decline in 2013 compared to the 2008 level. The model also shows that the recurrent budget balance moves into increasing deficit in 2009 to 2011, breaking the commitment to the medium-term fiscal strategy.

Tourism

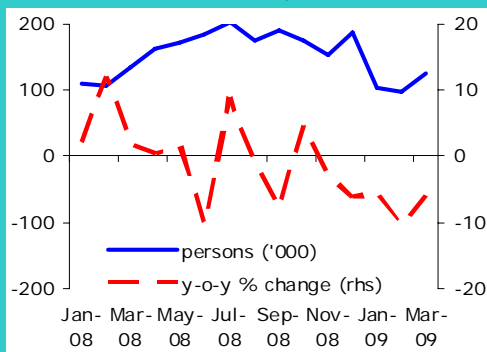
Australian outbound tourism (All destinations)



f=forecast

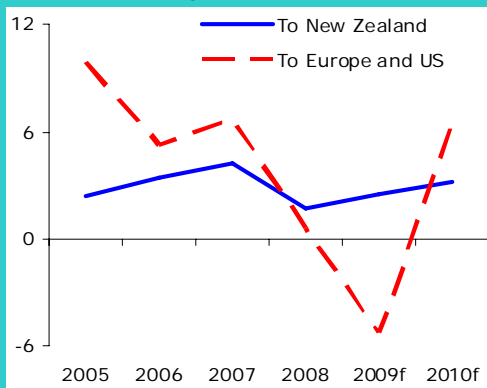
Source: Tourism Research Australia. 2008. Tourism Forecasting Committee *Forecast 2008 Issue 2*. Canberra.

New Zealand outbound tourism (All destinations, monthly)



Source: New Zealand Ministry of Tourism.

Australian tourism (key destinations) (% annual change)



f=forecast, US=United States

Source: Tourism Research Australia. 2008. Tourism Forecasting Committee *Forecast 2008 Issue 2*. Canberra.

Key risks

- Income and prices are key drivers of tourism demand. The international economic downturn will see a decline in household discretionary income. This will in turn result in a cutback in non-essential expenditures, such as vacations and holidays to the Pacific. Uncertainty in neighboring economies, notably regarding job prospects, will add to this contractionary effect on tourism to the Pacific.
- However, the Pacific may benefit from some positive price effects. Tourists from neighboring economies may decide to forego longer, more expensive trips, such as to Europe and the US, in favor of shorter trips to the Pacific. This sort of switching was unlikely early in this decade, because a lack of airline competition in the Pacific and the presence of high-cost government-owned airlines tended to make the region an expensive destination. But the recent entry of budget airlines has helped reduce airfares and make the region far more competitive. The recent decline in international fuel prices is also now working in the region's favor.
- The potential importance of price effects is shown in the end-2008 forecasts from Tourism Research Australia. While they project a 5% overall decline in tourism from Australia to Europe and the US, tourism from Australia to New Zealand is expected to increase. An important source of the differences between destinations is that New Zealand is assumed to benefit from additional airline capacity and lower airfares. Despite the global economic crisis, New Zealand is forecast to do better because it has a price advantage
- In the Pacific economies, so far the negative income effect appears to be outweighing the positive price effects. This is shown by lower overall tourist departures to the Pacific from Australia, New Zealand, and the US.
- Global tourism is projected to weaken over 2009. A prudent working assumption is that total tourism flows into the Pacific will also decline in 2009 and remain low throughout 2010. Tourist arrivals from Asia are at most risk, while those from Australia, New Zealand, and the US are also at risk.

Tourism

Arrivals in 2009

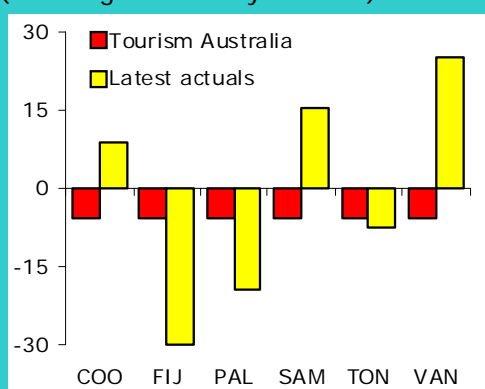
(assumed % change)

Country	Tourism Australia scenario	Latest Actuals scenario
Cook Islands	-5.5	8.9
Fiji Islands	-5.5	-29.8
Palau	-5.5	-19.5
Samoa	-5.5	15.4
Tonga	-5.5	-7.2
Vanuatu	-5.5	25.4

Source: ADB staff estimates.

Visitor arrivals

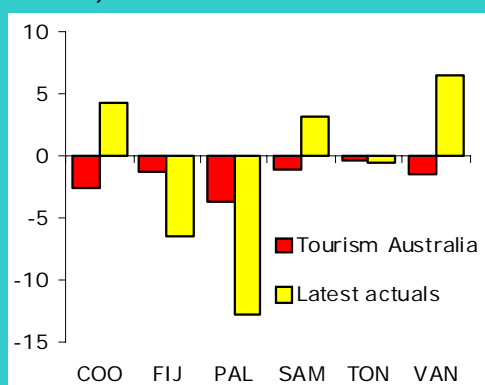
(% change in 2009 by scenario)



COO=Cook Islands, FIJ=Fiji Islands, PAL=Palau, SAM=Samoa, TON=Tonga, VAN=Vanuatu
Source: ADB staff estimates.

Tourism receipts

(change as % of GDP in 2009 by scenario)



COO=Cook Islands, FIJ=Fiji Islands, GDP=gross domestic product, PAL=Palau, SAM=Samoa, TON=Tonga, VAN=Vanuatu
Note: Scenarios assume a 1% increase in arrivals leads to a 1% increase in receipts and vice versa
Source: ADB staff estimates.

Scenarios

- A scenario analysis was conducted to explore the potential impact of alternative perspectives on the outlook for tourism.
- One scenario—the Tourism Australia scenario—draws on the 2008 year-end projections from Tourism Research Australia. They are for a 5.5% decline in tourism from Australia to the Fiji Islands. In this scenario, the 5.5% decline is assumed to apply to all major Pacific destinations.
- A second scenario—the Latest Actuals scenario—assumes that the 2009 outcome for arrivals matches the latest actual data from major source economies. For example, it assumes that arrivals to the Fiji Islands will decline by 29.8% over 2009. This is the decline in arrivals, on a year-on-year basis, from Australia and New Zealand as of March 2009.
- Under the Tourism Australia scenario, the weakening in tourism would reduce GDP growth. The effect is forecast to be larger the more tourism-intensive the economy. In this scenario, for example, there is a large contractionary effect in the Cook Islands. This large contractionary effect from tourism is one reason why the Cook Islands should be considering a fiscal stimulus in 2009.
- Under the Latest Actuals scenario, some Pacific destinations receive a positive economic stimulus from tourism over 2009. In contrast, the Fiji Islands is even worse off than under the Tourism Australia scenario. This is mainly because of the switching of tourism from the Fiji Islands underling the Latest Actuals scenario.
- The Fiji Islands is expected to win back tourists later in 2009, helped by the recent devaluation of its currency. Hence the switching of tourism from the Fiji Islands is expected to be temporary. For this reason, the Tourism Australia scenario is considered the more likely scenario.
- On a year-on-year basis, total arrivals to major Pacific destinations from Australia and New Zealand were down 13.0% as of March 2009. This suggests the overall decline of 5.5% assumed in the Tourism Australia scenario may prove to be optimistic.

Responding to the global economic crisis

Governments need to decide if the global economic crisis is a priority for economic management. If so, a proactive, targeted, and coherent policy response tailored to the individual circumstances of each Pacific economy would be best.

The first step in responding to the global economic crisis would be to better track and understand its impact. Reliable and frequent economic and financial monitoring is needed. This is largely in place in some Pacific economies, but in others, monitoring has a narrow coverage and suffers long lags. Economic monitoring is generally backward-looking, a limitation that will hinder early warning of approaching impacts. Effective monitoring is important to both the encouragement of an open dialogue on a policy response and reducing uncertainty facing business and households.

For those countries that operate an independent monetary policy, a cautious expansionary monetary expansion would be a sensible second step where conditions allow it. The level of official foreign exchange reserves is a good indicator of whether there is room to lower interest rates and/or expand liquidity. There is probably room when reserves are above a target of 3 to 4 months of imports and reserves are stable or declining slowly. Inflation is also a good indicator of whether a monetary expansion should be considered—the monetary stance should only be relaxed if inflation is under control.

If reserves are below the target and/or falling rapidly, it can be a sign that the exchange rate is out of line with the economic fundamentals. During the 1997 Asian financial crisis, the Fiji Islands and Solomon Islands were able to use exchange rate management to shield themselves from the full impact of the crisis. While the current circumstances are different, it is clear that maintenance of a competitive exchange rate will be important to lessening the impact of this crisis. It is preferable to achieve macroeconomic conditions that avoid a need for exchange rate adjustment, but authorities need to act decisively when there is a substantial misalignment of their exchange rate. The Fiji Islands has already done so through a 20% devaluation in April 2009.

The global economic crisis will add to fiscal pressure. Most 2009 budgets were formulated before the full extent of the global crisis was known, and it is very likely that their revenue forecasts will prove to be overestimates. The best course is to proactively manage the fiscal shock.

Governments may want to do more than just manage the fiscal shock. Most of the larger industrialized and emerging countries are implementing fiscal stimulus packages that are increasing government expenditure and/or reducing taxes. A proactive fiscal stimulus may also make sense in the Pacific as a way of countering the economic slowdown. Here, a fiscal stimulus can be thought of as a deliberate change on either the expenditure or revenue side of the government budget that raises aggregate demand above what it otherwise would be. The primary role of a fiscal stimulus would be to lift internal demand to try and offset the decline in external demand. A secondary role would be to protect the vulnerable that are made worse off, even with the efforts to lift aggregate demand.

It may be possible to cope with the fiscal shock, and where sensible fund a short-lived fiscal stimulus, by trimming low priority expenditures and increasing the revenue effort. This suggests an immediate need to review the composition of public expenditure and to reprioritize less productive or wasteful expenditures—especially on the recurrent side—so they are reined in or eliminated.

The ability to quickly trim low priority expenditure and increase the revenue effort is, however, likely to fall short of fully meeting the fiscal need. Extra resources are likely to be required. Options include external grants, where made available, and borrowing, where it is affordable. The composition of public spending would be crucial. Investment spending to rehabilitate and upgrade infrastructure, the protection of spending on social sectors (health and education), and support for the vulnerable warrant top priority. They need to be preserved even if revenue envelopes contract, and warrant targeting by any fiscal stimulus that is adopted. Any tax cuts provided as a fiscal stimulus also need to be carefully designed so they offer maximum support to economies and the poor and

vulnerable. In contrast, pay increases for public servants would be a very poor form of fiscal stimulus.

These observations highlight that any fiscal response needs to be highly prioritized and targeted. It needs to be consistent with overall fiscal prudence and avoid excessive buildup in public debt and pressure on the balance of payments. In some cases, a fiscal stimulus is already in place, not deliberately as a response to the global crisis but because budgets had already allowed for increases in budget deficits and the revenue outlook has subsequently weakened. In other cases the fiscal expansion appears to be too rapid and extra care is needed to ensure it provides value-for-money. There is a risk that overly rapid fiscal expansion in PNG and Timor-Leste will lead to new expenditure initiatives that are not aligned with national priorities.

Structural initiatives that enhance the region's competitiveness—such as reforming state-owned enterprises, removing distortions in the tax and duty systems and mobilizing customary land—can also support the region's economies. But many such initiatives carry long lead times, in some cases decades may be needed to achieve substantive change. Any quick-win initiatives that are available should be vigorously pursued as a means of lessening the economic downturn and helping economies prepare to recover.

Efforts to provide targeted help to the vulnerable, such as establishing social safety nets, have merit. But, like structural initiatives, they face the difficulty of long lead times. The best immediate option for helping the vulnerable is to limit the decline in economic growth, complemented where affordable by a short-lived fiscal stimulus that pays special attention to their needs.

Development partners have been an important source of support to the region in times of crisis. They can also help the Pacific economies through this global economic crisis. Development partners can support monitoring and policy dialogue, fast-track the activities they are involved in, help governments fast-track others, and if necessary offer prudent budgetary support for a short-lived fiscal stimulus that minimizes pressure on the balance of payments.

Budget support is normally provided with conditions. In this instance, an appropriate focus may be to minimize the risk that budget support would work against long-term growth prospects by easing the incentive for governments to improve their performance. Conditions attached to such support could be preventive (as opposed to curative); for example, by requiring protection of core social expenditures or preservation of maintenance of physical infrastructure (perhaps on a multi-year basis). Any budget support provided could also appropriately include sunset clauses to indicate that it is a temporary and specific response to the global crisis.

Table 1 provides a broad, preliminary assessment of key initiatives by country.

10 Steps to an effective response

- Step 1:** Track and understand the impact of the global economic crisis
- Step 2:** Encourage open policy dialogue
- Step 3:** Get the monetary policy stance right
- Step 4:** Maintain a competitive exchange rate
- Step 5:** 'Cut and trim' low priority government expenditure
- Step 6:** Raise the revenue effort
- Step 7:** Protect expenditure on services for the most vulnerable
- Step 8:** Secure external financial support, where needed and affordable
- Step 9:** Pursue quick-win structural initiatives
- Step 10:** Provide targeted support to the vulnerable

Actions best avoided

- Too large a fiscal expansion
- Excessive Government pay increases
- Subsidies for business
- Cuts to essential public services
- Labor-intensive approaches to public works that are too costly
- Borrowing when it is unaffordable
- Structural initiatives that cost jobs
- Reform programs that lack broad support

Table 1: Key potential responses to the global economic crisis—potential or already in place^a

Country	Information sharing and open dialogue	Careful, short lived monetary expansion	Maintain a competitive exchange rate	Manage the fiscal shock, and where sensible provide a short lived, value-for money fiscal stimulus, by					Quick-win structural initiatives	Help the vulnerable
				Making better use of existing resources	Using external grants	Drawing down own savings	Borrowing			
							Domestic	External		
Cook Islands	√			√	√	√	√	√	√	√
Fiji Islands	√	x	√	√	√		possibly	√	√	√
FSM	√			√	√	X	x	x	√	√
Kiribati	√			√	√	X	x	x	√	√
Nauru	√			√	√		x	x	√	√
Palau	√			√	√	X	x	x	√	√
PNG	√	√	√	√	√	√	√	√	√	√
RMI	√			√	√	X	x	x	√	√
Samoa	√	possibly	√	√	√		√	√	√	√
Solomon Islands	√	x	√	√	√		x	x	√	√
Timor-Leste	√			√	√	√	√	√	√	√
Tonga	√	possibly	√	√	√		x	x	√	√
Tuvalu	√			√	√	X	x	x	√	√
Vanuatu	√	possibly	√	√	√		√	√	√	√

FSM=Federated States of Micronesia, PNG=Papua New Guinea, RMI=Republic of Marshall Islands.

Legend: √ = justified, x = unsuitable, blank = not applicable.

a. Some initiatives are already in place. In some cases additional action may not be required, while in others there may be good arguments for winding back some recent actions.

Source: ADB. 2009. *Taking the Helm: A Policy Brief on a Response to the Global Economic Crisis*. Manila. May.

Please keep in mind:

Key economic management issues raised by the global economic crisis are discussed in more detail in 'Taking the Helm: A Policy Brief on a Response to the Global Economic Crisis', released by the Asian Development Bank in May 2009 and available at www.adb.org/Documents/Briefs/Taking-the-Helm/default.asp.

ADB is able to help counties develop their response to the global economic crisis. Support is available under the Pacific Economic Management Technical Assistance.

Latest Pacific Economic Updates

	GDP growth	Inflation	Credit growth	Trade balance	Import cover	Fiscal Balance
	(%, 2009f)	(y-o-y %)	(%)	(% of GDP)	(months)	(% of GDP)
Cook Islands ^a	1.0	8.8	0.1	-68.5		-8.1
		(Mar-Q 2009)	(Dec-Q 2008)	(2008)		(FY2009f)
Fiji Islands ^b	-0.5	0.5	4.8	-35.8	2.7	-3.0
		(Mar 2009)	(Dec 2008)	(2008)	(Feb 2009)	(2009f)
FSM	-0.1	5.0	17.7	-56.8		-3.0
		(2008)	(2007)	(2006)		(FY2008)
Kiribati	1.0	11.0		-78.9		-13.0
		(2008)		(2007)		(2008)
Marshall Islands	0.5	5.6	-7.9	-46.6		
		(Mar-Q 2009)	(FY2006)	(2006)		
Nauru	1.5	2.5		14.6		
		(Mar-Q 2009)		(2005)		
Palau	-2.0	8.6		-72.3		-4.8
		(Mar-Q 2009)		(2005)		(FY2008)
PNG	4.0	10.2	0.7	32.5	10.9	-2.9
		(Mar-Q 2009)	(Apr 2009)	(2008)	(Dec 2008)	(FY2009f)
Samoa	-1.0	12.4	0.0	-43.1	4.8	-5.5
		(Mar 2009)	(Mar 2009)	(2008)	(Mar 2009)	(FY2009f)
Solomon Islands	2.2	17.8	2.8	-20.5	2.5	-3.7
		(Jan 2009)	(May 2009)	(2008)	(Apr 2009)	(2009f)
Timor-Leste	10.0	2.7		-44.2		90.1
		(Mar 2009)		(2006)		(2009f)
Tonga	-2.0	2.4	4.5	-52.3	4.7	1.0
		(Mar 2009)	(Mar 2009)	(2007)	(Apr 2009)	(FY2009f)
Tuvalu	1.0	5.3		-57.4		-5.4
		(2008)		(2007)		(2008)
Vanuatu	3.5	5.8	1.6	-43.3	5.4	0.9
		(Dec-Q 2008)	(Jan 2009)	(2008)	(Feb 2009)	(2009f)

a = credit growth refers to growth in total lending; b = credit growth refers to growth in loans and advances by commercial banks to public and private sectors.

f=forecast, FSM=Federated States of Micronesia, FY=fiscal year, GDP=gross domestic product, PNG=Papua New Guinea, Q=quarter, y-on-y=year on year.

Note: period of latest data shown in brackets; import cover for PNG is months of non-mining and oil imports

Sources: ADB. 2009. *Asian Development Outlook 2009*. Manila (March) and the statistical releases of the region's central banks, finance ministries and treasuries, and statistical bureaus.

Key data sources:

The data used in the Pacific Economic Monitor are available in the ADB PacMonitor database, available in spreadsheet form at <http://www.adb.org/pacmonitor>

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two thirds of the world's poor. Nearly 1.7 billion people in the region live on \$2 or less a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance. In 2007, it approved \$10.1 billion of loans, \$673 million of grant projects, and technical assistance amounting to \$243 million.

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