

Prospects and Challenges in the Asia and Pacific Small States



Prepared by the APD Small States Unit
29th Meeting of South Pacific Central Bank Governors (Suva, Fiji)
December 4-6, 2014

Key Messages

- Global Outlook: Recovery continues despite setbacks
- Asia and Pacific Outlook: Steady growth
- Downside risks have increased
 - Weaker growth in the euro area, Japan, and some EMs
 - Financial market correction

Asia and Pacific Small States:

- Policies should focus on enhancing resilience
- Structural reforms are critical to lift potential growth

Global and Regional Outlook

The global recovery continues although it is uneven...

WEO Real GDP Growth Estimates and Projections 2014 and 2015

(Percentage change)



World

U.S.

Euro
Area

Japan

Brazil

Russia

India

China

APD Small
States

APD Small
States +
PNG

	World	U.S.	Euro Area	Japan	Brazil	Russia	India	China	APD Small States	APD Small States + PNG
2014 (WEO Oct. 2014)	3.3	2.2	0.8	0.9	0.3	0.2	5.6	7.4	2.4	2.7
2014 (WEO Apr. 2014)	3.6	2.8	1.2	1.4	1.8	1.3	5.4	7.5	2.3	2.5
2015 (WEO Oct. 2014)	3.8	3.1	1.3	0.8	1.4	0.5	6.4	7.1	2.7	2.8
2015 (WEO Apr. 2014)	3.9	3.0	1.5	1.0	2.7	2.3	6.4	7.3	2.2	2.3

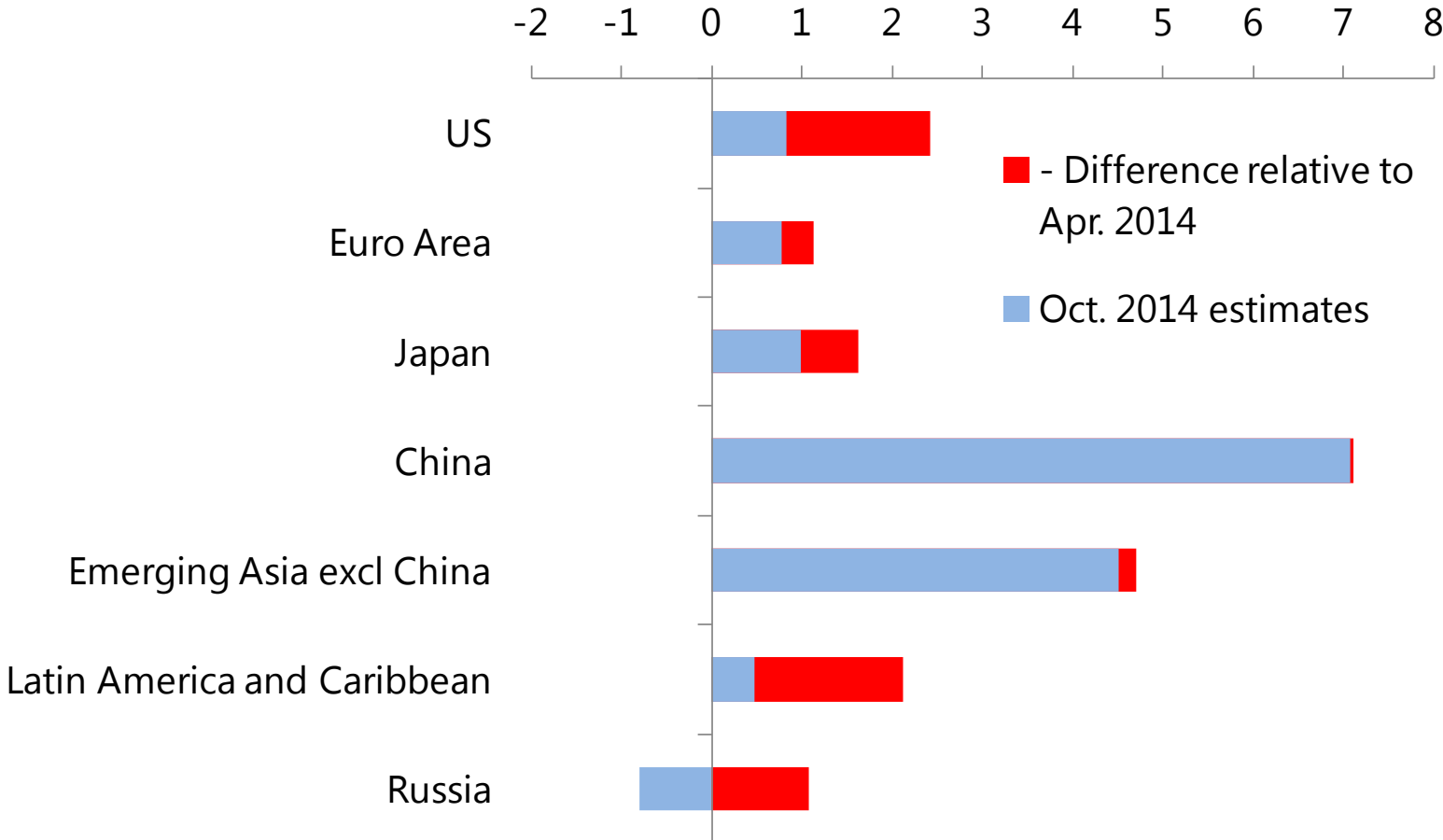
Source: IMF, *World Economic Outlook*.

Note: Median for APD Small States.

...and growth fell short of expectations in the first half of 2014

GDP Growth 2014:H1 - October vs. April 2014

(Annualized semiannual percent change)

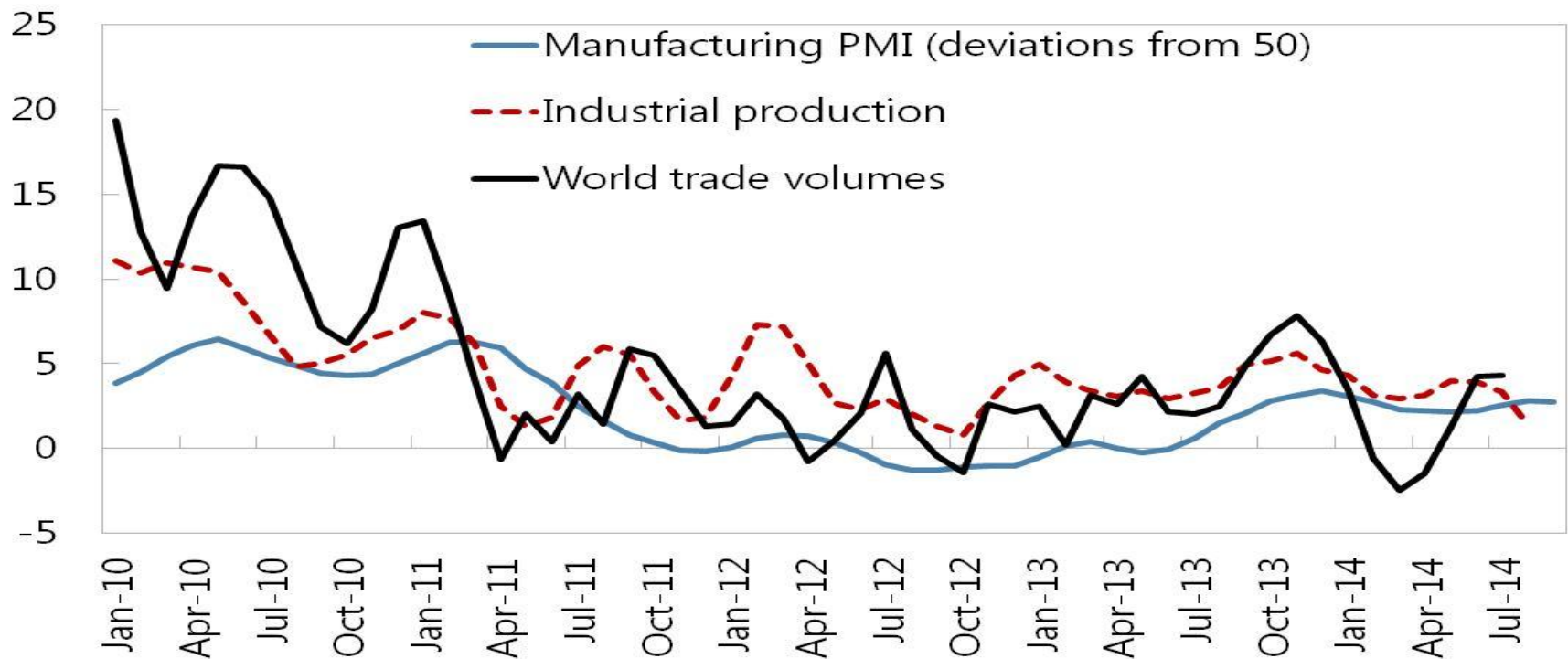


Source: IMF, *World Economic Outlook*.

Leading indicators suggest that activity will increase, but at a slow and uneven pace

World Trade, Industrial Production, and Manufacturing PMI

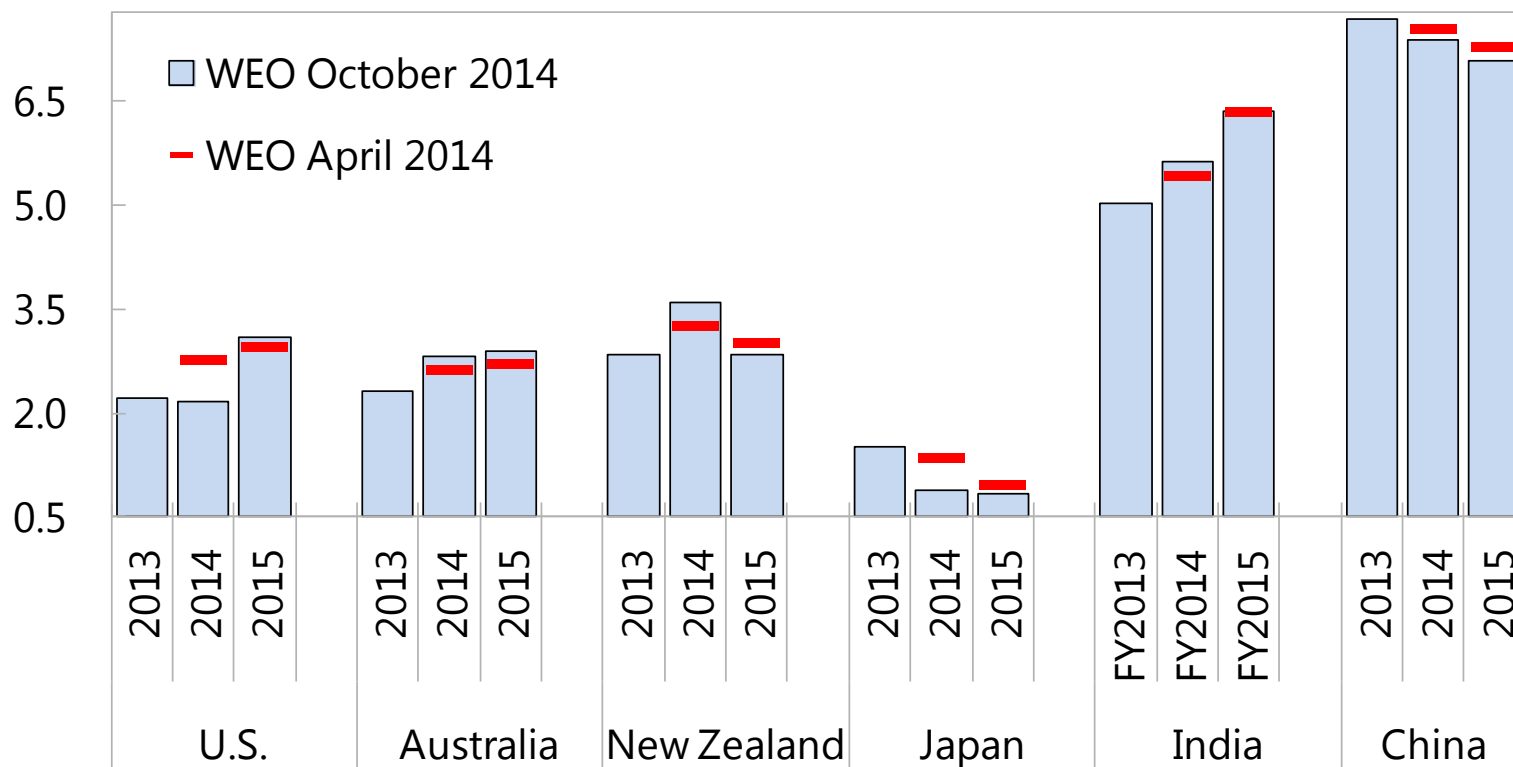
(Three-month moving average, annualized percentage change)



Growth momentum in Asia and Pacific has been steady (except for Japan)...

Economies with Strong Linkages to APD Small States: Real GDP Growth

(In percent)



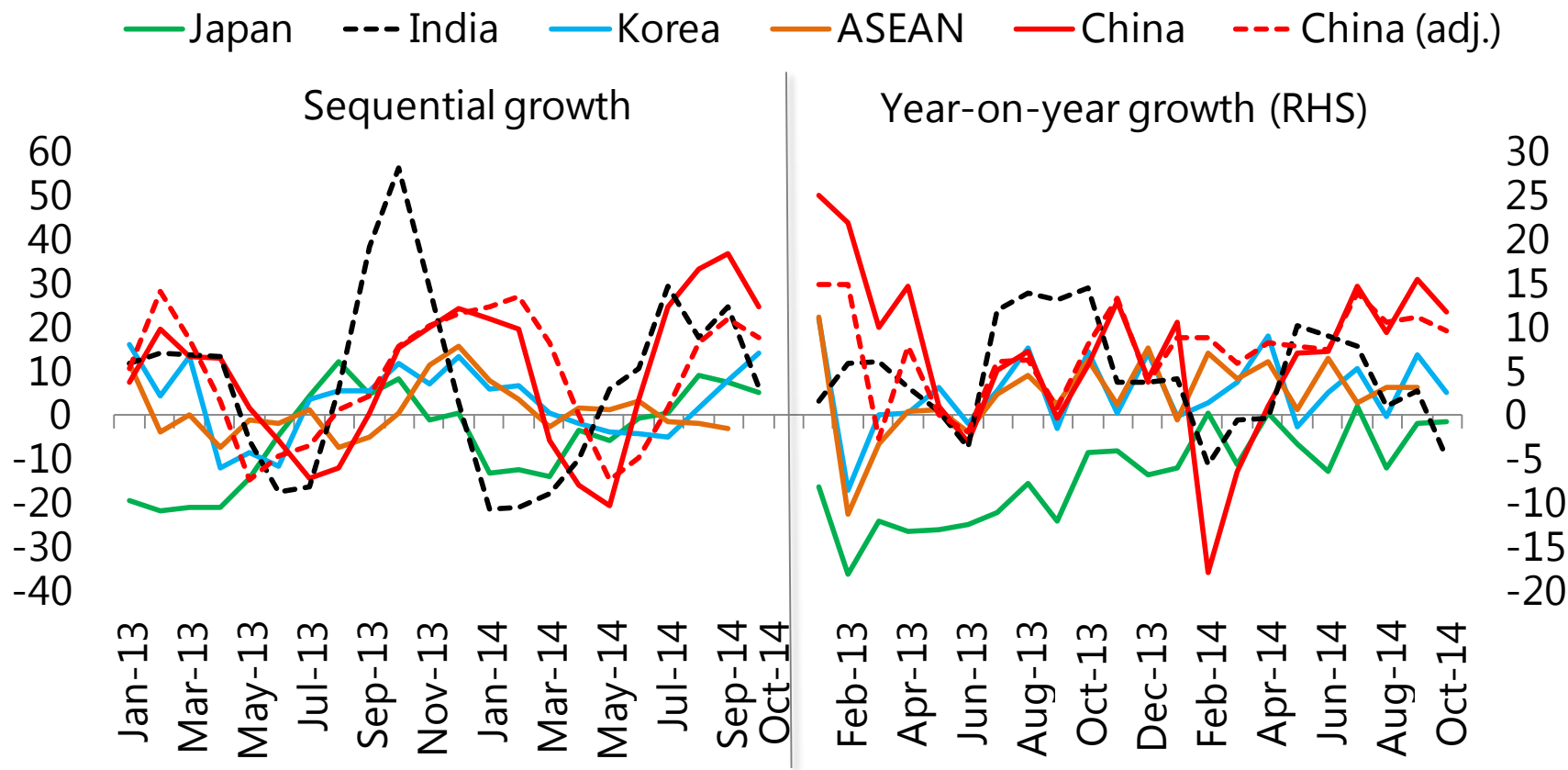
Source: IMF, *World Economic Outlook*

Note: 2013 = outturn; 2014 = estimate; 2015 = forecast

...with exports picking up

Asia: Exports by Economies

(Year-on-year growth; three-month percent change of three-mma, SAAR)



Sources: CEIC Data Company Ltd.; Haver Analytics; and IMF staff calculations. ASEAN includes Indonesia, Malaysia, the Philippines, Singapore, and Thailand. China (adj.) is adjusted with Hong Kong S.A.R.'s mirrored data to account for overinvoicing.

Global/regional risks and spillovers

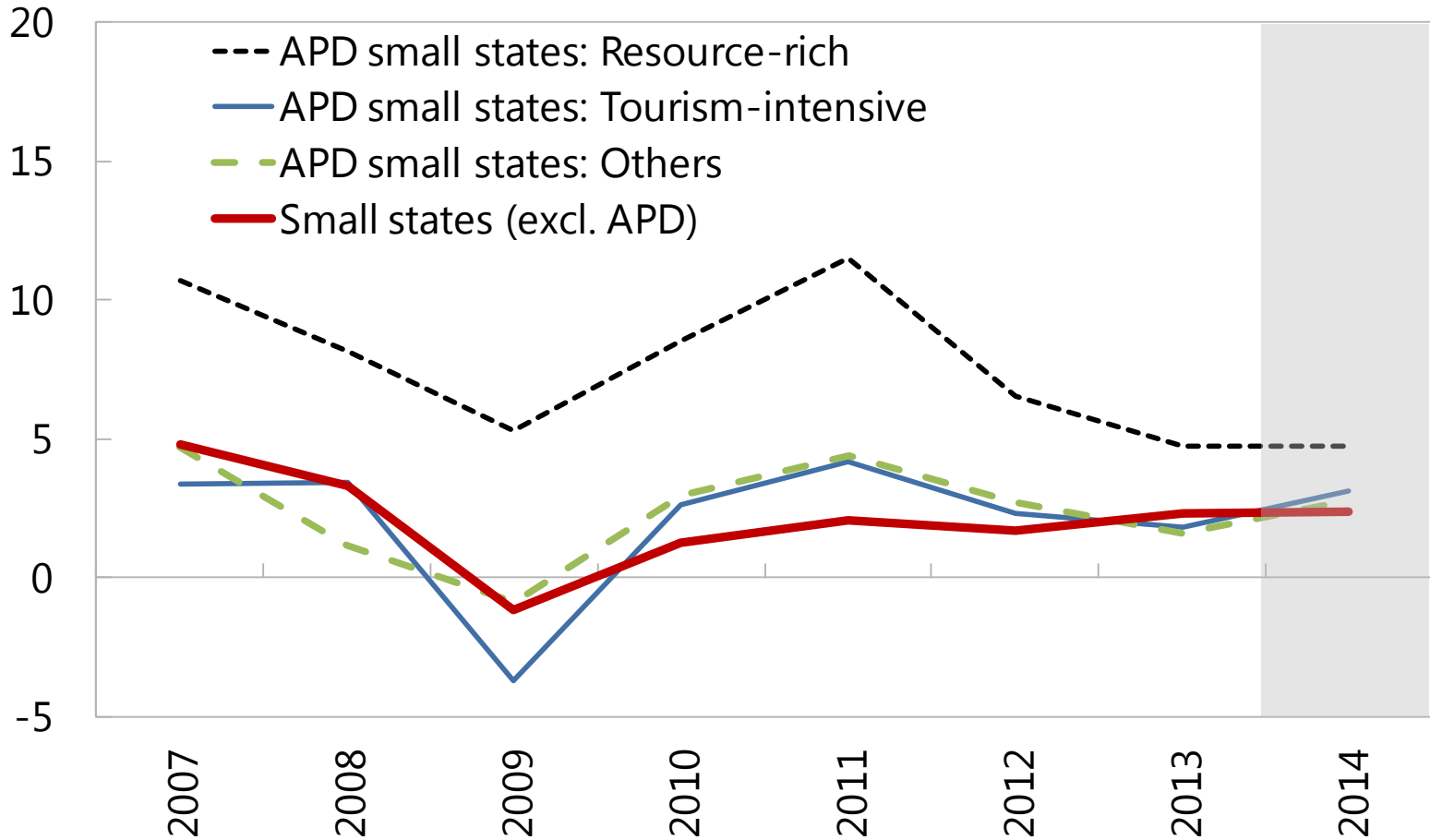
- Geopolitical tensions
- Financial market correction
- Stagnation risks in advanced economies
- Lower potential growth in some EMs
- Further reduction in oil price with different impact on oil-commodity exporters and importers

APD Small States and PNG: Cyclical and Structural Challenges

Growth has been uneven among APD small states

APD Small States: Real GDP Growth

(In percent)

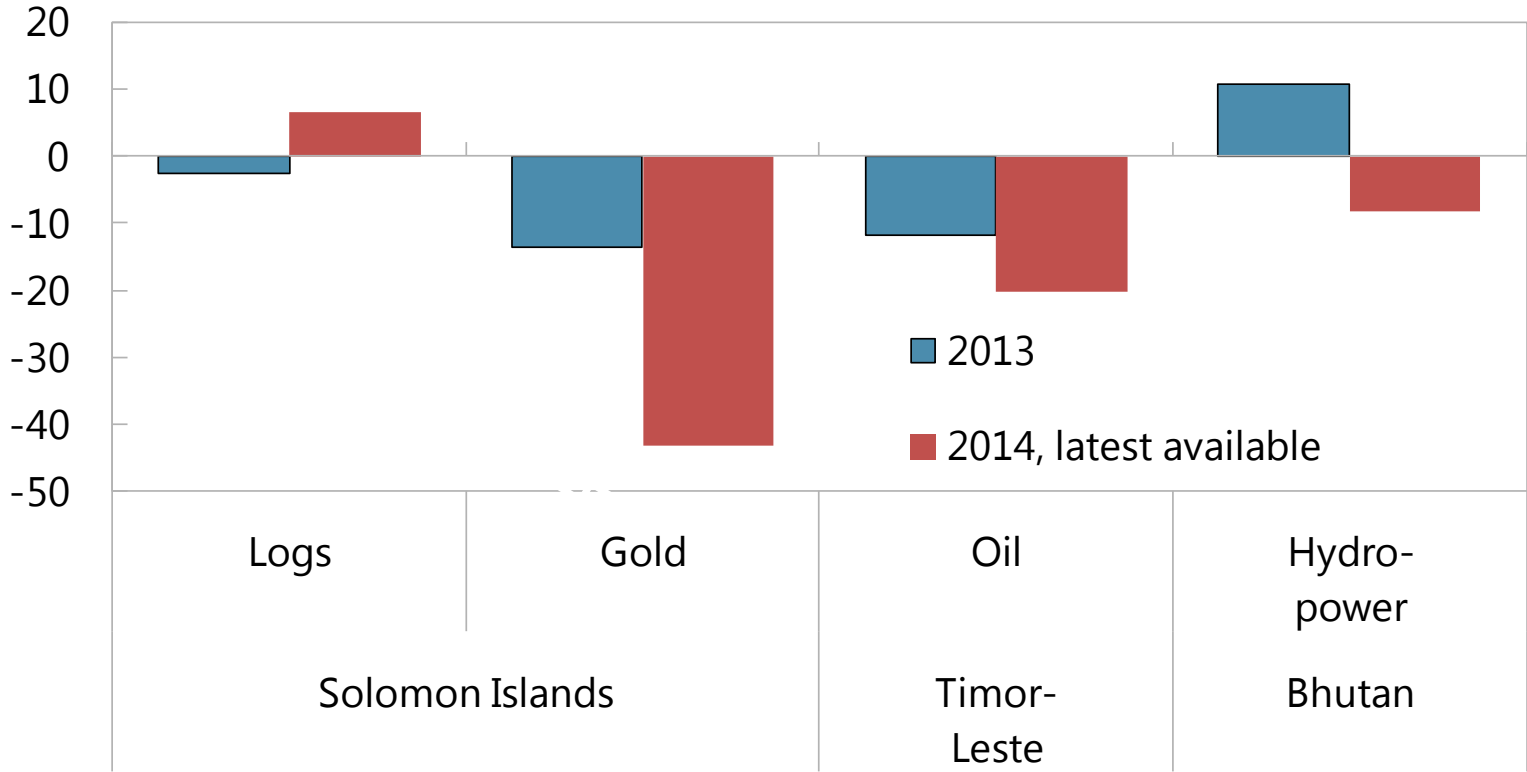


Source: IMF, *World Economic Outlook*.

Commodity production fell in Solomon Islands due to floods and in Timor-Leste due to depleting oil reserves under production...

APD Resource-Rich Small States: Production

(Year-on-year percent change)

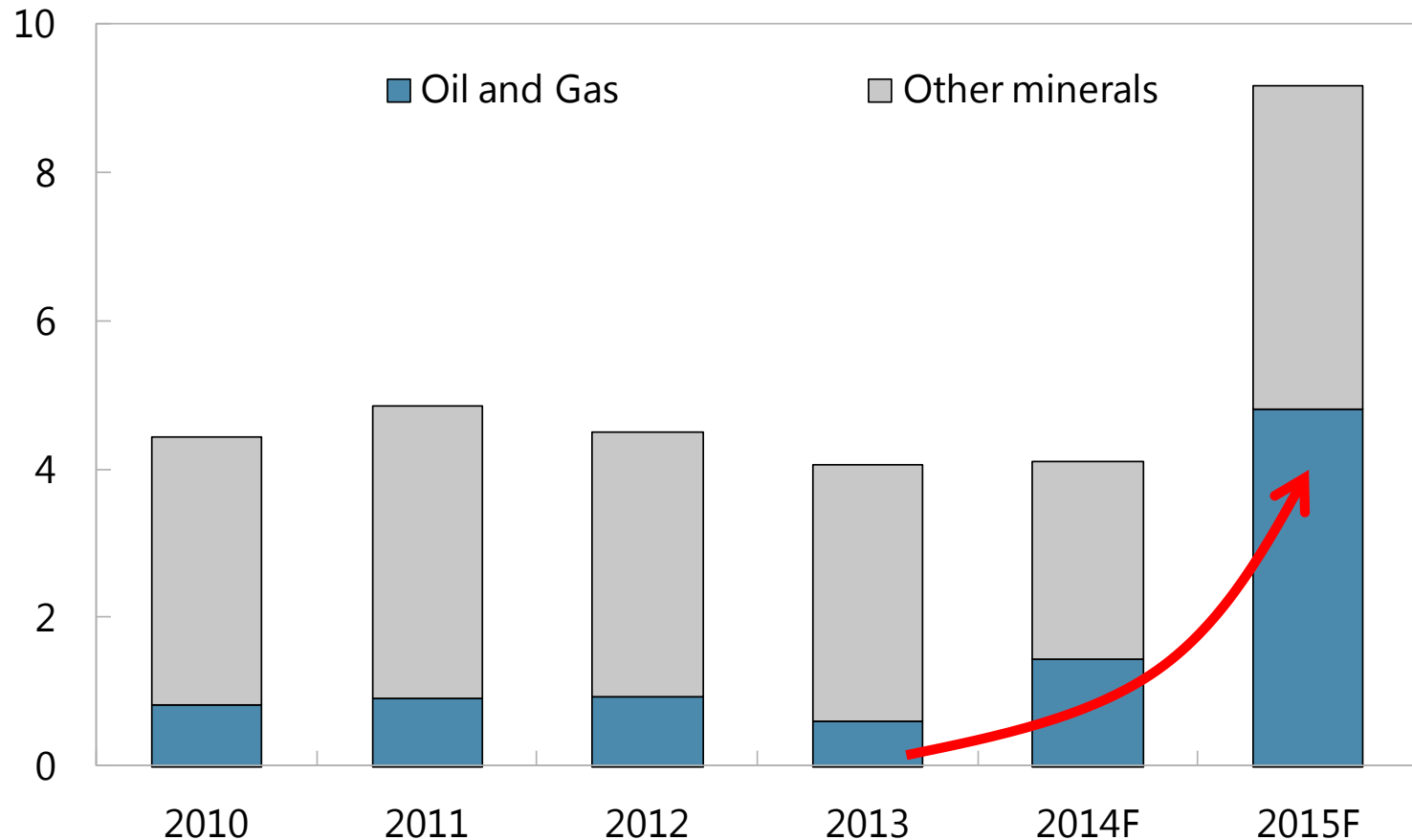


Note: January-August for Timor Leste and Buthan, and January-July for Solomon Islands.
Sources: Country authorities; and IMF staff calculations.

...while in PNG LNG will boost activity by 25 percent during 2014-15

Papua New Guinea: Exports of Minerals

(In billions of U.S. dollars)

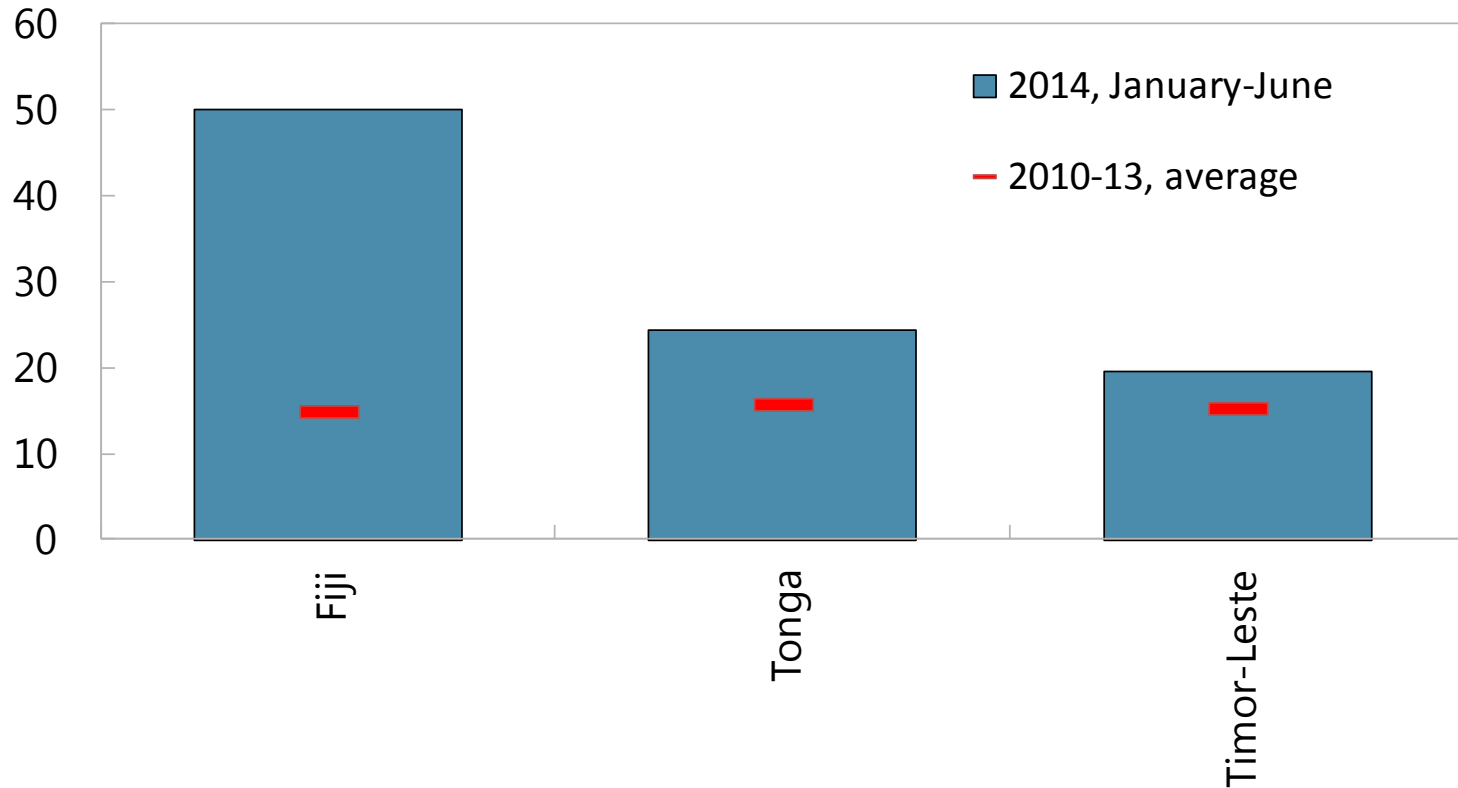


Source: IMF, staff estimates.

High-frequency data indicate a pickup in activity in some small states...

Selected APD Small States: Vehicle Registrations, January-June, 2014

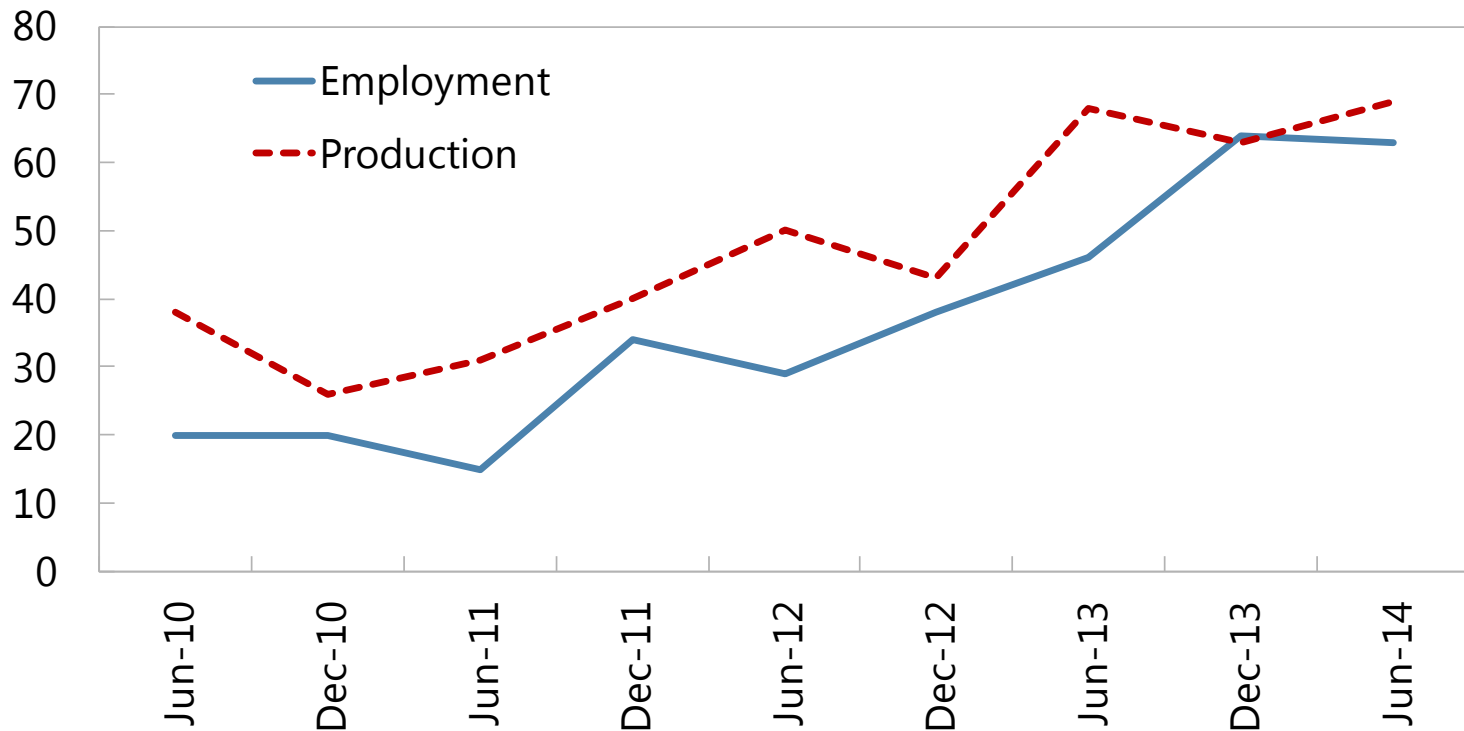
(Year-on-year percent change)



...especially in Fiji where business sentiment ahead of the election was strong...

Fiji: Business Expectations

(In percent)^{1/}



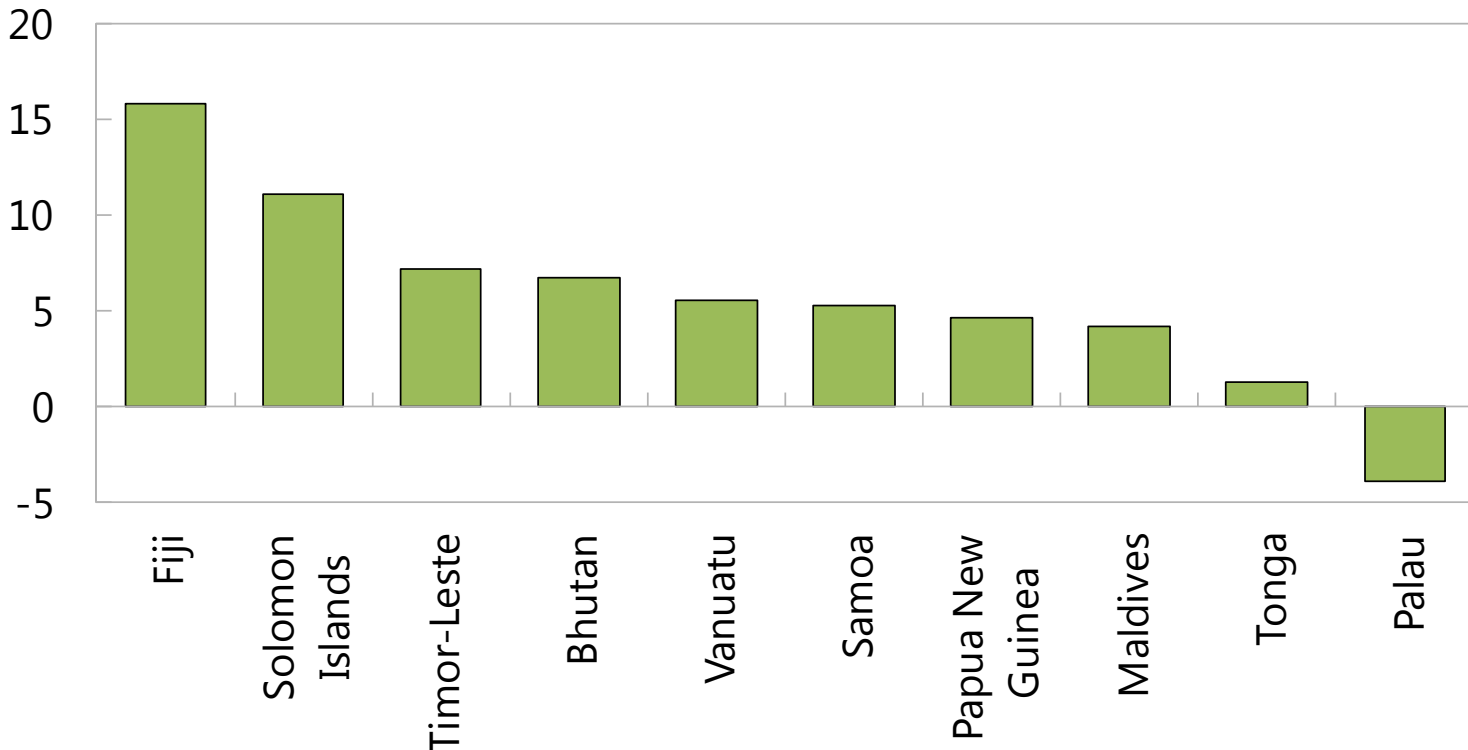
1/ Represents the percentage of firms aiming at increasing production and employment in the next 12 months after deducting the percentage of firms that aim at reducing production and employment.

Source: Reserve Bank of Fiji.

...consistent with developments in credit growth

APD Small States and PNG: Growth of Domestic Credit to Private Sector, 2014, Latest Available Data

(In percent; year on year)

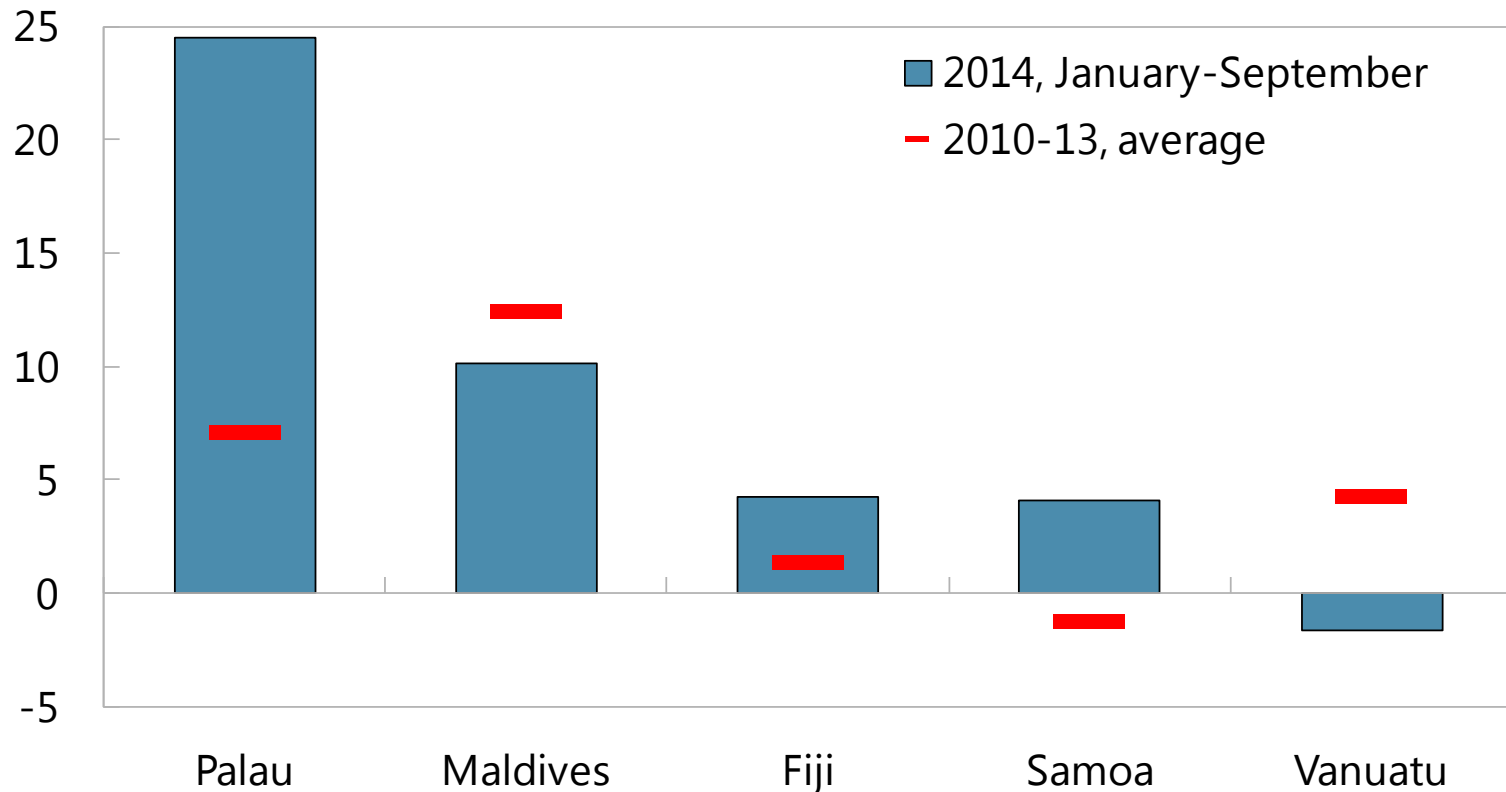


Note: September 2014 for Fiji and Maldives; August 2014 for Samoa, Solomon Islands, Tonga, and Vanuatu; July 2014 for Timor-Leste and Bhutan; and June 2014 for Palau and Papua New Guinea.

Tourist arrivals grew strongly reflecting the resumption of direct flights to Palau, an increase in Asian tourist arrivals in Maldives...

Tourism-intensive APD Small States: Tourist Arrivals

(Year-on-year percent change)



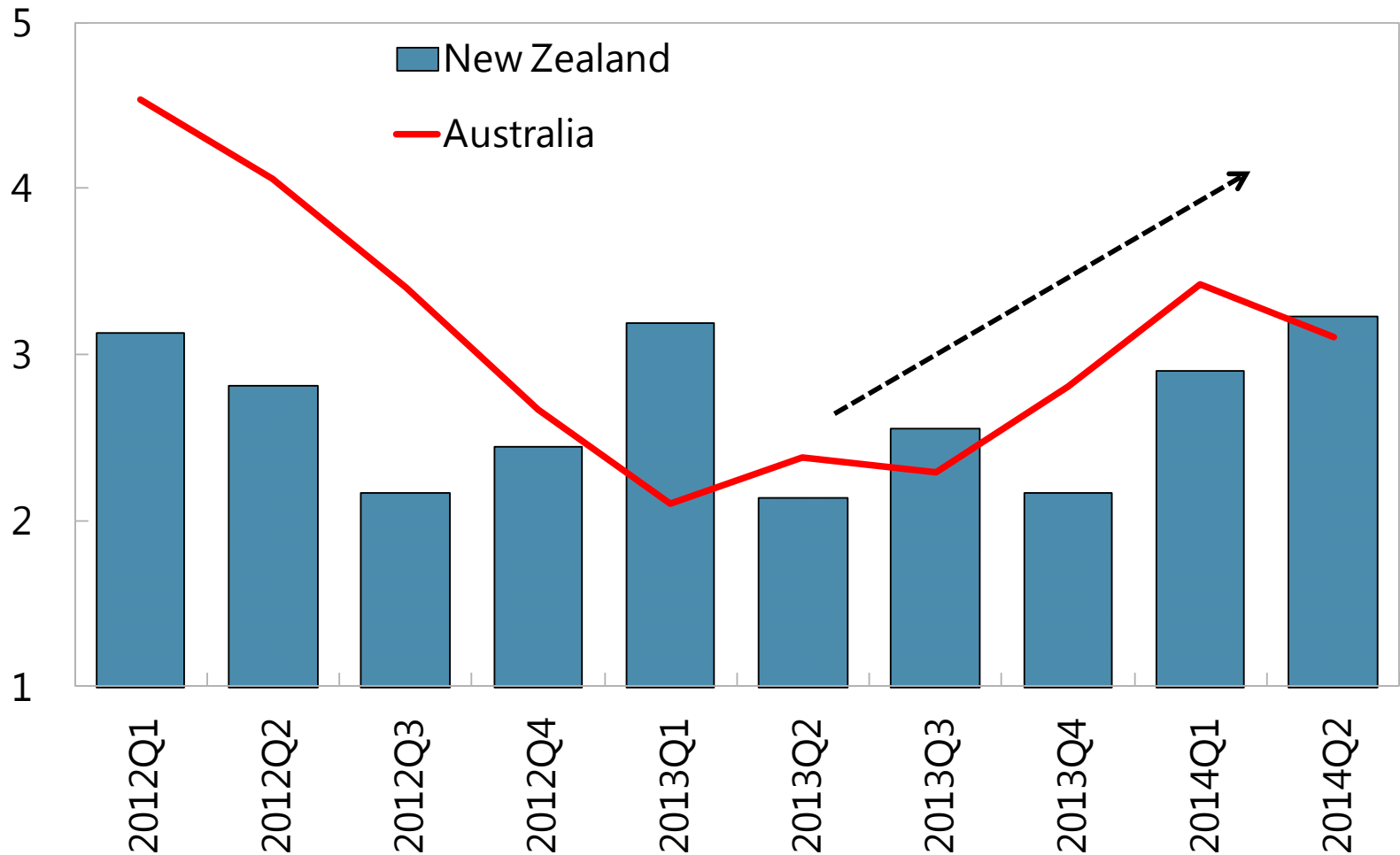
Note: For Vanuatu, data include only air arrivals.

Source: Country authorities.

... and solid growth in Australia and New Zealand

Real GDP Growth

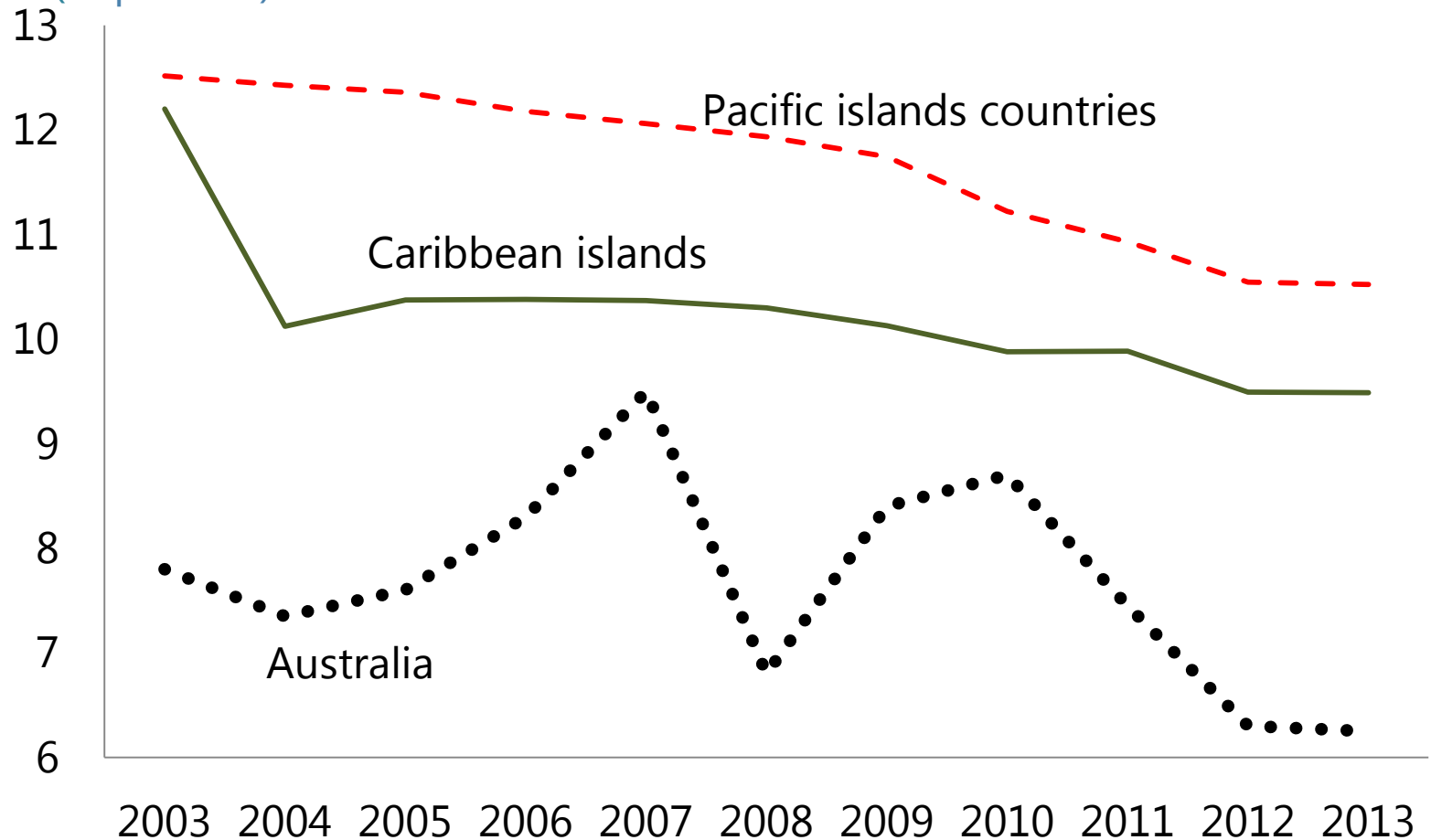
(In percent; year on year)



Cost of financing is high relative to the Caribbean islands ...

Average Lending Rates

(In percent)

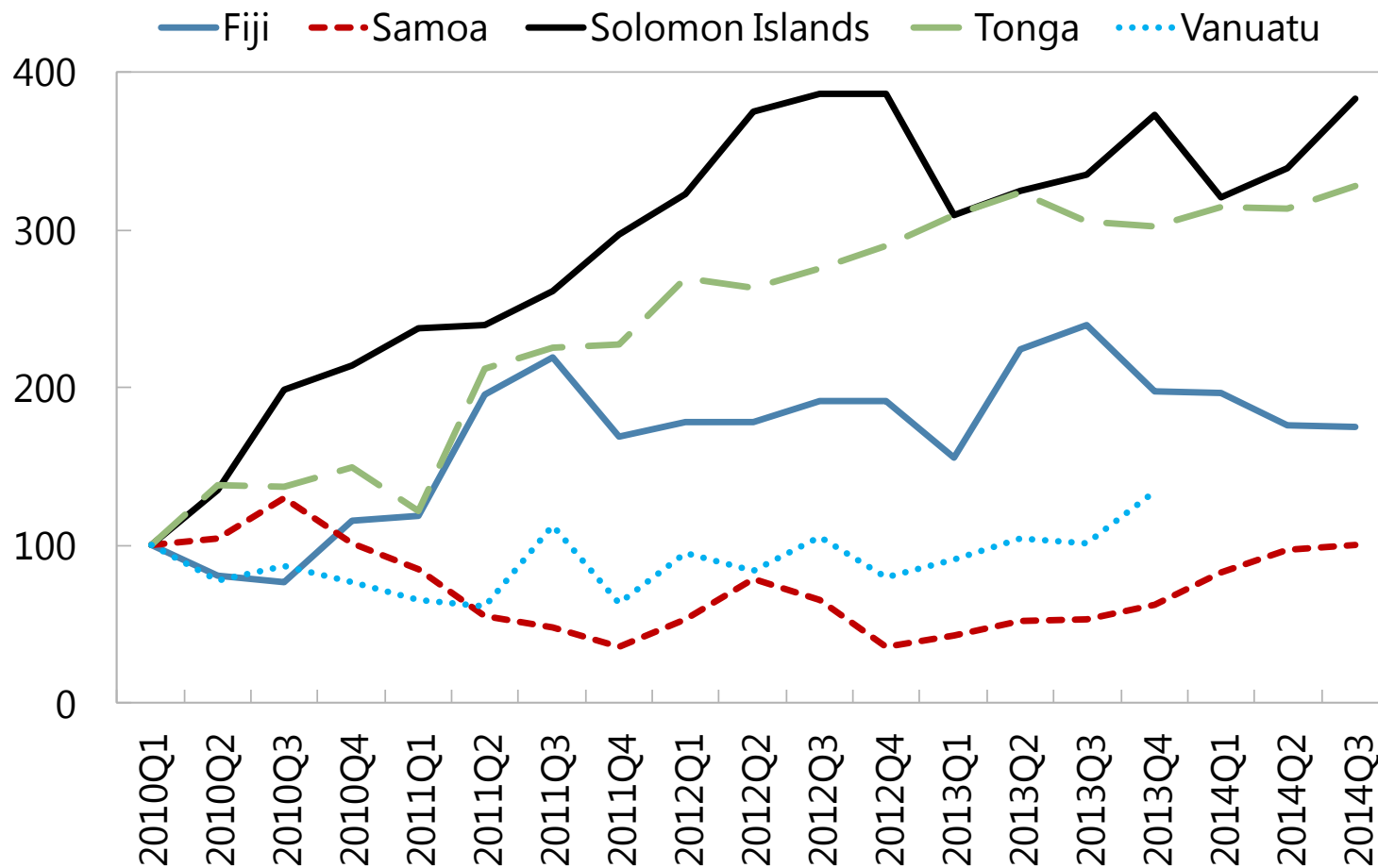


Source: Country authorities, IFS, and IMF staff calculations.

...and high excess reserves in the banking system suggest that monetary transmission mechanism remains weak

Selected APD Small States: Excess Reserves

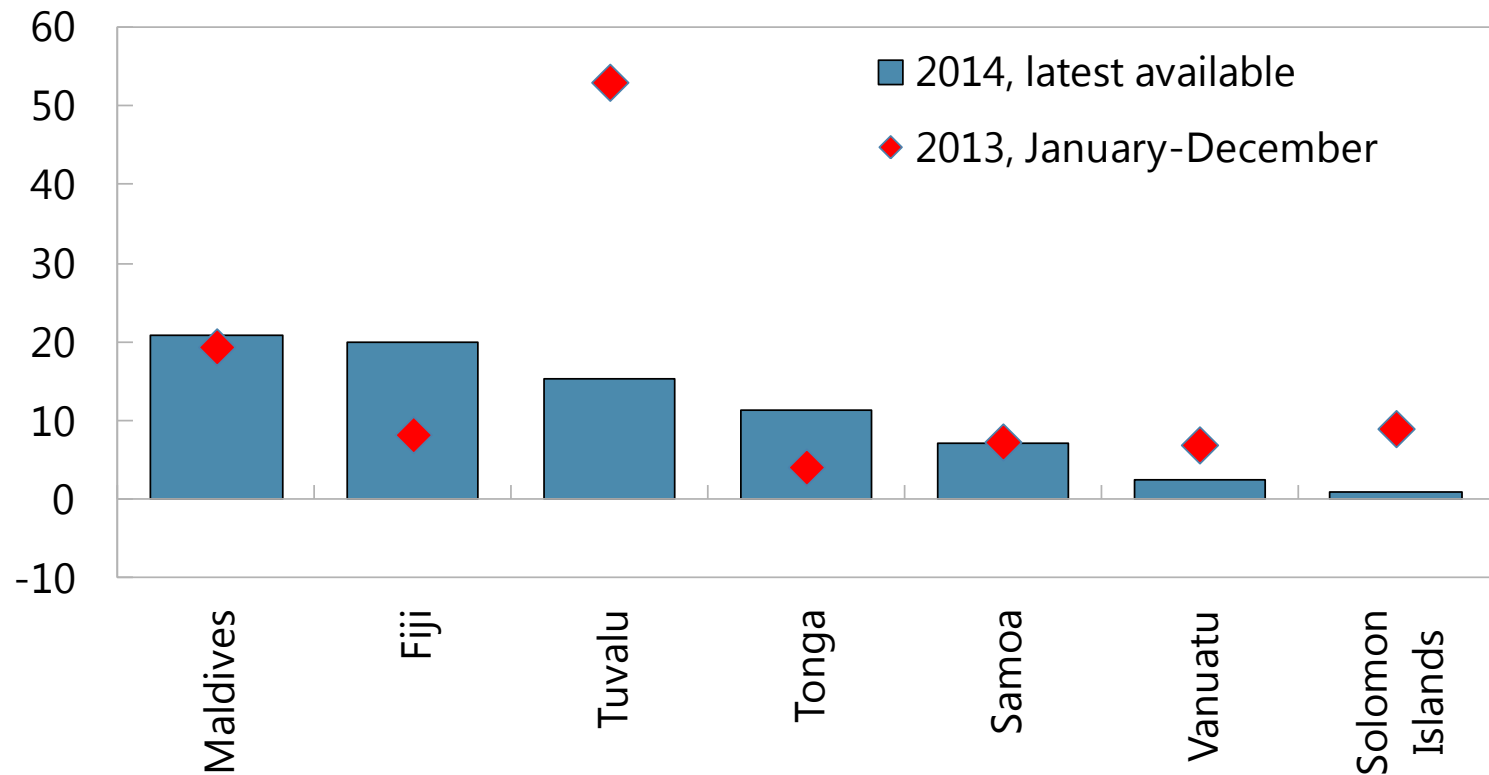
(2010Q1=100)



Fiscal revenue was strong in several small states...

APD Small States: Fiscal Revenue excl. Grants

(Year-on-year percent change)



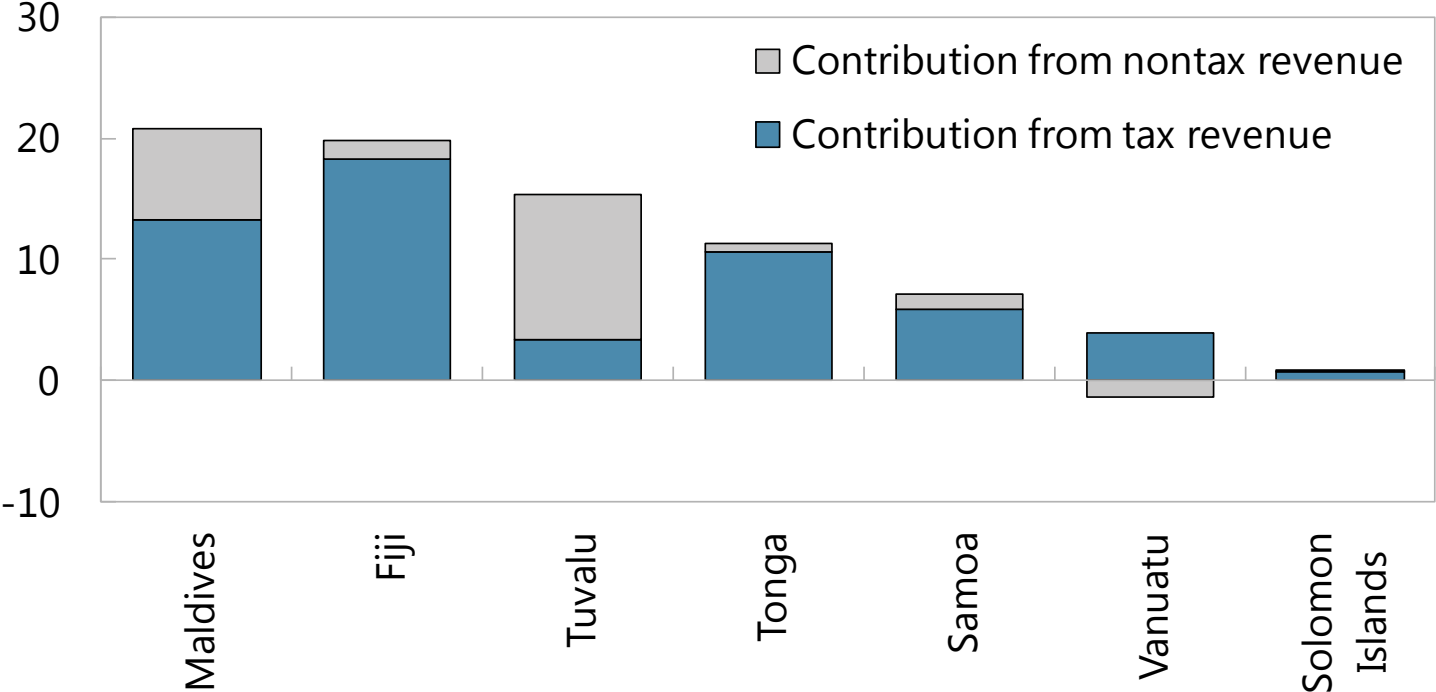
Note: January-August for Tuvalu and Vanuatu; January-July for Maldives and Solomon Islands; January-June for Fiji and Samoa; and January-March for Tonga.

Source: Country authorities.

...driven by buoyant tax collections in Fiji, Maldives, and Tonga; high fishing license fees in Tuvalu, and duties and land leases in Maldives

APD Small States: Fiscal Revenue excl. Grants, 2014, Latest Available Data

(Year-on-year percent change)

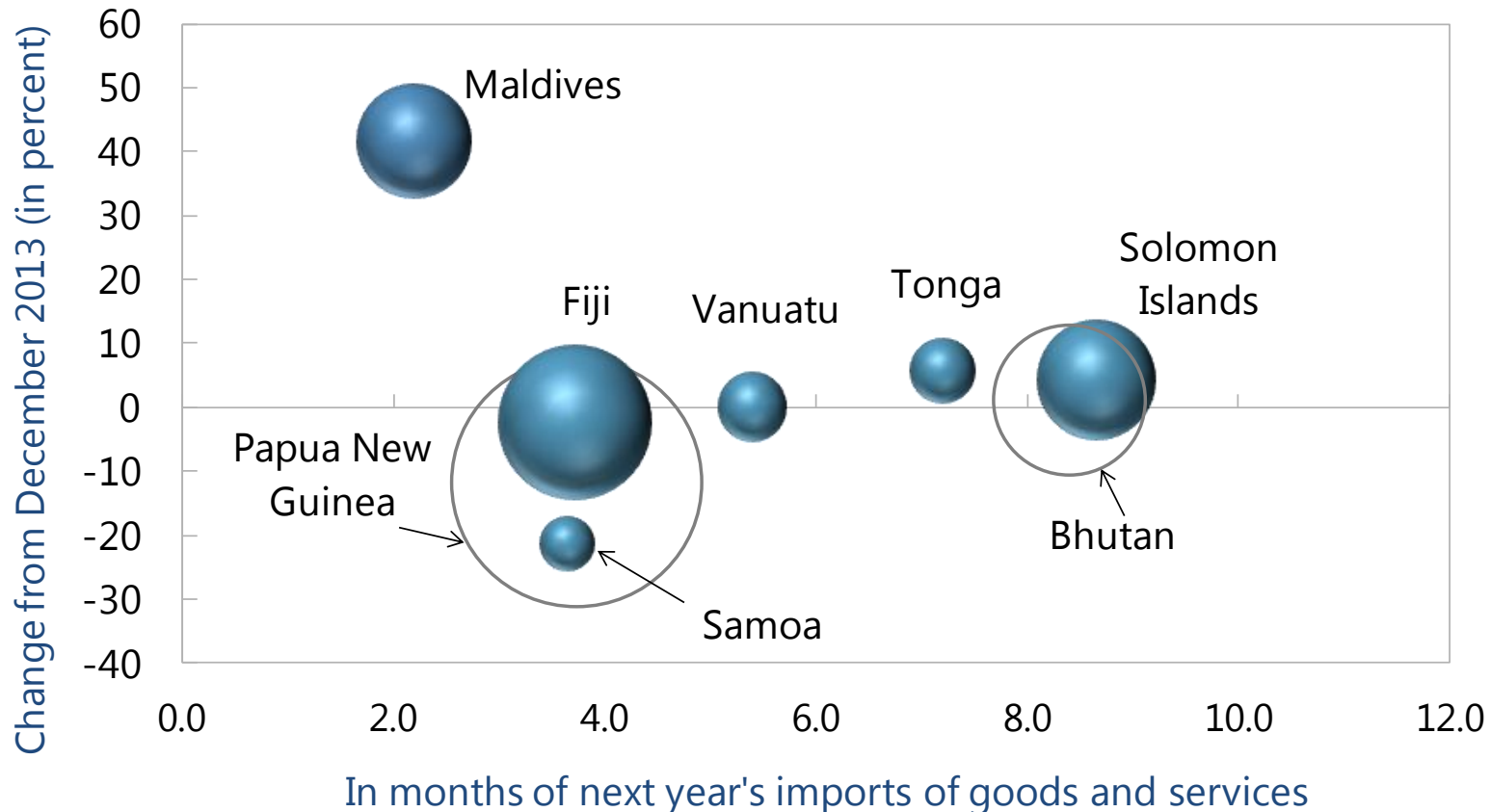


Note: January-August for Tuvalu and Vanuatu; January-July for Maldives and Solomon Islands; January-June for Fiji and Samoa; and January-March for Tonga.

Source: Country authorities.

Reserve buffers remain at comfortable levels in most countries...

APD Small States and PNG: International Reserves, July 2014

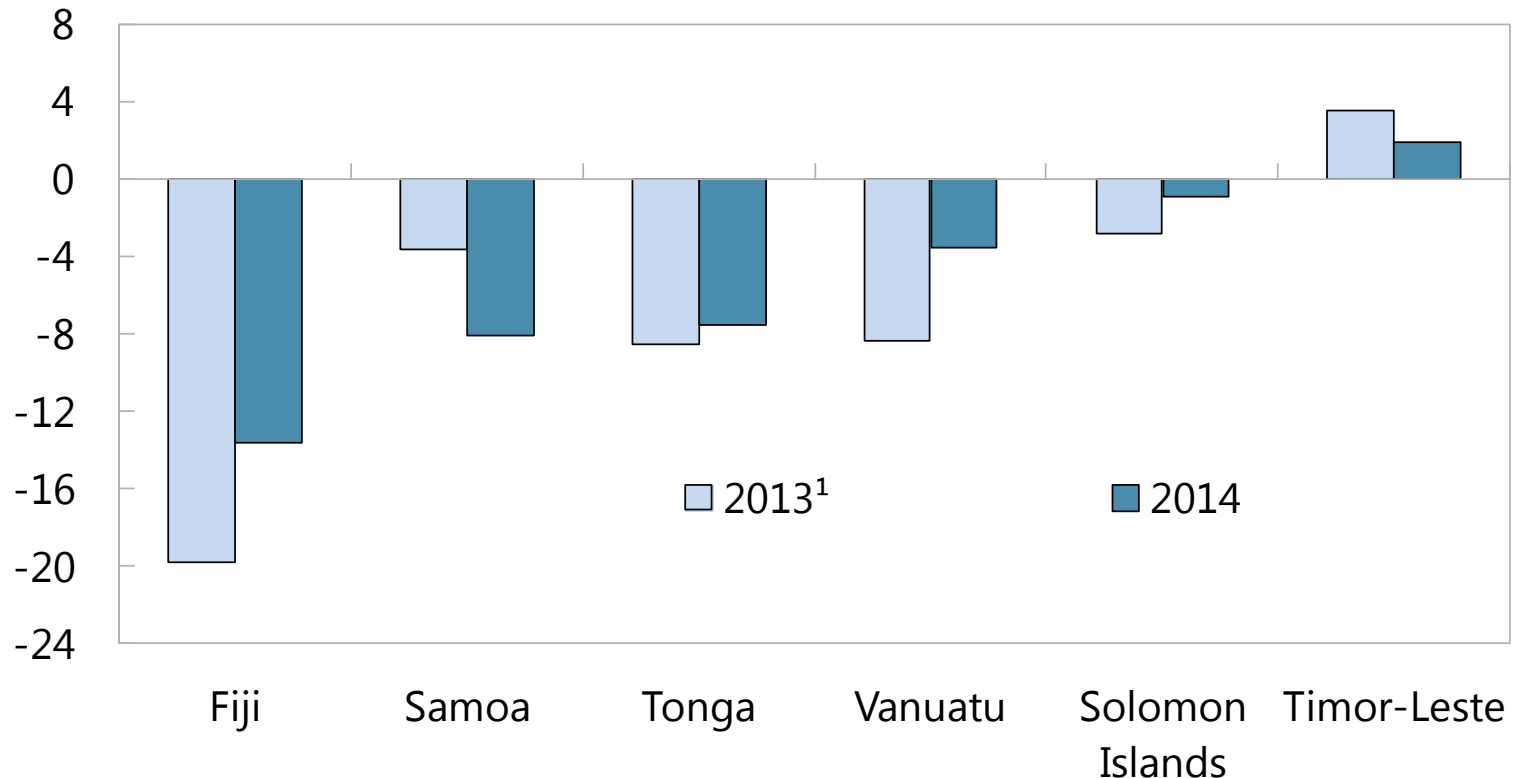


Note: The bubbles show the relative size of international reserves in billions of U.S. dollars.

...reflecting a narrowing of external imbalances

APD Small States: Current Account Balance, January-June 2014

(In percent of GDP)

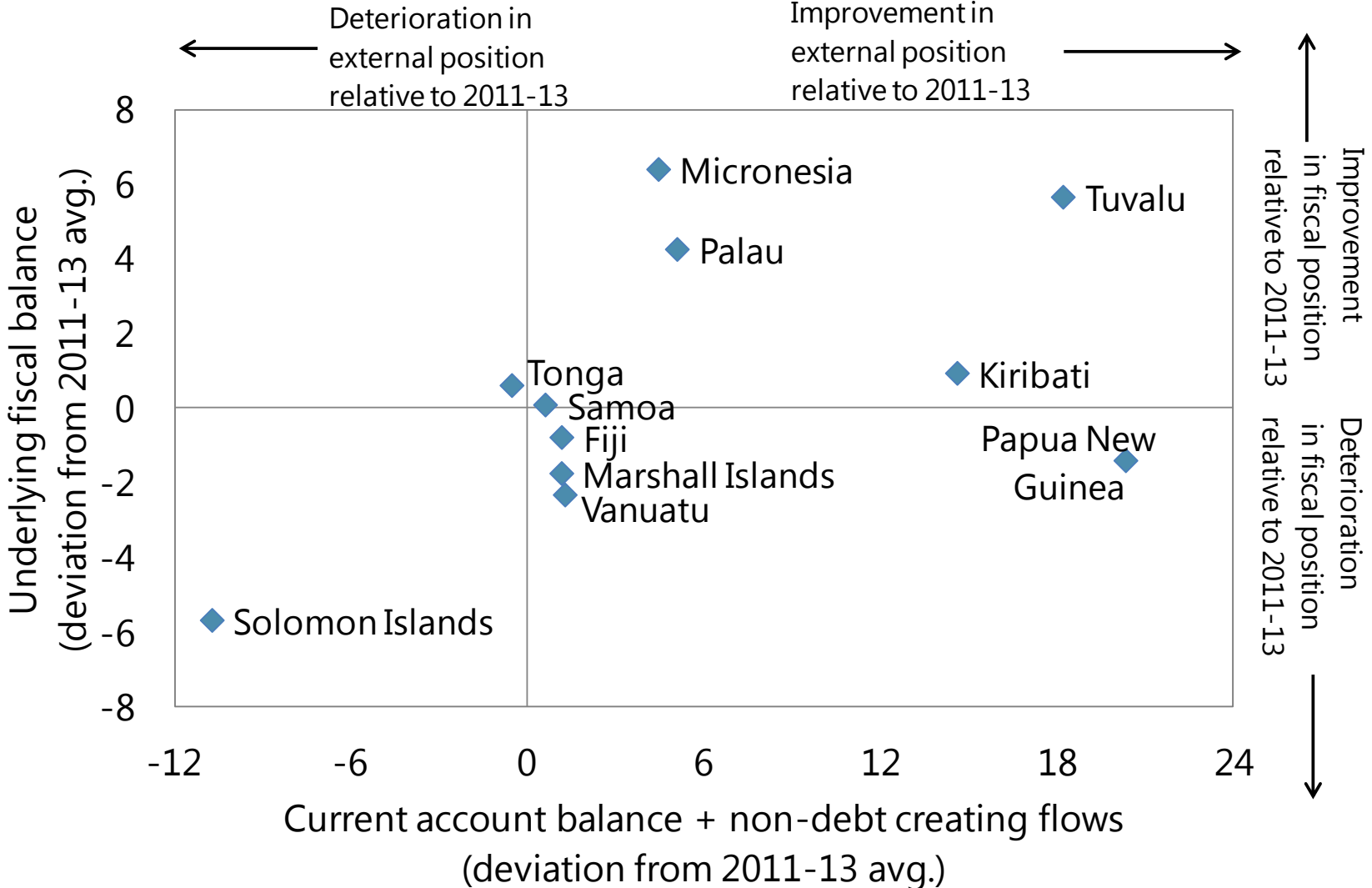


1/ Indicates the same period as the latest available in 2014.

Still, some need to rebuild policy buffers to enhance resilience...

Change in Fiscal and External Positions, 2014

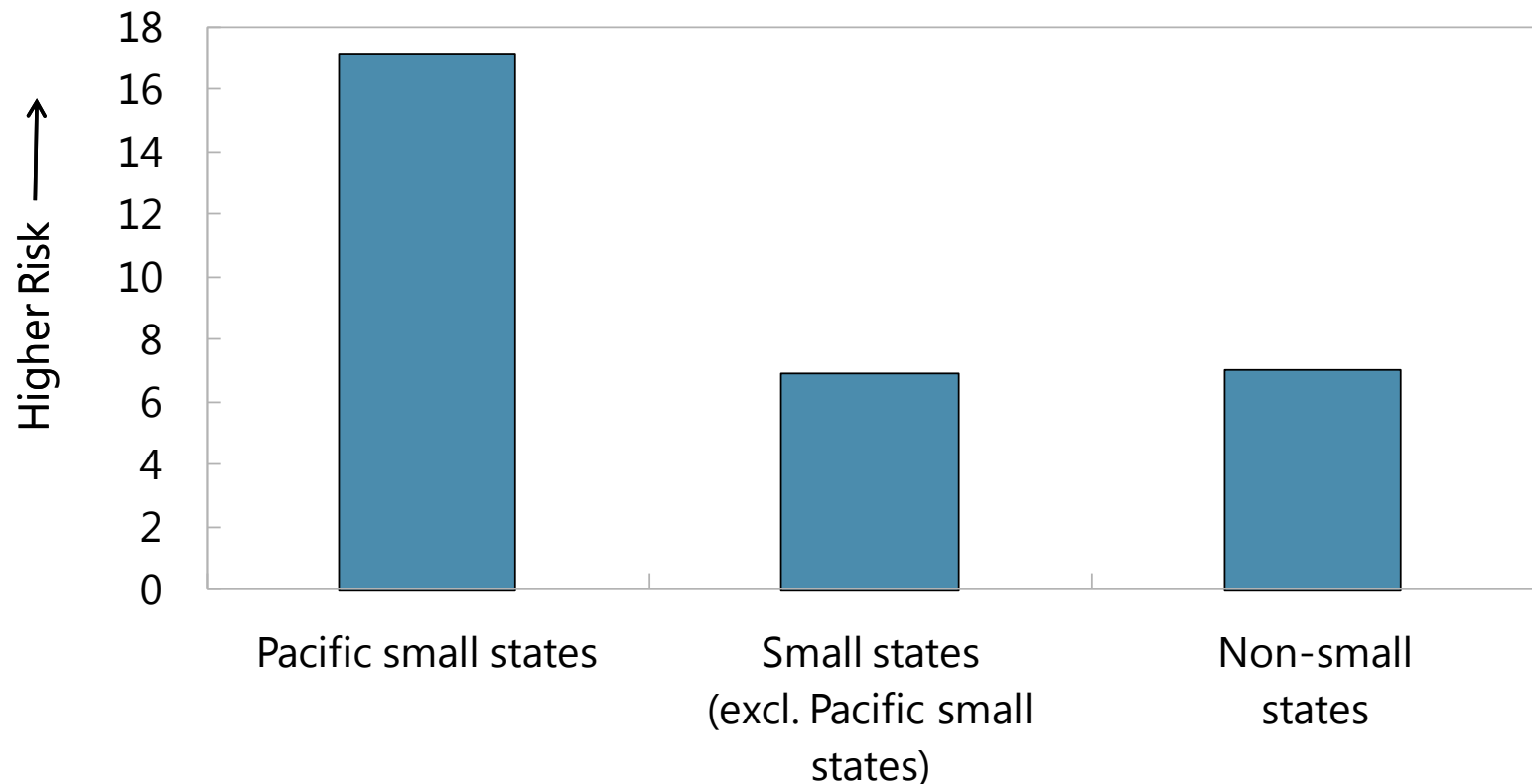
(Relative to 2011-13)



... given their high vulnerability to natural disasters...

Natural Disaster Risks - World Risk Index, 2013

(In percentage points)

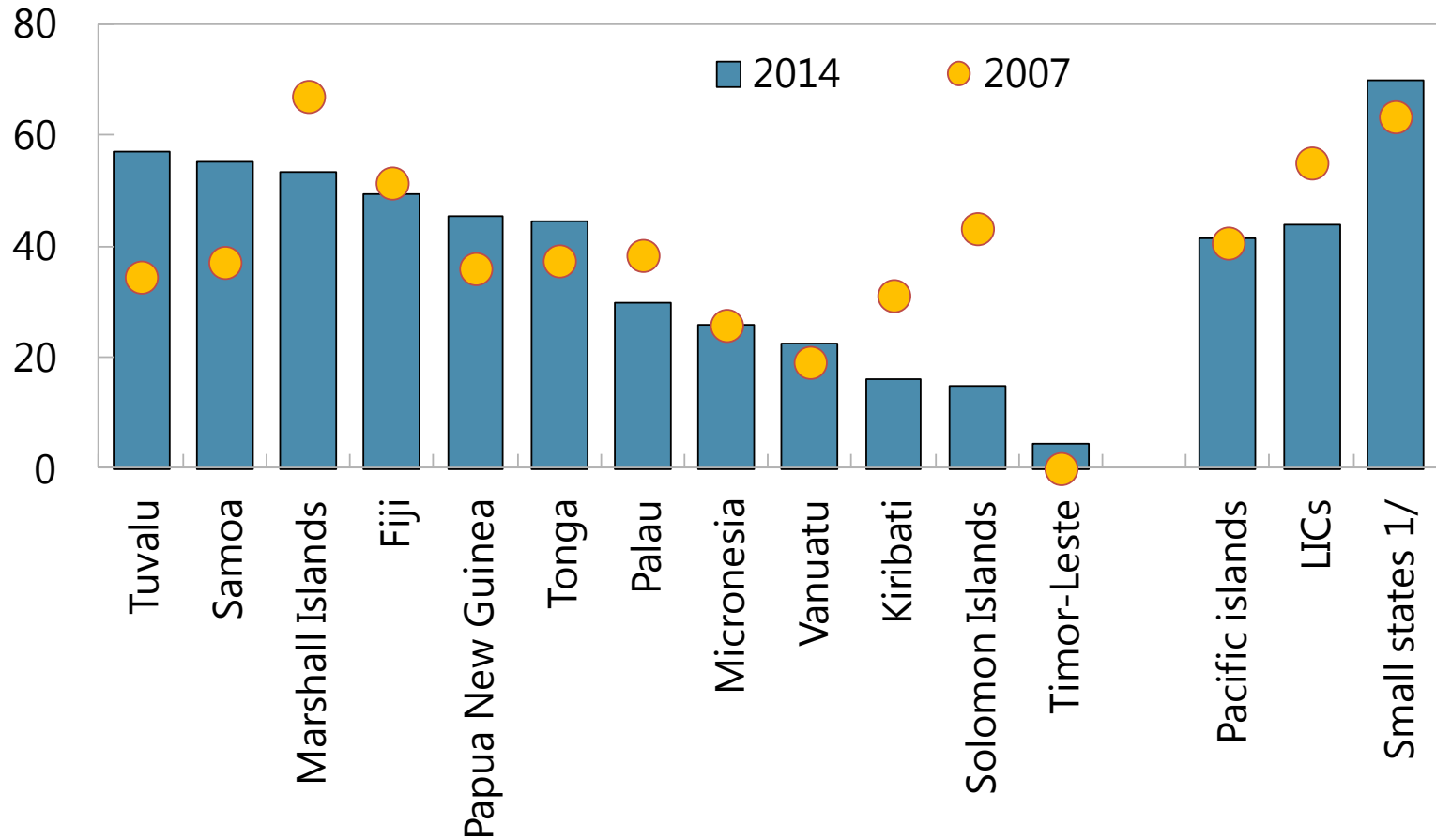


Note: High value indicates high risk. Maximum risk country = 36 percentage points.
Sources: Alliance Development Works, *World Risk Report 2013*; and IMF staff calculations.

... and lower fiscal space in some Pacific island countries

Gross Public Debt

(In percent of GDP)



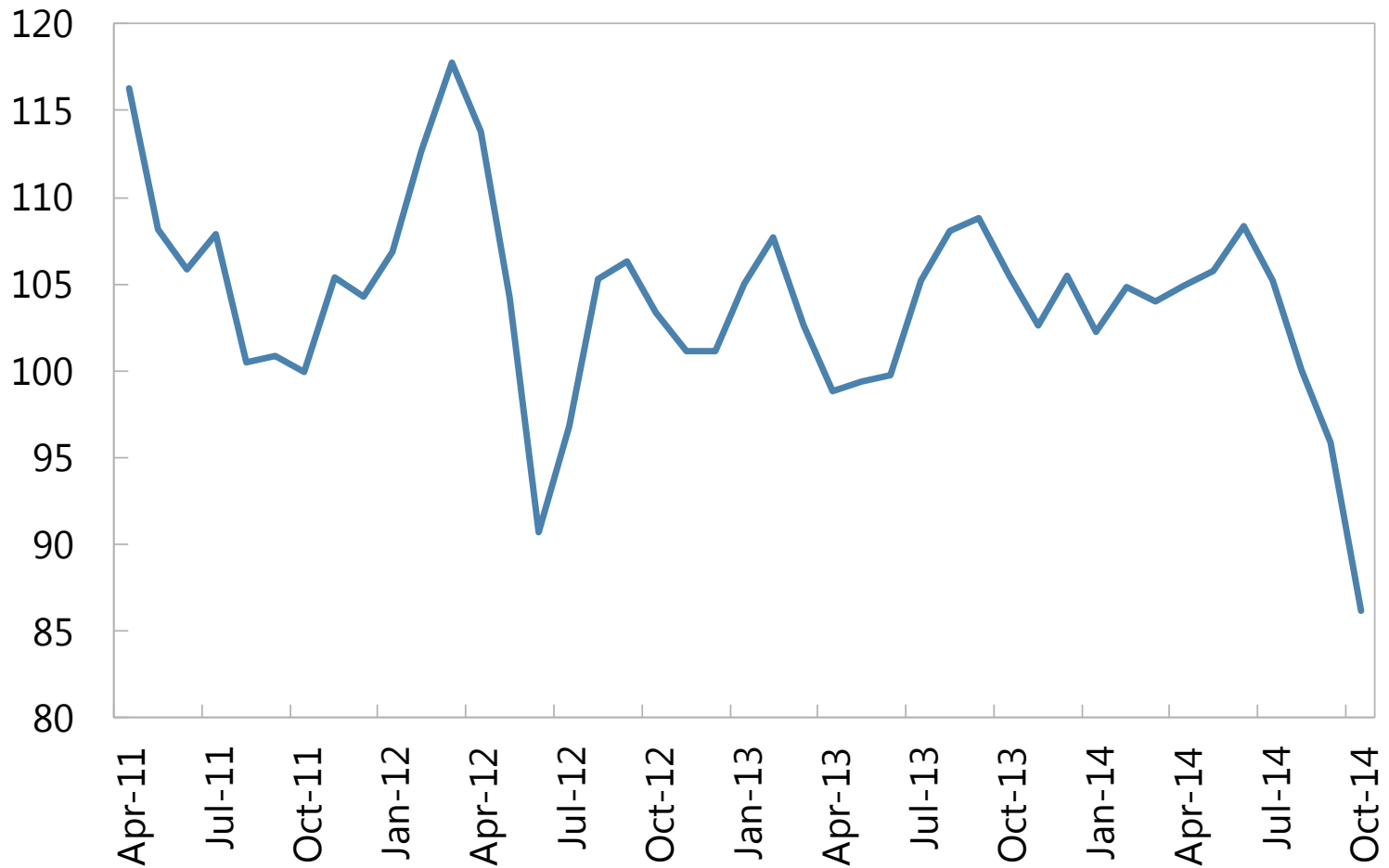
1/ Excluding Pacific islands.

Sources: IMF, WEO; and IMF staff estimates.

Oil price decline, if sustained, could improve policy tradeoffs...

Global Oil Price

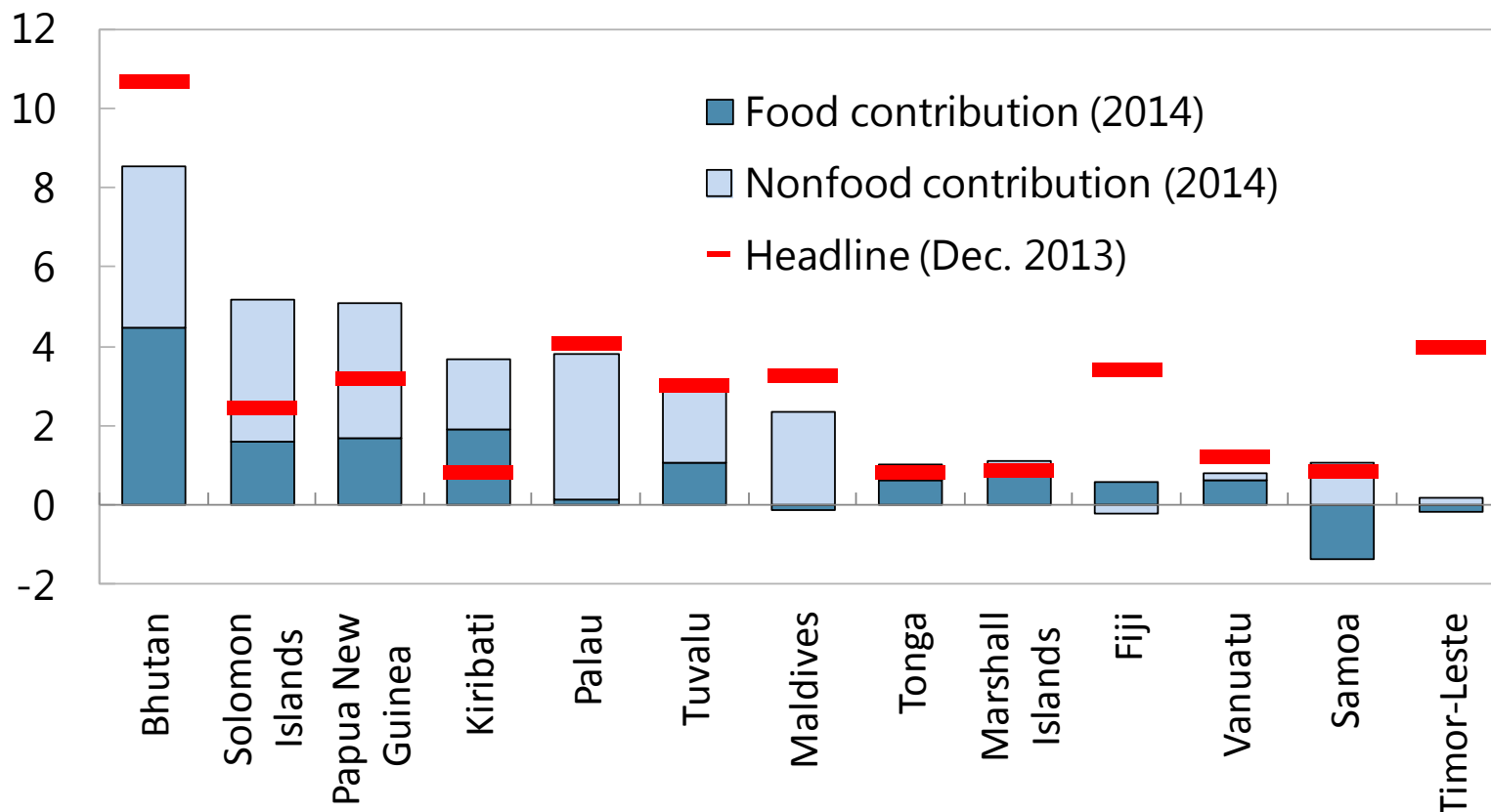
(US dollar per barrel)



...as inflation will continue to ease in most countries...

APD Small States and PNG: Inflation, 2014, Latest Available

(In percent)

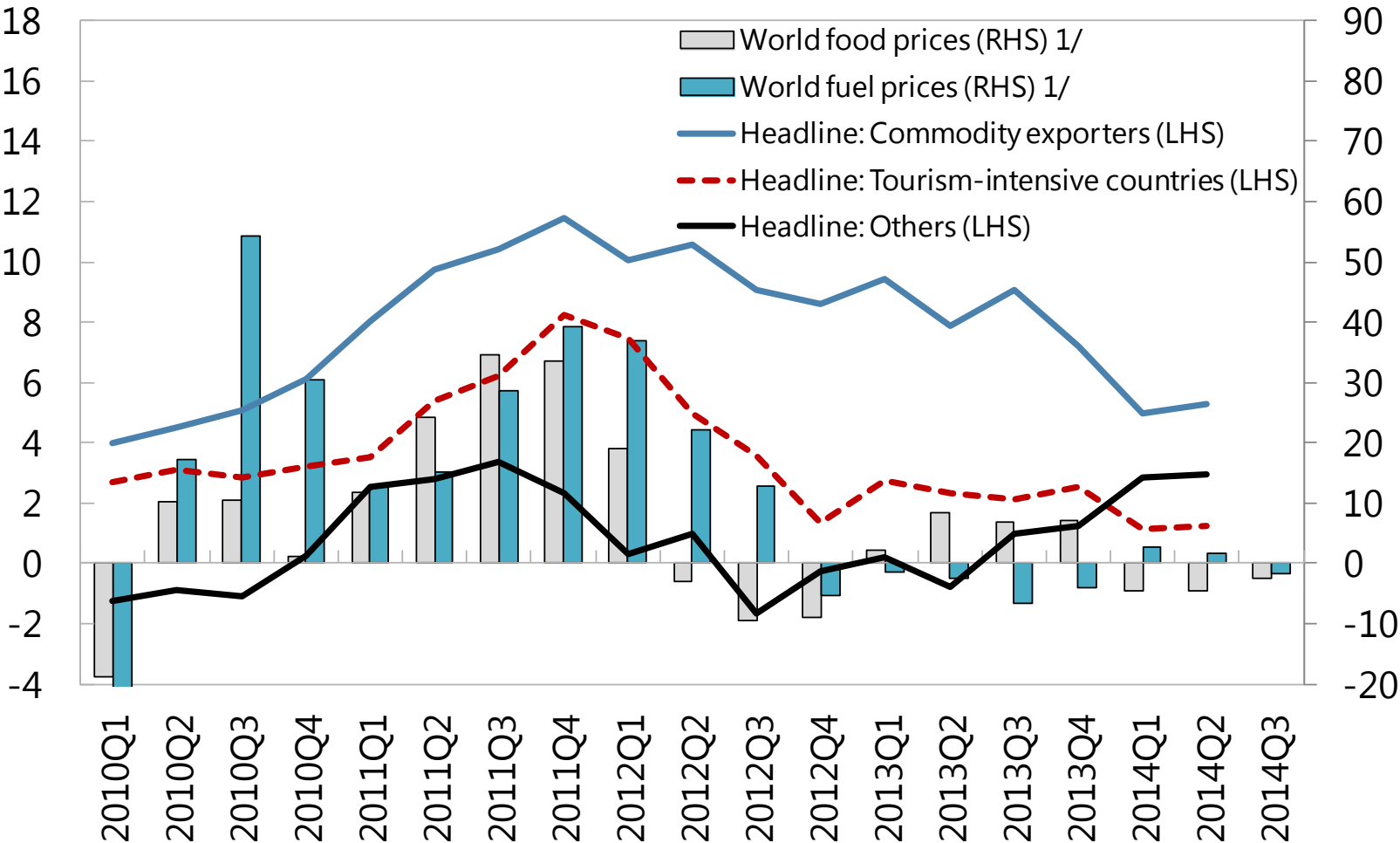


Note: September 2014 for Fiji, Palau, Samoa, Solomon Islands, Timor-Leste, and Tonga; August 2014 for Maldives; June 2014 for Bhutan, Kiribati, and Vanuatu; and March 2014 for the Marshall Islands and Tuvalu.
Source: Country authorities.

...owing to the pass-through of lower global food and oil prices

APD Small States: Inflation and Global Commodity Prices

(In percent)



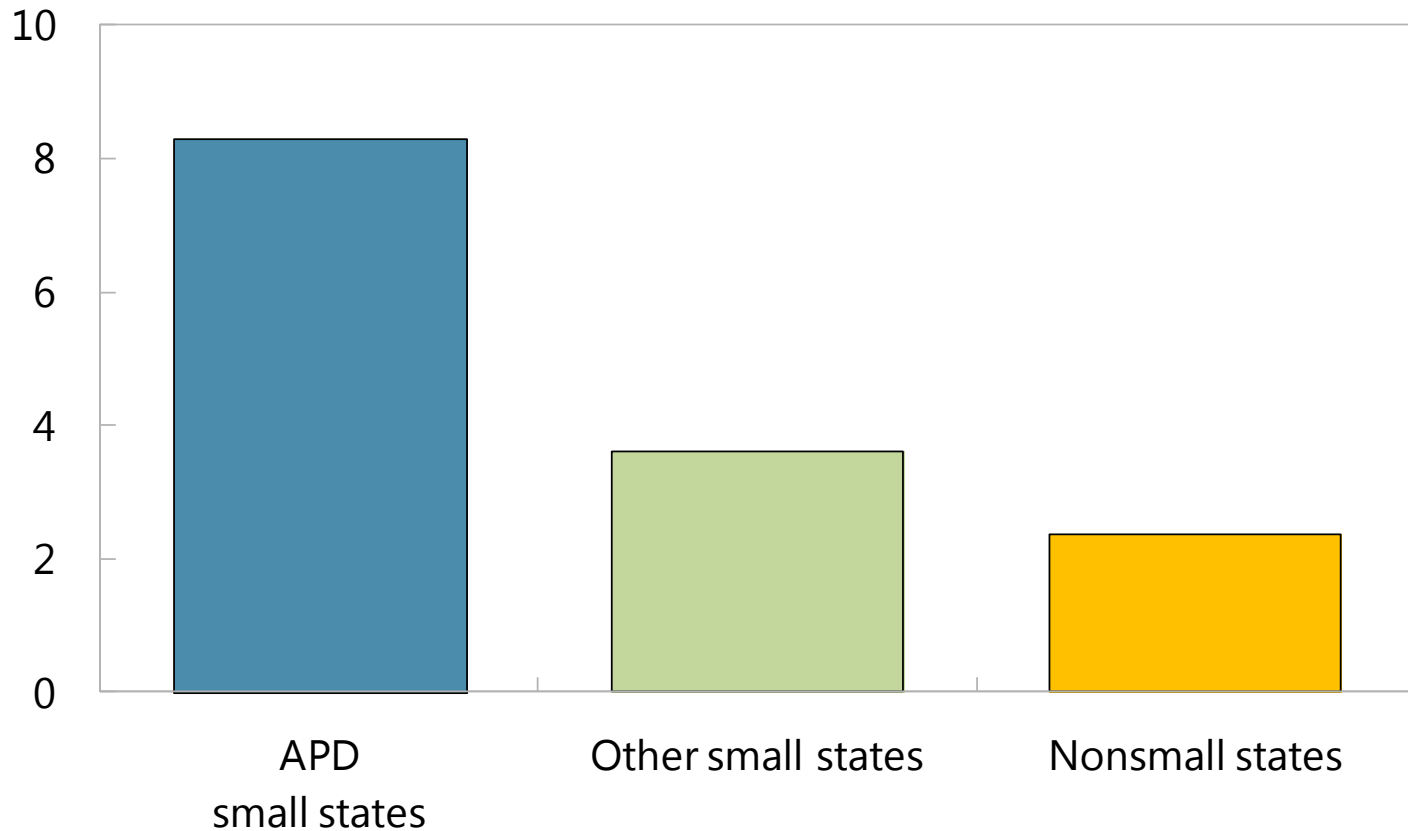
1/ Two-quarter lag.

Sources: IMF, International Financial Statistics Database; and country authorities.

Coping with revenue volatility is key in APD small states...

Volatility of Revenue, 1990-2013¹

(Standard deviation of revenue-to-GDP ratio)

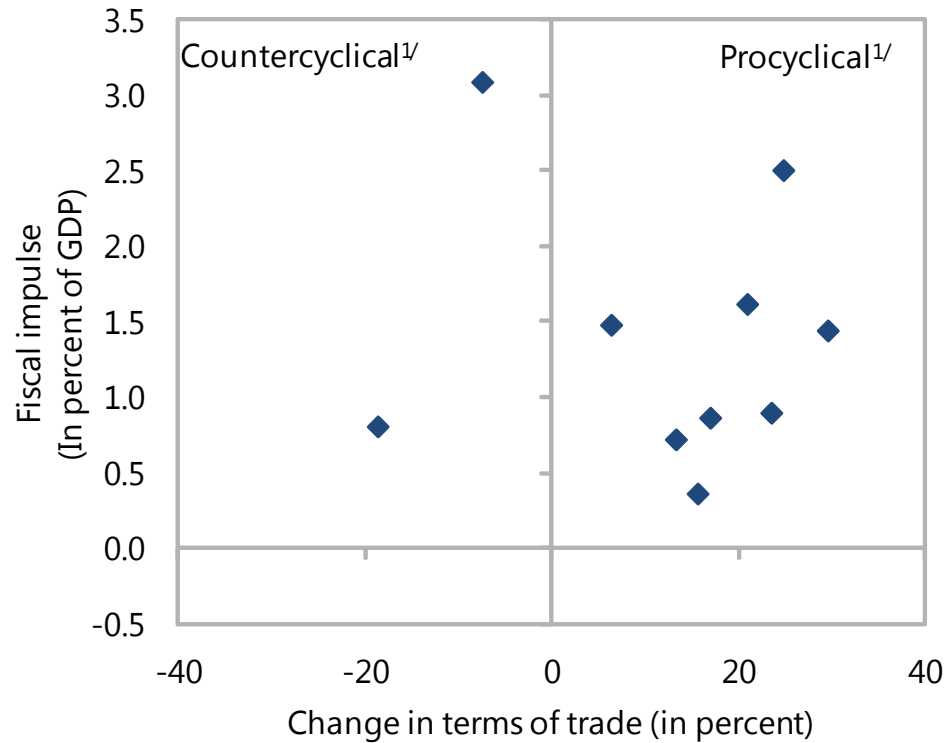
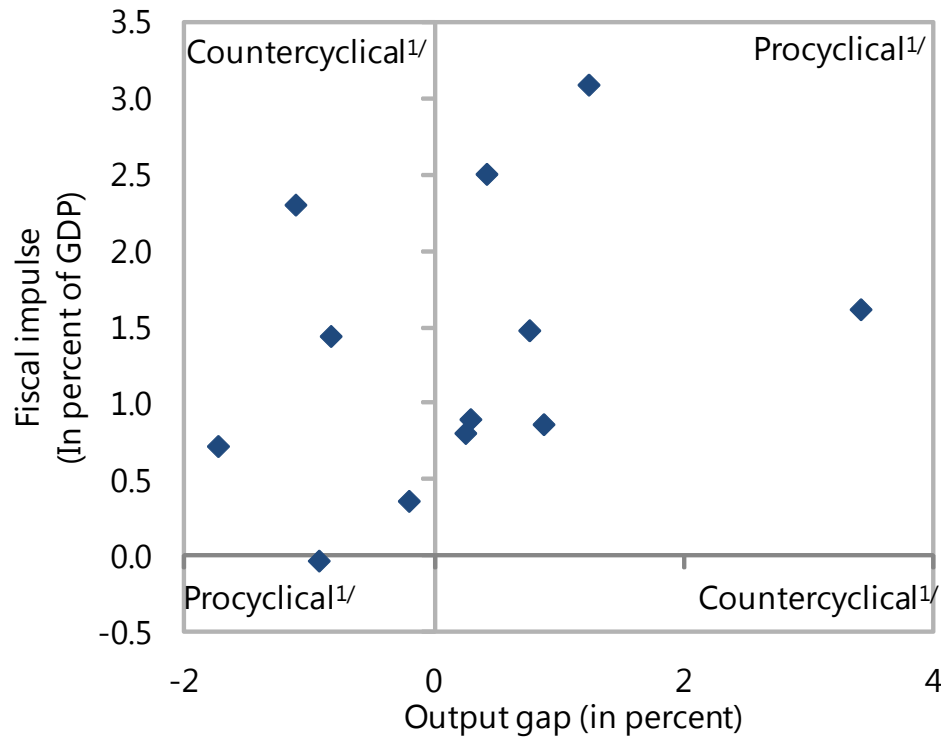


1/ Excluding grants.

Sources: IMF, WEO; and IMF staff estimates.

... to avoid procyclical fiscal policy

Asia and Pacific Small States: Procyclical Bias in Fiscal Policy, 2005-12



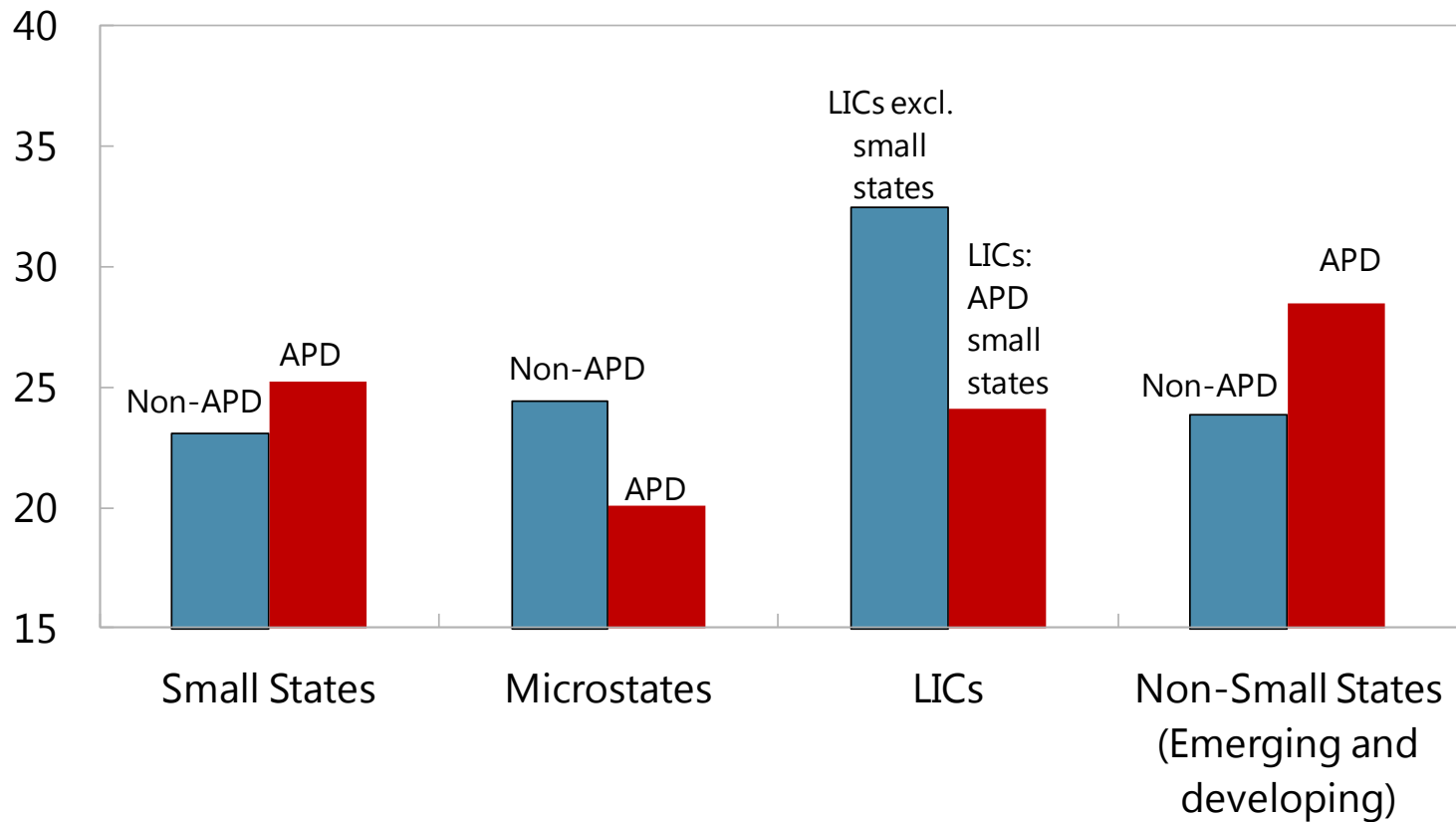
Source: IMF staff calculations, based on IMF, WEO.

^{1/} Indicates quadrants.

Improving the public spending mix is also essential...

Capital Government Expenditure, 2010-13

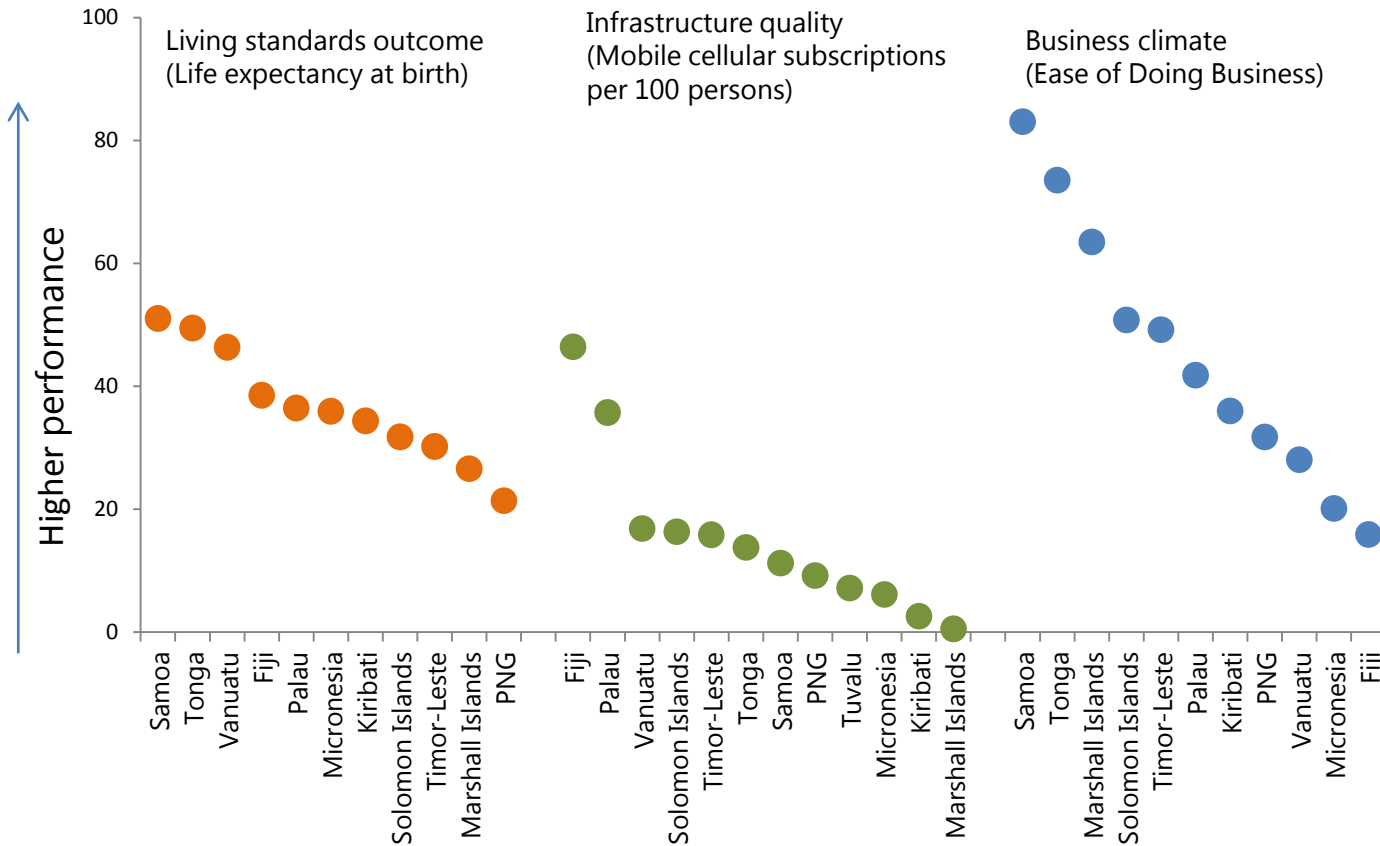
(In percent of government expenditure)



Sources: IMF, WEO; IMF; and IMF staff estimates.

...to address supply bottlenecks...

Pacific Island Countries: Structural Indicators¹ (Percentile ranks)



Priorities are country-specific, but generally include:

- Addressing the infrastructure bottleneck
- Increasing living standards
- Improving the business climate

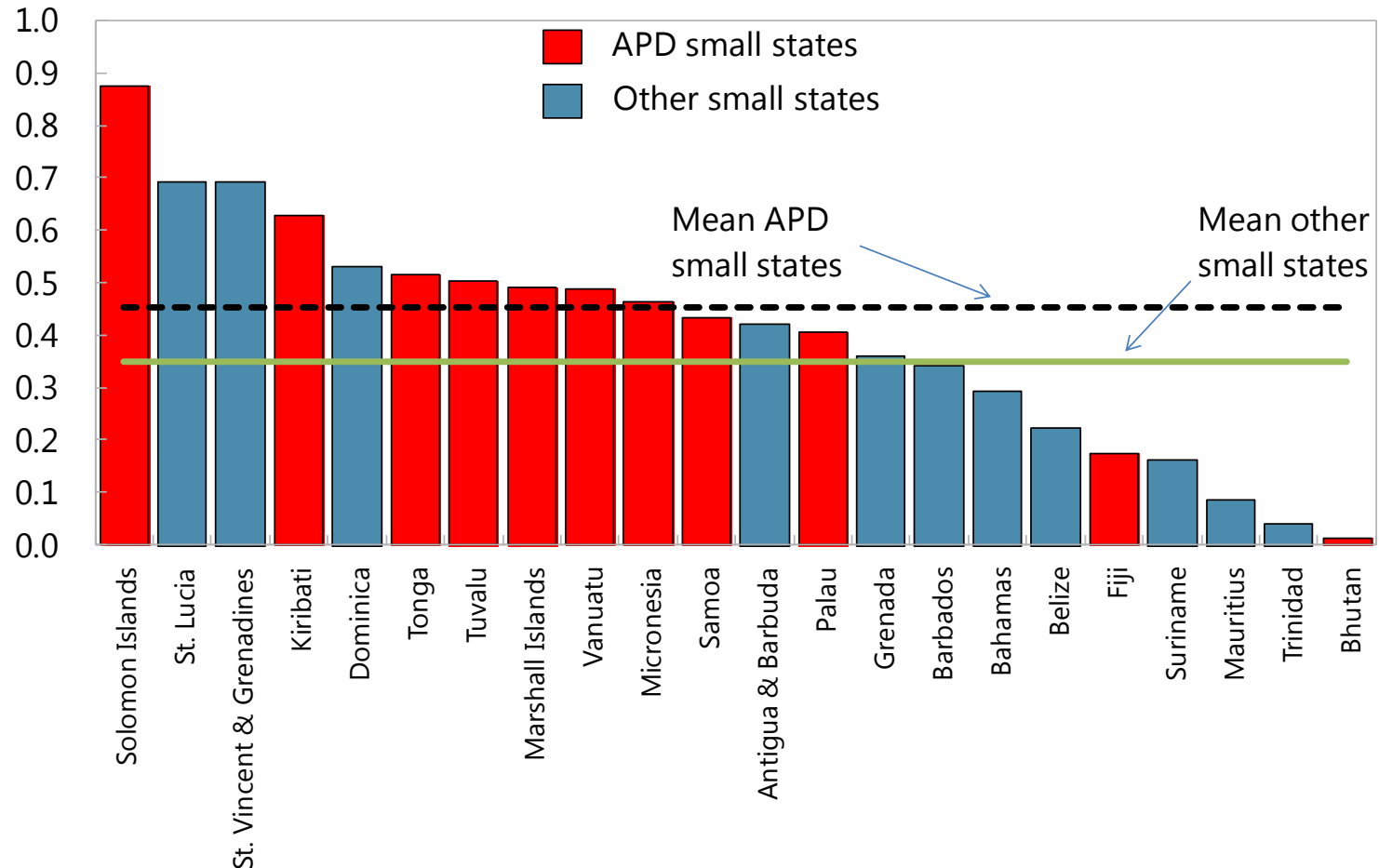
Sources: World Bank and IMF staff calculations.

¹ The scale reflects the percentile distribution in all countries for each respective dataset/survey and is based on the latest available data.

...and lower energy costs

Industry Electricity Tariffs

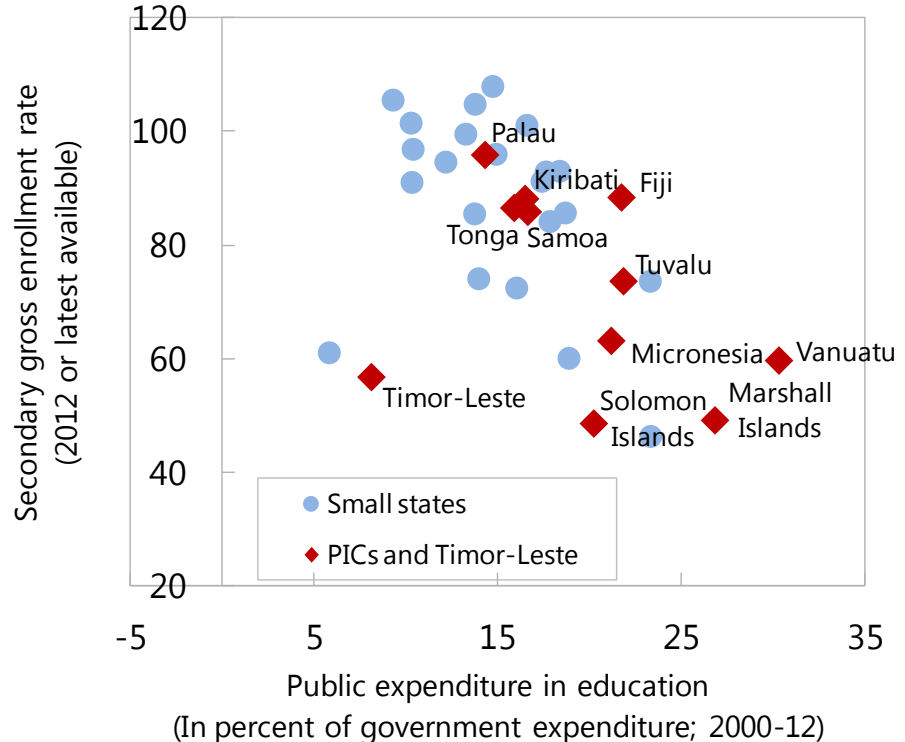
(In U.S. dollars per kWh; 2011-2013)



Sources: Country authorities; and IMF staff estimates.

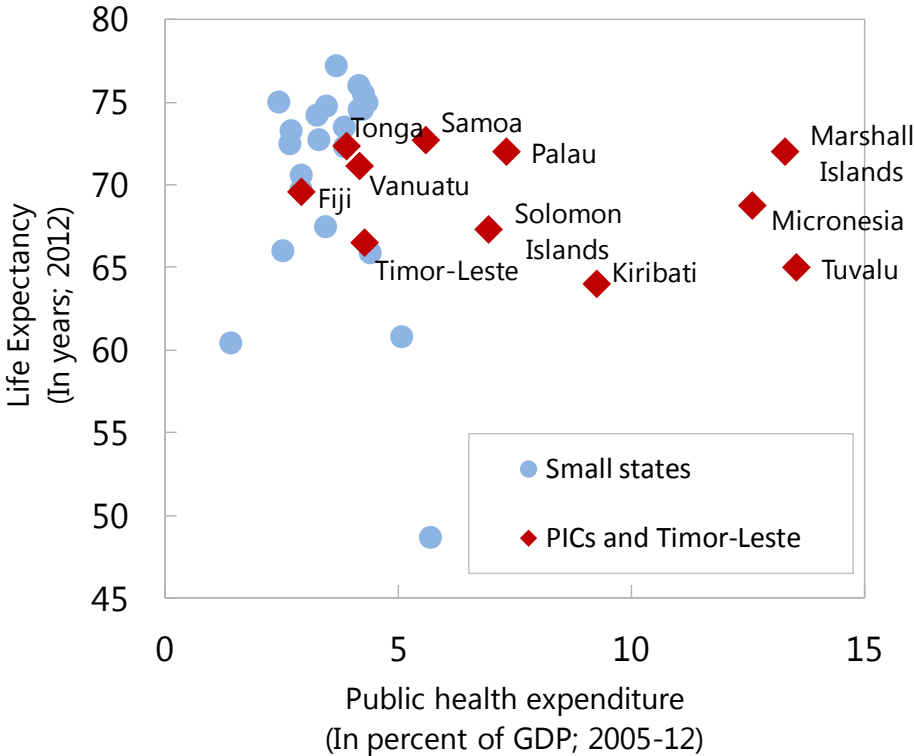
More efficient spending through PFM reforms is required to improve living standards

Public Expenditure in Education and Secondary Enrollment



Sources: World Bank, WDI; Country authorities; IMF, WEO; and IMF staff estimates.

Life Expectancy and Public Health Expenditure



Source: World Bank, WDI.

Policy Actions

- Continue rebuilding policy space for rainy days
- Enhance fiscal frameworks
 - use fiscal anchor to manage revenue volatility
 - strengthen medium-term orientation of fiscal policy
- Improve spending mix to close infrastructure gap
- Implement PFM to improve quality of spending

Thank You