Small Pacific countries

Seven of the 11 small Pacific economies grew in 2010, albeit slightly, and GDP was estimated to be flat in three. GDP fell in one (Tonga), in contrast to 2009 when the global recession contributed to contraction in seven economies.

The pickup in global travel in 2010 helped some countries. Government infrastructure projects, mostly donor financed, also supported economic activity, notably in the Cook Islands, the Marshall Islands, and the Federated States of Micronesia. Export receipts remained weak, however (except for Solomon Islands). Inflation decelerated from 2009 levels for most economies.

The economic outlook is more positive for 2011 on the back of continued global recovery. This will contribute to increased tourism earnings, export receipts, and remittances. Several economies will benefit from greater spending on public infrastructure. Growth is forecast to pick up in eight countries this year and, and for about half of them, edge still higher in 2012.

Inflation is projected to increase in all 11 countries this year, primarily owing to higher global food and fuel prices for these import-dependent economies, before price pressures ease for most of them in 2012.

Cook Islands

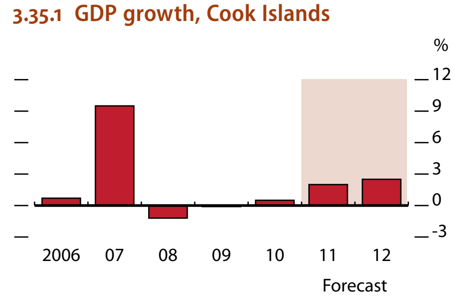
After 2 years of contraction, this economy grew by 0.5% in FY2010 (ended 30 June 2010), supported by expansion of tourism and fisheries, as well as the start of construction on some donor-financed infrastructure projects.

Visitor arrivals and expenditure rose by 2.7% and 2.6%, respectively. Exports of fish (54% of total exports) increased by 15.9%. These performances offset a 10.1% decline in pearl exports caused by a shortage of skilled pearl-seeding technicians.

Growth is projected to pick up to 2.0% in FY2011 (Figure 3.35.1), as infrastructure projects, including development of Avatiu port, gain momentum. However, tourism is subdued because of softness in consumer spending in New Zealand, the main source of visitors. Growth prospects are more positive for FY2012, on the expectation that tourism will pick up and infrastructure investment will increase. GDP growth is forecast to rise to 2.5% that year.

Inflation moderated to 3.5% in FY2010, but will likely quicken to average 4.0% in FY2011. Higher prices for imported oil and commodities, coupled with increased construction activity, have pushed up prices for food, housing-related costs (including electricity), and transport.

3.35.1 GDP growth, Cook Islands



Sources: Ministry of Finance and Economic Management. *Budget Estimates 2010/11: Part 1 Appropriation Bill Appropriations and Commentary*. http://www.mfem.gov.ck; ADB estimates.

Click here for figure data

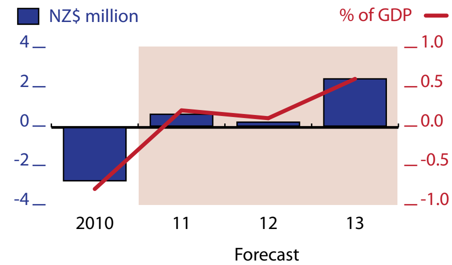
This chapter was written by Stephen Pollard and Elbe Aguba of the Pacific Department, ADB, Manila; Emma Ferguson and Laisiasa Tora of the Pacific Subregional Office, ADB, Suva; Milovan Lucich of the Pacific Liaison and Coordination Office, ADB, Sydney; and Rommel Rabanal, consultant.

Merchandise exports fell by 21% in FY2010, largely owing to the problems with pearl production, while imports rose by 42%. The trade deficit widened, and is expected to worsen as import growth, driven mainly by materials for projects that donors are financing, outpaces exports.

Government revenue exceeded budget estimates by 4.3% in FY2010, a result of better than expected receipts from company tax and one-time revenue from fines for illegal fishing. Expenditure was 9.6% over budget, partly on account of supplementary appropriations to cover cyclone recovery expenses and subsidies for Air New Zealand flights from Rarotonga to Sydney and Los Angeles. Still, the budget deficit of NZ$2.7 million (0.8% of GDP) narrowed sharply from 11.7% in FY2009.

The FY2011 budget projects an operating surplus of 0.2% of GDP (Figure 3.35.2), but this was framed against an earlier backdrop of a more positive tourism outlook. Consequently, revenue collections will need to be revised down. The government is aiming to trim expenditure by 1.5% relative to FY2010. Public debt is projected to fall by NZ$30 million to NZ$114.8 million in FY2011 (equivalent to 34% of GDP), mainly due to movements in exchange rates.

3.35.2 Fiscal balance, Cook Islands



Source: Ministry of Finance and Economic Management. 2010. *The Cook Islands Half Year Economic and Fiscal Update for the Financial Year 2010/2011*. December. http://www.mfem.gov.ck

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Kiribati

This economy, too, performed better in 2010, following 2 years of contraction (Figure 3.35.3). Estimated GDP growth of 0.5% was attributable mainly to additional spending by the public sector and to some pickup in private sector activity, especially in construction and retailing. This performance offset a fall in remittances and copra production.

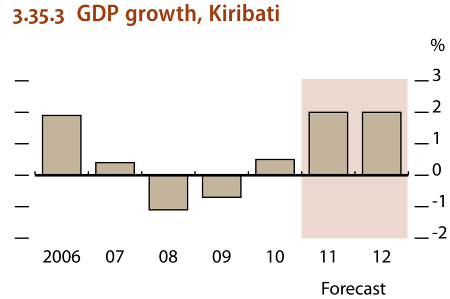
Remittances from the country's seafarers, which account for about 7% of GDP, fell by an estimated 13% in 2010 because of weakening demand for the country's seafarers and greater supply of such workers from other nations. Production of copra declined owing to bad weather.

Wage increases for the public service and higher subsidies for copra production were major factors in widening the budget deficit to an estimated 15% of GDP in 2010. The 2011 budget projects a further rise in public service wages, and in infrastructure investment, pushing the deficit out to 19% of GDP. The gap is to be financed from the country's wealth fund and short-term loans.

The value of the wealth fund—the main source of deficit financing—declined from A$637 million (420% of GDP) in 2007 to A$571 million (350% of GDP) in 2009, primarily due to losses on investments, as well as drawdowns that averaged around 19% of GDP annually from 2007 to 2010. Although the fund's investments recovered marginally last year, concerns remain about its sustainability. The International Monetary Fund recommends that the budget deficit be limited to 6.0% of GDP to preserve long-term financial sustainability.

Fiscal risks are likely to worsen if the government undertakes substantial external borrowing to fund capital works, and if drawdowns from the wealth fund remain high. The government has adopted a medium-term fiscal framework that should help to maintain fiscal discipline.

3.35.3 GDP growth, Kiribati



Sources: International Monetary Fund. *Kiribati: 2009 Article IV Consultation—Staff Report*; ADB estimates.

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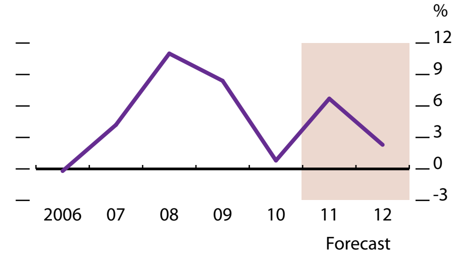
Economic growth is likely to pick up to about 2% in 2011 and 2012 as large, mostly donor-funded, capital works get under way. These include revamping the international airports in Tarawa and Kiritimati, upgrading the South Tarawa Road, and extending Betio port.

Inflation slowed to average 0.8% in 2010 (Figure 3.35.4), reflecting appreciation of the Australian dollar and the lagged pass-through from international to domestic prices. This year, though, inflation is expected to accelerate to 6.7%, driven by higher prices for imported fuel and food.

The current account deficit is set to widen from about 14% of GDP in 2010 to about 23% in 2012, in part a result of lower investment income from the wealth fund as drawdowns become smaller.

3.35.4 Inflation, Kiribati



Sources: International Monetary Fund. *Kiribati: 2009 Article IV Consultation—Staff Report*; ADB estimates.

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Marshall Islands

Supported by grant-financed increases in government spending and expansion in fish processing, the economy grew by an estimated 0.5% in FY2010 (ended 30 September 2010). This represented a turnaround after 2 years of declining GDP (Figure 3.35.5). Higher global prices of copra and coconut oil—the country's major agricultural exports—contributed to some increase in export receipts.

The fiscal balance improved, posting a surplus of about 0.3% of GDP in FY2010 (compared with a deficit the previous year), owing to improved tax collection and an increase in fishing fee income. Inflation quickened to 1.0% on higher prices for fuel, electricity, and transport.

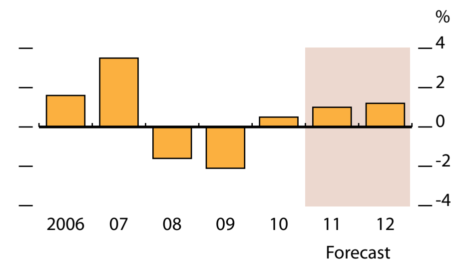
In preparation for when grants under the Compact of Free Association with the United States (US) expire, scheduled for 2024, the government is implementing tax reforms this year that aim to improve the fiscal position, including by raising revenue. It has taken some measures to trim expenditure, but needs to make more cuts for long-term fiscal sustainability. Such reductions could include allowances for civil servants and public officials and assistance to state enterprises.

Economic growth is expected to pick up marginally to 1.0% in FY2011 and 1.2% in FY2012. The outlook is supported by additional grants from Taipei,China and the European Union, which will partly offset the impact of a 5.5% cut in government spending this year. Fisheries, a key source of income, could benefit from planned subregional collaboration on managing fish-stocks.

Inflation is forecast to accelerate to about 5.0% in FY2011 on rising food and oil prices, coupled with some renewed demand-side pressures as the economy grows, before moderating to 3.8% in FY2012 as global commodity price pressures subside (Figure 3.35.6).

Risks to the outlook center on rising prices for commodities, a possible further downsizing of the US military base on Kwajalein, and the pace of phasing down compact-related grants from the US.

3.35.5 GDP growth, Marshall Islands



Sources: Republic of the Marshall Islands Fiscal Year 2009 Economic Review; ADB estimates.

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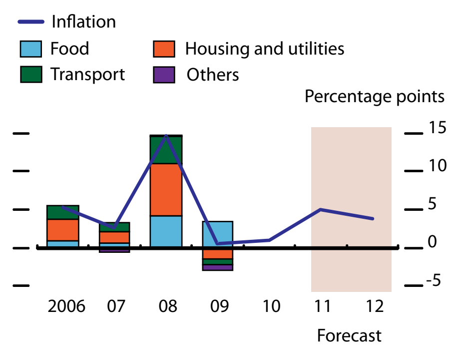
3.35.6 Contributions to inflation, Marshall Islands



Sources: Republic of the Marshall Islands Fiscal Year 2009 Economic Review; ADB estimates.

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Federated States of Micronesia

Growth of an estimated 0.5% in FY2010 (ended 30 September 2010) followed a similar increase in GDP in FY2009 (revised from a previously estimated slight contraction).

The modest expansion was driven by public infrastructure projects,

including extension of Pohnpei airport and the expansion of the fiber-optic communications network. The reopening of a fish-processing plant in Kosrai and an increase in small-scale agriculture stimulated by rising commodity prices helped the economy, as did some uplift in remittances and tourism receipts.

Inflation subsided to about 3.5% in FY2010, owing to lower prices for imported food and energy in the early part of the year.

Reflecting a general weakness in consumption spending, food imports from the US, the main trading partner, fell by 6.7% in value in FY2010.

The government trimmed expenditure by 3.6% in FY2010, cutting capital spending by almost 20% while raising current spending by 2.1% (for the public wage bill and subsidies). Tax revenue growth of 7.9% helped to generate a small fiscal surplus.

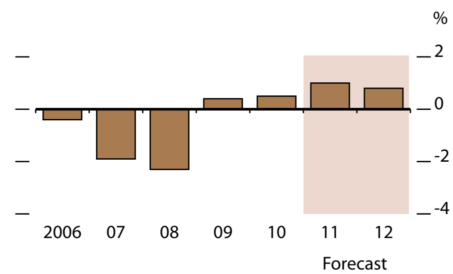
The fiscal situation has improved markedly since FY2009, in part because of efforts by state governments to raise revenue collection and cut spending. Nevertheless, much further progress is needed before FY2023, when grants expire under the Compact of Free Association with the US.

GDP growth is expected to pick up to 1.0% in FY2011 (Figure 3.35.7), based on a pipeline of infrastructure projects and the release of infrastructure funds delayed in previous years. With the Pohnpei airport extension scheduled for completion in mid-2011, improved direct flight connections could expand opportunities for tourism and exports. GDP growth is forecast at 0.8% in FY2012.

Inflation will likely inch up to 4.0% in FY2011 owing to higher global commodity prices, before easing to 3.0% in FY2012.

Sluggish development of the private sector, which is hindered by inadequate infrastructure, lack of skilled labor, and investment restrictions, remains an impediment to growth.

3.35.7 GDP growth, Federated States of Micronesia



Sources: Federated States of Micronesia Fiscal Year 2009 Economic Review; ADB estimates.

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Nauru

GDP was likely flat in FY2010 (ended 30 June 2010) (Figure 3.35.8) because storm damage to the port and weak demand restricted exports of phosphate.

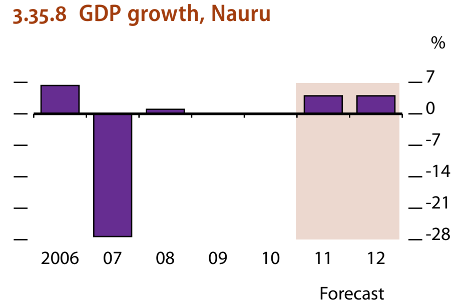
Repairs to the port, funded by the Russian Federation, with modest recovery in world phosphate demand, are expected to support a return to economic growth in FY2011 and FY2012. GDP growth of about 4% is forecast for each year.

Consumer prices declined by an estimated 0.5% in FY2010. The cost of telecommunications fell as a result of the entry of a new mobile telephone and Internet service provider. In FY2011 and FY2012, however, higher global food and fuel prices are expected to induce inflation of 2.5%.

The FY2010 budget outturn was a net cash position of A$7.7 million, with the surplus achieved after own-funded expenditure of A$20.2 million and donor-funded expenditure of A$11.2 million. This fiscal year's budget maintains the prudent fiscal management adopted since 2004. Spending in FY2011 is budgeted at A$29.0 million (excluding donor-funded projects), down by 9% from FY2010. Donor-funded expenditure is expected to total A$31.0 million. Without donor support, per capita GDP (estimated at US$2,240 in 2009) would fall by more than half.

Nauru faces an enormous debt burden as a result of poor

3.35.8 GDP growth, Nauru



Sources: Asian Development Bank. 2007. *Country Economic Report*. August; ADB estimates.

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decisions by previous governments. Total government external debt in 2010 was estimated at A$261 million. In addition, A$265 million is owed domestically by the government, mainly to depositors at the insolvent Bank of Nauru, and state-owned enterprise debts total about A$368 million. Total external debt is more than eight times GDP.

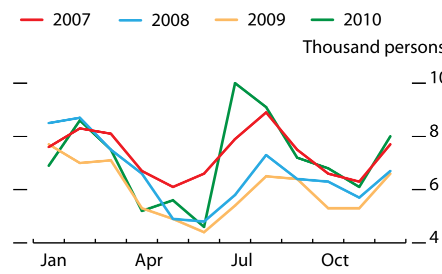
Over the medium term, the economy will remain heavily dependent on donors. Longer-term prospects depend on government reforms both to improve public financial management and the performance of state-owned enterprises, and to revitalize mining and quarrying, which now include coral aggregate used in construction (as well as phosphate). Tourism and fisheries offer untapped opportunities for greater economic self-sufficiency.

Palau

An upturn in tourism compensated for cuts in public expenditure to drive growth estimated at about 2.0% in FY2010 (ended 30 September 2010). This was the first year of growth after 4 consecutive years of contraction.

Tourism, which accounts for around half GDP, had seen visitor arrivals drop by a cumulative 16.5% over the previous 2 years. In FY2010, arrivals picked up by 11.7% as a result of the global economic recovery, new airline and charter connections to Palau, and intensified advertising and promotion. Growth was particularly strong in arrivals from Taipei,China. Arrivals from Japan, the largest source of visitors, rose sharply during the northern summer months. Total monthly arrivals recovered to 2007's levels by the second half of 2010 (Figure 3.35.9).

3.35.9 Visitor arrivals, Palau



Source: Palau Visitors Authority. http://www.visit-palau.com (accessed 16 March 2011).

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Domestic demand appears to have picked up a little last fiscal year. Consumption spending, as measured by the value of monthly food imports from the US, was just above the previous year's level. However, public investment on infrastructure projects remained low.

Inflation slowed to an estimated 3.8% on average from 5.2% in FY2009, due primarily to lagged effects of lower international prices of fuel and other commodities early in the year. Transport and household costs declined in the first quarter before climbing steadily.

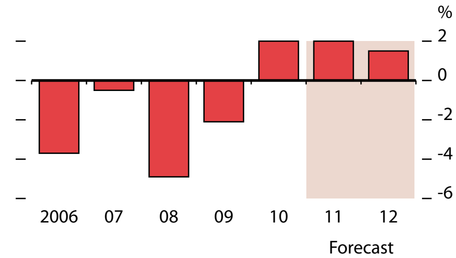
The original budget for FY2010 intended to reduce public expenditure by about 10%, as a start toward bringing outlays down to more sustainable levels. In a reversal of a recent trend of overoptimistic revenue projections, which had led to drawdowns in cash reserves and accumulation of public debt, the revenue shortfall was budgeted to narrow in FY2010.

However, a supplementary budget passed later in the year partly reversed the spending cuts and restored current expenditure to about the FY2009 level. Given the scheduled ending in FY2024 of grants from the US under the Compact of Free Association, it will be important to gradually reduce current expenditure to more sustainable levels, particularly the wages bill for the public service and purchases of goods and services. Otherwise, more severe spending cuts will be needed later. These reductions should be put through in parallel with increases in government revenue. Raising utility charges to eventually reflect the cost of service delivery would help.

Economic prospects remain largely dependent on the outlook for tourism. Visitor arrivals are projected to increase by around 7% in FY2011 (the first-quarter performance was strong), followed by another 5% gain in FY2012. Such expansion in tourism would help take GDP growth to 2% in FY2011 and 1.5% in FY2012 (Figure 3.35.10).

Inflation is projected at about 4.0% in FY2011, lifted by higher global food and fuel prices, easing to 2.5% in FY2012 as commodity price increases moderate.

3.35.10 GDP growth, Palau



Sources: International Monetary Fund. 2010. *Country Report* No. 10/116. May; ADB estimates.

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Samoa

Declines in agriculture, tourism receipts, and remittances offset growth in construction, manufacturing, and transport and communications in FY2010 (ended 30 June 2010), leaving GDP flat.

Even though visitor arrivals rose by 3.5% to 131,300, earnings from tourism fell by 6.0% to $130 million owing to a decrease in tourist spending per head. Remittances fell by 5.3% to $148.8 million.

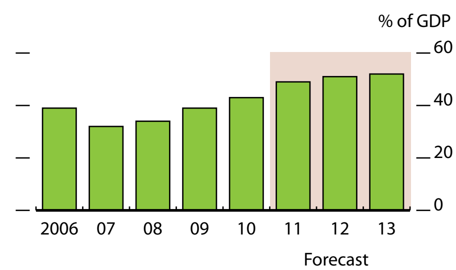
Merchandise exports increased by 18.8% to $12.2 million in FY2010, led by strong performances from nonu fruit and coconut oil. Merchandise imports picked up by 14.1% to $261.6 million, reflecting higher costs of petroleum and food. A wider trade deficit, coupled with reduced remittances, saw the current account deficit worsen to 8.1% of GDP.

However, the overall balance of payments was in surplus due to net disbursement of government loans for tsunami reconstruction (a tsunami hit coastal areas in September 2009). Foreign exchange reserves of $165.7 million at June 2010 were equivalent to 7.6 months of import cover.

Inflation slowed to average 1.2% in FY2010. The deceleration was a result of falling commodity prices and subdued domestic economic activity.

Fiscal policy was exceptionally expansionary in FY2010, with a budget deficit equivalent to 8.1% of GDP. Spending was boosted by measures to counter the impact of the global recession on the domestic economy, coupled with post-tsunami reconstruction. These steps were largely funded by grants and concessional borrowing. External debt levels went up to about 43% of GDP by end-FY2010 (Figure 3.35.11), exceeding the government's 40% target.

3.35.11 Total debt, Samoa



Source: Ministry of Finance. 2010. *Fiscal Strategy Statement Budget 2010/11*. 28 May.

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The FY2011 budget continues high levels of expenditure, reflecting the reconstruction effort and increases in public sector wages and pensions. The fiscal deficit is projected to widen to 9.3% of GDP.

The rise in government spending, and in private consumption to a lesser degree, are expected to produce a return to economic growth in FY2011, forecast at 2.1%. A stronger tourism marketing effort is likely to have some positive impact in FY2011, and private remittances should benefit from economic growth in Australia. For the first 7 months of FY2011, earnings from tourism and remittances rose by 4.0% and 1.1%, respectively.

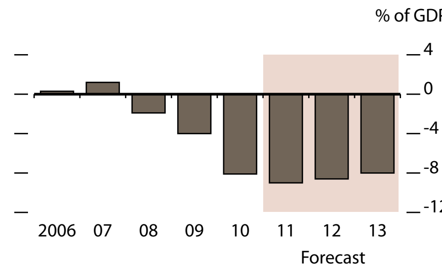
Growth is seen rising to 3.0% in FY2012 on continued post-tsunami reconstruction and an expected increase in tourism.

Inflation is projected to increase to around 3.0% this year as domestic economic activity picks up and as a result of higher global food and fuel prices.

The government intends to run fiscal deficits of over 8% of GDP through FY2013 (Figure 3.35.12). Although the deficits are to be financed through concessional borrowing and grants, sustaining such a stance holds risks—the government would find it hard to adjust to any external shocks, for example.

Structural reforms to improve the commercial focus of state-owned enterprises and to increase access to, and economic use of, customary land are needed for the potential benefits of public investment to be realized.

3.35.12 Budget balance, Samoa



Source: Ministry of Finance. 2010. *Fiscal Strategy Statement Budget 2010/11*. May.

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Solomon Islands

This economy recovered in 2010, growing by an estimated 4.0% after contracting by 1.2% in 2009 (Figure 3.35.13). Logging led the upturn. After a poor year in 2009, log export volumes rose by about 30% in 2010, a result of recovering demand in Asia that also helped to lift international log prices. Production of palm oil and cocoa, as well as the size of the fish catch, also increased, although copra production declined.

The services sector was sluggish in the first half of 2010, but business conditions improved in the second half according to a business expectations survey. Building activity indicators suggested expansion in construction as well.

GDP growth is forecast to accelerate to 7.5% in 2011, when the Gold Ridge mine in Guadalcanal is due to start producing and exporting gold. Logging is expected to decline during the forecast period, owing to falls in logging resources, but stronger global demand for other commodity exports, such as palm oil and copra, will bolster growth. Other positive factors include an expected rise in foreign investment in mining, including a new copper mine, and in telecommunications. Growth of about 4.0% is projected for 2012.

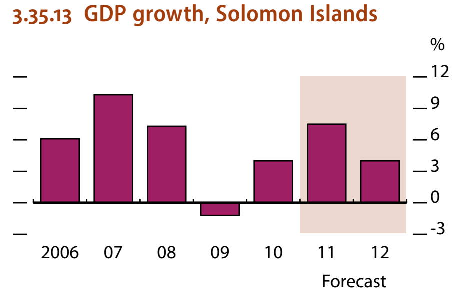
Inflation eased to average about 3.0% in 2010, largely due to a 40% fall in the price of rice caused by greater competition in food imports (rice constitutes around 18% of the consumer price index). Looking ahead, though, inflation is expected to accelerate to 4.2% this year and 6.3% in 2012, as a result of higher global prices for fuel and commodities and stronger domestic demand as the economy grows.

At an estimated 20% of GDP, the current account deficit remained wide in 2010, reflecting high levels of imports of mining and telecommunications equipment. The start of gold exports this year, coupled with growth in agricultural exports, is seen pulling back the deficit to 15% of GDP.

Despite the trade and current account deficits, foreign reserves rose to the equivalent of about 9 months of import cover, a consequence of large inflows of donor funds and the first tranche of a US$18.3 million stand-by credit facility approved by the International Monetary Fund in June 2010. Half this credit was disbursed in 2010 and the rest is scheduled for 2011. Foreign reserves are expected to remain strong in 2011, at about 6 months of import cover.

A tight fiscal situation for much of 2010 led to restrictions on expenditure until the fourth quarter and a government recruitment freeze. Budget support from donors, including large sums in the

3.35.13 GDP growth, Solomon Islands



Sources: Central Bank of Solomon Islands. *Quarterly Review September 2010*. http://www.cbsi.com.sb; ADB estimates.

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second half of the year, together with a better than expected revenue performance, resulted in a budget surplus.

After elections in August 2010, the incoming government was unable to draft a full budget before year-end, and instead passed a supplementary appropriations bill that enabled spending to continue in the first 3 months of 2011, at no higher than in the same period of 2010.

Tonga

Weakness in remittance and tourism contributed to a 1.2% contraction in GDP in FY2010 (ended 30 June 2010). Remittances fell by 10.0% and earnings from tourism fell by 13.3% owing to slow recovery in source countries, particularly New Zealand and the US. GDP has contracted in 3 of the past 4 years (Figure 3.35.14).

Private sector credit fell by around 13% in December 2010, in part reflecting consolidation in the banking sector and the write-off of bad debts.

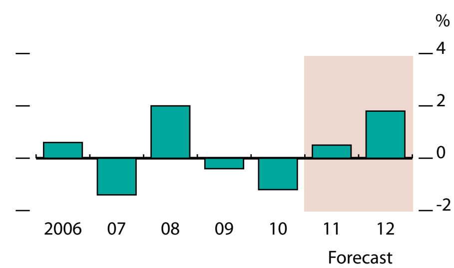
The government trimmed its nonwage operating costs and own-funded capital spending in FY2010, in response to a 4.0% decline in revenue (it fell short of the target by more than 20%). Budget support from donors limited the deficit to about 1.0% of GDP; without that support the gap would have been 2.3%.

In the external accounts, increased receipts from exports of sea cucumber more than made up for declines in fish and agricultural products in FY2010, so that total exports grew by 2.2%. Imports fell sharply, by 21.0%, reflecting weak domestic demand. The current account deficit narrowed to $16.6 million from $24.8 in FY2009. Official foreign reserves amounted to $98 million at end-December 2010, equivalent to 7.9 months of imports (Figure 3.35.15).

Donor-funded infrastructure activities are expected to support a return to economic growth of about 0.5% in FY2011. Government spending is budgeted to rise by 14.9%, based on commitments from donors, and will contribute to aggregate demand through higher public sector wages. Revenue, excluding grants, is to remain weak.

Inflation eased to 2.0% last year, mainly the result of better supplies and a related fall in prices for domestically produced food, as well as lower school fees. It is forecast to rise to about 3.0% in FY2011 on upward pressure from world oil prices and higher prices for imports from New Zealand, in part a result of exchange rate movements.

3.35.14 GDP growth, Tonga



Note: Fiscal year ending June.

Sources: Ministry of Finance. *Budget Statement: Review of the Tongan Economy and Outlook*. Various years. http://www.finance.gov.to; ADB estimates.

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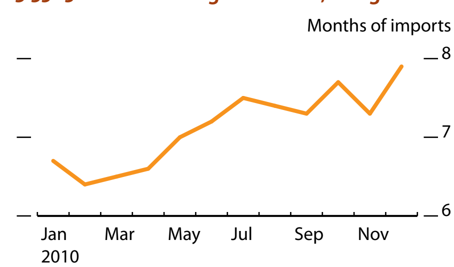
3.35.15 Official foreign reserves, Tonga



Source: National Reserve Bank of Tonga. *Official Foreign Reserves December 2010*. http://www.reservebank.to

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Tuvalu

This economy continued to feel the impact of the global recession in 2010. Even with higher government spending, GDP was estimated to be unchanged from 2009.

Seafarer employment—a significant income source for households—was weak and is likely to remain so due to subdued demand for Tuvaluan seafarers. Income from the ".tv" domain name and fisheries licenses fell as the Australian dollar (which Tuvalu uses) gained parity with the US dollar. The Australian dollar's strength also had an impact on

consumer prices: they eased from mid-2009, with the average decline in 2010 estimated at 1.9%.

The government continued to support the economy through spending. It approved three supplementary appropriation bills, together accounting for about 10% of GDP, in 2010. These were used to pay for the government's guarantee of an Air Fiji loan (Tuvalu is the biggest shareholder in the airline) and to increase capital spending by 15.7% from the original estimate.

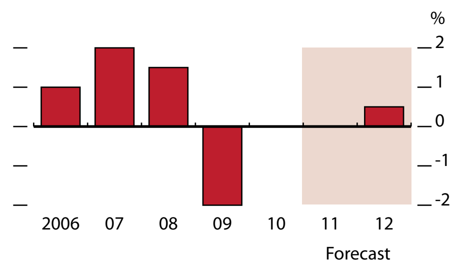
The fiscal deficit is estimated to have widened sharply to almost 30% of GDP in 2010, owing to lackluster domestic revenue and increased expenditure. Revenue is estimated to have declined by 17%, in part due to weak offshore income from all sources. Public debt (including guarantees) is about 44% of GDP, which is high for this small economy.

The value of the Tuvalu Trust Fund likely stabilized in 2010, after falling during the global recession. However, no distributions from this fund to the budget were made or are expected while international financial markets are volatile.

The economy is projected to stay flat in 2011 (Figure 3.35.16) as fiscal adjustments, mainly spending cuts, are made to ensure longer-term fiscal sustainability. Growth is expected to resume at about 0.5% in 2012 when donor-financed public works employing local workers are scheduled to start. Rising global food and fuel prices are likely to rekindle inflation, forecast at 1.5% in 2011 and 2.0% in 2012.

The number of households living in poverty has increased to about 20%, based on a 2010 household survey, from 14% in 2004. Declining remittances is the major cause. One way to ensure that funds are available to meet basic health and education needs for the poor would be selective cuts to other spending, such as medical insurance and scholarship programs, that benefit only a narrow section of the population.

3.35.16 GDP growth, Tuvalu



Sources: Central Statistics Division, Government of Tuvalu; ADB estimates.

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Vanuatu

Growth slowed to an estimated 3.0% in 2010 from an average of 5.7% in the previous 7 years. Agricultural production and construction increased, but tourism and retailing were soft.

The prolonged period of growth (8 years in a row) is attributable to increases in private investment, underpinned by policy reforms that included the opening of the aviation and telecommunications markets.

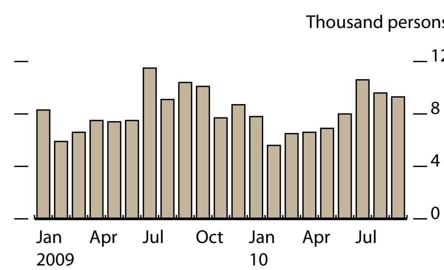
Last year, tourist arrivals declined by an estimated 2.6%, from record numbers in 2009 (Figure 3.35.17). The decline was largely due to a recovery in tourism to Fiji, which had lost market share to Vanuatu in 2009 (because of flooding and political uncertainty in Fiji).

Construction benefited from projects funded by the US Millennium Challenge Corporation as well as from some work on tourist facilities. Buoyed by higher prices for copra, coconut oil, and beef, agriculture recovered from a poor performance in 2009.

Inflation eased to average 3.4% last year. In the external accounts, the current account deficit likely widened to 2.4%, a result of lower tourism receipts.

The Reserve Bank of Vanuatu began to withdraw stimulus measures that it had implemented during the global financial crisis. It lifted

3.35.17 Visitor arrivals, Vanuatu



Source: Vanuatu National Statistics Office. *Tourism and Migration July 2010.* http://www.spc.int/prism/country/VU/stats

Click here for figure data

the statutory reserve requirement for banks to 6% from 5% in August (still below the 8%–10% range of 1999–2008) and foreshadowed further monetary tightening as global economic conditions improve.

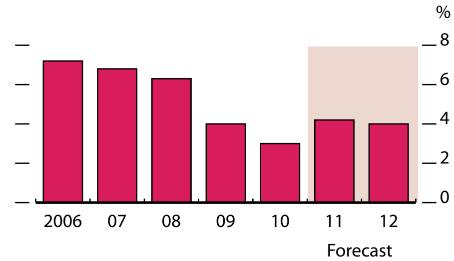
A near balanced budget was anticipated for 2010. Fiscal policy will likely remain broadly neutral in 2011, as the government is required under law to target budget surpluses.

GDP growth this year is forecast to rise to 4.2% (Figure 3.35.18), based on an expected increase in tourist arrivals—particularly from Australia—driven by robust economic conditions, a strong Australian dollar, and increased flights from that country. Agriculture is expected to pick up owing to high commodity prices. GDP growth of around 4.0% is expected in 2012, on continued gains in tourism and agriculture.

Higher food and fuel prices are forecast to raise inflation to 5.0% in 2011, before it eases to 4.0% in 2012. The current account deficit is expected to widen in 2011 and 2012 to 3.8% and 4.7% of GDP, respectively, as the pickup in domestic demand lifts imports.

Inadequate transport infrastructure and services hinder development of rural areas and outer islands, where income-generating opportunities are scarce. These areas need improved ports, wharves, and jetties, as well as more reliable and affordable shipping services. The country's road network is also inadequate: out of about 1,800 kilometers of roads, less than 100 kilometers is paved and about 400 kilometers is gravel surfaced.

3.35.18 GDP growth, Vanuatu



Sources: Reserve Bank of Vanuatu. 2010. *Quarterly Economic Review*. September. http://www.rbv.gov.vu; ADB estimates.

Click here for figure data