South Pacific economies

Public investments and tourism earnings continue to drive economies in the South Pacific. Increased visitor arrivals and public spending led economic expansion in the Cook Islands and Vanuatu, while growth decelerated in Samoa and Tonga as major infrastructure projects were completed. Growth in the South Pacific is expected to slow in the near term as construction on public investment projects continues to wind down.

Economic performance

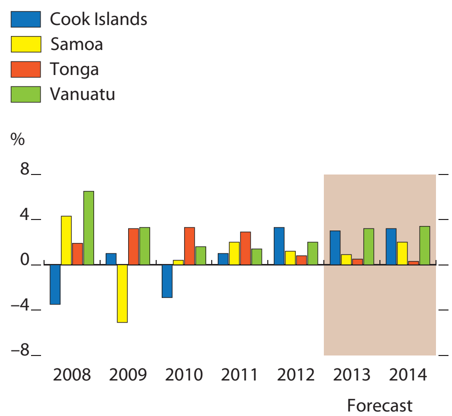
South Pacific economies expanded in FY2012 (ended 30 June 2012 in the Cook Islands, Samoa, and Tonga, and coincided with the calendar year in Vanuatu). The rate of growth varied across countries (Figure 3.37.1). Growth in the Cook Islands accelerated to 3.3% in FY2012, from 1.0% in the previous fiscal year, driven by public spending on infrastructure projects and the continued strong performance of the tourism sector. Tourist arrivals in the Cook Islands have increased by an average of 8.0% over the past 2 years (Figure 3.37.2). Higher tourist arrivals were also a main reason why Vanuatu's economy expanded by 2.0% in FY2012, accelerating slightly from 1.4% in FY2011 (Figure 3.37.3).

Infrastructure spending funded by development partners has been the main determinant of fluctuations in economic growth in Samoa and Tonga. The Samoan economy expanded by 1.2% in FY2012, compared with 2.0% the previous fiscal year, as reconstruction and rehabilitation following the 2009 earthquake and tsunami were completed. FY2012 was the second consecutive year of modest expansion in private remittances, but, when adjusted for inflation, remittances have been nearly flat (Figure 3.37.4). Tourism in Samoa showed signs of recovery from natural disasters in 2009, but the sector was hit by Cyclone Evan in December 2012. The cyclone caused damage estimated at $210 million, equivalent to 30% of GDP.

Despite a slight improvement in tourism performance, Tonga saw growth decelerate to 0.8% in FY2012 from 2.9% in FY2011 as major projects wound down. Remittances continued to fall, totaling $67 million in FY2012, which was equal to 15.0% of GDP. This number is down from a high of $107 million, or 30.0% of GDP, in FY2008 (Figure 3.37.5).

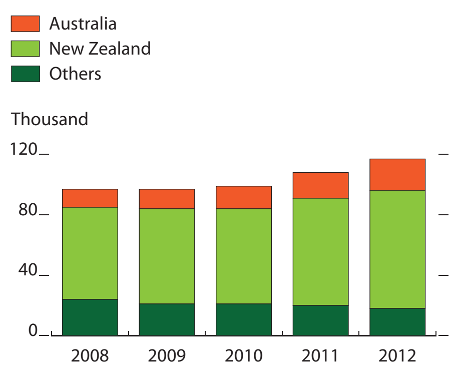
Inflation in Tonga slowed to 4.6% in FY2012 from 6.1% in FY2011 as infrastructure projects wound down and weak domestic activity relieved pressure on domestic prices (Figure 3.37.6). These factors offset increases in international food and fuel prices recorded in calendar year 2011, which made accelerated inflation the rule elsewhere in the South Pacific.

3.37.1 GDP growth



Sources: Cook Islands Statistics Office; Samoa Bureau of Statistics; Tonga Department of Statistics; and Vanuatu National Statistics Office.
Click here for figure data

3.37.2 Visitor arrivals to the Cook Islands



Source: Cook Islands Statistics Office.
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In the Cook Islands, higher transport and utility costs worsened inflation to 2.8% during the period from 0.6%. Higher food prices in early 2012 drove up inflation in Samoa to 6.2% from 2.9% in FY2011, and in Vanuatu to 1.3% from 0.8%. However, lower international price rises for food and fuel in the latter part of calendar year 2012 caused consumer prices to trend lower in the Cook Islands, Vanuatu, and Samoa, the last of which experienced deflation.

Public expenditures over FY2012 caused fiscal deficits across the South Pacific, though fiscal consolidation has narrowed budget gaps in some economies. In the Cook Islands, infrastructure spending resulted in a fiscal deficit, but at 2.2% of GDP it was well within the 3.0% government target. As of September 2012, Vanuatu had incurred a deficit of 1.7% of GDP, compared with a 2.3% deficit for the whole of 2011. Election-related spending in Vanuatu and the introduction of subsidies to copra farmers fueled expenditure growth in the face of flat tax revenue collections and declining grants.

Fiscal consolidation has helped improve the fiscal positions of Samoa and Tonga. Although Samoa's FY2012 deficit of 4.5% of GDP exceeded government targets, it was an improvement over the 5.3% deficit incurred in FY2011. During the same period, Tonga's budget deficit narrowed to 2.9% of GDP from 7.4% a year earlier, mainly reflecting lower personnel costs and capital expenditure.

Monetary policy across the South Pacific has remained accommodative. Despite excess liquidity in the banking sector, the central banks of Samoa, Tonga, and Vanuatu have kept interest rates stable and low in a bid to stimulate credit growth. In addition, the National Reserve Bank of Tonga stopped requiring banks to pay interest on their exchange settlement accounts to encourage lending to the private sector. The Cook Islands has no central bank and uses the New Zealand dollar as its official currency.

Most South Pacific economies have continued to run current account deficits. Tonga's current account deficit widened to 17.9% of GDP in FY2012 from 11.1% in FY2011, as imports of goods and services grew more quickly than exports. Samoa's current account deficit also widened, to 10.8% in FY2012 from 9.2% in the previous fiscal year. In contrast, Vanuatu's current account deficit narrowed slightly to 6.0% of GDP in 2012 from 6.3% in 2011.

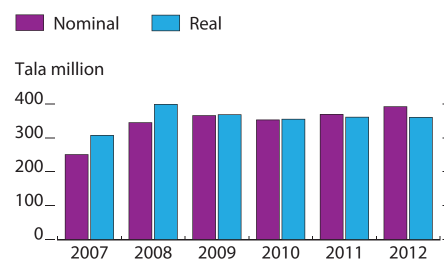
Economic prospects

Public investments and tourism will continue to drive growth in the South Pacific in FY2013 and FY2014. However, except in Vanuatu, growth will be slower than in recent years. Growth in the Cook Islands is projected to slow to 3.0% in FY2013 as infrastructure construction winds down and public spending declines, and as agricultural output slumps. Growth is expected to accelerate to 3.2% in FY2014 on the back of expected improving economic conditions in Australia and New Zealand. Future growth may be constrained if tourism service providers do not expand facilities. In Tonga, growth is projected at 0.5% in FY2013 and 0.3% in FY2014. The expected slowdown reflects the completion of public investment projects, weak business activity, and slow recovery in remittances and private sector credit.

3.37.3 Visitor arrivals to Vanuatu

Sources: Vanuatu National Statistics Office; ADB estimates.
Click here for figure data

3.37.4 Private remittances to Samoa



Source: Central Bank of Samoa.
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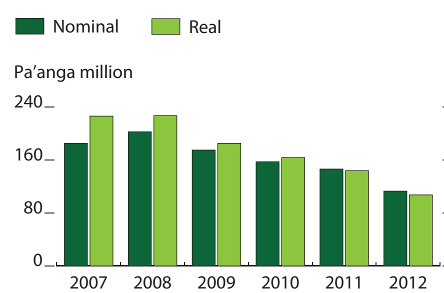
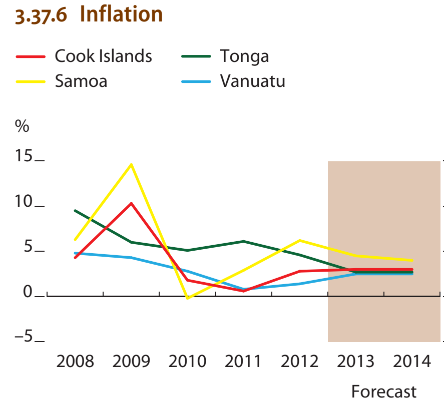
3.37.5 Private remittances to Tonga



Sources: National Reserve Bank of Tonga; Tonga Ministry of Finance and National Planning.
Click here for figure data

3.37.6 Inflation



Sources: Cook Islands Statistics Office; Samoa Bureau of Statistics; Tonga Department of Statistics; and Reserve Bank of Vanuatu.
Click here for figure data

The Samoan economy is projected to grow by only 0.9% in FY2013 as infrastructure damage caused by Cyclone Evan depresses output from agriculture, tourism, and other productive sectors. Economic recovery efforts, once fully in place, are expected to have a positive impact on GDP in FY2014, with projected growth picking up to 2%. Restoring productive capacity and reconstructing essential infrastructure are expected to take 2–3 years.

In Vanuatu, growth is expected to pick up to 3.2% in 2013 and 3.4% in 2014, as delayed construction projects commence implementation and agricultural production likely recovers. Visitor arrivals are expected to increase modestly as tourists avoid destinations affected by Cyclone Evan and travel to Vanuatu instead.

The Cook Islands' fiscal deficit is expected to edge up to 2.3% of GDP in FY2013—still within government targets—as increases in personnel and capital expenditures are largely offset by higher tax collections and grant inflows. Samoa's fiscal deficit is forecast to increase substantially, to 11.8% of GDP, as the fallout from the cyclone severely depresses tax revenue collections and causes a spike in expenditures to restore essential infrastructure. Tonga's FY2013 budget plans a small surplus of 0.2% of GDP, in spite of a projected current expenditure increase. This is because the bulk of the increases will be covered by scheduled large project grants. Vanuatu has yet to pass its 2013 budget because the new government has not submitted an appropriation bill. However, a deficit of 2.6% of GDP is expected for the year as expenditure growth is seen to continue to outpace revenue growth, which is constrained by the country's narrow tax base.

International food and fuel prices are projected to decline over the next couple of years. In line with this, inflation in the Cook Islands is expected to remain relatively low at 3.0% through FY2013–FY2014. Tonga's inflation is seen to moderate to 2.7% in FY2013 and stabilize at that rate through FY2014 in light of the economy's low growth outlook and international price movements.

Despite experiencing deflation in the first half of FY2013, Samoa is expected to see inflation remain relatively high, at 4.5% for the full fiscal year, as cyclone-related supply disruptions push up domestic food prices. Inflation is expected to slow to 4.0% in FY2014 in line with declining international food and fuel prices, and as the domestic distribution network is restored.

In Vanuatu, prices are expected to rise by 2.5% in both 2013 and 2014 as the implementation of major construction projects and economic acceleration exert upward pressure on prices.

Central banks in the South Pacific are expected to retain their accommodative monetary policies to support economic activity. Inflation and international reserves are forecast to remain at acceptable levels, but sluggish private sector investment remains a concern.

South Pacific economies are expected to continue running current account deficits in FY2013. Imports of materials for post-cyclone reconstruction are seen widening Samoa's deficit to 13.4% of GDP, while stronger imports arising from growing domestic demand and construction projects funded by development partners will expand Vanuatu's current account deficit to 10.0% of GDP. In contrast, the current account deficit in Tonga is expected to narrow to 6.3% in FY2013. Weaker

3.37.1 Selected economic indicators (%)

Cook Islands	2013	2014
GDP growth	3.0	3.2
Inflation	3.0	3.0
Current account balance (share of GDP)	...	...
Samoa		
GDP growth	0.9	2.0
Inflation	4.5	4.0
Current account balance (share of GDP)	–13.4	–15.5
Tonga		
GDP growth	0.5	0.3
Inflation	2.7	2.7
Current account balance (share of GDP)	–6.3	–6.3
Vanuatu		
GDP growth	3.2	3.4
Inflation	2.5	2.5
Current account balance (share of GDP)	–10.0	–10.0

... = data not available.
Source: ADB estimates.

domestic demand arising from the completion of infrastructure projects and the slow growth outlook will depress imports.

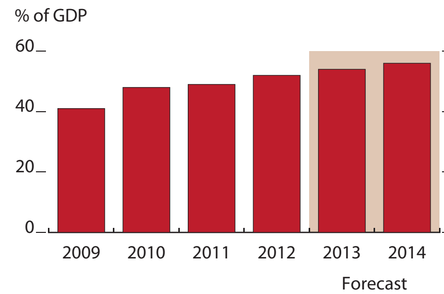
Policy challenge—the burden of debt

Borrowing to finance development spending has worsened debt positions in the South Pacific. The resulting financial obligation could limit governments' fiscal flexibility and resulting ability to respond to future economic shocks. Exchange rate fluctuations could affect countries' capacity to repay debt involving large loans denominated in foreign currency.

Samoa's government has borrowed heavily to repair damage wrought by natural disasters. As a result, the economy's external debt reached 45.0% of GDP in FY2012 (Figure 3.37.7). This ratio was projected to increase to 54.0% in FY2013, but it may turn out to be higher because of the impact of Cyclone Evan on agricultural and tourism output, and thereby on domestic revenues, which may prompt higher actual borrowing to finance rehabilitation. For its part, Tonga has borrowed to finance reconstruction following civil unrest that took place in 2006. Its total public debt was estimated at 45.0% of GDP in FY2012, above the 40% maximum recommended by the International Monetary Fund for most low-income countries (Figure 3.37.8).

Most South Pacific countries plan fiscal consolidation toward reducing expenditure, improving fiscal balances, and easing public debt burdens. However, countries at high risk of debt distress must appropriately pace their fiscal consolidation to avoid disrupting governments' delivery of basic services or inducing economic contraction. Consolidation efforts must be complemented by structural reform to further ease fiscal pressures and help promote private sector-led economic growth. For economies receiving budget support, maintaining the implementation of these measures is central to the joint policy reform matrix agreed with development partners.

3.37.7 External debt of Samoa



Source: Samoa Ministry of Finance. 2012. Fiscal strategy statement: Budget 2012/2013. May.

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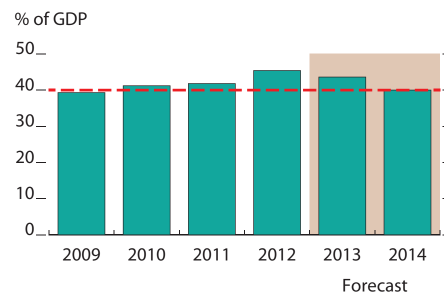
3.37.8 Public debt of Tonga



Note: The line denotes the International Monetary Fund's recommended maximum for public debt.

Source: International Monetary Fund. 2012. Tonga, *Country Report* No. 12/166. July.

Click here for figure data