South Pacific economies

Tourism and public infrastructure spending funded by development partners still sustain the economies of South Pacific. The winding down of public investments slowed growth in the Cook Islands and Tonga, while construction and increased tourism contributed to expansion in Vanuatu. Samoa's economy contracted following natural disasters. Growth is expected to pick up in the near term as infrastructure spending rises in most South Pacific economies.

Economic performance

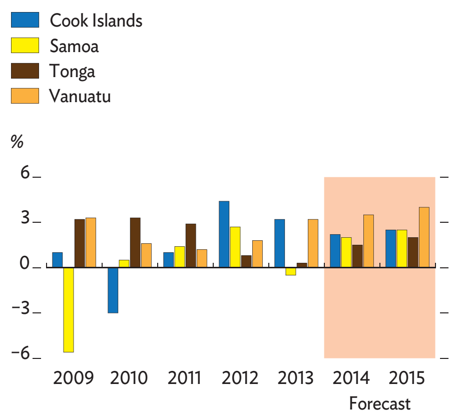
Growth in GDP generally weakened in the South Pacific in FY2013 (ended 30 June 2013 in the Cook Islands, Samoa, and Tonga, and 31 December 2013 in Vanuatu) (Figure 3.37.1). In the Cook Islands, GDP growth decelerated to 3.2% from 4.4% in FY2012 because capital investments funded by development partners fell by 24.8%. Tourism boosted the economy as arrivals increased by 3.5%, though well below the 8.7% recorded in FY2012 (Figure 3.37.2). Samoa's economy contracted by 0.5% in FY2013 following devastation caused by Tropical Cyclone Evan in December 2012. The cyclone damaged public infrastructure in the capital and the southern part of the island of Upolu. It badly affected tourism and agriculture, driving Samoa's tourist arrivals and receipts down by 6.0% in FY2013 and agriculture output down by an estimated 3.0%. Growth in Tonga slowed to 0.3% from 0.8% in FY2012 with the withdrawal of the stimulus arising from construction financed by development partners, and continuing declines in private commercial lending.

Only Vanuatu maintained its upward growth path in 2013, as GDP growth accelerated to 3.2% from 1.8% in 2012. Tourist arrivals rose by 2.1% overall as air arrivals recovered from declines in 2012 and cruise ship visitors increased. Agricultural production recovered slightly after declining in 2012.

Inflation slowed in the South Pacific in FY2013, cooled by declines in international food and fuel prices and by weaker economic activity in most subregional economies (Figure 3.37.3). Inflation in the Cook Islands averaged 1.9%, down from 3.0% in FY2012 despite an increase of 10.8% in the cost of tobacco and alcohol and of 7.2% for household services.

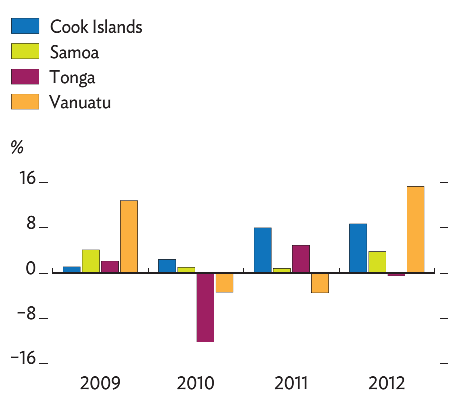
Despite disruption from the cyclone, prices in Samoa contracted by 0.2%, a reversal of 6.2% inflation recorded in FY2012. Widespread replanting and recovery of supply networks in the wake of the cyclone, together with the continued declines in international food and fuel prices, helped subdue domestic prices.

3.37.1 GDP growth in the South Pacific



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

3.37.2 Growth in tourist arrivals to the South Pacific



Sources: Cook Islands Statistics Office; Central Bank of Samoa; National Reserve Bank of Tonga; Vanuatu National Statistics Office.
Click here for figure data

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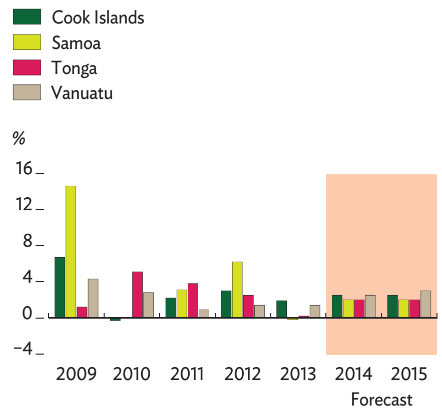
In Tonga, inflation dropped to 0.2% from 2.5% in FY2012. Apart from international price movements, the appreciation of the pa'anga against the currencies of Tonga's main trading partners helped reduce the cost of imports and slow inflation. In Vanuatu, inflation averaged 1.4% in 2013, unchanged from a year earlier, as higher domestic demand related to increased economic activity offset lower international food and fuel prices.

Governments in the South Pacific have implemented fiscal reforms in recent years, but most continue to run budget deficits. The Cook Islands recorded a fiscal deficit of 2.0% of GDP, roughly the same as in FY2012. Unexpectedly high tourism revenues and below-budget expenditures to underwrite Air New Zealand routes helped keep the shortfall below the 2.3% target. Samoa's fiscal deficit is estimated at 4.4% of GDP, only slightly improved from the 5.0% deficit in FY2012 as post-cyclone reconstruction and rehabilitation spending stalled fiscal reforms. The deficit was financed largely by soft loans and grants from traditional development partners. Tonga recorded a budget deficit of 4.9% of GDP. Although this improved on the 6.9% deficit in FY2012, it underperformed relative to the 0.1% surplus targeted in the budget, largely because external grants disappointed expectations and a supplementary budget funded land purchases for airport development. Reductions in current expenditures only partly offset the additional spending. Vanuatu, on the other hand, improved its monitoring of value-added tax receipts and reaped unexpectedly high revenues, which increased by 10% year on year in January–September 2013. Vanuatu recorded a small fiscal surplus equivalent to 0.3% of GDP during this period and estimates its fiscal position to be close to balance in 2013 as a whole.

Monetary policy generally remained expansionary across the South Pacific. Central banks in Samoa and Tonga kept interest rates low to unlock tight credit, spur private borrowing, and promote economic activity. The National Reserve Bank of Tonga's loose monetary policy was enabled by its plentiful foreign reserves, equivalent to 8–9 months of import cover. The growth of credit to the private sector nevertheless continued to slow, though recent signs suggest this is bottoming out. Personal loans other than for housing grew steadily in the second quarter of FY2013, driven by aggressive lending from MBf Bank, a Malaysian-owned commercial bank, and withdrawals from the National Retirement Benefits Fund to pay school fees. In March, the Reserve Bank of Vanuatu cut, for the first time since 2008, its main policy interest rate (the rediscount rate) from 6.0% to 5.5%. Unlike Samoa, Tonga, and Vanuatu, the Cook Islands has no central bank, as it uses the New Zealand dollar.

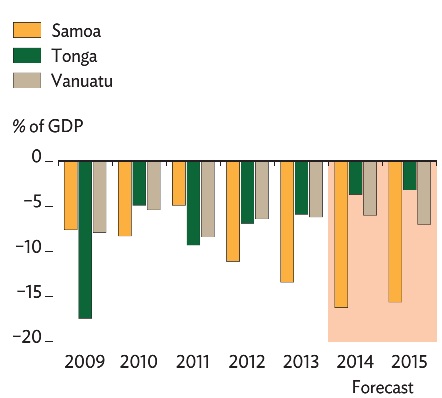
South Pacific economies continued to run current account deficits driven by large imbalances in merchandise trade (Figure 3.37.4). Samoa's current account deficit widened to 13.4% of GDP from 11.1% in FY2012, mainly on a 5.2% increase in the merchandise trade deficit coupled with reduced inflows of services income. In Vanuatu, the current account deficit is estimated at 6.2% of GDP, slightly improved from 6.4% in 2012. The gap was more than covered by foreign direct investment and development partner inflows. Tonga's current account

3.37.3 Inflation



Sources: Cook Islands Statistics Office; Central Bank of Samoa; National Reserve Bank of Tonga; Tonga Department of Statistics; Vanuatu National Statistics Office; ADB estimates.
Click here for figure data

3.37.4 Current account balance



Sources: National Reserve Bank of Tonga; Reserve Bank of Vanuatu; International Monetary Fund; ADB estimates.
Click here for figure data

deficit was estimated to have narrowed slightly to 5.9% of GDP from 6.9% in FY2012, as remittances increased by 3.3%. The Cook Islands does not report balance of payments estimates.

Economic prospects

Tourism and public infrastructure spending are seen to continue driving growth in the South Pacific in FY2014 and FY2015.

In the Cook Islands, growth in FY2014 is forecast to slow to 2.2% as business activity traces the fall in capital expenditures and continued weakening in tourist arrivals. Growth is expected to recover to 2.5% in FY2015, assuming tourist arrivals revert to long-term trends and capital projects resume.

The Samoan economy is expected to expand by 2.0% in FY2014 as post-cyclone reconstruction and rehabilitation continues, and tourism bounces back following the reopening of a key resort in Apia and the opening of two new resorts in late 2013. Driven by higher domestic demand and increased fish exports, agriculture is emerging as a significant contributor to growth in FY2014. Growth is seen accelerating further to 2.5% in FY2015.

Tonga is expected to rebound in FY2014, and growth of 1.5% is forecast as the development partner-financed airport runway upgrade proceeds in earnest. Response to the damage caused by Tropical Cyclone Ian, which hit Tonga's Ha'apai islands in January 2014, is expected to trigger additional economic activity through development partner-financed reconstruction and increased remittances in response to lost livelihoods. Stimulus from rehabilitation is expected to carry over into FY2015 and boost growth to 2.0%.

Growth in Vanuatu is expected to pick up to 3.5% in 2014, driven mostly by increased construction spending. A modest increase in tourist numbers is expected from the strengthening Australian and New Zealand economies. These trends are expected to continue and the economy to expand by 4.0% in 2015.

Inflation in the Cook Islands is projected to remain low at 2.5% in FY2014 and FY2015 as major imports are sourced from New Zealand and fuel prices stay stable. Samoa will likely shift out of price contraction and record inflation at 2.0% in FY2014 and FY2015, reflecting higher prices for local agricultural produce. Inflation in Tonga is seen to accelerate to 2.0% in FY2014 and FY2015, and in Vanuatu to 2.5% in 2014 and 3.0% in FY2015, driven in both economies by construction projects and continuing economic recovery.

Monetary policy in the South Pacific will likely remain accommodative to promote domestic economic activity amid expectations that inflation will remain within central bank targets. Although lending to businesses continues to contract in Tonga, lending to households grew steadily in the first half of FY2014. Commercial lending in Samoa continued to contract over the same period as declines in loans to public institutions offset marginal rises in lending to households and private business. This credit crunch will remain a concern as commercial interest rates have started to move upwards. The Reserve Bank of Vanuatu expects to retain its loose monetary

3.37.1 Selected economic indicators (%)

Cook Islands	2014	2015
GDP growth	2.2	2.5
Inflation	2.5	2.5
Current account balance (share of GDP)	...	...
Samoa		
GDP growth	2.0	2.5
Inflation	2.0	2.0
Current account balance (share of GDP)	−16.2	−15.6
Tonga		
GDP growth	1.5	2.0
Inflation	2.0	2.0
Current account balance (share of GDP)	−3.7	−3.2
Vanuatu		
GDP growth	3.5	4.0
Inflation	2.5	3.0
Current account balance (share of GDP)	−6.0	−7.0

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

stance in the near term but should monitor bank activity to mitigate credit risks amid expectations of higher growth.

Samoa's current account deficit is projected to widen to 16.2% of GDP in FY2014 because of imports for reconstruction, before falling to 15.6% in FY2015. Tonga's external position will likely continue to improve as its current account deficit narrows to 3.7% of GDP in FY2014 and 3.2% in FY2015 on the back of modestly higher growth and improving remittances. Vanuatu's current account deficit is expected to dip to 6.0% of GDP in FY2014, then increase slightly to 7.0% in FY2015 as imports to a recovering domestic economy rise and ongoing construction is funded through continued foreign direct investment and development partner inflows.

Policy challenge—creating the right policy environment for private sector development

Tourism and development partner-funded public infrastructure spending strongly influence growth in the South Pacific, the impact of their fluctuations in recent years highlighting that domestic private sector contributions are limited. This makes promoting entrepreneurship and private investment, and generating employment through greater private business activity, integral to achieving sustainable economic growth and poverty alleviation in the South Pacific. The challenges posed by the remoteness and small size of national markets can be mitigated by reform to the laws and policies that shape the business environment. Making public infrastructure more efficient and reducing the cost of doing business can also contribute to an enabling environment for private business development.

Governments in the South Pacific have implemented a number of legal reforms to promote private sector development, aided by technical assistance from development partners. Vanuatu's Companies Act, 2012 and Companies Insolvency and Receivership Act, 2013—passed to promote local business activity and facilitate administrative processing with the government—are prime examples of the type of reform that is needed. The new laws allow the establishment of companies with a single shareholder or director, as well as community-based companies, and provide for an electronic business registry to reduce the cost of opening, running, and closing a business. Samoa has launched such a registry to promote private business in both urban and remote areas. The Cook Islands and Tonga are pursuing similar business law reform.

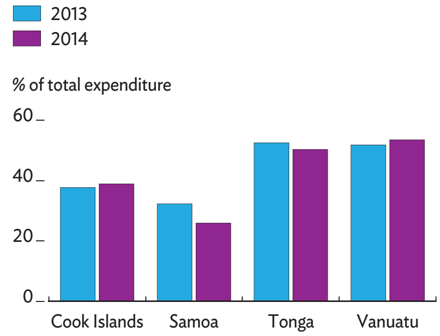
Samoa took steps to simplify private businesses' access to secured financing by passing its Personal Property Securities Act, 2013. Tonga and Vanuatu have also implemented reforms addressing secured transactions. Mindful of the complexities of landownership in the Pacific, these measures facilitate the use of vehicles, farm equipment, and other moveable assets as collateral.

Only limited data are currently available on the impact of these new reforms. However, experience indicates that business law reform dramatically decreases processing time and fees, thereby increasing the number of companies formed and secured loans issued.

Other constraints on private sector investment and development are being addressed. Reform to public financial management and state-owned enterprises can lighten the fiscal burden of public service wages that crowd out other government expenditure (Figure 3.37.5), while improving public service quality and transparency. By creating new fiscal space, such reform can increase the government resources available for purchases of goods and services from the private sector. It can remove the need to increase revenue collection through tax or utility charges, leaving more disposable income. Further, reform to state-owned enterprises can level the playing field and generate new business opportunities for the private sector.

Private sector development reforms have been incorporated in joint policy action matrices agreed by South Pacific governments and their development partners. However, much work remains to ensure actual progress. Apart from continuing with prudent public expenditure management to keep public wages reasonable, further efforts are needed to improve the governance and rationalization of state-owned enterprises—or their privatization.

3.37.5 Subsidies and public sector wages



Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Ministry of Finance; Tonga Ministry of Finance and National Planning; Vanuatu Ministry of Finance and Economic Management.

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