CENTRAL PACIFIC ECONOMIES

Three years into the pandemic, Central Pacific economies have started on the road to recovery. Growth is gradually accelerating in Kiribati but moderated last year in Nauru and Tuvalu. A surge in global commodity prices since the Russian invasion of Ukraine translated into higher inflation across the Central Pacific. While all three economies are expected to grow with mostly moderate inflation over the forecast horizon, the external environment will significantly influence both indicators.

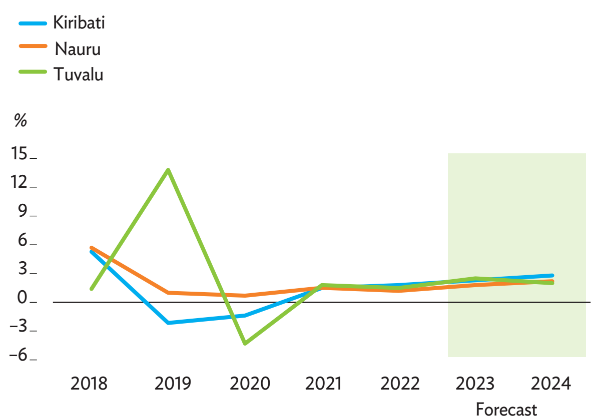
Kiribati

Economic growth was sustained in 2022 by the resumption of infrastructure projects and higher social protection spending. Despite a severe drought, the economy grew by 1.8% in 2022 (Figure 2.37.1). This reflected in part higher government spending on its copra subsidy, unemployment benefits, and other social protection schemes. In addition, Kiribati's reopening of its international borders in August 2022 permitted the resumption of infrastructure projects.

Growth is forecast to accelerate in 2023 and 2024 as recovery gains traction. The roll out of energy, water, and transport projects in 2023 and sustained social protection spending are expected to accelerate growth to 2.3% in 2023 and 2.8% in 2024 (Table 2.37.1). With help from development partners, the government has programmed 2023 outlays for infrastructure projects and social protection equal to 39.6% of 2022 GDP. The easing of travel restrictions for international visitors and the free movement of goods are likewise expected to support growth prospects in Kiribati. The main downside risks to the forecast are any future outbreak of COVID-19 becoming unmanageable and ever-present natural hazards such as drought and tropical cyclones, which could jeopardize infrastructure projects dependent on imported equipment and materials.

Figure 2.37.1 GDP Growth

The resumption of infrastructure projects supported growth in 2022, and border reopening will likely sustain growth to the forecast horizon.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year in Nauru and coinciding with the calendar year in Kiribati and Tuvalu.

Sources: Kiribati, Nauru, and Tuvalu budget documents; International Monetary Fund Article IV reports; Asian Development Bank estimates.

Kiribati's fiscal position improved in 2022 and is expected to return to surplus. The fiscal deficit narrowed to the equivalent of 3.3% of GDP in 2022 from 12.8% in 2021. After 2 consecutive years of decline under the pandemic, fishing license revenue bounced back in 2022 by 18.1% (Figure 2.37.2).

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Table 2.37.1 Selected Economic Indicators, %

Despite mixed growth outcomes in 2022, growth is expected to accelerate in 2023 across the Central Pacific.

	2021	2022	2023	2024
Kiribati				
GDP growth	1.5	1.8	2.3	2.8
Inflation	1.0	5.0	3.7	3.0
Nauru				
GDP growth	1.5	1.2	1.8	2.2
Inflation	1.2	2.3	2.5	1.9
Tuvalu				
GDP growth	1.8	1.5	2.5	2.0
Inflation	6.7	7.6	3.3	2.8

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year in Nauru and coinciding with the calendar year in Kiribati and Tuvalu.

Source: Asian Development Bank estimates.

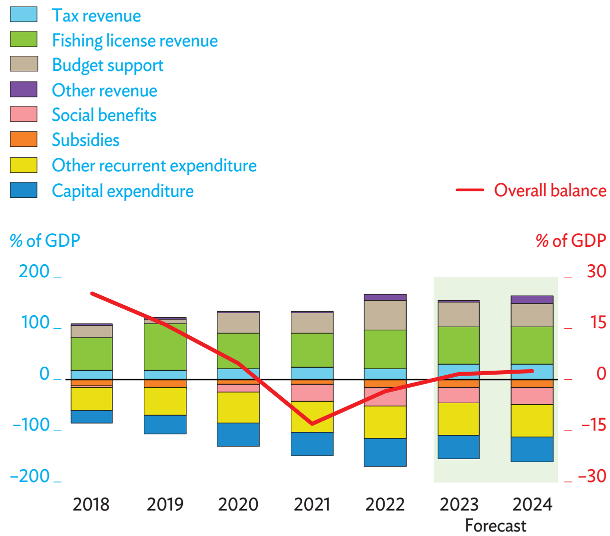
Relaxed movement restrictions allowed the deployment of more I-Kiribati observers on fishing vessels, which significantly increased fishing activity. Recovery in fishing license revenue was the sole driver of revenue collection as lower collection of value-added and excise taxes shrank tax revenue by 17.7%. Meanwhile, expenditure jumped by 17.1% as high spending on social protection continued and more capital projects resumed. The fiscal balance is forecast to return to surplus in 2023 and 2024 with further increase in fishing license revenue, recovery in tax collection, and continued budget support from development partners.

Inflation accelerated in 2022 and will likely remain elevated in the next 2 years. Inflation accelerated to 5.0% in 2022 as global prices for Kiribati imports rose (Figure 2.37.3). While movement restrictions and supply disruption under the pandemic mostly disappeared, the Russian invasion of Ukraine became an important factor in the movement of global prices for commodities, particularly food, fuel, and raw materials. However, direct impact on Kiribati was moderated by fuel and other energy subsidies from the government. Inflation is expected to decelerate to 3.7% in 2023 and 3.0% in 2024—still elevated as events overseas drive price movements.

Stronger external revenue translated into a higher current account surplus in 2022. The Kiribati current account surplus increased on recovery in fishing license revenue and steady remittance flow. These developments offset higher deficits on goods and services. Sustained remittances are expected to continue supporting a surplus despite a resumption of infrastructure projects, which are dependent on imported materials and equipment.

Figure 2.37.2 Kiribati Fiscal Components

Kiribati's fiscal position improved as fishing license revenue recovered.

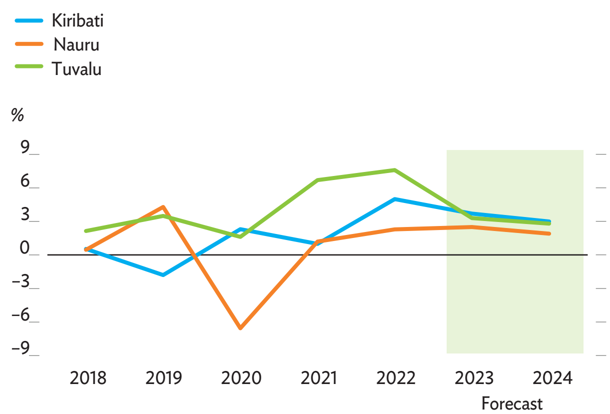


GDP = gross domestic product.

Source: Asian Development Bank estimates using Kiribati budget documents.

Figure 2.37.3 Inflation

Higher global prices for fuel, food, and other commodities accelerated inflation in 2022.



Note: Years are fiscal years ending on 30 June of that year in Nauru and coinciding with the calendar year in Kiribati and Tuvalu

Sources: Kiribati , Nauru, and Tuvalu budget documents; International Monetary Fund Article IV reports; Asian Development Bank estimates.

Nauru

Economic growth slowed as the future of the Regional Processing Centre (RPC) remained unclear. The slowdown to 1.2% in fiscal year 2022 (FY2022, ended 30 June 2022) mainly reflected reduced activity in the RPC. The FY2022 budget, passed in June 2021, assumed that RPC operations would transition into enduring capability after December 2021. In September 2021, the governments of Nauru and Australia signed a new agreement on the transition which keeps the RPC open. The FY2023 budget assumed that enduring capability would begin in January 2023, but that discussion on the details of its implementation would continue. Lower income tax collection indicates that the number of expatriates working in the RPC declined in FY2022.

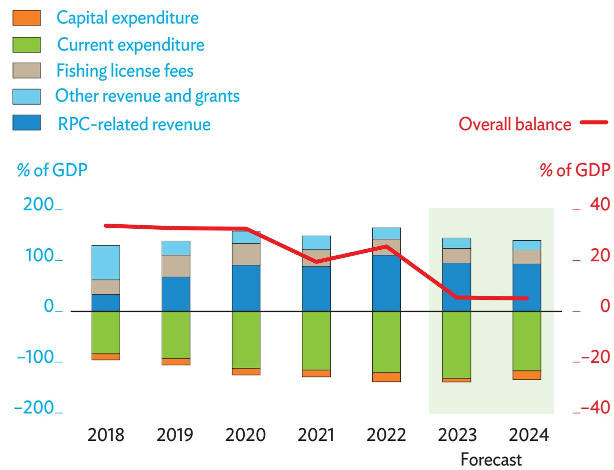
Growth is expected to edge up to 1.8% in FY2023 and 2.2% in FY2024 on infrastructure projects jointly funded with development partners. These projects include Nauru Port, which is expected to spur growth in other areas such as retail trade, transportation, and fishing. A solar energy project including a power plant is scheduled for completion by July 2023 and will add 6 megawatts to the grid. Other notable projects include community housing and the rehabilitation of previously mined areas.

Domestic transmission of COVID-19 was detected in mid-June 2022, sparking lockdowns. With almost all eligible adults and children vaccinated with at least two doses, the government was able to lift most movement restrictions after 3 months. However, more than 4,600 cases in a population of 10,834 in August 2022 gave Nauru one of the highest case loads per capita in the Pacific. To cushion the impact of the lockdown, the government increased its ex gratia payments to public workers, pensioners, and people with disabilities. The allocation for overseas medical referral has already been raised three times in FY2023.

The fiscal surplus increased in FY2022, but its future remains unclear. Government revenue depends largely on the RPC, fishing license fees, and grants. In line with the transition to enduring capability, visa fees and taxes declined, while hosting fees for the RPC rose by more than 150%. This raised revenue attributable to the RPC by 63.2% and widened the fiscal surplus from the equivalent of 19.5% of GDP in FY2021 to 25.5% in FY2022 (Figure 2.37.4). The budget for FY2023 targeted an 8.6% surplus, but with higher expenditure reflected in three supplementary budgets to December 2022, the surplus is now expected to be only 5.4%. Fiscal surpluses have been deposited in the Nauru Trust Fund and a fiscal cash buffer, which stood at A$175.4 million in June 2022, more than quadruple the minimum requirement that it cover 2 months of spending.

Figure 2.37.4 Nauru Fiscal Components

Higher revenue from the Regional Processing Centre drove up the fiscal surplus in FY2022.



FY = fiscal year, GDP = gross domestic product, RPC = Regional Processing Centre.

Note: Years are fiscal years ending on 30 June of that year.

Source: Asian Development Bank estimates using Nauru budget documents.

Inflation accelerated in FY2022 and is expected to rise further in FY2023 before easing in FY2024. Inflation accelerated to 2.3% in FY2022 along with global prices for food and fuel and is forecast to reach 2.5% in FY2023 before easing to 1.9% in FY2024. Price increases would be much higher if the government had not reduced import duties on fuel in June 2022 and extended electricity subsidies. Further, the government subsidizes the state-owned airline and shipping line, which allows them to charge less when bringing supplies into the country.

Higher imports and lower grants pushed the current account to a deficit equal to 2.5% of GDP in FY2022. Exports of services are expected to increase in the next few years following Air Nauru's successful bid under the Pacific Flights Programme of the Government of Australia for the Brisbane–Nauru–Tarawa–Majuro–Pohnpei link.

Despite the election of a new president in September 2022, the main economic policies are expected to remain unchanged. Only 2 of 19 members of parliament were not reelected, both of them in the opposition. The President was elected unopposed by his fellow members of the parliament, and the previous president was elected deputy speaker. Though the campaign lasted less than a month, election spending spurred economic activity.

Tuvalu

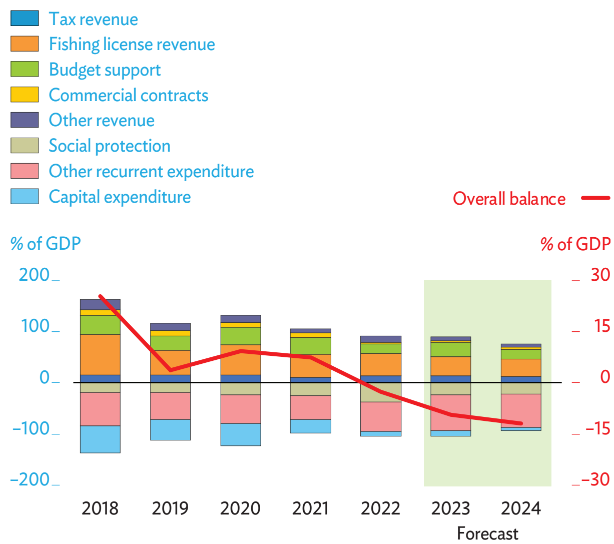
Growth moderated in 2022 under external and domestic shocks. After recovering in 2021, the economy grew by 1.5% in 2022. Stringent COVID-19 measures that were relaxed only at the end of the year restrained economic activity. Other lingering effects of the pandemic, such as supply chain disruption and delayed shipments of construction materials, further dragged on recovery. Tuvalu's borders remained closed to international visitors until the end of November 2022. Despite these efforts, the country faced an outbreak of COVID-19 in the second half of the year. Separately, the government declared a state of public emergency in November 2022 because of extreme drought across the country. While some infrastructure projects resumed, most government spending was directed toward social protection to mitigate impacts from the COVID-19 outbreak and drought.

Faster growth is expected to the forecast horizon, driven by more infrastructure projects and the reopening of borders. Several infrastructure projects funded by development partners, including harbors, health facilities, and submarine cables, are scheduled for rollout in 2023. Other projects to develop outer islands and to improve domestic air services are in progress. With Tuvalu reopening its borders to international visitors, the resumption of business travel and the implementation of infrastructure projects are expected to boost growth to 2.5% in 2023. However, the Russian invasion of Ukraine is likely to drag on growth as resulting inflation creates additional spending pressures and delays expenditure on other items, which will likely slow growth to 2.0% in 2024.

A fiscal deficit, the first since 2012, equivalent to 2.5% of GDP in 2022, is expected to persist through 2024 (Figure 2.37.5). Recurrent revenue recovered in 2022 as tax collections rose by 33.8% and fishing license revenue edged up by 3.0%. However, spending on social protection increased by 55.7%. The deficit is forecast to balloon in 2023 and 2024 as the government ramps up infrastructure spending and revenue weakens.

Figure 2.37.5 Tuvalu Fiscal Components

The government increased spending on social protection to mitigate impacts from COVID-19 and drought.



GDP = gross domestic product.

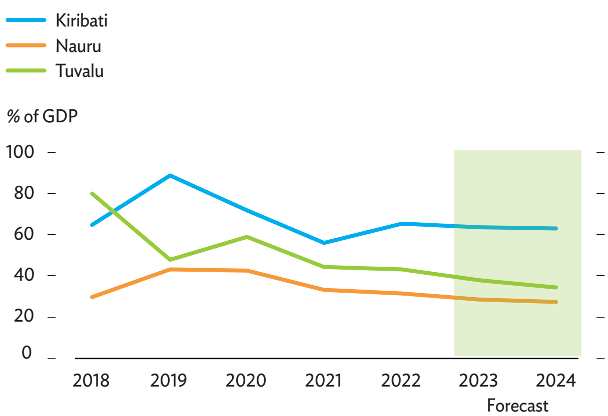
Source: Asian Development Bank estimates using Tuvalu budget documents.

Inflation accelerated in 2022 but will likely slow in 2023 and 2024. After surging in 2021 with the implementation of sin taxes, inflation rose further to 7.6% in 2022. The Russian invasion of Ukraine drove up the cost of imported fuel and, consequently, electricity prices. Food prices have likewise soared because of supply constraints. Inflation is expected to moderate to 3.3% in 2023 and 2.8% in 2024 as global supply chains recover, but events overseas will continue to have a significant impact on price movements.

Higher import prices widened the current account deficit in 2022. The import-dependent economy posted a current account deficit equivalent to 4.1% of GDP as the Russian invasion of Ukraine pushed up global prices for fuel and agricultural commodities. Lower revenue from fishing licenses (Figure 2.37.6) and reduced assistance flows from development partners in 2022 also played a role in expanding the deficit. However, lower fuel prices will likely contribute to narrower deficits in 2023 and 2024.

Figure 2.37.6 Fishing License Revenue

Fishing license revenue rebounded in Kiribati but was declining in Nauru and Tuvalu.



GDP = gross domestic product.

Notes: Years are fiscal years ending on 30 June of that year in Nauru and coinciding with the calendar year in Kiribati and Tuvalu.

Sources: Kiribati , Nauru, and Tuvalu budget documents; International Monetary Fund Article IV reports; Asian Development Bank estimates.

Policy Challenge—Strengthening Water Security

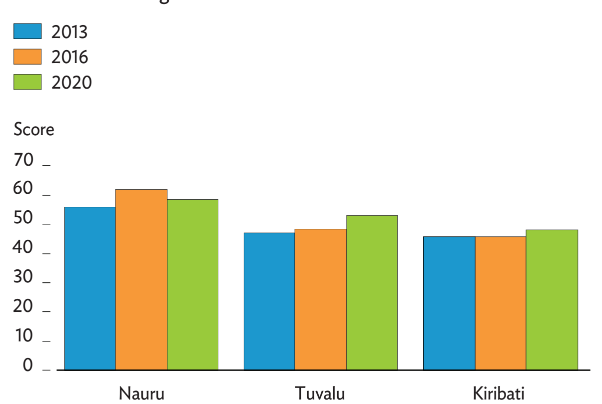
The economies of the Central Pacific are highly vulnerable to climate change and shortages of potable water. Kiribati and Tuvalu experienced extreme drought in 2022, compelling governments to activate disaster response. Nauru's small land area makes collecting enough freshwater for its population a perennial challenge. All three countries extend just a few meters above sea level, making them susceptible to surges stirred up by tropical cyclones that may flood islands for days and contaminate drinking water. Prolonged drought can deplete water supplies, causing serious shortages and health issues.

Despite some gains, improving water security in the Central Pacific remains a work in progress. In 2020, ADB released the fourth edition of the *Asian Water Development Outlook*, which assessed the water security situation of its members in Asia and the Pacific. Among the three Central Pacific economies, Nauru posted the highest score at 58.6 points out of 100, followed by Tuvalu at 53.0 points and Kiribati at 48.2 (Figure 2.37.7). Nauru's 2020 water security score was a downgrade from its 2016 score because of weaker water disaster resilience. Kiribati and Tuvalu both improved their scores in 2020, Kiribati benefiting from a huge gain in environmental water security and Tuvalu from better scores for rural household water security and environmental water security. Room exists for more improvement. In the 2020 assessment, Nauru is barely above the Pacific average score of 55.9 points, and Kiribati and Tuvalu both underperform it (Figure 2.37.8).

A number of water projects are planned or being implemented. One of the biggest water infrastructure projects in Kiribati is the South Tarawa Water Supply Project. The $61.8 million project, supported by multilateral development partners, aims to improve access to safe and climate-resilient water supplies. The project has been hampered by the pandemic, and inflation and supply disruptions continue to pose

Figure 2.37.7 National Water Security Scores in the Central Pacific

Despite progress, improving water security in the Central Pacific remains a challenge.

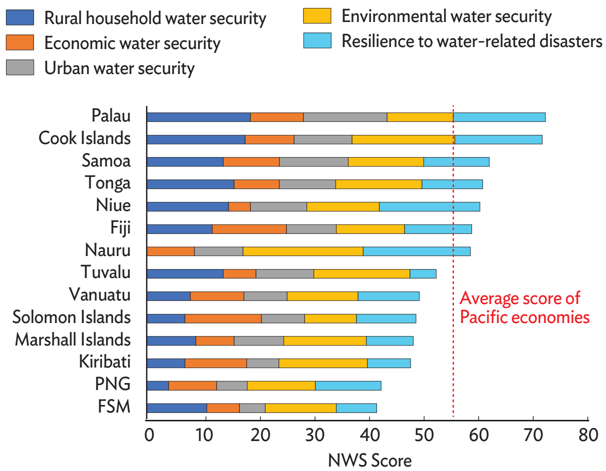


Note: Perfect score is 100.

Source: ADB. 2020. *Asian Water Development Outlook 2020: Advancing Water Security across Asia and the Pacific*. Manila.

Figure 2.37.8 Water Security in Pacific Developing Member Countries, 2020

Water security in the Central Pacific barely matches the average among Pacific developing member countries



FSM = Federated States of Micronesia, NWS = national water security, PNG = Papua New Guinea.

Note: Perfect score is 100. Nauru has no score for rural household water security because it is 100% urban; the NWS index is determined by multiplying the sum of key dimensions by a factor of 5/4.

Source: ADB. 2020. *Asian Water Development Outlook 2020: Advancing Water Security across Asia and the Pacific*. Manila.

implementation challenges. The Government of Nauru prioritized in its FY2023 budget the Nauru Sustainable Urban Development Project. With grant financing from development partners, the project is designed to improve essential water supply, sanitation, and solid waste management services and to expand capacity for urban planning. This complements a government-funded pipeline project to minimize contamination of Nauru's brackish water. In Tuvalu, a government project addresses water security challenges in communities. Working with development partners, the government has rolled out a project to improve the supply, storage, and distribution of potable water to communities and schools on the capital, Funafuti. The upcoming Funafuti Water and Sanitation Project builds on this to increase access to safe water, improve sanitation, and lower the incidence of waterborne disease.

Improving water security in the Central Pacific requires a multipronged approach. The usual sources of financing for water investments are taxes, revenue from water tariffs, and transfers from development partners. In the Central Pacific, as elsewhere in the subregion, small populations and inadequate fiscal resources and technical expertise mean heavy dependence on support from development partners. Heightened vulnerability to climate change and fiscal constraints highlight the importance of external financing. Projects need adaptation plans based on evidence using updated data. Detailed project implementation arrangements are especially important because delays in project implementation can leave communities with insufficient potable water. Yet capacity constraints mean these countries struggle to implement projects efficiently and effectively. Improving water security in the Central Pacific thus requires steady financing, strong project management, enhanced public financial management, and other support mechanisms provided by good governance.