SOUTH PACIFIC ECONOMIES

The Cook Islands, Niue, Samoa, and Tonga have struggled to recover from 3 years of economic disruption. In all four countries, GDP in fiscal year 2022 (FY2022, ended 30 June 2022) languished lower than in FY2019, tourism recovery was uneven, and labor supply issues came to the fore. Public expenditure will provide some stimulus, but fiscal positions will be mixed in the medium term. Remittances to Samoa and Tonga may help households grapple with rising inflation.

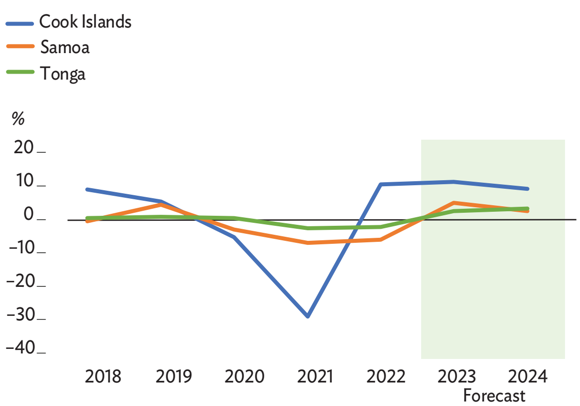
Cook Islands

The economy rebounded in FY2022 by 10.5% following sharp contraction in FY2021 (Figure 2.39.1). Growth was driven by recovery in tourism arrivals following the reopening of borders in January 2022. Arrivals were 66.0% of FY2019 levels, with 88.7% of travelers from New Zealand, the primary tourist market.

Growth is forecast at 11.2% in FY2023 and 9.1% in FY2024 (Table 2.39.1). Support to growth will come from steady recovery in tourism arrivals, led again by New Zealand, and from infrastructure projects, notably upgrades for health facilities and the Rarotonga airport. Natural hazards and acute labor shortages are downside risks to recovery, though the active recruitment of foreign workers should mitigate labor shortages.

Figure 2.39.1 Economic Growth

Economic recovery commenced once borders reopened.



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

Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; Asian Development Bank estimates.

Table 2.39.1 Selected Economic Indicators, %

Recoveries have commenced, but inflation is near record highs.

	2021	2022	2023	2024
Cook Islands				
GDP growth	−29.1	10.5	11.2	9.1
Inflation	1.8	4.2	7.7	2.3
Samoa				
GDP growth	−7.1	−6.0	4.8	2.5
Inflation	−3.0	8.8	10.2	2.0
Tonga				
GDP growth	−2.7	−2.2	2.5	3.2
Inflation	1.4	8.5	9.4	1.5

GDP = gross domestic product.

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

Source: Asian Development Bank estimates.

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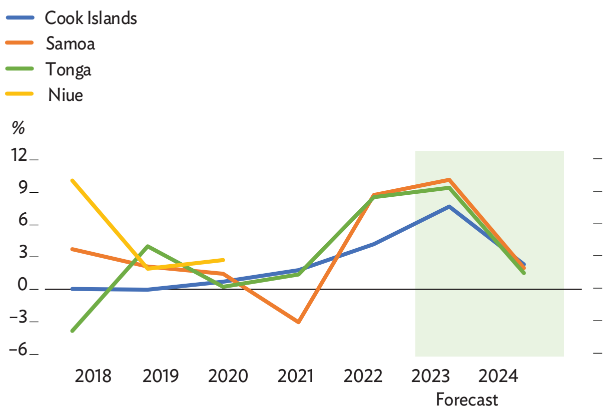
Inflation increased in FY2022 and is expected to rise further before falling back to trend in FY2024. The Russian invasion of Ukraine disrupted supplies by escalating global fuel prices and transportation costs. Inflation increased from 1.8% in FY2021 to 4.2% in FY2022, with prices up 9.3% for transportation and 6.8% for food (Figure 2.39.2). It is expected to climb further in FY2023 before falling in FY2024 to 2.3% as imported fuel and food prices normalize.

Figure 2.39.2 Inflation

Inflation remains at or near record highs across the South Pacific.



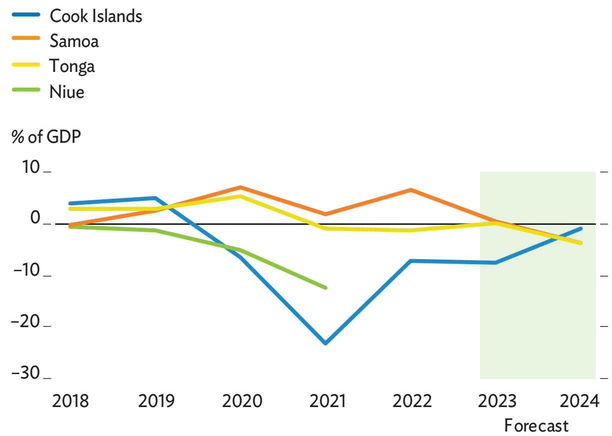
Note: Years are fiscal years ending on 30 June of that year.

Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; Asian Development Bank estimates.

The fiscal deficit is expected to narrow over the medium term as public debt remains stable. The government reduced its fiscal deficit to the equivalent of 7.0% of GDP in FY2022 on 23.0% growth in tax revenue and 14.2% lower expenditure with underspending on capital projects. The deficit is projected to be slightly higher in FY2023 at 7.4%, despite further growth in tax revenue (Figure 2.39.3). After supporting economic stimulus measures and public spending during the pandemic, public debt equaled 43.9% of GDP in FY2022 but is expected to ease back below 35.0% by FY2024.

Figure 2.39.3 Fiscal Balance

Falls in tax revenue were offset by grants in Samoa and Tonga, alongside low mobilization of public investment for all economies.



GDP = gross domestic product.

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Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; Asian Development Bank estimates.

Samoa

The economy shrank for a third year in FY2022, by 6.0%. Closed borders and community transmission of COVID-19 affected tourism receipts, which were 24.2% of GDP in FY2019, and constrained mobilization for many public sector capital projects. GDP in FY2022 was 15.4% lower than in FY2019.

GDP may rebound in FY2023 from a low base, but medium-term prospects are mixed. The mobilization of public investment projects from a low base and the initial return of visitor arrivals will likely support GDP growth of 4.8% in FY2023. However, difficulties in rebuilding tourism services and fierce international competition may limit the ability to sustain visitor growth currently supported by visiting friends and relatives, back after lengthy separations. These factors are forecast to limit growth to 2.5% in FY2024.

Inflation persists well above trend. Inflation is forecast to increase from 8.8% in FY2022 to 10.2% in FY2023. Monthly inflation from July 2022 to January 2023 averaged 12.2% year on year, with prices of imported goods up by an average of 16.0% in the same period. The major increases were for food, transportation, communications, and restaurants.

Inflation is expected to moderate heading into FY2024 as softer international commodity prices begin to feed through to local prices.

Remittances and the return of tourism receipts in FY2023 are expected to narrow the current account deficit. Remittance growth remained strong, increasing by 22.2% in the 12 months to December 2022 on continued expansion of regional labor programs and sustained engagement by Samoan diaspora. As tourism receipts recover in the short term, the current account deficit is forecast to narrow sharply from the equivalent of 12.4% of GDP in FY2022 to 1.3% in FY2023. Official foreign currency reserves are sound, as of December 2022 covering 9.6 months of goods imports, well above the 4.0 months targeted by the Central Bank of Samoa.

Expansionary fiscal policy and lower revenue will likely push the fiscal balance into deficit. The government achieved a fiscal surplus equal to 6.4% of GDP in FY2022 on improved tax compliance, grant inflows, and deferred implementation of planned public investment. With borders open, some capital works delayed in FY2022 will be able to commence, though the major construction phases for some larger projects will likely occur in FY2024. As expenditure bottlenecks loosen, a narrower fiscal surplus equal to 0.8% of GDP is projected in FY2023 which may turn into a fiscal deficit equal to 3.5% in FY2024. Public external debt is forecast to decrease from the equivalent of 47.5% of GDP in FY2022 to 37.4% in FY2024.

Tonga

Disasters and COVID-19 further shrank GDP in FY2022. The economy contracted by 2.2% in FY2022 following the eruption of the Hunga Tonga–Hunga Ha'apai (HTHH) volcano and consequent tsunami in January 2022, which occurred alongside the first community transmission of COVID-19. The eruption caused extensive damage to property, infrastructure, and agriculture, with the World Bank estimating total economic losses equal to 36.4% of GDP. The undersea fiberoptic cable to Tonga was severed for nearly a month immediately following the tsunami, disrupting telecommunications and remittance inflows. Remittances nevertheless grew by 1.0% in FY2022 from their previous record set in FY2021.

Easing mobility restrictions and revived public investment will likely expand GDP by 2.5% in FY2023. Tourist accommodation capacity lost to the HTHH eruption will limit the ability of tourism to contribute to stronger economic recovery, but continued public investment is projected to support GDP growth at 3.2% in FY2024.

Inflation is forecast to accelerate further from 8.5% in FY2022 to 9.4% in FY2023. Prices increased by 9.7% in the 12 months to January 2023, and will likely remain elevated. Inflation in FY2023 is expected to be driven by import prices, local supply constraints, and domestic food price increases. Inflation is projected to drop sharply to 1.5% in FY2024 as local agriculture continues to recover from the eruption and easing international commodity prices feed through to the local economy.

Despite these shocks, the fiscal deficit equaled a modest 1.2% of GDP in FY2022. Tax collection was boosted as several large vendors automated their payment of value-added tax, grants from development partners increased, and public capital spending fell. While financing needs for reconstruction remain large, significant increases in grants from development partners will likely generate a fiscal surplus equal to 0.3% of GDP in FY2023. With remaining financing gaps funded from cash reserves, external debt is expected to fall from 38.5% of GDP in FY2022 to 31.7% in FY2023.

The current account deficit is likely to widen dramatically, which may reduce official reserves in the medium term. Remittances have begun to decline from record levels, falling by 2.7% in November 2022 as compared with a year earlier, likely affected by rising living costs and economic slowdowns in source countries. Returning friends and relatives may have converted some remittance receipts into informal cash transfers or tourism receipts. Continued moderation in remittances and substantial need for imported goods and materials for reconstruction are expected to enlarge the current account deficit from the equivalent of 5.7% of GDP in FY2022 to 9.0% in FY2023 and 11.2% in FY2024. This rapid widening will likely reduce official foreign currency reserves from 13.5 months of import coverage as of December 2022 to about 6 months in FY2024.

Niue

The economy likely contracted for a third consecutive year in FY2022 as tourism remained below pre-pandemic levels. High fuel prices and freight costs and tightening supply constraints weighed on limited fiscal space. Though borders reopened, travel was frequently interrupted by new COVID-19 cases, which may have affected consumer confidence.

The fiscal deficit in FY2022 equaled 13.3% of FY2019 GDP as higher recurrent expenditure outweighed moderate gains in recurrent revenue. Official grants declined by 19% from FY2021. The government projects a higher deficit equal to 21.4% of GDP in FY2023 as both capital and recurrent spending increase significantly.

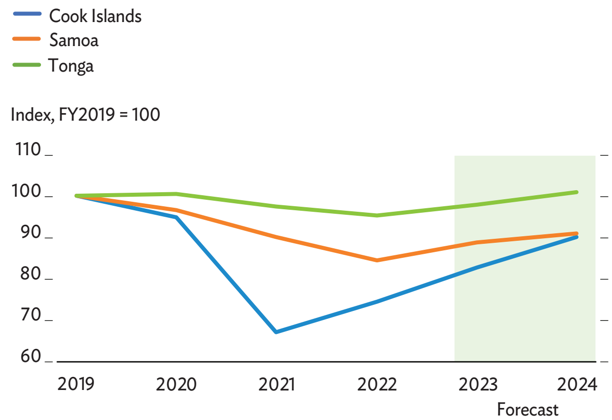
The impact of recent import price movements is unknown for lack of inflation data. The latest inflation data available are from 2020. Inflation in Niue normally mirrors price movements in New Zealand, where prices rose by 7.2% in the 12 months to December 2022. Domestic price controls partly mute the transmission of foreign price trends, though, making it a challenge to infer domestic price movements. In November 2022, for example, the Niue authorities held fuel prices constant despite increased import prices.

Policy Challenge—Navigating a Long Path to Recovery

Despite mitigated health impacts from the pandemic, output in South Pacific economies remains below pre-pandemic levels (Figure 2.39.4). Economic recovery in the South Pacific remains fragile, at risk from further shocks, and easily reversible. Tourism and related businesses have lost financial and human capital, which may delay their recovery. Slower growth may degrade recovery in other retail and commercial services and in governments' fiscal positions. As the eruption in Tonga has illustrated, the South Pacific is highly exposed to natural hazards, and post-disaster emergency response and reconstruction costs need to be factored into long-term development financing estimates. Fiscal positions are much weaker than when the COVID-19 crisis began 3 years ago, with elevated debt in the Cook Islands, cash constraints in Niue, and weaker medium-term recovery prospects in Samoa and Tonga.

Figure 2.39.4 Change in Gross Domestic Product

Economies in the South Pacific are still considerably smaller than before the pandemic.



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Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; Asian Development Bank estimates.

Labor availability is becoming a key policy issue across the region and may hinder any return to pre-crisis trends. The ongoing shortage of local labor in the Cook Islands has likely increased dependency on attracting labor from abroad. Proactive immigration measures adopted during the COVID-19 crisis may need to be expanded to ensure adequate labor supply to support continued growth. In Samoa and Tonga, the reopening of borders and resumption of international travel are essential to salvaging tourism and resuming public infrastructure programs, but they have also opened up regional labor opportunities that have drawn away workers. In pursuit of higher incomes, an estimated 18.2% of male Tongan workers and 14.1% of male Samoan workers participated in at least one regional labor program in New Zealand or Australia in 2022. This is a rising trend. In response, Samoa briefly paused the mobilization of workers in early 2023 but soon resumed its engagement in the programs.

Repeated disasters have likely set back Tongan tourism for decades. A collaborative study by the Government of Tonga, the ADB Private Sector Development Initiative, and the World Bank highlighted the dramatic impacts of Cyclone Harold in 2020 and the HTHH eruption in 2022 on accommodation capacity. Cyclone Harold affected 18% of providers, damaging 28% of rooms. HTHH affected 27% of providers and damaged 32% of rooms, completely destroying or severely damaging 23 properties, half of which had already been damaged by Cyclone Harold. Three properties were destroyed for a second time after rebuilding from the first disaster. In addition to the 20 or so businesses that cannot rebuild without financial assistance, many businesses continue to operate below capacity for lack of funds to invest. Even if travelers return to Tonga in the medium term, the supply of accommodation may take many years to recover.

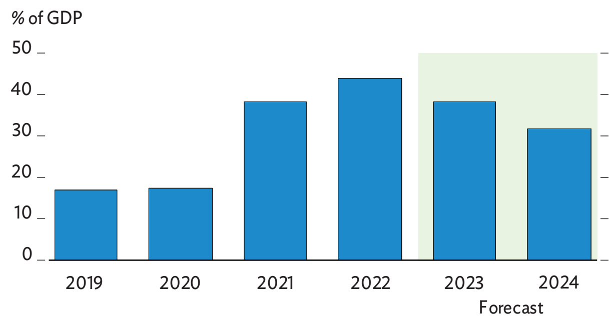
Tourism in Samoa faces significant uncertainty in the medium term. The ability of the industry to recover to pre-crisis levels in the medium term may be stymied by nonperforming loans to some large accommodators from before COVID-19, extended closure until August 2022, and the loss of labor. While visitor numbers in the second quarter of FY2023 were about two-thirds of those pre-pandemic, much of this was a rebound in visiting friends and relatives. Visitors identified as holidaymakers were off their previous highs by half. Uneven recovery and ongoing uncertainty suggest some consolidation in visitor accommodation in the medium term.

Despite these challenges, Tonga and Samoa avoided large fiscal deficits during the crises. Both countries also avoided taking on significant new debt, thereby preserving the downward trend in their ratios of debt to GDP despite economic and revenue disruption. Remittances and official grants boosted foreign currency reserves to all-time records. Together, these buffers will mitigate future shocks in both countries, strengthened by contingent disaster grant financing instruments provided by ADB and the World Bank. While economic recovery may face headwinds, ongoing reform to strengthen tax compliance and administration will help both countries meet growing fiscal needs.

While tourism is on its way to recovery, elevated debt in the Cook Islands may inhibit public investment in the short term. From a low 16.7% of GDP in FY2019, public debt reached a peak of 49.3% in FY2022 (Figure 2.39.5). Along with cash reserves equal to 25.8% of GDP in FY2019, the increase in credit helped the government avoid cash solvency crises in 2020, 2021, and 2022. The retention of tourism businesses facilitated a rapid return of visitor arrivals, which will support economic and fiscal recovery. However, large public investments in key infrastructure will likely need to be postponed. While gross debt is still below the government ceiling of 65%, debt servicing is set to increase from a low of about 6% of revenue in FY2021 to 16% by FY2030. Without access to concessional resources, this will crimp new debt financing of public infrastructure until FY2026, when an anticipated return to fiscal surpluses should support higher expenditure.

Figure 2.39.5 Public Debt in the Cook Islands

Previously low debt in the Cook Islands dramatically increased during the pandemic.



GDP = gross domestic product.

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The Pacific needs to balance post-pandemic recovery carefully. Governments need to balance ongoing needs for private and public investment against their desire to restore fiscal health. Continued grant financing from development partners and improved domestic revenue collection across all countries will help, but financing needs for public investment and the challenges facing the private sector are more acute now than these nations have experienced in recent years.