THE PACIFIC

The 2023 and 2024 forecasts for growth in the Pacific economy are revised up from *ADO April 2023*'s projections. A strong recovery in tourism and stimulus-inducing public infrastructure projects have driven faster-than-expected growth, particularly in Fiji, the second-largest economy in the subregion. Capacity constraints exacerbated by the pandemic weigh on the outlook, especially for smaller economies. The inflation forecast is revised down for 2023 and up for 2024. International commodity prices remain elevated and their lagged pass-through to domestic markets is keeping inflation high in many Pacific economies.

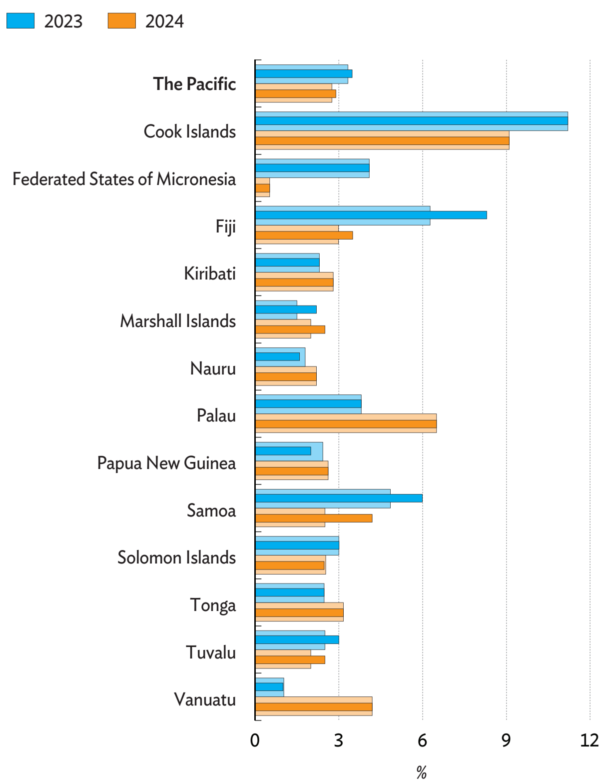
Subregional Assessment and Prospects

This update forecasts growth of 3.5% for the Pacific economy in 2023, up from 3.3% projected earlier (Figure 2.5.1). Visitor arrivals to Fiji have been higher than expected, prompting an upward revision in the country's growth projection for the year. Similarly, arrivals have also been stronger than expected in the Cook Islands, Samoa, and Tonga. The Marshall Islands' growth forecast is revised up on higher fisheries output and construction, including development partner–funded projects and preparations for the Micronesian Games in June 2024. Faster growth is expected in Tuvalu as loosened travel restrictions and reduced shipping bottlenecks ease the implementation of infrastructure projects.

Some parts of the subregion will see subdued growth this year. The forecast for Papua New Guinea, the largest economy, is revised down because output in sectors other than mining and liquefied natural gas (LNG) has been lower than initially expected. Other contributing factors include difficulties in sourcing foreign exchange and disruptions in power and water supply. Nauru's growth forecast is adjusted down due to the base effects of higher growth in the previous fiscal year.

Figure 2.5.1 GDP Growth in the Pacific

The growth outlook for the subregion is revised up on robust recoveries in tourism and public construction.



GDP = gross domestic product.
Note: Lighter colored bars are *Asian Development Outlook April 2023* forecasts.
Source: *Asian Development Outlook* database.

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The 2024 growth forecast for the Pacific is increased to 2.9% from 2.8%. This reflects expectations of faster growth in Fiji on a continued strong recovery in tourism and increased government spending on infrastructure. Growth in Samoa will be driven by tourism and public spending. Construction projects should drive faster growth in the Marshall Islands and Tuvalu than was forecast in April. Growth in the Marshall Islands is projected to get a further lift from hosting the Micronesian Games. However, Tonga's economy is expected to grow more slowly than was earlier forecast as competition from other international tourist destinations and difficulties in local air capacity impede the recovery in visitor arrivals. Slower growth is also forecast for Nauru as the slowdown in Regional Processing Centre operations dampens economic activity.

Capacity constraints that emerged during the pandemic pose significant downside risks to the outlook. The impact of COVID-19 on economic activity in the subregion led many workers to seek employment elsewhere, notably under temporary worker schemes in Australia and New Zealand. Closed borders caused tourism facilities to fall into disrepair and disasters triggered by natural hazards damaged or destroyed properties. Labor constraints are affecting the implementation of infrastructure projects which, coupled with a shortage of tourist facilities, could dim tourism's recovery prospects and make it difficult to attract reinvestment in the sector.

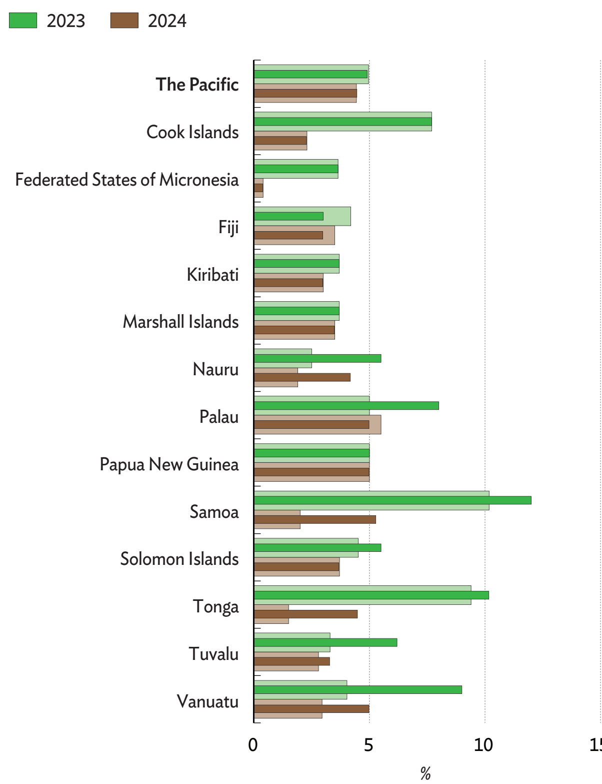
Vulnerability to disasters and climate events continue to have serious implications on growth and inflation in Pacific economies. An expected El Niño will likely depress agriculture and fisheries output and reduce local food supply. This, together with more frequent climate events, could worsen damage and losses, and hinder recovery by weakening food and water security. Climate events also pose a threat to fishing revenue, a major source of income for many governments in Pacific economies.

Inflation is now forecast at 4.9% this year, down from April's 5.0% projection (Figure 2.5.2). Inflation in Fiji will slow on lower fuel prices, and declining utility and transport costs. The downward revision, however, masks upward adjustments to the inflation forecasts of some smaller economies. In the Cook Islands, Nauru, and Samoa, elevated international food and fuel prices—due in part to the lingering impacts of the Russian invasion of Ukraine—and their lagged pass-through to domestic prices caused higher-than-expected inflation in fiscal year (FY) 2023. These factors, coupled with a reduced petroleum subsidy, are also behind Kiribati's raised inflation forecast.

Domestic developments are contributing to the higher inflation forecasts for 2023 for some economies. Elevated import prices initially lifted inflation in Tonga in FY2023; this was later accelerated by supply constraints and surging costs of locally produced food. Tuvalu's inflation forecast is raised because the impact of the November 2022 drought on food prices has been more severe than expected. Palau's is raised on the introduction of value-added taxes, which increased food and fuel prices, and higher electricity and wastewater tariffs that affected the cost of household utilities. Inflation accelerated in the first

Figure 2.5.2 Inflation in the Pacific

The subregional forecast for 2023 is revised slightly down on slowing inflation in Fiji, but higher-than-expected inflation has raised the forecasts for smaller economies.



Note: Lighter colored bars are *Asian Development Outlook April 2023* forecasts.
Source: *Asian Development Outlook* database.

quarter of 2023 in Solomon Islands on higher prices for transportation and food. Although this has eased somewhat, price pressures are expected to return in the fourth quarter, when the country hosts the Pacific Games. Higher inflation—possibly the highest in decades—is expected in Vanuatu because the impact of cyclones in March on crops and local supply chains has been more severe than estimated in *ADO April 2023* and because of price pressures from a 36% increase in the minimum wage implemented in June.

This update revises the forecast for subregional inflation in 2024 to 4.5% from the earlier 4.4% projection. Continued lags in the impact of international commodity price trends on local prices will keep domestic inflation high in Nauru and Samoa. The 2024 inflation forecasts for Tonga, Tuvalu, and Vanuatu are raised on adverse price movements in these economies. Lower inflation, however, is forecast for Fiji next year following recent local price trends. For Palau, the high base estimated for FY2023 will result in softer inflation than was forecast in April.

Fiji

The growth forecasts for Fiji for 2023 and 2024 are revised up. A stronger-than-expected recovery in tourism and a notable increase in government spending, as announced in the budget for fiscal year 2024 (FY2024, ending 31 July 2024), prompted the revisions (Table 2.5.1). *ADO April 2023* assumed that intense competition from other tourist destinations would moderate the recovery in visitor arrivals. However, the numbers have been greater than expected, with arrivals in the year to date exceeding the same period in 2019. This update expects the rebound in tourism will be sustained, despite monetary policy tightening in Fiji's major tourism source markets. Fiscal spending was earlier projected to fall in FY2024, but the government has allocated higher spending, with notable increases in key infrastructure allocations, such as for road transport and hospitals.

Table 2.5.1 Selected Economic Indicators in Fiji, %

Stronger economic growth is being buoyed by a sustained recovery in tourism and moderate inflation.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	20.0	6.3	8.3	3.0	3.7
Inflation	4.3	4.2	3.0	3.5	3.0

GDP = gross domestic product.

Sources: Fiji Bureau of Statistics; Asian Development Bank estimates.

Tourism's stronger-than-expected recovery is being driven by visitor arrivals from Australia and New Zealand, Fiji's traditional source markets. Visitor data as of July 2023 show monthly arrivals have outperformed 2019 levels since September 2022 for Australia, October 2022 for Canada, December 2022 for New Zealand (except July 2023), and July 2023 for the United States. Arrivals from Canada have been boosted by a Vancouver–Nadi direct flight, which started at the end of 2022. Tourist arrivals in the first 7 months of 2023 were up 20% for Australia, 6% for New Zealand, and 60% for Canada compared to the same period in 2019. To cater to the increased demand, Fiji Airways, the national airline, deployed two new wide-body aircraft in August, adding around 30,000 new seats from the fourth quarter of 2023; introduced direct flights to Canberra; and increased the frequency of flights to other destinations, including Hong Kong, China. Other airlines will start new flights out of Fiji in late 2023. Increased competition and moderating demand in major source markets remain downside risks in 2024. Even so, post-pandemic, tourists from these markets are staying longer and spending more.

The performances of other sectors have been mixed. Construction improved despite the higher cost of building materials, exports of non-sugar agricultural products increased in the first 5 months of 2023, and there was a notable increase in the exports of taro and spices. But gold production declined due to low-quality ore, and timber was affected by supply issues, including bad weather and limited accessibility to forests.

Government revenue improved, buoyed by increased tourism. The better-than-expected recovery in tourism translated into higher government revenue and a narrower FY2023 fiscal deficit, equivalent to 6.2% of GDP compared to 7.4% forecast in *ADO April 2023*. Government revenue increased by 22.6% in FY2023, and expenditure was up a modest 0.6%. The government is targeting a 37.8% increase in FY2024 revenue to finance a 26.0% increase in budgeted spending. If the target is hit, the fiscal deficit's downward trend should continue, to a forecast 4.8% of GDP in FY2024 and a lower debt-to-GDP ratio of 79.3%, compared to 81.2% in FY2023.

The inflation forecasts are revised down for 2023 and 2024 on lower-than-expected consumer prices, especially since April. Lower fuel prices translated into utility prices declining by 4.6% and transport prices by 9.9% in the 12 months to July 2023. The new value-added tax and import duties rates, effective August, will keep inflation at a forecast 3.0% for 2023 and 2024.

Papua New Guinea

Growth is revised down for 2023 because of a worse-than-expected economic performance so far this year (Table 2.5.2). Sales in various sectors are reported to be down 20%–30% in the first half. Imports plummeted by 61% in the first quarter year on year (yoy) across all product categories, including machinery, which suggests postponed or abandoned private investments. The slowdown is also being caused by the difficulties businesses are having in sourcing foreign exchange. The Bank of Papua New Guinea, the central bank, continues to release only $100 million monthly to the foreign exchange market, falling short of demand. Other reasons for the slowdown are power and water supply disruptions, frequent flight cancellations due to technical problems with Air Niugini's aging fleet, and glitches in the rollout of a new operating system at Bank of South Pacific, the country's largest bank. The problems related to the rollout have affected businesses and consumers through delayed staff payments, trouble with reconciling financial data, and banking operations failing to function smoothly.

Table 2.5.2 Selected Economic Indicators in Papua New Guinea, %

Growth is revised down for 2023 after a tough first half for businesses and consumers.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	3.2	2.4	2.0	2.6	2.6
Inflation	5.3	5.0	5.0	5.0	5.0

GDP = gross domestic product.

Sources: Bank of Papua New Guinea; Asian Development Bank estimates.

Moreover, mining, one of the economy's largest sectors, has weakened its contribution to growth due to decreased gold production in the first half of the year and a less optimistic outlook for copper output.

On the upside, some services are benefiting from resumed international travel and easing global supply chain disruptions. These include accommodation and restaurants, communication, and real estate. Additional government spending will provide some stimulus this year. The outlook for LNG production has also improved following higher-than-expected output in the first quarter, but LNG output over the whole of 2023 will still likely be lower than in 2022. The 2024 growth forecast remains unchanged from *ADO April 2023*, with growth driven by non-resource sector output.

In July, fuel supply issues reemerged, prompting the government to declare a 30-day national emergency. This decision came after the two largest airlines suspended domestic flights when Puma Energy, the country's only aviation fuel supplier, announced its intention to limit the distribution of fuel because of a dispute with the central bank over forex and regulatory issues. The government, however, aims to ensure fuel availability and explore introducing competition in the fuel market.

The government has announced that it will embark on a macroeconomic reform agenda. This will be aided by an International Monetary Fund (IMF) program approved in March 2023, following a request by the government for an SDR684.3 million budget-support loan (equivalent to $918.3 million) tied to governance-related reforms over 38 months. These reforms will focus on (i) strengthening debt sustainability through a multiyear fiscal consolidation program and creating the fiscal space to meet critical social needs, (ii) strengthening the mandate and autonomy of the Bank of Papua New Guinea, (iii) alleviating forex shortages by transitioning to a market-clearing exchange rate, and (iv) operationalizing the Independent Commission Against Corruption.

Headline inflation eased in the first quarter of 2023, and April's projection for full-year inflation is retained. Price increases for clothing and footwear, communication, health, and recreation were below

2.0% yoy. The prices of alcoholic beverages, tobacco, and betel nut declined by 6.3% yoy and education by 22.9%. However, price pressures on some essential consumer items remained elevated, including food and nonalcoholic beverages, up by 8.7% yoy, household equipment (12.2%), and transport (4.9%). The Kina Facility Rate remains unchanged at 3.50%.

The revenue collection performance in the first half of 2023 was mixed. Tax collection was on track for almost half the budget forecast for the year, but nontax revenue was significantly behind. Stronger collection in salaries and wages tax, corporate profit tax from the resources sector, and import excise in the first half of the year resulted in revenue being revised up by K1.6 billion from the 2023 budget forecast. All of this additional revenue will be allocated to recurrent expenditure, leaving the projected overall fiscal deficit unchanged at the equivalent of 4.4% of GDP this year. Expenditure on compensation of employees, comprising mainly the public sector wage bill, was within the budget plan in the first half of the year, although a risk of overruns remains. Public debt is forecast at 52.2% of GDP in 2023. Under the IMF program, Papua New Guinea is required to limit the present value of new external borrowing to $1.405 billion, maintain a fiscal deficit not exceeding K4.985 billion (4.3% of GDP), collect at least K12.558 billion in non-resource taxes, and maintain social expenditure of at least K3.866 billion (3.4% of GDP).

The outlook is subject to several upside risks related to major resource projects. Porgera Gold Mine's reopening is making progress after Barrick Niugini, the operator of the mine, and the government signed the Porgera Project Commencement Agreement, but the issuance of a special mining lease and other requirements, such as a public hearing, are pending. A final investment decision on the Papua LNG project is expected in early 2024. The project getting underway would stimulate economic activity, boost tax revenue, and help alleviate foreign exchange shortages. The main downside risk is disruptions caused by the limited supply of foreign exchange, such as fuel rationing, particularly if the shortage drags on.

Solomon Islands

Growth forecasts are retained for 2023 and 2024 (Table 2.5.3). The recovery in growth, after 3 years of contraction, is still expected to be driven by government spending and investment associated with the Pacific Games this year and elections next year. The games, to be held in Honiara in November, should boost retail trade, accommodation and food services, and logistics and transport. Gains in these sectors are expected to partially compensate for otherwise weaker domestic demand due to higher-than-expected inflation. Additional sources of growth include the pick-up in business activity following the lifting of COVID-19 restrictions, higher exports, and the resumption of development partner–funded projects.

Table 2.5.3 Selected Economic Indicators in Solomon Islands, %

A moderate recovery is expected, but increased global commodity prices are putting upward pressure on inflation.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	−4.2	3.0	3.0	2.5	2.5
Inflation	5.5	4.5	5.5	3.7	3.7

GDP = gross domestic product.

Sources: Central Bank of Solomon Islands; Asian Development Bank estimates.

Increased government spending has widened the fiscal deficit in line with *ADO April 2023*'s expectation. Expenditure was up 27% in the first half of the year from the same period in 2022, with higher outlays for goods and services, salaries and wages, and support to state-owned enterprises. But revenue fell 6% over the same period. A supplementary budget in June raised expenditure by 8% compared to the original budget, mainly for the Pacific Games. The increased deficit is expected to be financed largely by development partners.

Export growth is largely being driven by minerals and higher-than-expected shipments of logs and timber. Exports in the first half of 2023 rose 45% from the same period in 2022, boosted by a 300% increase in mineral exports, largely from the reopened Gold Ridge

Mine. Log exports rose 15% in the first half of 2023, following a 6% increase in production. Fish exports rose by 10%, with the fish catch rising by a similar percentage. The first half of 2023 saw boosted exports of palm oil and cocoa.

The current account deficit in the first half of 2023 was slightly lower than in the first half of 2022, but is still expected to widen for the year as a whole. Exports of goods and services increased by 45%, but imports rose by only 36%, mainly due to a nearly 100% increase in the imports of machinery and transport equipment and a 60% rise in fuel imports. Imports are expected to increase in the second half of the year, particularly machinery and transport equipment, food, fuel, and manufactured goods for the Pacific Games. Construction of 161 telecommunicators towers funded by a $65 million concessional loan began in August. Twenty towers are targeted for completion before the start of the games.

Remittances, higher by 55% in the first half of 2023 from the same period last year, are helping to lower the current account deficit. Seasonal workers from Solomon Islands in Australia and New Zealand totaled 6,090 in June, up 56% from June 2022. The government expects this to total 7,000 by the end of the year.

Visitor arrivals are expected to rise on a further recovery in tourism and improved aviation infrastructure. International travel will benefit from the arrival of Solomon Airlines' second long-haul aircraft in August. The first aircraft was grounded several times in the first half of 2023 for maintenance, leading to significant delays and disruptions. The second aircraft is financed by a $3 million loan from the Solomon Islands National Provident Fund. Other aviation developments include the completion of the new Honiara International Airport terminal in March, the construction of a new terminal at Munda International Airport, and the return of the Brisbane–Munda route, planned for October.

This update revises up the inflation forecast for 2023 from April's projection. Inflation accelerated to 9.2% in the first quarter before slowing to 4.9% in the second. Higher overall inflation was mainly due to rapid increases in the indices for transportation (up 18.5%) and food and nonalcoholic beverages (up 14.3%). After raising the cash reserve ratio from 5% to 6% in March, the Central Bank of Solomon Islands maintained its tight monetary policy stance in September. Inflation is expected to decelerate in the third quarter, but likely to pick up in the fourth due to increased demand from the Pacific Games.

Vanuatu

The forecast for weak growth in 2023, due to extensive damage caused by twin cyclones in March, is retained (Table 2.5.4). The cyclones' impact continued to be felt in the second quarter, particularly through high inflation, which is also being lifted by the lagged effects of increased global commodity prices. The economic pressure on households is expected to be offset by higher government spending in the second half of the year. A strong economic recovery is still expected in 2024.

Table 2.5.4 Selected Economic Indicators in Vanuatu, %

Damage from disasters has constrained growth and is pushing inflation higher than earlier forecast for 2023 and 2024.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	2.0	1.0	1.0	4.2	4.2
Inflation	6.7	4.0	9.0	3.0	5.0

GDP = gross domestic product.

Sources: Vanuatu National Statistics Office; Asian Development Bank estimates

The cyclones exacerbated technical and institutional challenges to the implementation of projects, as anticipated in *ADO April 2023*. Government expenditure in the first half of 2023 was in line with expectations, with capital expenditure 70% lower than the same period last year, while the use of goods and services was down by 12%. Expenditure on salaries and wages rose by 3%, and expenditure on subsidies, grants, and transfers was up 8%. The implementation of infrastructure projects has still not fully recovered, despite the lifting of pandemic restrictions.

The fiscal deficit is now expected to widen because of substantial post-disaster reconstruction and rehabilitation needs. A supplementary budget in

May raised the overall budget by 8%, increasing capital expenditure by 33% and expenditure on goods and services by 7%. With grant revenue projected to rise by 8% and tax and nontax revenues to remain unchanged, the fiscal deficit is now expected to rise from the equivalent of 5.0% of GDP in the original budget to 7.8% in 2023. The government's post-disaster needs assessment estimated damage and loss from the cyclones at $433 million (40% of GDP).

Revenue from honorary citizenship programs continues to fall. Revenue was 5.2% lower in the first half of 2023 compared to the same period in 2022. Although the drop was in line with assumptions in *ADO April 2023*, the situation is expected to worsen in the second half of 2023 and put further pressure on the fiscal situation. In July, the Government of the United Kingdom revoked the visa waiver for Vanuatu passport holders, which is likely to further reduce demand for honorary citizenships. Revenue from the programs, which peaked in 2020, declined by 10% in 2021 and 34% in 2022.

Visitor arrivals remain below pre-pandemic levels. Data on visitors from Australia and New Zealand indicate that arrivals were back to 76% of their pre-pandemic level in the first half of 2023, in line with the projections in *ADO April 2023*. Tourism activity is expected to increase further in the second half as flight disruptions decline and benefits from Vanuatu's first full year of open borders since the pandemic are realized. The resumption in June of direct flights from Brisbane to Vanuatu's second largest city, Luganville, will further boost tourism. In August, the government introduced new visa categories that are mainly intended to allow in more foreign workers, especially for the tourism industry.

Remittances from seasonal workers in Australia and New Zealand continue to support domestic demand. The impact of the cyclones on households would have been worse were it not for the remittances of seasonal workers. Studies show that remittances tend to increase after disasters, mainly for relief and reconstruction. In line with *ADO April 2023*, participation in seasonal worker programs is expected to increase. Visa approvals under the New Zealand scheme rose by 42% in the year to June 2023 compared to the same period in 2022, and approvals in the Australian schemes are also expected to be significantly higher.

The forecast for inflation in 2023 is revised sharply up from April's projection. Damage to crops and disruptions to supply chains caused by the cyclones were considerably greater than estimated earlier. This, together with a 36% increase in the minimum wage in June, means that inflation in 2023 is now expected to be at its highest level in decades and monetary policy is therefore expected to be tightened in September. The inflation forecast for 2024 is also revised up. Inflation next year is expected to be lower than 2023's rate, but still above the Reserve Bank of Vanuatu's 1%–4% target range.

Central Pacific Economies

Forecasts for the Central Pacific economies are mixed. Kiribati's growth forecasts are unchanged from *ADO April 2023*'s, but inflation for 2023 is revised up due to the rising prices of imports. Nauru's growth forecasts for 2023 and 2024 are revised down due to the reduced activities of the Regional Processing Centre; the inflation estimates for both years are significantly revised up. Higher inflation forecasts for Tuvalu due to external factors and last November's drought are risks to the upward revisions to the growth forecasts for 2023 and 2024.

Kiribati

GDP growth forecasts for 2023 and 2024 are unchanged (Table 2.5.5). This is consistent with expectations that economic activity related to energy, water, and transport projects will continue to support the recovery. Elevated social protection expenditure

Table 2.5.5 Selected Economic Indicators in Kiribati, %

Inflation is expected to accelerate in 2023 on higher prices for imported goods.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	1.8	2.3	2.3	2.8	2.8
Inflation	5.0	3.7	6.0	3.0	3.0

GDP = gross domestic product.
Source: Asian Development Bank estimates.

equivalent to 29.5% of GDP in 2023 is expected to underpin the forecasts. However, ever-present natural hazards could cause delays in project implementation.

***ADO April 2023*'s forecast of a fiscal surplus for 2023 is revised to a deficit.** Government revenue is now forecast to be lower amid sustained higher spending. Although revenue from fishing licenses is expected to be lower as changing weather patterns affect fish catches, this should be more than offset by growth—forecast at 46.2%—in tax revenues from company, excise, and value-added taxes. Total revenue is expected to grow by 4.5% in 2023. Government spending is forecast to increase slightly faster than revenue, driven by social protection spending.

The forecast for inflation is revised up for 2023 and unchanged for 2024. Prices are expected to remain elevated, with external factors influencing domestic price movements. The government inflation report for the second quarter of 2023 indicated price increases in imported food products, such as canned goods, frozen goods, and powdered beverages, as well as transport fares. The latest price movements are in line with the increase in petroleum prices in Kiribati after the government reduced the subsidy last year. The inflation forecast for 2024 is unchanged as state-owned Kiribati Oil Company, the sole oil importer, restored oil prices to lower levels, following a higher subsidy for 2023.

Nauru

This update revises down the estimate for GDP growth in fiscal year 2023 (FY2023, ended 30 June 2023) due largely to the reduced operations of the Regional Processing Centre (RPC). These were caused by the RPC's shift in July 2023 to an enduring capability model, whereby the center remains operational regardless of its level of activity. Because the RPC was the second biggest employer after the national government from 2014 to 2021, changes in its operations have a huge impact on the economy. The downward revision to FY2023's growth forecast also reflects a base effect, as FY2022's growth estimate was revised up to 2.8% from *ADO April 2023*'s 1.2% projection (Table 2.5.6).

Government spending rose by a mere 0.9% in FY2023 after increasing 11.4% in FY2022. Although capital expenditure fell by 53.2%, and social spending declined 31.8%, personnel costs, which account for 21% of total expenditure, increased by 18.9%, largely reflecting a 10% cost-of-living adjustment. With revenue and grants decreasing by 3.9%, the fiscal surplus declined to the equivalent of 17% of GDP in FY2023 from 25% of GDP in FY2022.

Table 2.5.6 Selected Economic Indicators in Nauru, %

The Regional Processing Centre's reduced operations led to lower growth in 2023, while inflation was higher on the lagged impact of global prices.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	2.8	1.8	1.6	2.2	1.6
Inflation	1.0	2.5	5.5	1.9	4.2

GDP = gross domestic product.

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

Source: Asian Development Bank estimates.

The growth forecast for FY2024 is revised down. The FY2024 budget projects a 10.0% decrease in revenue and grants, with tax revenue expected to fall by 59.0%. RPC-related revenue is projected to decline by 14.6% due to the loss of visa fees, and reduced hosting fees and related tax revenue. This will be partly offset by a one-off funding provision from the Government of Australia to provide training to RPC employees under the Alternative Pathway program to prepare them for non-RPC employment. The training is expected to be provided by Fiji National University, covering key skills, including construction, nursing, and fisheries. Because of the anticipated decrease in revenue and grants, the government aims to reduce expenditure by 11%, resulting in a slightly reduced surplus for FY2024, forecast at 16% of GDP.

Inflation in FY2023 was higher than forecast earlier. There has been a considerable lag in the impact on domestic prices of higher global commodity prices caused by the Russian invasion of Ukraine. Higher inflation in FY2023 was mainly driven by transportation costs (up 20%) and food and nonalcoholic beverages (up 10%). Updated data indicate that inflation for FY2022 was just 1.0%, lower than *ADO April 2023*'s 2.3%.

High inflation is expected to persist in FY2024, but at a lower rate than FY2023. This is mainly in line with the lag in the impact of global price movements on domestic inflation. But inflation is expected to ease slightly in the second half of FY2024 in line with anticipated global price movements. Subsidies for electricity and freight costs were maintained in the 2024 budget.

Tuvalu

The forecasts for growth in 2023 and 2024 are revised up. The removal of travel restrictions and fewer shipping bottlenecks have improved the economic outlook from the expectations in early 2023 (Table 2.5.7). Infrastructure projects are likely to continue to drive economic growth. The recent opening of the harbor in Nukulaelae, and the completion of harbors in the other outer islands in the next few years, will increase mobility and economic activity. A renewable energy project is underway and is due for completion in 2024. The drought in November 2022 caused the government to declare a state of public emergency. Alongside the increased occurrence of disasters, climate change can threaten Tuvalu's economy through impacts on fishing revenues, food and water security, damage to infrastructure, and loss of human lives.

Table 2.5.7 Selected Economic Indicators in Tuvalu, %

Inflation remains high and may be a drag on growth in 2023 and 2024.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	0.7	2.5	3.0	2.0	2.5
Inflation	12.2	3.3	6.2	2.8	3.3

GDP = gross domestic product.
Source: Asian Development Bank estimates.

The inflation forecast for 2023 is revised significantly up. This reflects higher-than-expected inflation in the first half due to high domestic food prices caused by the drought. Food prices rose by 8% in the second quarter after an average 18% increase in the preceding 3 quarters, with fruit and vegetable prices rising 30% from the second quarter of last year. The forecast for slightly higher inflation in 2024 than April's projection reflects recent price outcomes and despite a reduction in freight charges, as proxied by the Drewry World Container Index.

Fiscal deficit forecasts are unchanged. The deficit is expected to widen to an equivalent of 9.2% of GDP in 2023 and 11.9% of GDP in 2024. Although tax collection will grow moderately this year, lower fishing revenue will weaken total revenue. Higher infrastructure spending and expectations of a softer revenue performance will also widen the deficit.

North Pacific Economies

Growth forecasts for the Marshall Islands are revised up from *ADO April 2023*'s projections, but unchanged for the Federated States of Micronesia (FSM) and Palau. The inflation forecast for Palau is adjusted to incorporate the impact of tax and tariff measures; inflation forecasts for the FSM and the Marshall Islands are unchanged. Food and fuel prices are at risk from an expected El Niño that could disrupt local agriculture and fisheries production, and the possibility of further international commodity shocks due to the Russian invasion of Ukraine. Likely extensions of Compacts of Free Association with the US bode well for fiscal resources.

Federated States of Micronesia

Growth forecasts are unchanged from *ADO April 2023*'s projections. The economy is on track to recover to its pre-pandemic level in fiscal year 2023 (FY2023, ending 30 September 2023 for all three North Pacific economies), underpinned by a rebound after the economy was fully reopened and pandemic measures were lifted in August 2022 (Table 2.5.8). The expansion in construction, hotels and restaurants, and transport will fade in FY2024 due partly to base effects and the economy returning to normal levels of activity. The FSM's high dependence on imports and its exposure to international commodity price volatility remain the key risks to the outlook in the short term. In addition, the reopening of international borders may spur out-migration and exacerbate capacity constraints that hinder growth.

Table 2.5.8 Selected Economic Indicators in the Federated States of Micronesia, %

The economy is expected to rebound this year as it recovers from the pandemic before moderating to more normal growth next year.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	2.0	4.1	4.1	0.5	0.5
Inflation	5.0	3.6	3.6	0.4	0.4

GDP = gross domestic product.

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

Source: Asian Development Bank estimates.

Table 2.5.9 Selected Economic Indicators in the Marshall Islands, %

Faster economic growth is expected, driven by fisheries and construction output.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	−0.9	1.5	2.2	2.0	2.5
Inflation	3.3	3.7	3.7	3.5	3.5

GDP = gross domestic product.

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

Source: Asian Development Bank estimates.

Inflation forecasts are unchanged from *ADO April 2023*'s projections. Inflation is expected to decelerate in line with modest decreases in the prices of key commodities. Nonetheless, the outlook is far from certain given that imports account for 68.2% of the consumer price index and international commodity markets remain volatile and vulnerable to geopolitical risks, as well as the potential impact of weather-related developments, such as El Niño, on food prices. In the first quarter of FY2023, a steady acceleration in the transport, food and beverages, and housing and utilities sub-indices drove a 6.9% increase in consumer prices.

The fiscal surplus is projected to steadily increase after declining during the pandemic. At the equivalent of 4.4% of GDP, the fiscal surplus in FY2022 was the lowest since FY2013 due to pandemic spending and the impact of the economic downturn on revenues. The reversal of these factors should see the surplus increasing to 5.4% in FY2023 and 7.4% in FY2024. Moreover, the FSM stands to benefit from increased financial assistance under the proposed extension of its Compact of Free Association with the US, which is up for Congressional approval. This includes annual sector grants worth $140 million ($2.8 billion over 20 years) and a total infusion of $500 million to the FSM Trust Fund.

Marshall Islands

Growth forecasts are revised up. The economy is expected to expand faster than earlier forecast, driven largely by revived fisheries and construction output (Table 2.5.9). In May 2023 alone, the number of vessels calling at Majuro port was almost equal to that in January–April, indicating a pickup in fishing transshipments. Construction financed by development partners and preparations for the Micronesian Games in June 2024 are also spurring economic activity. El Niño poses a significant downside risk to the outlook as it could depress agriculture and fisheries output.

Inflation projections are retained from *ADO April 2023*'s projections. The impact of lower international fuel prices is expected to be offset by domestic factors, such as revived business activity and increased power tariffs in the urban centers of Majuro and Ebeye during FY2023. Furthermore, the suspension of the country's sole air cargo carrier between February and June 2023 resulted in supply chain disruptions. Demand from the Micronesian Games and the potential impact of El Niño on food prices are expected to keep inflation elevated in FY2024 relative to past years.

A fiscal deficit equivalent to 2.9% of GDP is still expected for both the current and next fiscal year. Government spending is still seen growing faster than revenues, especially given higher prices, preparations for the Micronesian Games, and El Niño's possible impact on revenues from fishing license fees. An upside risk is the increased likelihood that a new Compact of Free Association with the US will be signed, although this is unlikely to happen before the current agreement expires on 30 September. The new agreement would substantially increase financial assistance, as well as continue postal, weather, aviation, and disaster assistance services provided by the US.

Palau

GDP growth forecasts are unchanged from *ADO April 2023*'s projections (Table 2.5.10). International arrivals increased by 234.1% yoy in the third quarter of FY2023, but the year-to-date total still represents only 24.1% of FY2019's level. Tourist arrivals from Taipei,China and the People's Republic of China (PRC) have grown rapidly. In FY2022, tourist arrivals from Palau's top source markets prior to the pandemic—Taipei,China, Japan, the Republic of Korea, and the PRC—remained low as direct flights had not been fully restored. Still, latest data show signs of catch-up with the resumption of scheduled flights by United Airlines and chartered flights by Taipei,China's flag carrier, as well as a new Air Niugini connection from Port Moresby. Given the challenging economic environments in major source markets and competition from other travel destinations, the pace of recovery in tourism remains uncertain.

Table 2.5.10 Selected Economic Indicators in Palau, %

A sharp rise in inflation expected this year on tax and tariff increases.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	–1.0	3.8	3.8	6.5	6.5
Inflation	10.2	5.0	8.0	5.5	5.0

GDP = gross domestic product.
Note: Years are fiscal years ending on 30 September of that year.
Source: Asian Development Bank estimates.

The inflation forecast for FY2023 is considerably higher than *ADO April 2023*'s due to recent tax and tariff developments. The introduction of value-added taxes in January 2023 pushed up food and fuel prices, and increases in electricity and wastewater tariffs raised household utility costs. Because of the resulting higher base, FY2024's inflation forecast is slightly lower than the earlier projection. Palau remains vulnerable to volatility in international prices because of its dependence on imported commodities. Although oil prices have declined faster than expected, they will likely rise over the rest of the year and into 2024. Further shocks to fuel or food prices from the Russian invasion of Ukraine or El Niño on agriculture are upside risks to inflation.

Fiscal gaps remain despite the prospect of increased financial resources. Revenues are expected to recover only gradually in line with the positive growth outlook, although economic activity will likely remain well below pre-pandemic levels over the forecast horizon. Thus, the country is still expected to run fiscal deficits equivalent to 9.5% of GDP in FY2023 and 10.2% in FY2024. Tax reforms coinciding with already elevated inflation may dampen consumption and constrain revenue growth in the near term. The main upside risk to the fiscal outlook for FY2024 is the enhanced financial assistance package under Palau's renewed Compact of Free Association with the US, which is pending Congressional approval. However, absorptive capacity remains a constraint to maximizing the uptake of increased fiscal resources.

South Pacific Economies

The Cook Islands, Niue, Samoa, and Tonga continue to recover faster than expected. But visitor arrivals and flight access to the Cook Islands and Niue are still below pre-pandemic levels. Inflation is a growing challenge in all four countries, with higher-than-expected results for fiscal year 2023 (FY2023, ended 30 June 2023 for all four) due to domestic and imported price pressures. Labor constraints are becoming increasingly prominent in these countries and may be a drag on future growth if not mitigated through active interventions in skills training, immigration, and labor force participation.

Cook Islands

Growth was stronger than expected in FY2023 (Table 2.5.11). After a full year of open borders, growth was driven by tourist arrivals that, at 116% of FY2022's level and 70% of FY2019's, exceeded expectations earlier in the year. New Zealand, as the primary tourism market, accounted for 80.5% of arrivals. Natural hazards and acute labor shortages are downside risks to the recovery, although the active recruitment of foreign workers should somewhat mitigate labor shortages.

Table 2.5.11 Selected Economic Indicators in the Cook Islands, %

GDP growth rebounded stronger than expected in 2023.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	10.5	11.2	14.5	9.1	9.1
Inflation	4.2	7.7	13.0	2.3	2.3

GDP = gross domestic product.

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

Source: Asian Development Bank estimates.

Table 2.5.12 Selected Economic Indicators in Samoa, %

The recovery in 2023 accelerated faster than expected, but so did inflation.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	–5.3	4.8	6.0	2.5	4.2
Inflation	8.8	10.2	12.0	2.0	5.3

GDP = gross domestic product.

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

Source: Asian Development Bank estimates.

Inflation over FY2023 was higher than projected in *ADO April 2023*, but is expected to fall back to trend in FY2024. Global supply disruptions escalated international fuel prices and transportation costs, which raised commodity prices, particularly for electricity and food. This increased the cost of living in the Cook Islands and reduced the purchasing power of consumers. However, inflation is expected to decelerate as imported fuel and food prices normalize, and the forecast for FY2024 is unchanged.

A small fiscal surplus is now estimated for FY2023. *ADO April 2023* forecast a fiscal deficit, but the outturn was a surplus equivalent to 1.5% of GDP, driven by a 22.2% rise in tax revenue, mainly from value-added taxes, and 18.0% lower expenditure yoy due to underspending on capital projects. This update forecasts a fiscal deficit of 1.5% of GDP in FY2024, assuming public investment spending achieves its targets. Public debt equaled 45.6% of GDP in FY2023, and is expected to decline to 38.1% in FY2024.

Samoa

Growth for FY2023 is revised up on a stronger-than-expected rebound (Table 2.5.12). Visitor arrivals and domestic demand supported a recovery in tourism, commerce, and services through to the March quarter of 2023 and visitor arrivals in the June quarter recovered to near pre-pandemic levels. This momentum is forecast to continue into FY2024, with these sectors getting an additional lift from the increased mobilization of public spending, which has so far been subdued. Labor turnover has been significant, especially in tourism services. Continued growth in labor participation, as well as attracting former residents and overseas workers back to the domestic market, will be required to support growth.

Inflation in FY2023 was higher than earlier forecast because of persistent increases in import prices. *ADO April 2023* forecast inflation reaching its highest level since FY2009, but the final result exceeded that estimate. Increases in the prices of local and imported food were the largest contributors to inflation, with most other categories posting declines or modest increases. Domestic inflationary pressure is expected to persist because the impact of international prices has not yet been fully felt, prompting the inflation forecast for FY2024 to be revised up.

This update estimates a fiscal surplus for FY2023, equivalent to 2.4% of GDP, on strong revenue growth. This is considerably higher than the 0.8% surplus forecast in April. Revenue growth was due to improved collection, higher-than-expected economic output, and the impact of inflation on consumption taxes. Although these factors are expected to continue to support the fiscal position in FY2024, expenditure for the District Development Plan and preparations for the Commonwealth Heads of Government meeting will likely result in a fiscal deficit of 3.5% of GDP, unchanged from April's projection.

Tonga

An earlier-than-expected recovery in visitor arrivals improved economic activity in FY2023, but growth in FY2024 is expected to be lower than was projected in April (Table 2.5.13). Competition from other international destinations and limited domestic air capacity are expected to slow growth

Table 2.5.13 Selected Economic Indicators in Tonga, %

The faster recovery in visitor arrivals and GDP growth in 2023 will slow in 2024.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	–2.2	2.5	2.8	3.2	2.6
Inflation	8.5	9.4	10.3	1.5	4.5

GDP = gross domestic product.

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

Source: Asian Development Bank estimates.

in visitor arrivals. This will make it harder to attract much-needed reinvestment in tourism following the destruction of several properties from disasters in 2022 and 2020. Capacity constraints in carrying out capital projects will weigh on future growth, due in large part to labor shortages.

Inflation in FY2023 accelerated faster than was projected in *ADO April 2023*. Increases in consumer prices were initially driven by higher import prices, but domestic prices quickly caught up due to local supply constraints and the surging costs of local food items. Inflation has accelerated since May 2023. Despite a recovery in domestic agriculture and the prospect of softer international commodity prices, inflationary pressures are expected to remain and the inflation forecast for FY2024 is therefore revised up.

Post-disaster reconstruction will put downward pressure on fiscal balances. While financing needs for post-disaster reconstruction remain large, this will be offset by significant funding from development partners. As a result, a slight fiscal surplus equivalent to 0.4% of GDP is estimated for FY2023 (0.3% in *ADO April 2023*), and a modest surplus of 1.9% of GDP is forecast for FY2024. Consequently, external debt is expected to fall by more than was projected in April. The debt-to-GDP ratio is estimated at 31.7% in FY2023 and forecast to be 28.7% in FY2024.

Niue

The economy is likely to perform slightly better in FY2024 if expectations of a doubling in visitor arrivals starting this November are on the mark. The economy contracted by 4.7% in FY2020 and 6.2% in FY2021 as prolonged border closures stalled tourism and slowed public investment spending. Having just a single weekly flight since borders reopened in June 2022 has hindered a quick recovery in the tourism industry. Although visitor arrivals in the first quarter of 2023 were higher than in the same period of last year, they remained well below pre-2019 levels.

The budget balance is expected to be in line with *ADO April 2023*'s forecast. FY2023's fiscal deficit is estimated at 26.4% of FY2021's GDP (21.4% of FY2019's) as expenditure grew faster than revenue. Donor grants declined by 24.7%. An expected sharp increase in tourism arrivals from November 2023, when a second weekly flight is to be introduced, bodes well for fiscal outcomes.

Inflation is likely to remain elevated over the near term in line with higher prices in New Zealand, Niue's main trading partner. Annual average inflation in New Zealand was 6.8% from July 2022 to June 2023, with food prices increasing by 10.6%.