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OUT OF SESSION PAPER

REGIONAL ECONOMIC OUTLOOK

This briefing paper, compiled by the Forum Secretariat, discusses recent regional and global economic performances and highlights the short-term economic outlook for the information of Ministers.

BRIEFING PAPER

REGIONAL ECONOMIC OUTLOOK

Purpose

This paper discusses recent regional and global economic performances and highlights the short-term economic outlook for the information of Ministers.

Background

2. Pacific economies have underperformed for much of the last two decades, compared to other similar regions.¹ This economic growth performance has been affected by both domestic and external factors.

3. Forum Economic Ministers have recognised that domestic factors are important in understanding and improving the economic performance of Forum Island Countries (FICs).² Whilst the region faces natural constraints to growth, there are also issues in the areas of governance, macroeconomic management and public sector efficiency that Governments need to address to improve their growth prospects.

4. External conditions do have an impact on regional economic performance as well, particularly through the dampened global demand for products and services, combined with rising fuel and food prices which result in higher domestic inflation.³

5. In 2011, regional economies are forecast to grow by 1.7 percent, from an estimated 0.8 percent in 2010. Regional economies remain on a path of recovery from the impacts of the global economic crisis. Despite measures undertaken by FICs to assist with recovery, economic growth for 2012 is expected to remain close to 2011 levels.⁴

Issues

World Economic Outlook

6. The International Monetary Fund (IMF) expects the global economy to slow from 5.1 percent in 2010, to 4.3 percent in 2011 and 4.5 percent in 2012.⁵ Global expansion remains uneven and fragile. Growth in advanced economies is still weak, while emerging and developing economies continue to expand strongly (refer **Chart 1**).

7. Economic activity in the **United States** is expected to slow in 2011 with growth forecast at 2.5 percent compared to 2.9 percent in 2010. In part, this is due to transitory

¹ 2008 *Pacific Economic Survey*, Commonwealth of Australia, 2007 FEMM Keynote address by Mr Rick Hounipwela, then Governor of Central Bank of Solomon Islands, and 2010 FEMM Keynote address by Mr Siosiu Utoikamanu and Mr Savenaca Narube.

² 2006-2010 *Forum Economic (FEMM) Action Plans*. For example, the 2010 Action Plan highlighted the need to maintain macroeconomic stability and continue with necessary reforms to help broaden the economic base.

³ IMF, *World Economic Outlook Update*, June 2011.

⁴ *Asian Development Outlook*, April 2011. Note regional growth estimate cited in paragraph 5 does not include Papua New Guinea and Timor-Leste. With Papua New Guinea and Timor-Leste included regional growth is expected at 5.3 percent in 2010, and 6.3 percent in 2011.

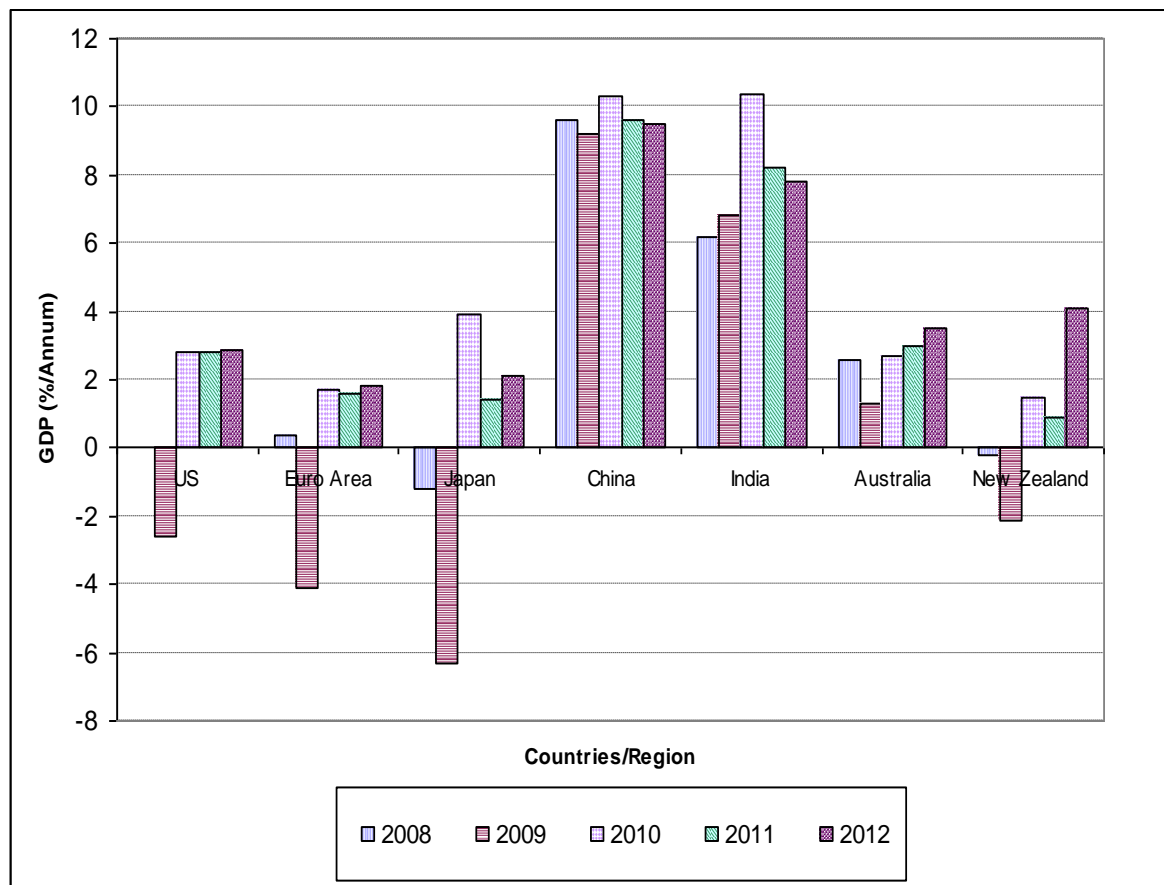
⁵ *World Economic Outlook Update*, IMF, June 2011.

factors – including higher commodity prices and supply chain disruptions from the Japanese earthquake on U.S. manufacturing. In contrast, the **euro area** is expected to perform better in 2011, with growth forecast at 2 percent compared to 1.8 percent in 2010. As highlighted in **Chart 1** the IMF expects economic growth to fall in **Japan** (from 4 percent in 2010 to -0.7 percent in 2011) attributed to the impact of the natural calamity earlier this year.

8. **Emerging and developing** economies are expected to grow strongly relative to advanced economies in 2011 (6.6 percent growth compared to 2.2 percent growth forecast for advanced economies). However, compared to their 2010 growth forecast, emerging and developing economies are expected to slow moderately (from 7.4 percent in 2010 to 6.6 percent in 2011), with the economies of **India** (from 10.4 percent in 2010 to 8.2 percent in 2011) and **China** (from 10.3 percent in 2010 to 9.6 percent in 2011) expected to lose steam.⁶

9. The **Australian** economy is forecast to grow by 3 percent in 2011 compared to 2.7 percent in 2010, due to investment plans in the resources sector and stronger commodity exports.⁷ The impact of recent earthquakes is expected to slow economic activity in **New Zealand** this year with growth projected at 1 percent (compared to 1.5 percent in 2010), but growth is expected to rise substantially in 2012 led by reconstruction.⁸

Chart 1: Economic Growth in Major Economies: 2008 – 2012



Source: IMF, *World Economic Outlook* April 2011 and *World Economic Outlook Update*, June 2011.

⁶ *Ibid.*

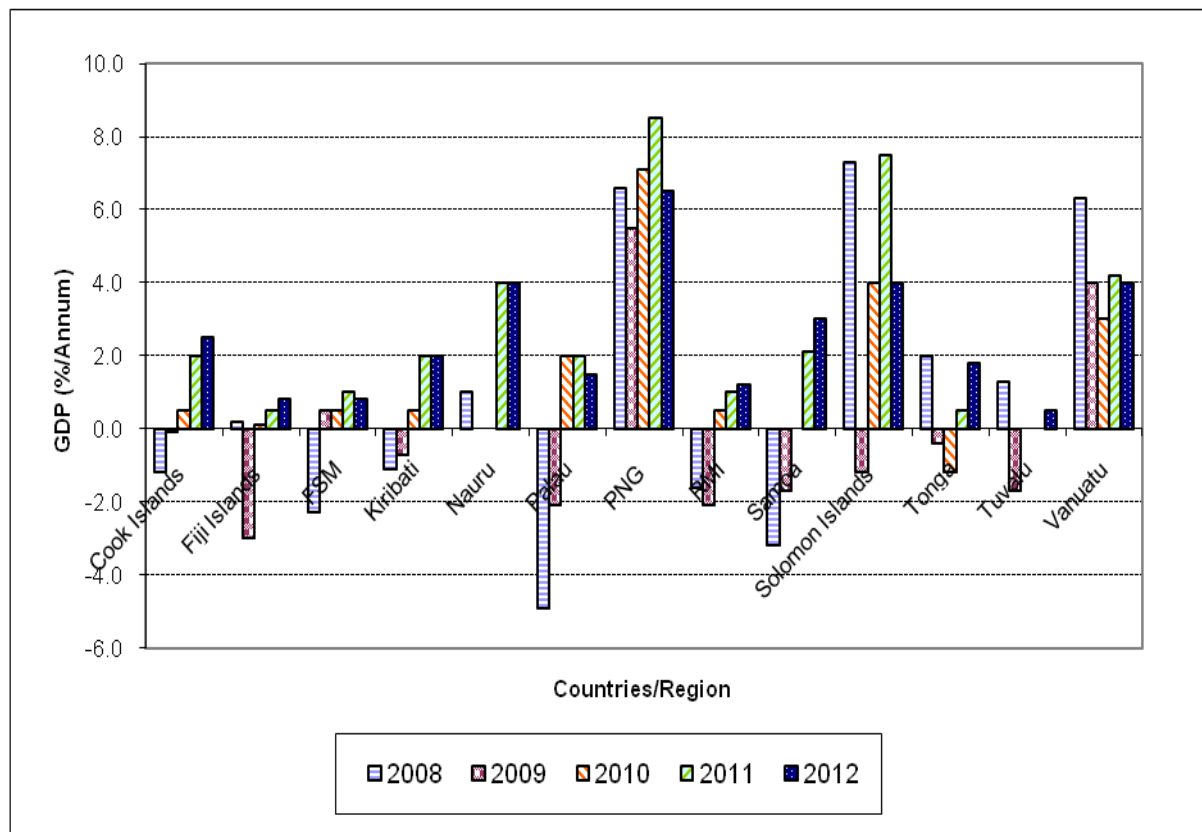
⁷ IMF, *World Economic Outlook*, April 2011.

⁸ *Ibid.*

Regional Economic Outlook

10. Economic growth in FICs is expected to be low for most in 2011, except Vanuatu (4.2 percent), and resource rich countries particularly Papua New Guinea (with an expected growth rate of 8.5 percent), Solomon Islands (7.5 percent) and Nauru (4 percent).⁹ Refer to **Chart 2**.

Chart 2: Annual GDP Growth Rates of FICs: 2008 – 2012



Source: *Asian Development Outlook 2011, ADB Pacific Economic Monitor*, February 2011.

11. The strong growth forecast for **Papua New Guinea** stems from construction associated with the Liquefied Natural Gas project, a rise in commodity prices for exports and general rise in investor confidence. Commodity exports including logs, palm oil, copra and the resumption of gold production in the **Solomon Islands** secures a better outlook for 2011. Growth prospects for **Nauru** are better in 2011 on the back of improved global demand for its phosphate exports.¹⁰

12. The positive outlook for **Vanuatu** is driven by agriculture production and recovery in tourist arrivals. Also contributing is increased private sector activity through liberalised aviation and telecommunication markets, which support broader growth. The economies of **Cook Islands** and **Kiribati** are expected to grow by 2 percent in 2011 primarily due to donor-financed infrastructure investments. **Palau** is expected to grow by 2 percent in 2011, on the back of strong visitor arrivals. **Samoa's** economy is expected to grow by 2.1 percent in 2011 due to an increase in private investment and government expenditure specifically

⁹ *ADB Pacific Economic Monitor*, February 2011.

¹⁰ *Ibid.*

for the ongoing post-tsunami reconstruction. Economic growth of between 0 to 1 percent is forecast for the remaining FICs.¹¹

Downside Risk to Growth Prospects

13. The main downside risk to the region's growth projections is increasing inflationary pressures, driven by high fuel and food prices. Inflation of 4 percent is expected across FICs in 2011.¹²

Upside Possibilities for FICs

14. The 2010 Forum Economic Ministers' Meeting (FEMM) supported expanding the economic base to enable countries to realise better economic growth.¹³ Measures that were agreed by 2010 FEMM to help broaden the economic base and raise growth included:

- Persevering with reform and implementation of policies, supported by strong leadership and political will;
- Pursuing reforms to create an enabling environment for private sector development;
- Reforming the governance of State Owned Enterprises (SOEs) based on commercial principles, to improve service delivery and release resources for other priorities; and
- Strengthening areas of comparative advantage such as agriculture, tourism, and fisheries sectors.

15. Policy reforms in appropriate sectors are necessary to create an environment that is conducive to private sector development. For example, a recent comparative study by the Asian Development Bank has revealed that there is opportunity for better SOE performance that would lead to improved economic growth. According to the Study, this can be realised if the enabling environment supports full commercial orientation with strong governance arrangements, appropriate performance incentives and hard budget constraints.¹⁴

16. A positive outlook over the short term in major FIC trading partner economies will support an expected rise in tourist arrivals to the Pacific and some recovery in remittance flows.¹⁵

Conclusion

17. While global economic growth is expected to be slower in 2011 compared to 2010, growth prospects in 2011 for major FIC trading partners is expected to support regional recovery mainly through an expected rise in tourism and improved remittance flows. However, increasing inflationary pressures are expected to continue, which may undermine FICs' growth prospects in 2011.

Pacific Islands Forum Secretariat,
Suva.
30 June 2011

¹¹ *Ibid.*

¹² *Ibid.*

¹³ *2010 FEMM Action Plan.*

¹⁴ Asian Development Bank, 2011. *Finding Balance: Benchmarking the Performance of State-Owned Enterprises in Fiji, Marshall Islands, Samoa, Solomon Islands, and Tonga.*

¹⁵ *ADB Pacific Economic Monitor*, February 2011.