

CURRENT GLOBAL CONDITIONS - IMPLICATIONS FOR THE REGION

The last few months have been very unsettling times for the global economy. The events in the US and the Eurozone have caused a lot of uncertainty and are now threatening to send the global economy back into recession.¹ This brief provides an overview of the possible flow on effects of the current global economic conditions on the Forum Island Countries (FIC), some of which were identified by FEMM following the 2008 global economic crisis.

2. The interconnectedness of the global economy means that any global economic slowdown will trickle down to the Forum Island Countries (FICs) through our major trading partners. Territories of the US and France may generally be directly affected through reductions in Government financing. Some of the more specific transmission channels are outlined below.

Remittances

3. Remittance flows are dependent on income level and employment situations of the sending countries. If there is a reduction in income levels, then remittances are also expected to fall, consequently reducing money flowing into the region. During the 2008 economic crisis, remittances to the Pacific decreased substantially following weakness in NZ, Australian and US labour markets.²

Tourism

4. Tourism, like remittances will depend on the propensity to earn and spend in the tourist source countries. If income levels fall then tourists have less money to spend on holidays abroad. During the 2008 recession, tourist numbers to the majority of the countries in the region remained fairly stable due to the resilience of the Australian and NZ markets, however tourist numbers from Asia and the US fell resulting in a decrease in tourist for some FICs.³

Export Demand

5. If there is a slowdown in the global economy including Australia and New Zealand, FICs will see a reduction in exports as world demand decreases. This is mainly expected to impact the larger FICs that have large export volumes to the two countries.

Exchange Rates

6. With the Australian and NZ currencies recently trading at all time highs against other major currencies⁴, it will be more costly for FICs that trade heavily with NZ and Australia (with

¹ More information on global economic conditions and the current crisis can be found in Issue 1 and 2 of this Series.

² ADB 2008, Policy Brief on the Global Economic Crisis - Pacific Studies Series

³ ADB 2008, Policy Brief on the Global Economic Crisis - Pacific Studies Series

⁴ The main reason for appreciating Australian and NZ currencies are strong export receipts particularly from commodities, however insurance flows into the country due to disasters, and high interest rates are other factors pushing up the currency value.

the exception of those that use the Australian and NZ currencies) to buy their products. However, it also means that FIC export goods to Australia and NZ will be cheaper.

Commodity Prices

7. When investors are anxious about the economy, they sell assets that are considered risky and place their money in assets that are considered safer, such as gold. As the demand for gold increases, so does its price. This is beneficial for countries like PNG, Solomon Islands and Fiji that export gold.

8. The International Crude Oil price has also been affected by the crisis. Due to a reduction in demand for fuels as a result of economic uncertainty, there was reduction last month in the price of crude oil. Whether or not this trend will continue is unclear. The International Energy Agency (IEA) revised down its projected oil demand for 2011 by 0.06 percent citing worldwide fears of an economic slowdown.⁵ The reduction in the international price of oil may have benefits to the region in terms of a reduction in inflationary pressures and lower cost of energy.

9. International food prices have also declined, albeit modestly, mainly due to improving supply prospects over the near term. The lack of sensitivity of food prices to the projected economic slowdown is attributed to the fact that the reason behind the recent high food prices has been reduced supply due to adverse weather conditions. However, the lower oil prices and the weaker economic outlook have eased upward pressure on food prices. The region can expect a slight reduction in food prices, however over the medium term food prices are expected to remain elevated.

Trust funds

10. A number of FICs have substantial public savings invested in offshore markets under trust funds. During the 2008 crisis, when financial stock markets fell, some of the trust funds fell by 20 to 30 percent in value.⁶ Depending on the portfolio of investments, some countries may see the value of their trust fund decline more than others. Countries like Tuvalu, Palau, and Kiribati who rely on national trust funds as part of financing for recurrent spending may be affected to a larger extent than other countries like FSM and RMI, whose funds are only used in the longer term.⁷

Conclusion

It is important to understand that changes in global economic conditions do have an impact on the regional economies. While some general channels through which the impact of a global economic slowdown can be transmitted to FICs have been identified in this brief, further monitoring to understand the extent of the impacts is needed, and will be provided once revised macroeconomic estimates are available.

7 October 2011

⁵ International Energy Agency Oil Market Report, August 2011

⁶ ADB 2008, Policy Brief on the Global Economic Crisis - Pacific Studies Series

⁷ ADB 2008, Policy Brief on the Global Economic Crisis - Pacific Studies Series

