

**Pacific High-level Policy Dialogue on
“The Role of Macroeconomic Policy and Energy Security in supporting
Sustainable Development in the Pacific”**

8-9 October 2012, Nadi, Fiji

**Jointly organized by
UN ESCAP and Sustainable Development Working Group of the Council of Regional
Organizations in the Pacific (CROP)**

**Session 1 – Stimulating and Sustaining Growth, Building Resilience: the
Role of Macroeconomic Policies**

Growth, Spillovers and Policy Options in the Pacific

by
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Growth, Spillovers and Policy Options in the Pacific

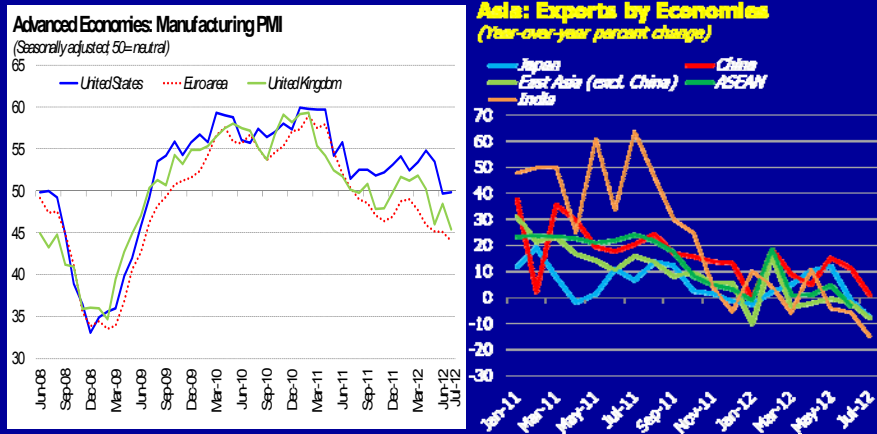
Pacific High-Level Dialogue on Macroeconomic Policy
and Energy Security, Nadi Fiji, October 8-9, 2012

Yongzheng Yang
Resident Representative for Pacific Island Countries
International Monetary Fund

Outline

- The global and regional environment
- Channels of spillover to the Pacific
- How might Pacific island countries respond in the short run?
- What has happened to long-term growth in PICs?
- What can be done to raise long-term growth?

Global recovery lost momentum in 2012Q2, with Asia's external demand further deteriorating...



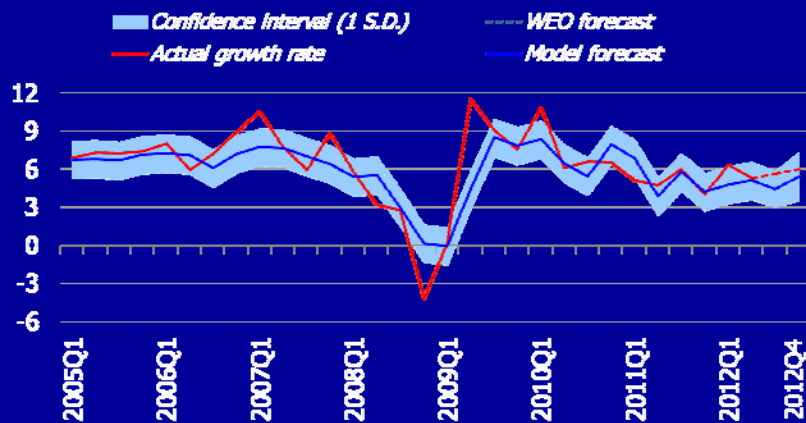
3

...leading to slowing growth across the region...



Near-term outlook points towards a continuation of moderate growth

Indicator Model for Asia: Projected versus Actual Growth in Real GDP
(Quarter over quarter, in percent; SAAR)

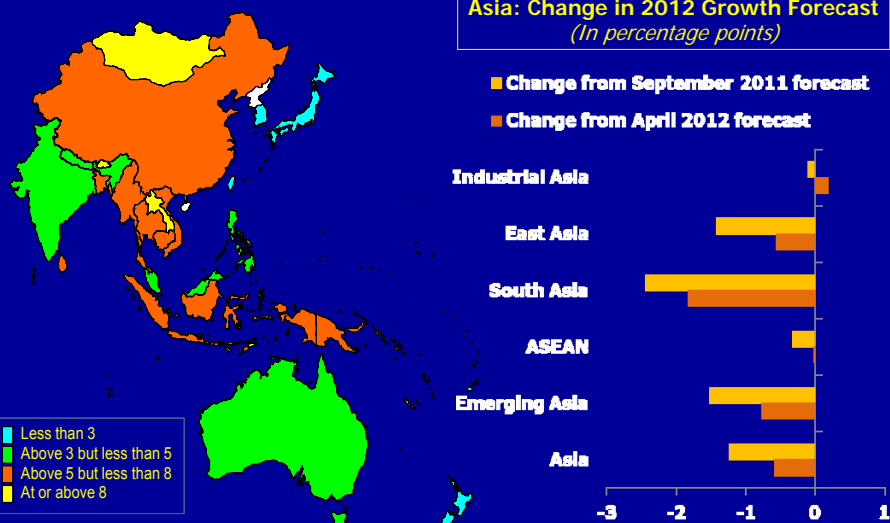


5

Asia remains a growth leader, despite downward revisions

Asia: Change in 2012 Growth Forecast
(In percentage points)

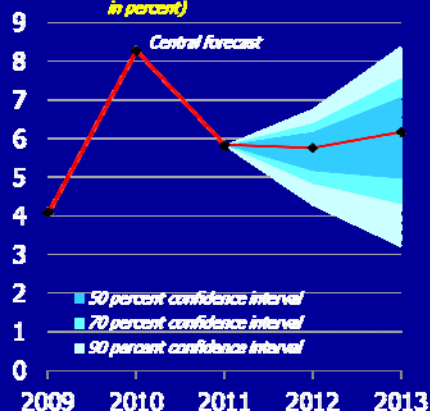
- Change from September 2011 forecast
- Change from April 2012 forecast



Risks to growth tilts further to the downside

Asia: Real GDP growth

(Central forecast and selected confidence intervals in percent)



Global risks

1. Escalation in euro area crisis
2. 'Fiscal cliff' in the US
3. Sharp increase in commodity prices

Regional risks

1. Hard-landing in China
2. Permanent drop in potential growth

7

Channels of Spillovers to the Pacific

The Outlook

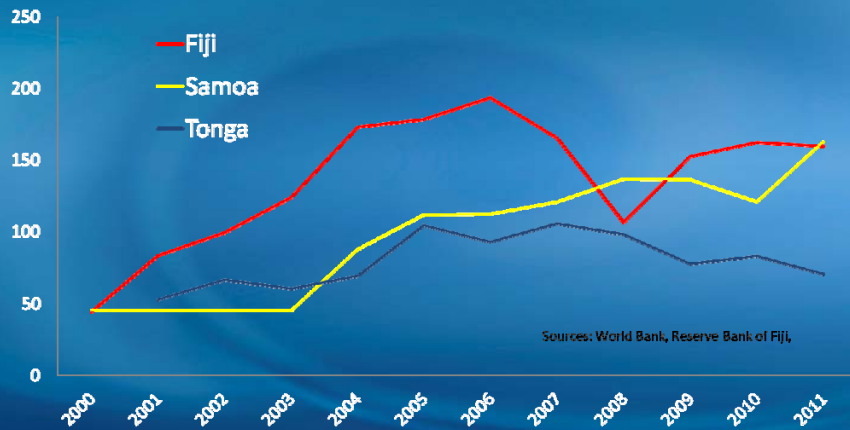
- Remittances (Samoa, Tonga, Tuvalu, Fiji)
- Tourism (Palau, Samoa, Vanuatu, Fiji)
- Trade flows
- Terms of trade via commodities
- Financial: mainly through trust funds (Kiribati, Tuvalu)



10

Remittances (In millions of USD)

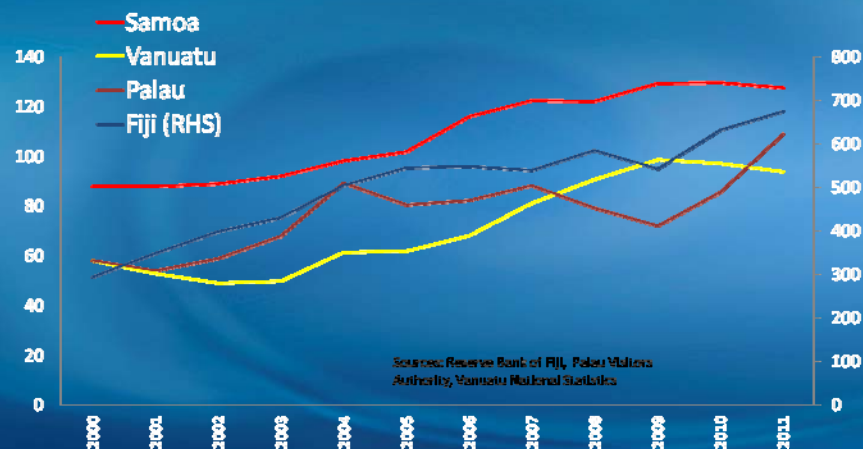
The Outlook



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Tourist Arrivals (In thousands)

The Outlook

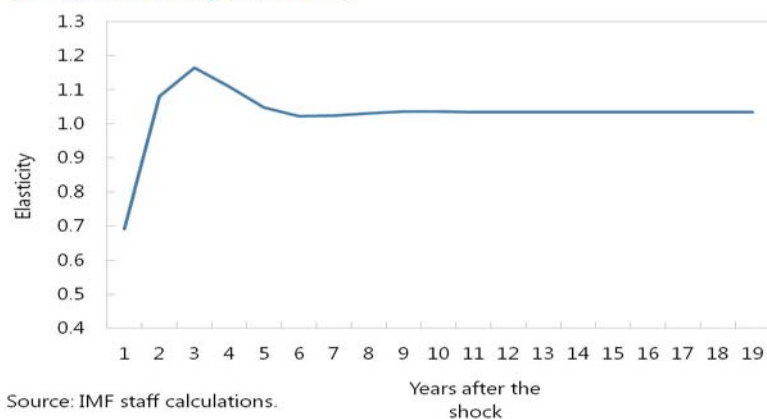


10

Elasticity of PIC GDP to Regional GDP

The Outlook

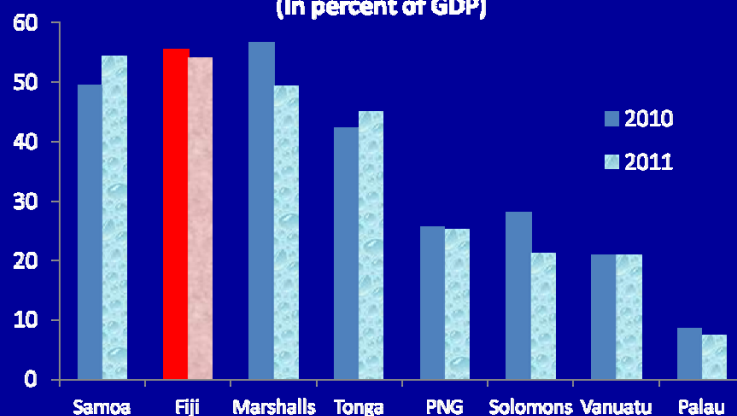
Response of PIC GDP to Changes of Australia GDP
(In response to one percent shock)



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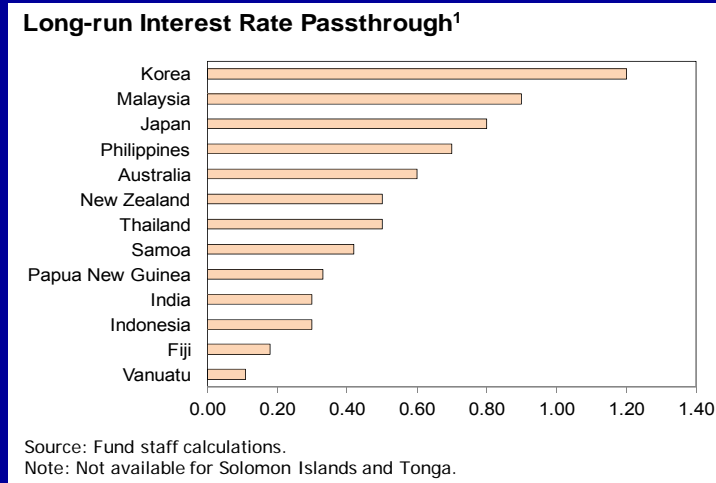
High public debt limits scope for fiscal stimulus

Central Government Debt
(In percent of GDP)



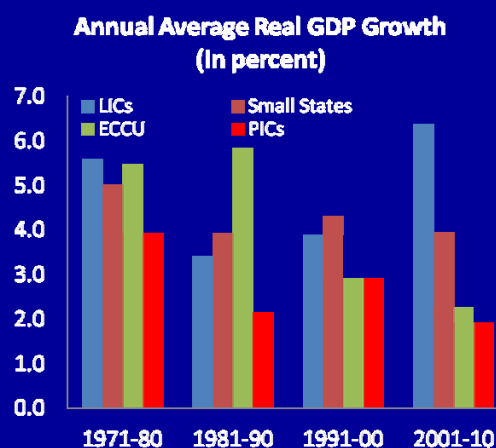
12

Low interest rate pass-through constrains the effectiveness of monetary policy (from policy rate to lending rate)



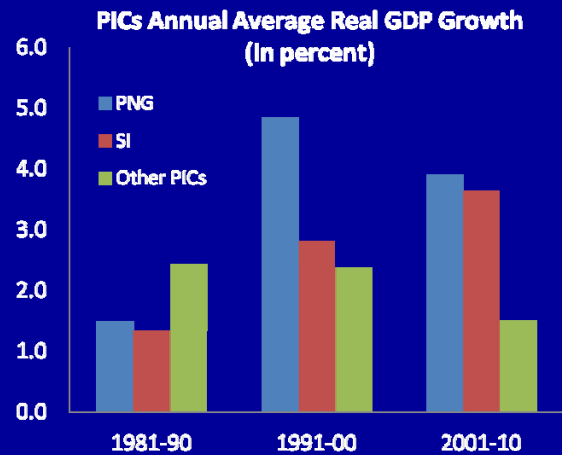
Growth has been slow and become slower

- Global crisis hit PICs hard
- Seven PICs below pre-crisis income
- This is the slowest decade
- Growth has fallen behind others



PIC growth has diverged

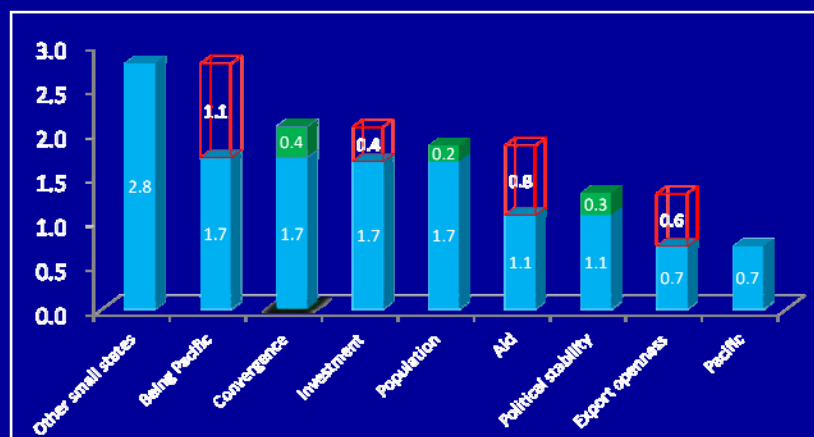
- PNG and SI. Have surged ahead
- Other PICs have slowed
- Growth has become less volatile



15

The Pacific Speed: Geography *and* policies do matter

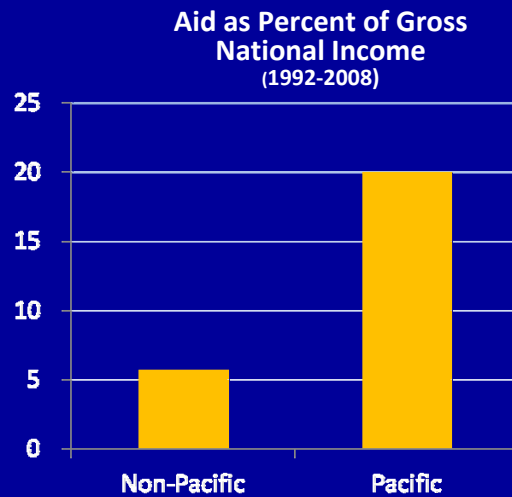
(Average annual p.c. GDP growth, in percent)



16

The Role of Aid in Small States

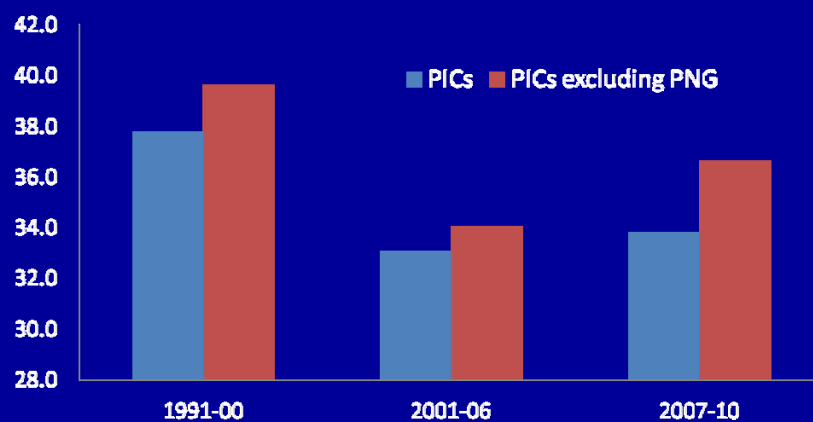
- Helps raise living standards
- much aid is for poverty reduction rather than growth
- Possible to increase growth in the long run, e.g., via human capital buildup.



17

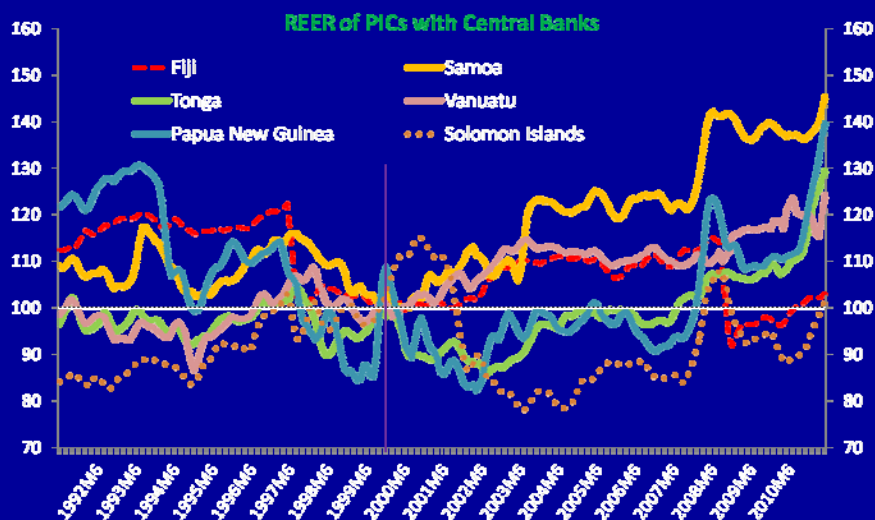
Export openness has fallen

Goods and Services Exports (In percent of GDP)



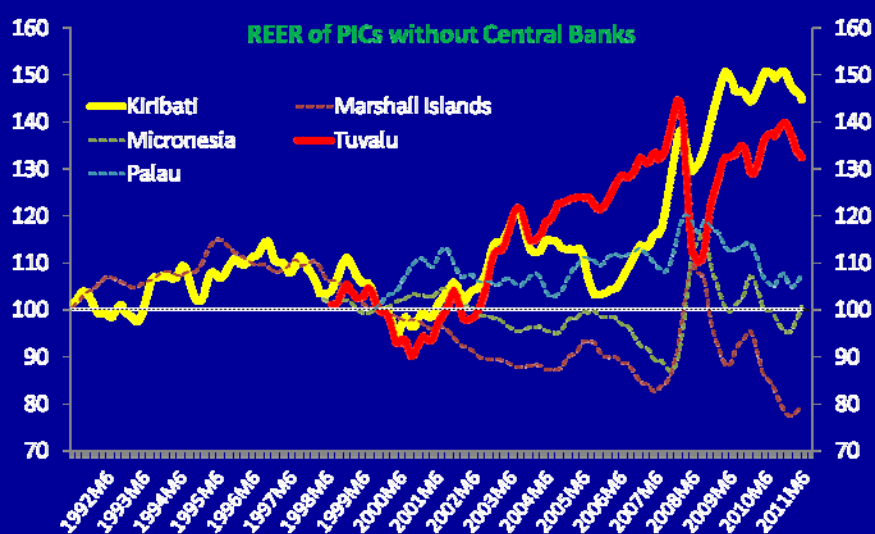
18

Exchange rates have appreciated for some (1)



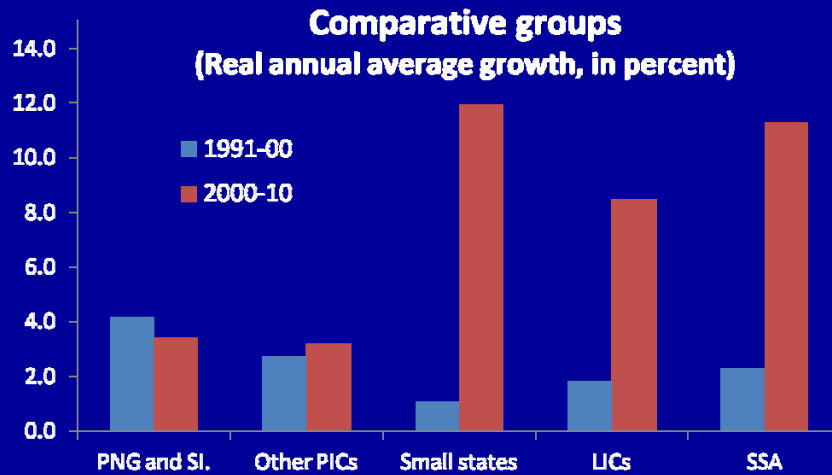
19

Exchange rates have appreciated for some (2)



20

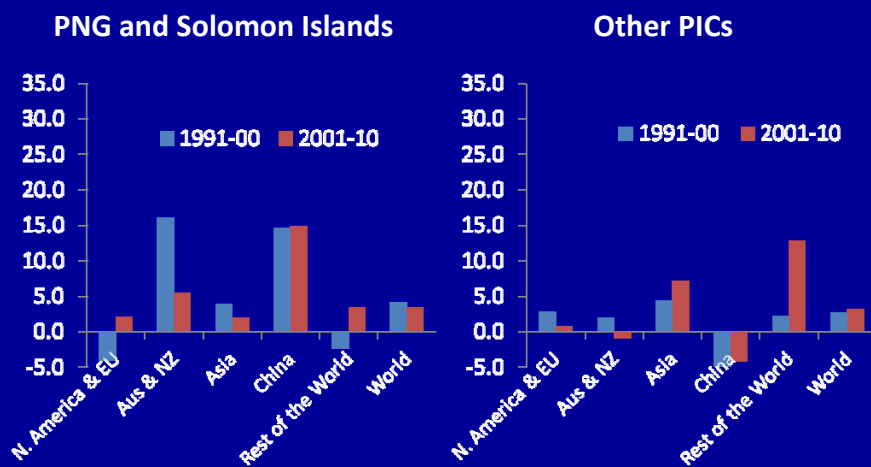
What do exports show?



21

Export growth by destination

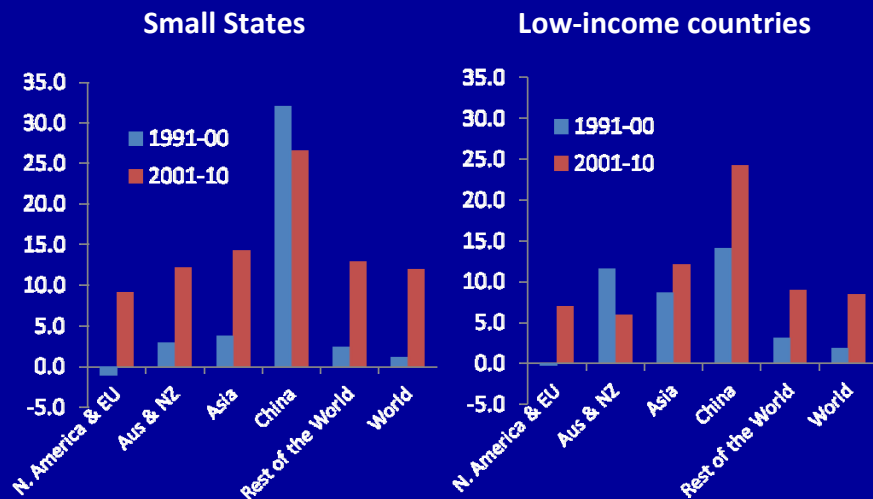
(Real annual average growth, in percent)



22

Other groups have surged

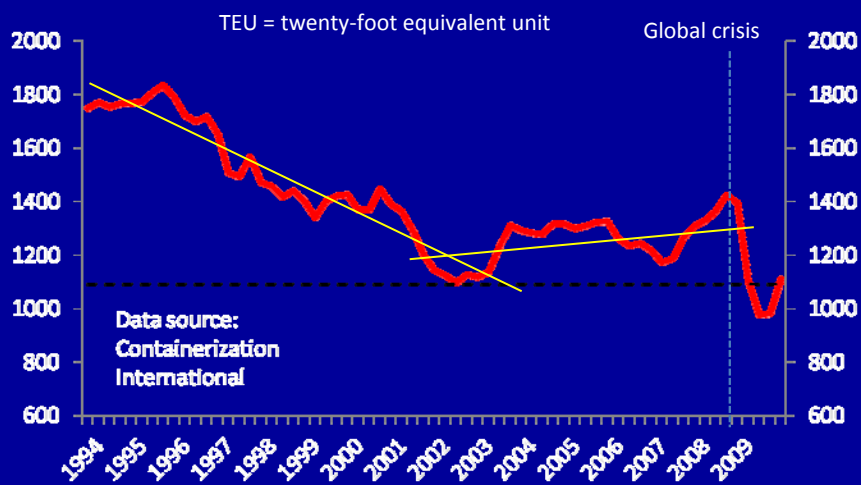
(Real annual average growth, in percent)



23

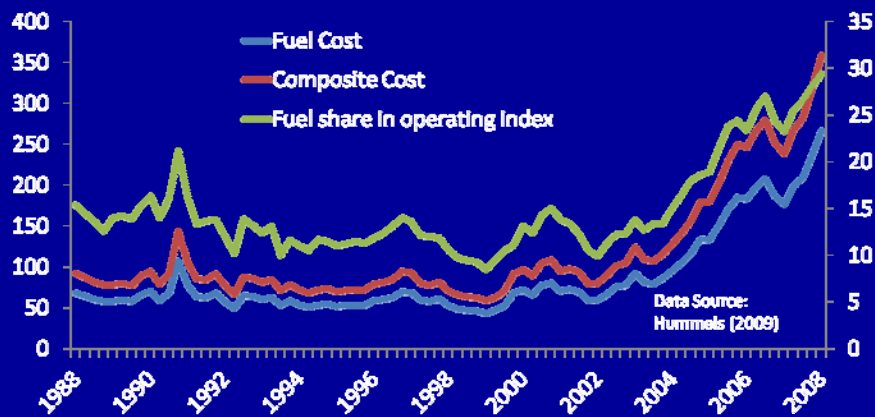
International containerized freight

(US\$/TEU, deflated by US GDP deflator)



24

Trends in airline costs (index)



25

Policy implications—Short Term

- **Rebuild policy buffers over time:**
 - Room for further monetary policy easing is limited
 - Monetary policy is unlikely to be very effective
 - Fiscal space has become limited for many because of high and rising debt levels
- **More flexible exchange rates:**
 - Cushion short-term shocks
 - Help regain long-term competitiveness

26

Policy Implications—Long Term

- **Structural policies:** raise efficiency and supply response; competitive exchange rates may not be feasible or enough.
- **Supporting private sector:** encourage investment and exploit comparative advantage in resource-based industries: fisheries, tourism, agriculture, etc.
- **Trade policy:** look north while deepening integration with traditional markets, especially with respect to labor services.
- **Transport/communication:** regional approaches/ integration to reduce cost and increase competition?

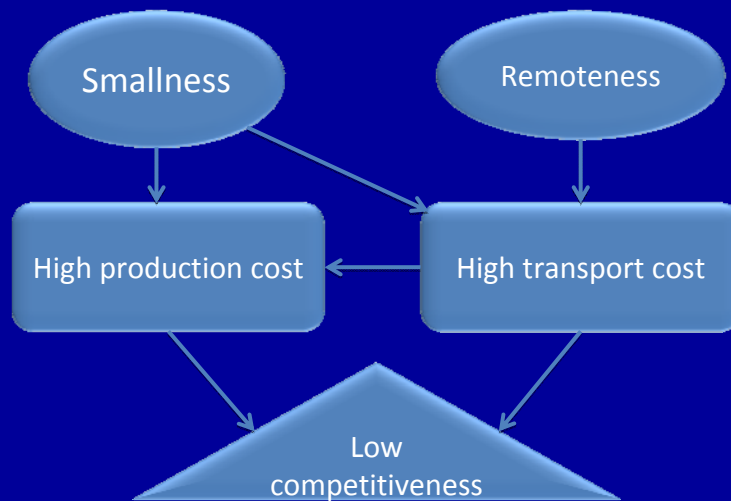
27



Thank You

28

Growth constraints: theory



29

Why has growth slowed?

(Change in determinants over time)

Determinant:	Change
Initial income level	Little
Investment	Little
Population growth	Little
Aid	?
Political stability	?
Export openness	↓
Growth volatility	↓
Remoteness	No
Regional dummies	No

30

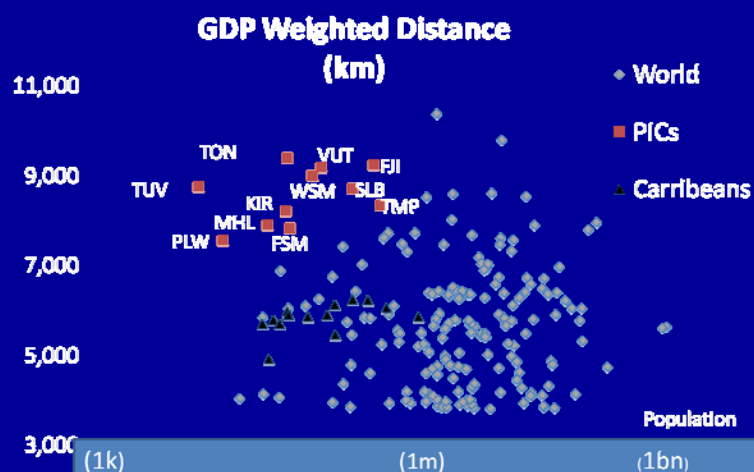
Expanded growth Convergence Model

(Sample: Cross-sectional, 45 small states, 1992-2008)

- Per capita GDP growth is a function of:
 - Initial income level (per capita GDP in 1992) +
 - Investment (in percent of GDP) –
 - Population growth –
 - Aid (in percent GNI) ±
 - Political stability +
 - Openness +
 - Growth volatility –
 - Remoteness –
 - Regional dummies Pacific –
 - Others Many are tested, but insignificant

31

PICs are small and remote

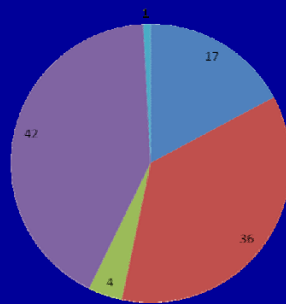


32

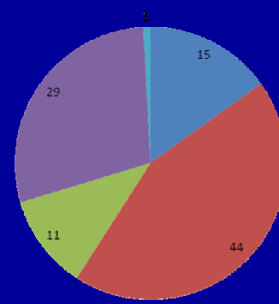
What do exports show? (1)

PNG and Solomon Islands

1992-2000



2001-2010



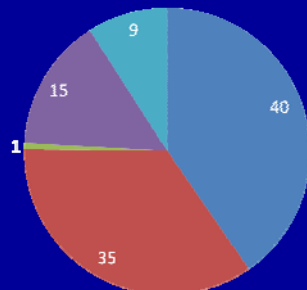
■ N America + EU
■ Aus & NZ
■ China
■ Rest of Asia
■ Rest of the World

33

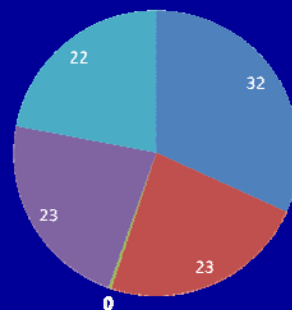
What do exports show? (2)

Other PICs

1992-2000



2001-2010



■ N America + EU
■ Aus & NZ
■ China
■ Rest of Asia
■ Rest of the World

34

What do exports show? (3)

Small States

1992-2000

2001-2010



35

Growth Constraints: Empirics

Sample: 45 countries (averages over 1992-2008 subject to data availability)

Africa (14)	America (12)	Europe (4)	Pacific (9)	Asia (6)
Botswana	Antigua and Barbuda	Estonia	Fiji	Bahrain
Cape Verde	Bahamas, The	Malta	Kiribati	Bhutan
Comoros	Barbados	Montenegro	Micronesia, F.S.	Brunei
Djibouti	Belize	San Marino	Palau	Maldives
Equatorial Guinea	Bermuda		PNG	Qatar
Gabon	Dominica		Samoa	Timor-Leste
Gambia, The	Grenada		Solomon Islands	
Guinea-Bissau	Guyana		Tonga	
Lesotho	St. Kitts and Nevis		Vanuatu	
Mauritius	St. Lucia			
Namibia	St. Vincent and the Grenadines			
Sao Tome & Principe	Suriname			
Seychelles				
Swaziland				

36

Increasing competitiveness: Policy options - macro and micro

