

# NORTH PACIFIC ISLANDS

## Key conditions and challenges

**Table 1**

	FSM	MHL	PLW
Population, million	0.11	0.04	0.02
GDP, current US\$ billion	0.42	0.23	0.22
GDP per capita, current US\$	3835	5663	11022
LMIC poverty rate (\$3.65)	40.8 <sup>a</sup>	6.1 <sup>b</sup>	
Gini index	40.1 <sup>a</sup>	35.5 <sup>b</sup>	

Source: WDI, World Bank, and official data.

Notes: The actual year for the table data is 2023.

Abbreviations: LMIC = Lower middle-income;

FSM = Federated States of Micronesia; PLW = Palau;

MHL = Republic of the Marshall Islands; Estimates for

poverty rates and Gini index do not exist for Palau.

a/ Most recent value (2013), 2017 PPPs.

b/ Most recent value (2019), 2017 PPPs.

*Economic activity rebounded in FY23 in the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), and Palau. Inflation subsided in FY23 in RMI but remained high in FSM and Palau. Poverty rates are expected to decline in the coming years, contingent on continued growth. The newly approved Compact of Free Association (COFA) agreement with the United States will deliver US\$6.5 billion in assistance to the region over the next 20 years. Structural reforms are needed to boost long-term growth and achieve fiscal sustainability.*

Following a contraction in FY22, economic activity gained momentum in the North Pacific in FY23 with a pick-up in capital projects, fisheries output, and tourism. Economic activity is expected to further expand in FY24 but downside risks to the outlook remain high. In the short term, the key challenges include (1) slower than expected recovery of tourist arrivals (particularly in Palau); and (2) higher than expected global food and fuel prices due to an escalation of geopolitical tensions and conflict.

The Compact of Free Association (COFA) agreement approved by the United States on March 9, 2024, will deliver a total of US\$6.5 billion in assistance to the three North Pacific countries over the next 20 years starting in FY24. FSM will receive US\$3.3 billion, RMI US\$2.3 billion, and Palau \$889 million. The allocation of funds will be governed by the new Fiscal Procedures Agreement (FPA) and the new Compact Trust Fund Agreement, both of which have been revised and updated, allowing the countries greater autonomy and control of the funds.

Even with the approval of the new Compact, implementing reform-based fiscal adjustments, such as domestic revenue mobilization and expenditure rationalization, remain crucial to enhancing fiscal sustainability. Natural disasters and climate change continue to pose a threat to economic activity and livelihoods. Structural

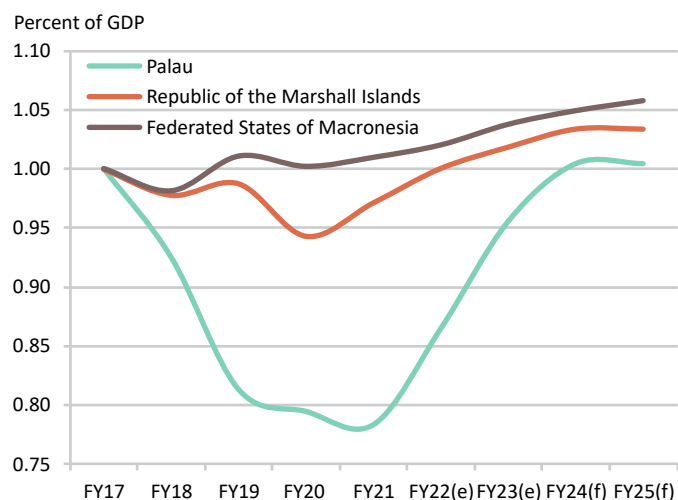
reforms are needed to ensure a sustainable economic recovery that supports the livelihood of the bottom 40 percent of households and poverty reduction. Based on the Lower Middle Income Class Poverty Line of \$3.65 (2017 PPP USD per person per day), FSM has a poverty rate of 40.7 percent (2013 data) and RMI has a poverty rate of 6.1 percent (2019 data). The lack of recent household data for Palau and FSM presents a challenge in monitoring development progress. In Palau, the 2023-2024 household income expenditure survey is currently concluding fieldwork and could be used for poverty measurement.

## Recent developments

In **FSM**, growth rebounded to 0.8 percent in FY23, supported by the reopening of borders, resumption of capital projects, and an increase in national government wages. Inflation reached a decade high of 6.2 percent reflecting the lagged effects of elevated global commodity prices and domestic supply constraints. FSM registered fiscal surpluses of 1.6 percent of GDP in FY23, from 7.8 percent in FY22. Government debt declined to 12.4 percent in FSM in FY23 and the risk of overall debt distress has been upgraded to medium from high.

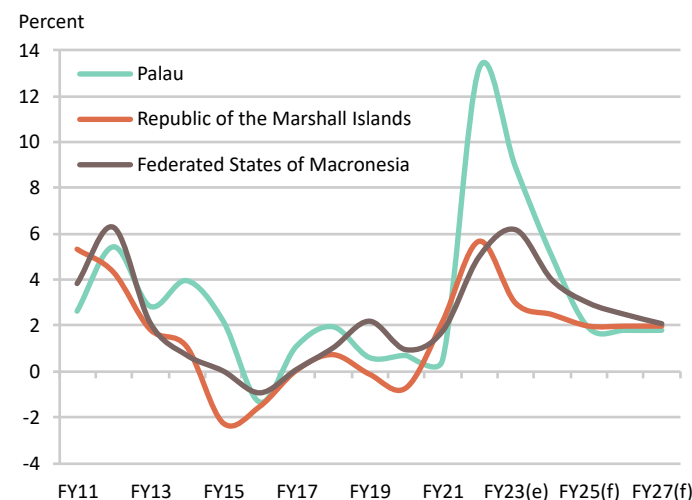
In **RMI**, output expanded by 3 percent due to a revival in fisheries activity as well as strong demand for services. Inflation moderated to 3 percent in RMI from 5 percent in FY22 as supply chain disruptions eased leading to a reduction in food and fuel prices. A balanced budget was achieved as

**FIGURE 1 North Pacific Islands / Real GDP, relative to 2019 GDP**



Sources: National sources, IMF WEO, and World Bank projections.

**FIGURE 2 North Pacific Islands / Consumer price inflation**



Sources: National sources, EconMap, IMF WEO, and World Bank projections.

COVID-19-related grants were withdrawn. At 21.6 percent of GDP debt remains sustainable, but the overall risk of debt distress is high.

In **Palau**, economic growth recorded 0.8 percent in FY23, as tourism activity picked up due to arrivals from Macau. While inflation reduced from a peak of 13.3 percent in FY22, it remained high at 8.9 percent in FY23 due to high food and fuel import prices. A modest fiscal surplus of 0.3 percent of GDP was driven by increased consumption tax collections. Debt remains sustainable and debt levels are estimated to have reduced to 66.2 percent of GDP in FY23 as new debt taken during the pandemic is serviced.

Poverty in the North Pacific is expected to have risen between 2020-2022 relative to pre-crisis levels. Poverty is projected to decline in RMI and Palau from FY23 onwards as these economies recover. A decline in poverty is also expected in FSM from FY23, though the real incomes of the poor have been subject to inflationary pressures. In both RMI and FSM, poverty reduction could occur with even very low GDP growth, if per capita GDP growth is higher due to population decline. In RMI, between the 2011 and 2021 census data collections, the population declined from 53,000 to 42,000.

## Outlook

In **FSM**, the economy is projected to accelerate slightly to 1.1 percent in FY24, supported by the continued pick-up in public investment and the increase in public sector wages. On the longer term, FSM is faced with the risk of returning to a low-growth trajectory of below 1 percent, as growth prospects are hampered by an increase in outmigration and the low efficiency of public investment. Inflation is expected to remain high at 4 percent in FY24 before subsiding thereafter. Following a surplus of 1.3 percent of GDP in FY24, the fiscal balance is projected to turn into a small deficit in FY25 and thereafter, amid declining fishing revenues and normalizing grants.

In **RMI**, output is expected to grow by 3 percent in FY24 mainly driven by continued expansion of the fishery sector and strong construction and services activity. Economic activity is expected to reach pre-pandemic levels in FY24. In line with easing global food and energy prices, inflation in FY24 is expected to subside to 2.5 percent, before further declining to 2 percent from FY25 onwards. A fiscal surplus of 1.7 percent of GDP is projected

for FY24 in RMI, with modest surpluses expected from FY25 onwards due to new Compact funding.

In **Palau**, the recovery in tourism is projected to lead to a double-digit expansion of 12.4 percent in FY24. GDP is projected to remain on a lower trajectory until tourist arrivals reach pre-pandemic levels in FY26. Inflation in Palau is expected to decrease but remain high at 5.9 percent in FY24 and decline further from FY25 onwards. A large fiscal surplus of 2.7 percent of GDP is projected for FY24, as tourism activity leads to an increase in revenues. Modest fiscal surpluses are expected from FY25 onwards due to continued increases in tourism receipts and full implementation of the tax reform bill.

The outlook is subject to significant downside risks. Interest rates are expected to remain high globally and may create adverse spillover effects. If growth in advanced economies is slower than anticipated, the projected recovery in tourism may fail to materialize and weaken growth prospects in Palau. Higher-than-expected global food and fuel prices could reignite inflationary pressures. The region's vulnerability to natural disasters and climate change remains an important underlying adverse risk to economic growth.

**TABLE 2 North Pacific Islands / Macro poverty outlook indicators**

(annual percent change unless indicated otherwise)

	2022e	2023e	2024f	2025f	2026f	2027f
<b>Real GDP growth, at constant market prices</b>						
Federated States of Micronesia	-0.9	0.8	1.1	1.7	1.1	0.8
Republic of the Marshall Islands	-0.6	3.0	3.0	2.0	1.5	1.5
Palau	-2.0	0.8	12.4	11.9	3.5	2.0
<b>Poverty rates of the Republic of the Marshall Islands</b>						
International poverty rate (\$2.15 in 2017 PPP) <sup>a,b,c</sup>	0.8	0.8	0.8	0.8	0.6	0.6
Lower-middle income poverty rate (\$3.65 in 2017 PPP) <sup>a,b,c</sup>	5.6	4.9	4.6	4.3	4.1	3.8
Upper middle-income poverty rate (\$6.85 in 2017 PPP) <sup>a,b,c</sup>	30.0	27.7	25.7	24.0	23.4	22.3

Sources: ECONMAP, IMF, and Worldbank.

Note: e = estimate; f = forecast. Values for each country correspond to their fiscal years ending September 30.

a/ Calculations based on EAPPOV harmonization, using 2019-HIES.

b/ Projection using neutral distribution (2019) with pass-through = 1 (High) based on GDP per capita in constant LCU.

c/ For 2022-2025 projections, no change in population is assumed due to a lack of updated population projections.