### NORTH PACIFIC ISLANDS

#### Table 1

<table>
<thead>
<tr>
<th>Country</th>
<th>2022 GDP, US$ billion</th>
<th>2022 GDP per capita, current US$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federated States of Micronesia</td>
<td>0.39</td>
<td>3586</td>
</tr>
<tr>
<td>Republic of the Marshall Islands</td>
<td>0.21</td>
<td>5277</td>
</tr>
<tr>
<td>Palau</td>
<td>0.22</td>
<td>11065</td>
</tr>
</tbody>
</table>

Sources: WDI, World Bank staff estimates.

Following recessions in FY22, economic activity is projected to gain momentum in FY23 in the Federated States of Micronesia (FSM), Republic of the Marshall Islands (RMI), and Palau. Modest fiscal surpluses are needed to boost long-term growth and achieve fiscal sustainability.

#### Key conditions and challenges

COVID-19 outbreaks in FY22 stalled economic activity in the North Pacific by delaying border reopening plans in FSM and RMI and halting the recovery of tourism in Palau. Economic activity is expected to gain momentum in FY23, but downside risks to the outlook remain high. In the short term, the key challenges facing the North Pacific include (1) monetary policy tightening in major markets, (2) slow recovery of tourist arrivals (particularly in Palau), and (3) fiscal risks.

Although all three countries have come to an agreement with the U.S. on a new fiscal chapter of the Compact, the agreement has yet to be approved by the U.S. Congress. In addition, several challenges persist that could hinder long-term fiscal sustainability. First, details of the new fiscal chapters are not yet public, so it is unclear if the shortcomings of the previous agreement have been addressed. Second, the fiscal chapter is not in perpetuity and will expire again, subject to negotiations. Third, the new agreement can reduce incentives to enact meaningful fiscal reforms, especially in FSM and RMI, where the reform agenda has progressed slowly.

Even with the renewal of the fiscal chapter of the Compact, implementing reform-based fiscal adjustments, such as domestic revenue mobilization and expenditure rationalization, remains crucial to enhancing fiscal sustainability. Natural disasters and climate change continue to pose a threat to economic activity and livelihoods. Finally, structural reforms are needed to ensure a sustainable economic recovery that supports the livelihood of the bottom 40 percent of households. The lack of recent household data presents a challenge in monitoring development progress and assessing the effects of shocks, which also limits the potential for evidence-based policymaking.

#### Recent developments

The pandemic drove FSM into the third consecutive year of recession in FY22, with a further contraction of 0.6 percent. In RMI, output also declined significantly in FY22 by 4.5 percent due to a decrease in fish production. Inflation increased to 4.4 percent in RMI and 5 percent in FSM in FY22 driven by rising global commodity prices due to the war in Ukraine. FSM and RMI registered fiscal surpluses of 1.6 percent and 0.7 percent of GDP in FY22, respectively. Government debt declined to 22 percent of GDP in RMI and to 14 percent in FSM. Debt remains sustainable but the overall risk of debt distress is high in both countries.

In Palau, output contracted by 2.3 percent in FY22, due to a lack of tourism activity while inflation surged to 13.2 percent due to higher food and fuel import prices driven by the war in Ukraine. The fiscal deficit remained sizeable at 3.1 percent of GDP in FY22. The deficit has been financed by concessional external borrowing, causing general government debt to rise to 90 percent of GDP. Despite rising levels, debt...
remains sustainable due to the concession- 
al nature of new debt. 

Poverty in the North Pacific is expected to 
have risen relative to pre-crisis levels. The 
sharp economic contraction in FY20 and 
FY21 led to formal-sector job losses and low-
er demand for goods in the informal econo-
my. In Palau, the disruption in tourism ac-
tivities likely led to increased vulnerability 
of households employed in the sector. In 
FSM and RMI, many households rely on an-
ual remittance inflows that are estimated to 
have dropped in FY21. In RMI, poverty is es-
pected to have fallen in FY21, and then risen 
in FY22, with a reduction projected in FY23. 
A decline in poverty is also expected in FSM 
from FY23, given the projected return to eco-

**Outlook**

In FY23, FSM’s economy is projected to ex-

pand by 2.8 percent, supported by positive 
spillovers from the reopening of borders, 
a pick-up in construction activity, and 
increased capital expenditure. Similarly, 
RMI’s economy is expected to grow by 
3 percent mainly driven by a recovery 
in the fishery sector. However, GDP in 
both RMI and FSM is only expected to 
reach pre-pandemic levels in FY24. In 
line with easing global food and energy 
prices, inflation in FY23 is expected to 
subside to 4.7 percent in FSM and to 3 
percent in RMI, before further declining in 
FY24. Despite a recovery in tourism, the 
Palaun economy is expected to con-
tract by 1.4 percent in FY23. GDP is pro-
jected to remain on a lower trajectory 
until tourist arrivals reach pre-pandemic 
levels in FY26. Inflation in Palau is ex-
pected to remain high at 14.5 percent in 
FY23, partly due to the introduction of 
new consumption taxes. It is then project-
ed to decline starting from FY24. 
A fiscal surplus of 0.1 percent of GDP is 
projected for FY23 in RMI, with small 
surpluses expected from FY24 onwards.

In FSM, following a surplus of 1.4 per-
cent of GDP in FY23, a deficit of 5.9 per-
cent of GDP is projected in FY24, fur-
ther widening to reach 7 percent of GDP 
by FY26 predicated on the expiration of 
the compact in 2023. In Palau, the deficit 
is projected to decline to -0.5 percent of 
GDP in FY23, as non-grant revenues re-
main below pre-crisis levels. Modest fis-
cal surpluses are expected from FY24 on-
wards due to an increase in tourism re-
ceipts and full implementation of the tax 
reform bill. 

The outlook is subject to significant 
downside risks. Interest rates are expect-
ed to remain high globally and may cre-
ate adverse spillover effects. If growth 
in advanced economies is slower than 
anticipated, projected recovery in 
tourism may fail to materialize and 
weaken growth prospects in Palau. The 
region’s vulnerability to natural disas-
ters and climate change remains an im-
portant underlying adverse risk to eco-

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

<table>
<thead>
<tr>
<th></th>
<th>2021e</th>
<th>2022e</th>
<th>2023f</th>
<th>2024f</th>
<th>2025f</th>
<th>2026f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth, at constant market prices</td>
<td></td>
<td></td>
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<tr>
<td>Federated States of Micronesia</td>
<td>-3.2</td>
<td>-0.6</td>
<td>2.8</td>
<td>2.8</td>
<td>1.3</td>
<td>0.8</td>
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<tr>
<td>Republic of the Marshall Islands</td>
<td>1.0</td>
<td>-4.5</td>
<td>3.0</td>
<td>3.0</td>
<td>1.8</td>
<td>1.5</td>
</tr>
<tr>
<td>Palau</td>
<td>-12.1</td>
<td>-2.3</td>
<td>-1.4</td>
<td>10.4</td>
<td>10.5</td>
<td>5.1</td>
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<tr>
<td>Upper middle-income poverty rate (US$6.85 in 2017 PPP)(^{a,b,c})</td>
<td></td>
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<td></td>
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<td></td>
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<tr>
<td>Republic of the Marshall Islands</td>
<td>30.0</td>
<td>32.1</td>
<td>30.6</td>
<td>28.8</td>
<td>27.1</td>
<td>25.9</td>
</tr>
</tbody>
</table>

Sources: ECONMAP, IMF, and Worldbank. 
e = estimate; f = forecast. 
Notes: 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.