IMF Executive Board Concludes 2012 Article IV Consultation with Tuvalu

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On August, 5 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tuvalu.[1]

Background

A slow recovery is underway in Tuvalu, but there are important risks. GDP grew in 2011 for the first time since the global financial crisis, led by the private retail sector and education spending. We expect growth to rise slowly from 1.1 percent last year to 1.2 percent this year as the services sector continues to grow. Falling prices for imported goods such as clothing pulled inflation down to 0.5 percent in 2011, but the prices of domestically produced goods and services are also broadly stable. However, falling numbers of Tuvaluan seafarers, and the corresponding drop in their remittances, are hurting household incomes at a time when a strong Australian dollar is increasing imports. The possibility that seafarer income both does not recover and is not replaced by opportunities such as seasonal employment schemes is the biggest risk to long-term sustainable growth.

Even beyond employment, Tuvalu remains exposed to the difficult global environment. Strong performance at the Tuvalu Trust Fund (TTF) has brought closer the point where it will begin to recapitalize the Consolidated Investment Fund (CIF). But a reversal could hurt the TTF, depriving the government of necessary support. Proceeds from licensing and joint ventures have improved the government’s revenue prospects, but further strengthening of the Australian dollar could negate these gains. On the other hand, a rapid weakening of the dollar could cause prices of imported goods to rise quickly. In the current fragile environment, this would present serious difficulties for Tuvaluan households.

A large fiscal expansion in 2009-10 is now slowly being unwound. Expenditure rose quickly during and after the Global Financial Crisis, nearly exhausting Tuvalu's financing buffer, the CIF. The deficit before grants rose to around half of GDP in 2010, but in 2012 is expected to fall to only 10 percent, as tax compliance among private companies has improved and costs related to various educational and medical programs have been trimmed.

The current account deficit is widening, though reserves are also rising. In 2011, the trade deficit reached 58 percent of GDP, while remitted wages, the largest source of foreign exchange, fell to only 8 percent of GDP. Income from Tuvalu's large asset holdings abroad has so far cushioned the blow, as has donor support, and the rising level of reserves.

A program to improve the management of public enterprises has shown some successes, with improved payment culture in utilities and improved risk management at the country's two banks. But more work needs to be done, particularly in compliance with taxes and employee social contributions.

Executive Board Assessment

Executive Directors welcomed the resumption of economic growth in Tuvalu, but noted downside risks stemming from continued exposure to external shocks and debt distress, in the context of limited availability of policy levers. Against this background, Directors encouraged the authorities to re-build fiscal buffers and accelerate structural reforms to boost medium-term growth prospects.

Directors commended the authorities for taking measures to lower the 2012 budget deficit, but urged further fiscal adjustment within a multi-year budget framework. They supported an increase in the value-added tax next year, while stressing the importance of improving tax compliance and ensuring that the new investment strategy of the Tuvalu Trust Fund does not add undue risk. Directors also encouraged the authorities to reduce subsidies and contain non-essential spending without compromising development goals.

Directors welcomed the adoption of a Policy Reform Matrix with focus on governance, social programs, and macroeconomic stability. They commended plans to increase the participation of the private sector in economic activity, and urged faster progress in operating public enterprises on commercial terms. Directors called for policies to improve labor skills and seasonal employment overseas. Directors also stressed the financial sector's crucial role in fostering growth. They noted the high level of non-performing loans in the banking system, and welcomed efforts by the National Bank of Tuvalu and the Development Bank of Tuvalu to improve credit quality.

Directors encouraged the authorities to improve the availability and quality of economic statistics, and welcomed IMF technical assistance provided for this purpose.

Tuvalu: Selected Social and Economic Indicators, 2008–2013

	2008	2009	2010	2011 Proj.	2012 Proj.	2013 Proj.
			Percent change			
Real sector						
Real GDP growth	7.6	-1.7	-2.9	1.1	1.2	1.3
Consumer prices (period average)	10.4	-0.3	-1.9	0.5	2.6	2.7
			(In percent of GDP)			
Government finance 2/						
Revenue	72.4	90.2	74.0	94.5	84.1	71.9
of which Taxes	16.8	16.2	16.2	18.9	19.3	19.3
of which Grants	17.1	30.6	22.1	38.2	24.5	12.3
Total Expenditure	75.9	93.3	104.1	93.3	79.8	82.0
Expense	67.9	77.7	87.1	78.5	75.6	76.5
Net Acquisition of Nonfinancial Assets	5.1	15.6	17.0	14.9	4.3	5.5
Net Lending/Borrowing	-0.7	-3.1	-30.0	1.1	4.2	-10.1
Tuvalu Trust Fund 3/	262.8	275.8	310.0	331.7	354.7	364.0
Consolidated Investment Fund 3/	34.1	44.2	20.8	9.0	11.2	5.6
Balance of payments						
Current account balance	-4.7	9.6	-1.3	-10.1	-3.0	-1.2
(In percent of GDP)	-13.2	27.8	-3.8	-29.2	-8.5	-3.3
Trade balance	-18.3	-16.0	-18.6	-19.5	-18.0	-16.5
Exports	0.6	0.6	0.5	0.6	0.7	0.7
Imports	19.0	16.6	19.1	20.2	18.7	17.2
Services balance	-26.8	-21.9	-22.7	-28.9	-20.8	-21.3
Income balance	24.9	27.8	21.4	18.8	24.2	25.0
Current transfers (net)	15.5	19.8	18.7	19.4	11.6	11.6

of which: remittances, employee compensation	6.2	5.2	3.3	3.3	3.9	4.1
of which: government	12.7	17.2	16.2	17.0	9.3	9.1
Gross official reserves 5/	30.0	29.9	26.0	23.9	23.1	23.8
(In months of imports of goods and services)	-8.6	-7.9	-6.0	-6.7	-6.6	-6.8
Debt indicators						
Gross external public debt	17.4	18.3	17.0	14.5	12.8	13.1
(In percent of GDP)	48.3	53.0	49.1	41.7	36.1	35.8
Debt Service	0.9	0.6	0.5	0.4	0.6	0.6
(In percent of exports of goods and services)	21.4	15.4	11.2	10.7	14.5	15.1
Exchange rates						
Australian dollars per U.S. dollar						
Period average 6/	1.2	1.3	1.1	1.0	0.9	0.9
End-period 6/	1.5	1.1	1.0	1.0	0.9	0.9
Nominal effective exchange rate (2005=100)	102.5	98.1	111.6	119.3	...	...
Real effective exchange rate (2005=100)	103.5	100.7	115.2	123.2	...	...
Nominal GDP (In millions of Australian dollars)	36.0	34.6	34.7	34.7	35.6	36.6
Nominal GNI (In millions of Australian dollars)	58.7	60.8	55.5	58.9	62.1	65.5

Sources: Tuvalu authorities, PFTAC, Asian Development Bank, UNDP, CIA World Factbook, and IMF staff estimates.

1/ Tuvalu uses the Australian dollar as its currency. It has no central bank operations.

2/ Data for 2011 are Tuvalu authorities and staff estimates.

3/ Data for 2010 are provisional estimates of Tuvalu authorities.

4/ Rates for personal and business loans.

5/ Defined as sum of foreign assets of the National Bank of Tuvalu, the Consolidated Investment Fund, and SDR holdings. Excludes the Tuvalu Trust Fund. Data for 2010 are as of October.

6/ Data for 2012 are as of end-May.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic

developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

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