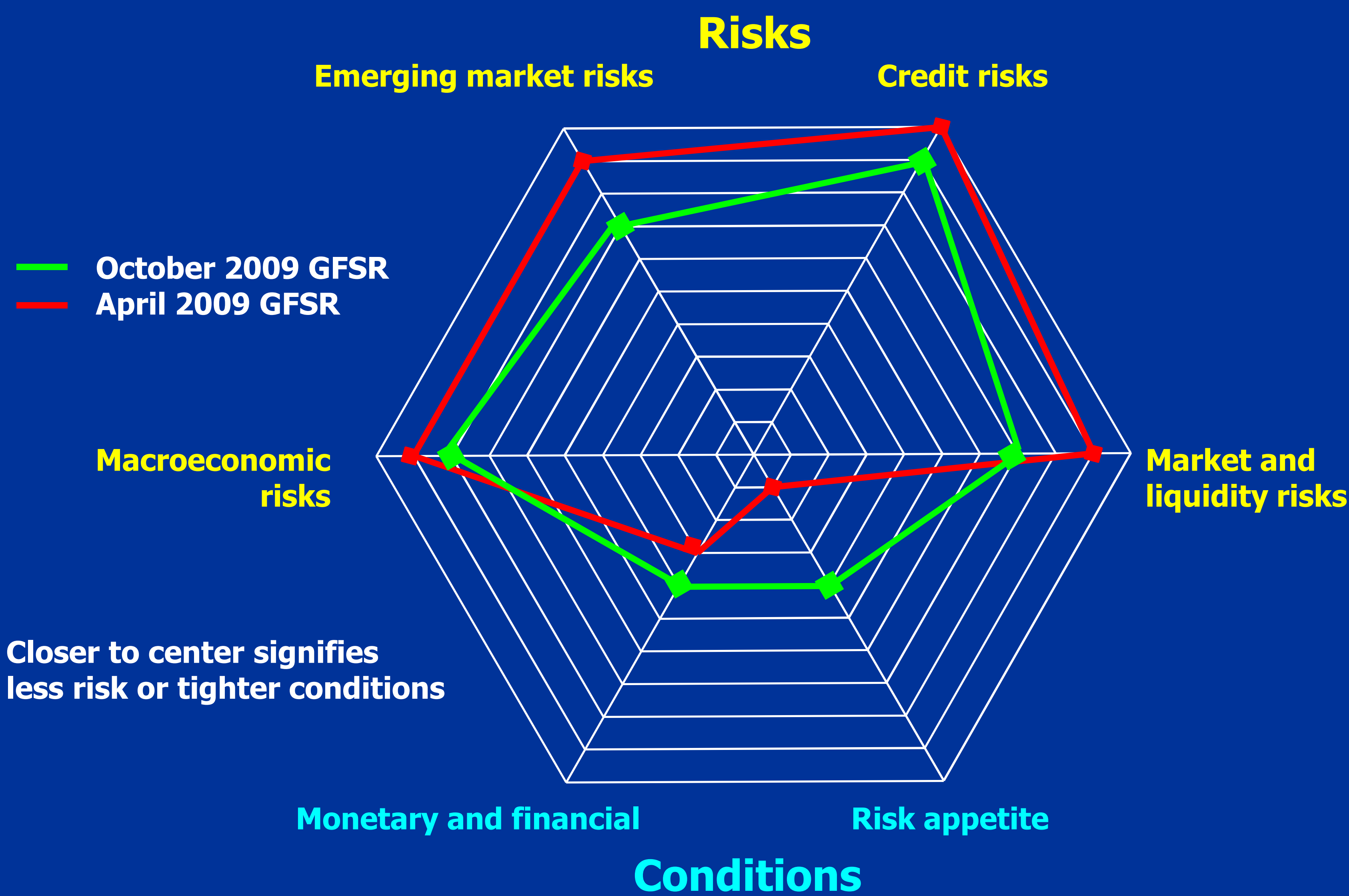
The Global Economy, The Regional Economic Outlook for Asia Pacific, and Prospects for the Pacific Islands

Presentation to the Economics Association of Fiji

November 2009

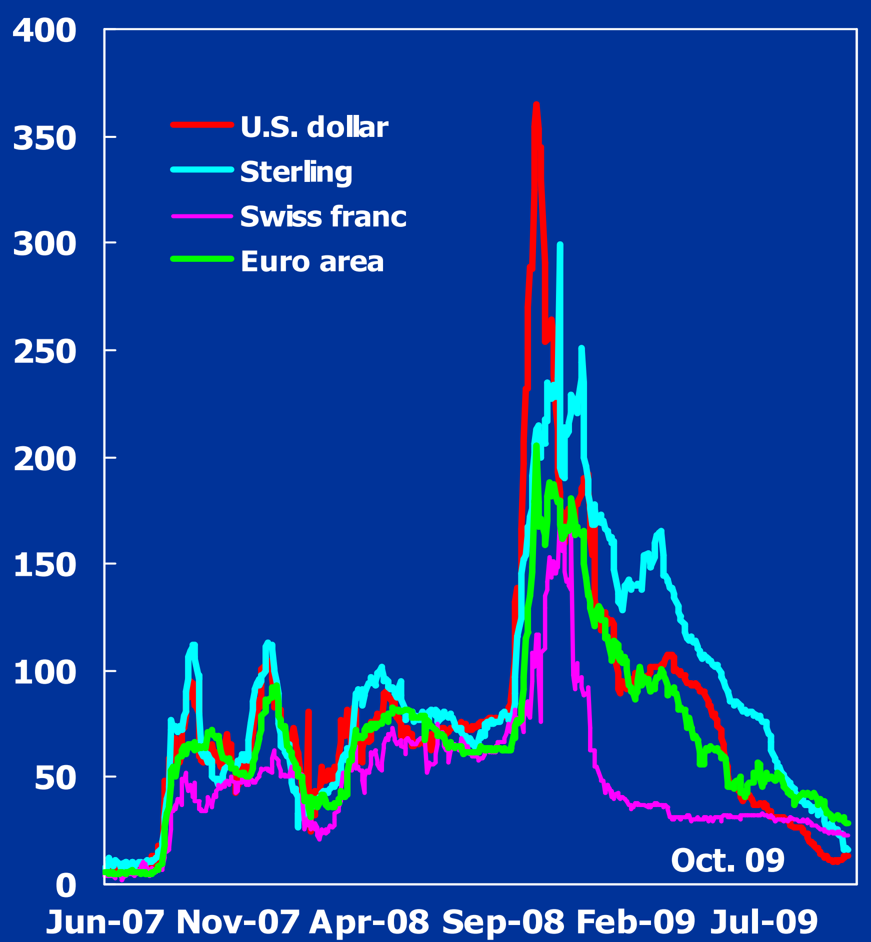
I. Global Economic Snapshot

Financial stability risks have abated, due to policy actions and improved growth prospects

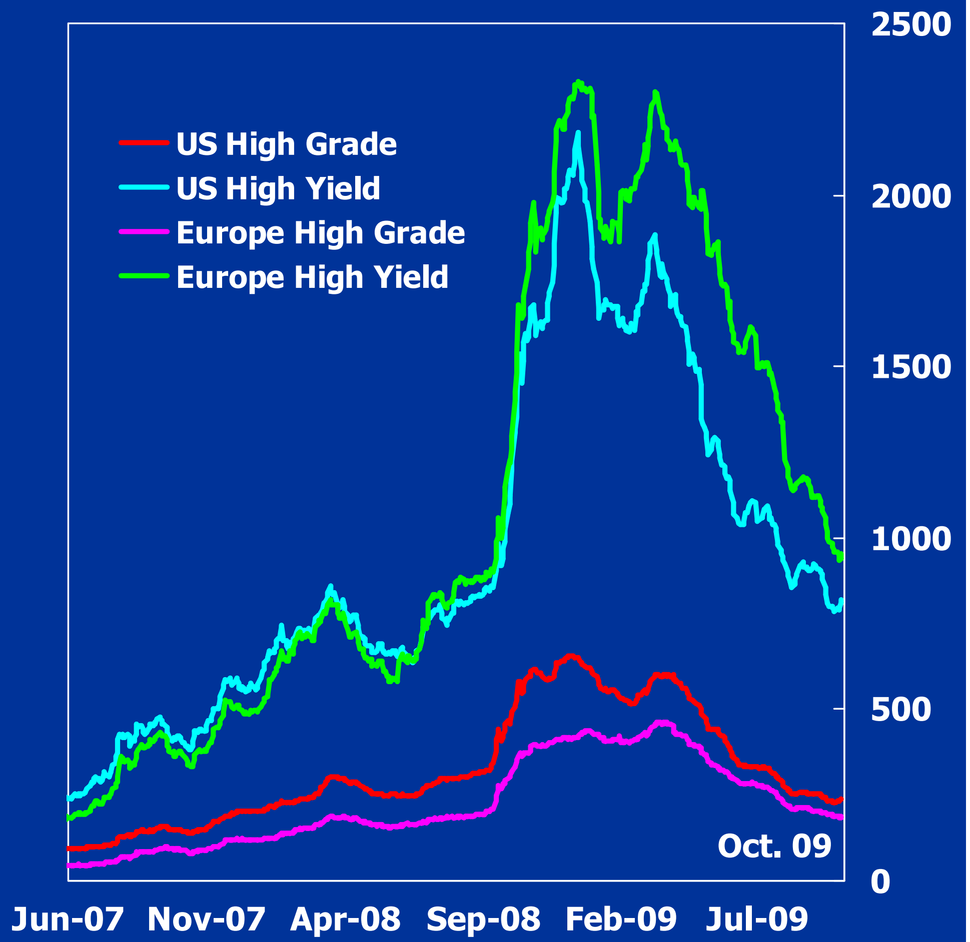


Credit market stress is continuing to ease

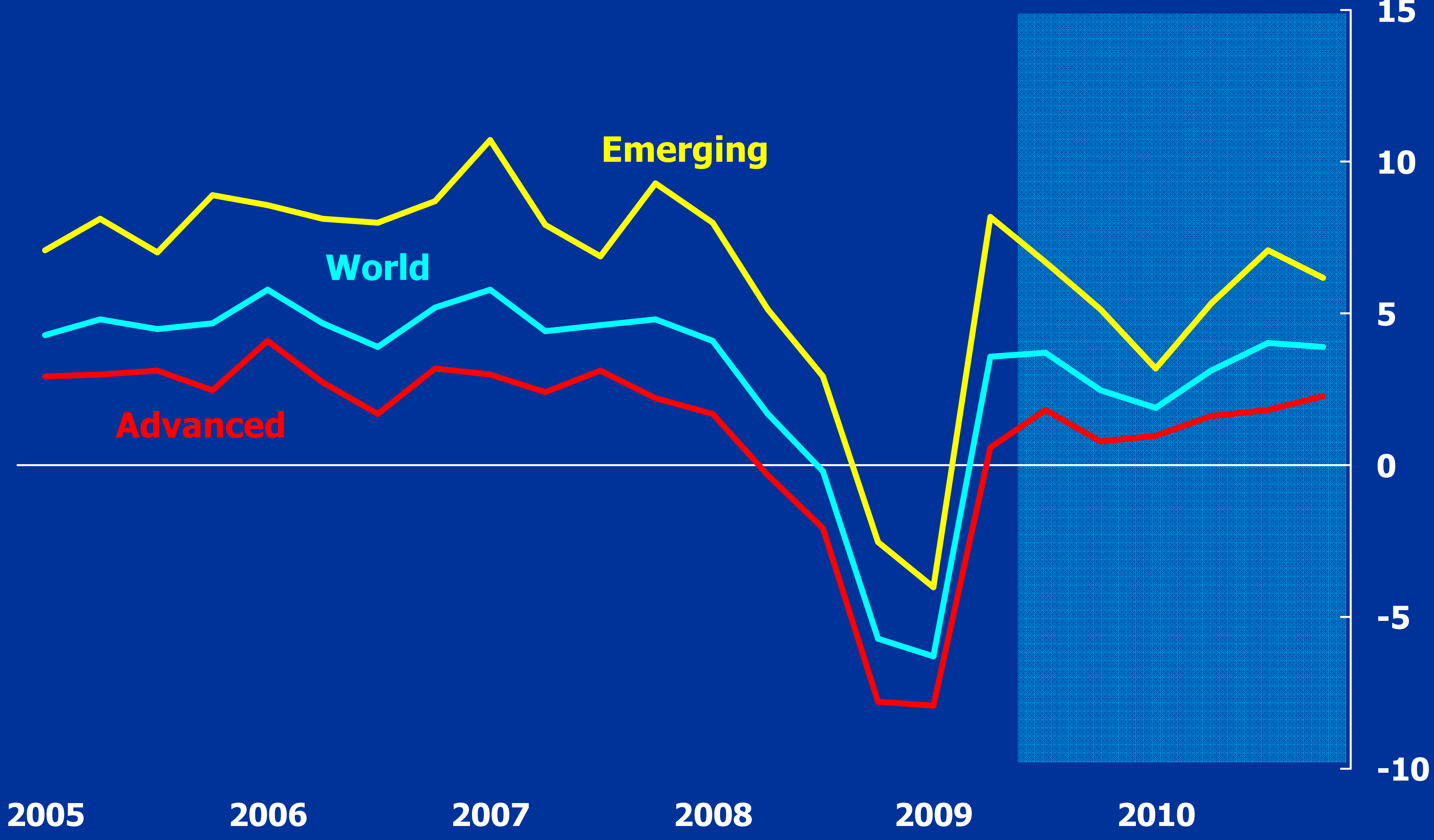
Three-month Libor – OIS Spreads
(basis points)



Corporate Spreads
(basis points)



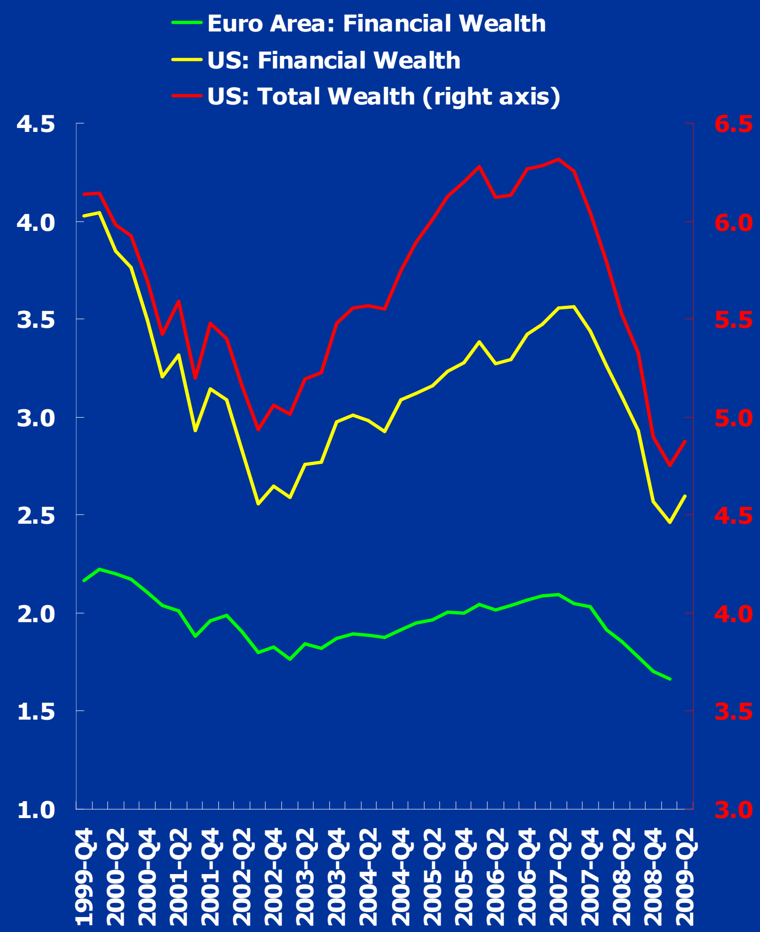
Although the global economy is growing again, recovery will be somewhat sluggish
(*percent; quarter-over-quarter, annualized*)



Households in the U.S. and Euro area will continue to repair the damage to their balance sheets…

United States and Euro Area: Household Net Wealth

(ratio with disposable income)

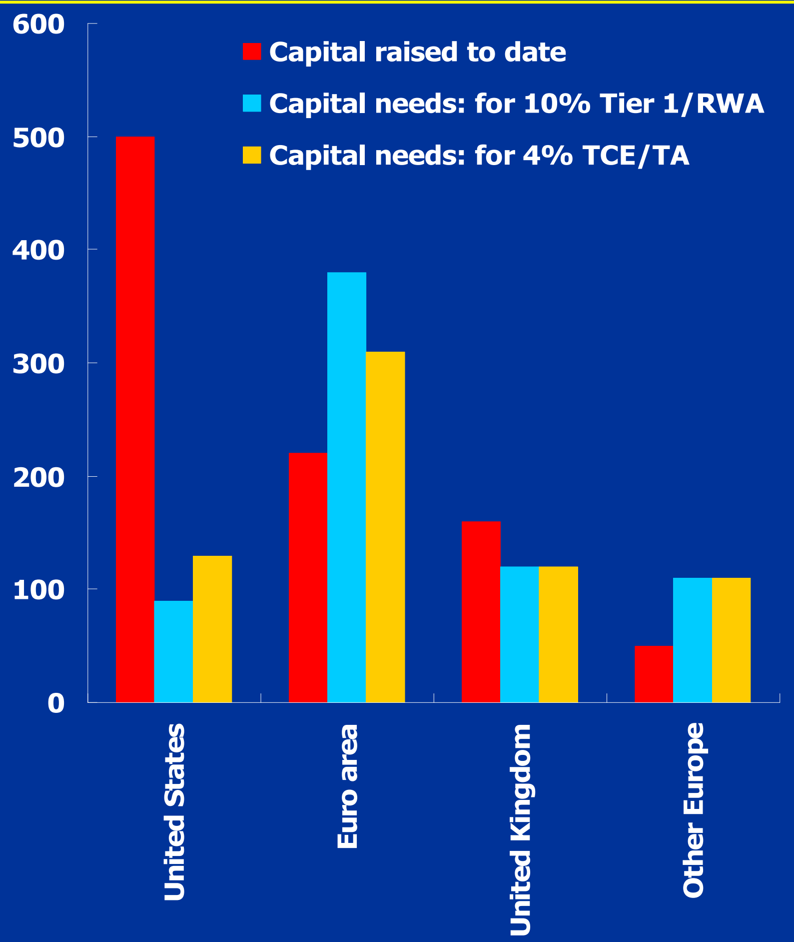


United States and Euro Area: Household Saving

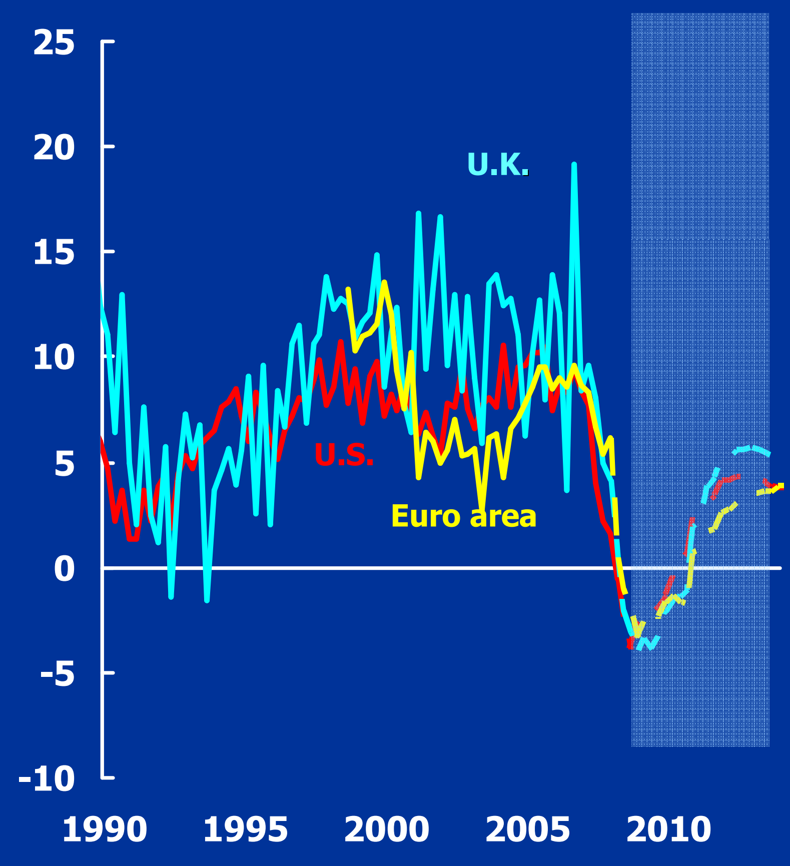
(ratio with disposable income)

...credit growth will remain anemic in the U.S. and Europe as banks face further deleveraging pressures

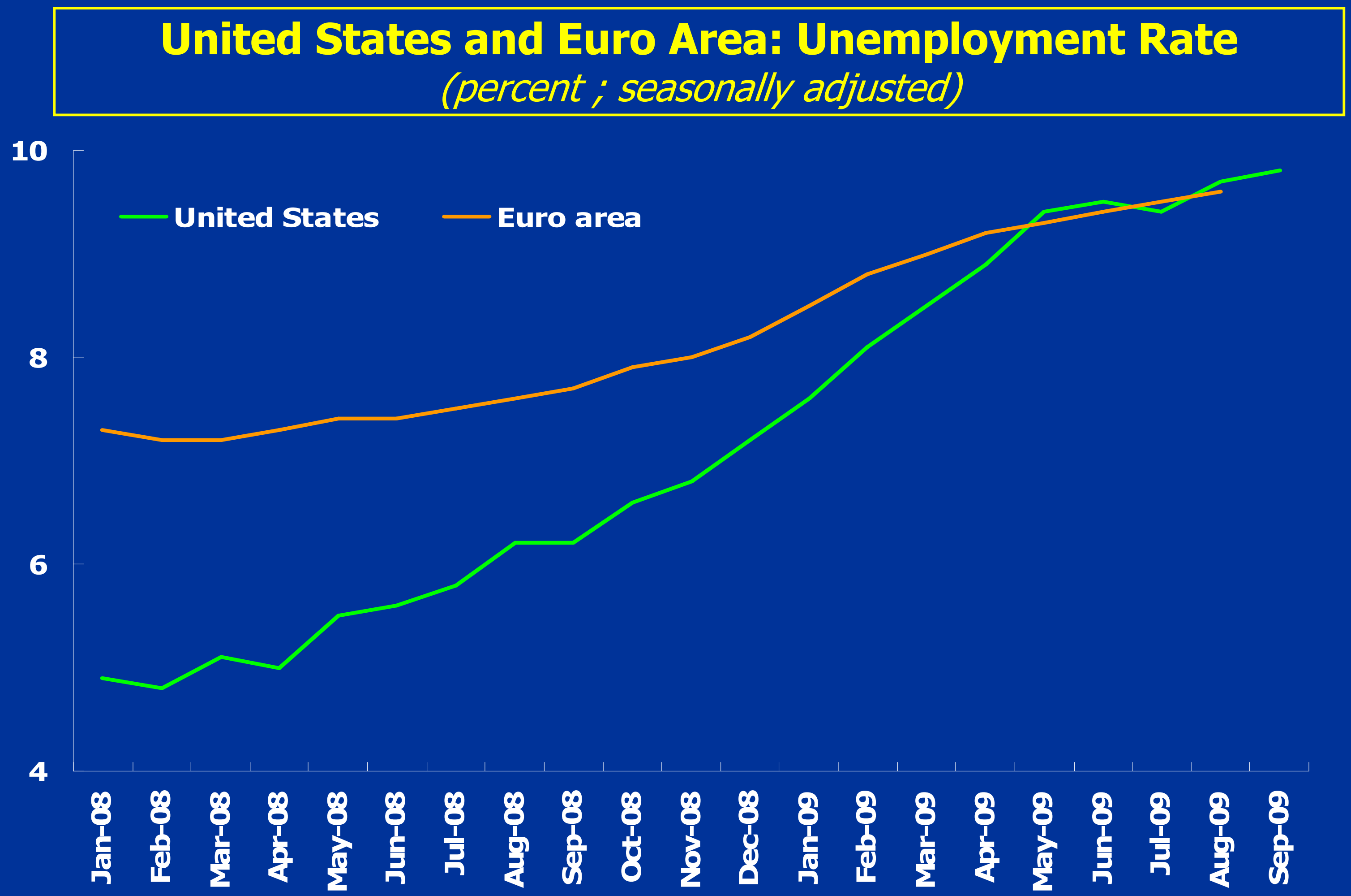
Bank Capital
(billions of U.S. dollars)



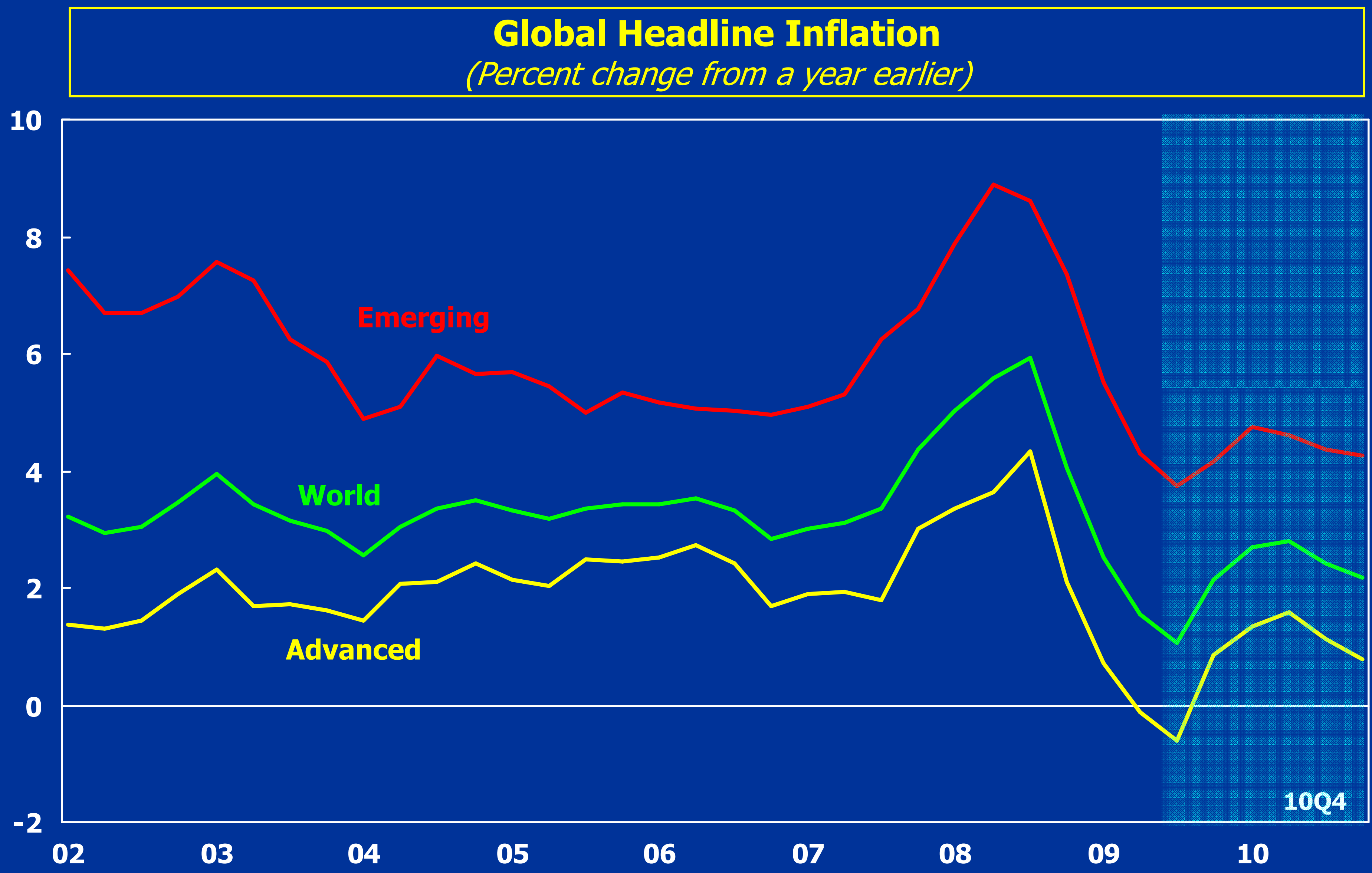
Private Sector Credit Growth
(in percent of outstanding)



...and labor markets will remain weak: another jobless recovery?



Large output gaps should keep inflation in check

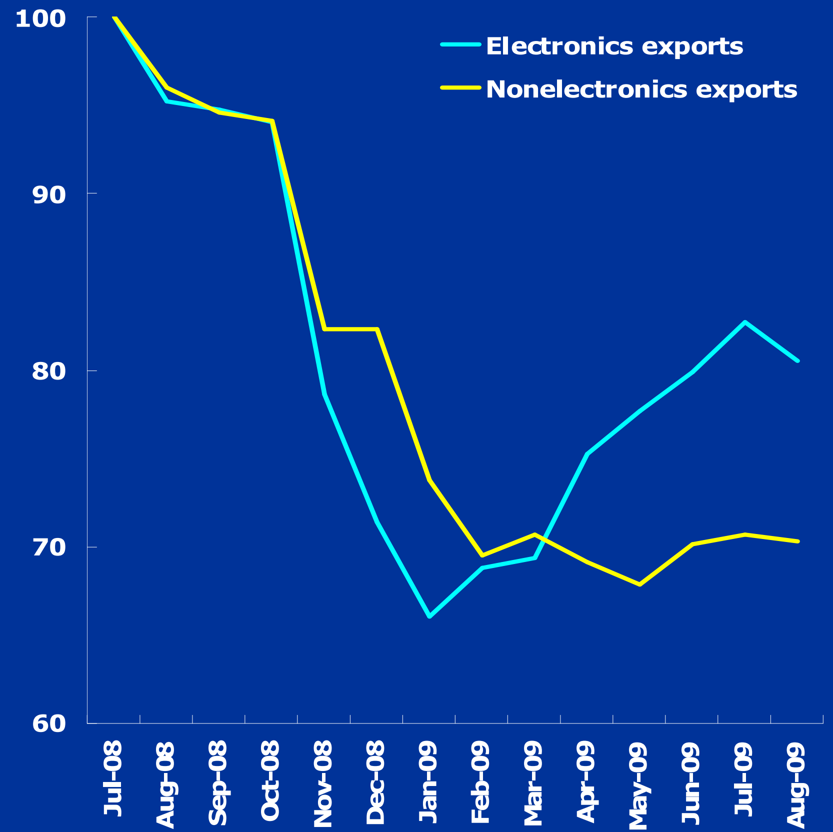


II. Asia’s Recovery and Outlook

Export-oriented economies have experienced a V-shape recovery so far, as global trade has normalized

Asia: Electronics and Non-electronics Exports[1]

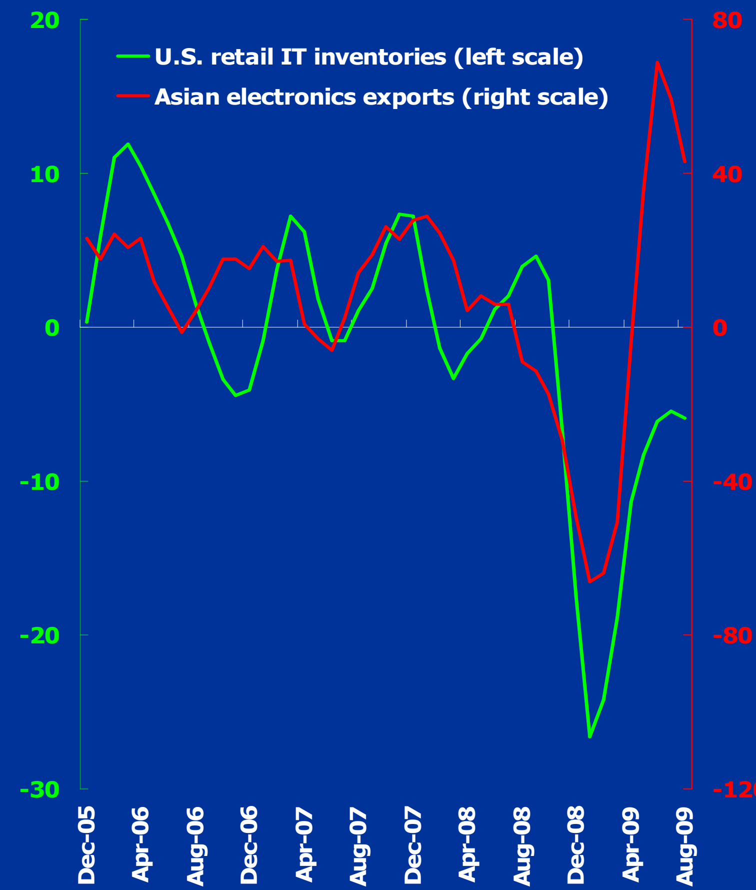
(July 2008 = 100, seasonally adjusted)



[1] Includes Japan, NIEs, Malaysia, Philippines, Thailand and China.

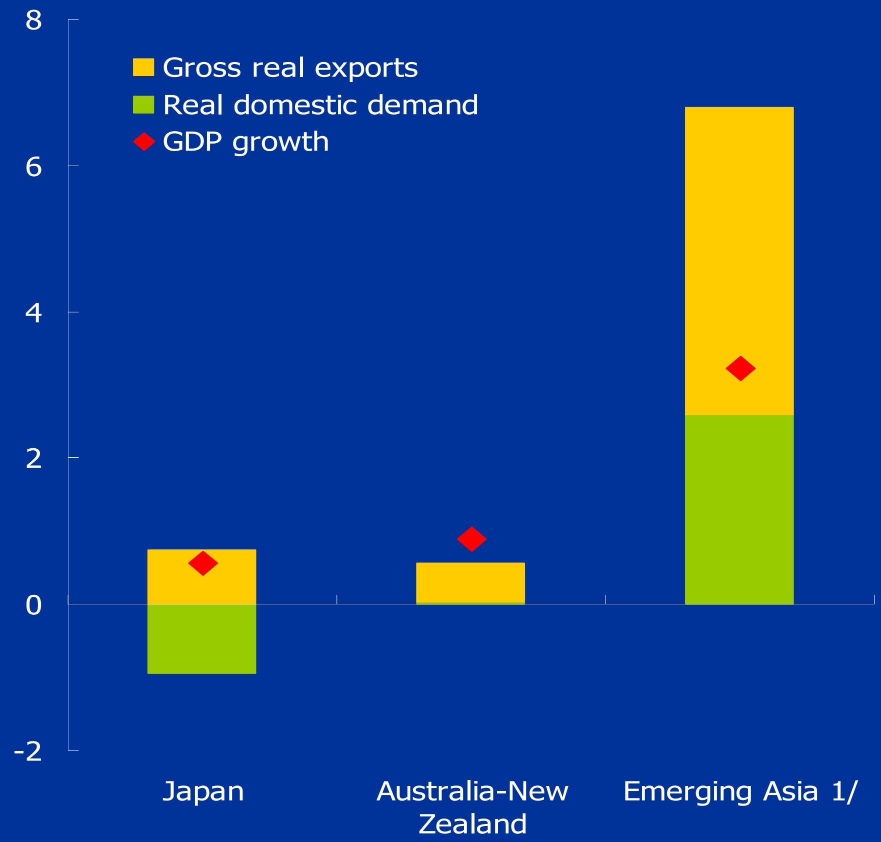
U.S. Retail IT Inventories and Asian Electronics Exports

(3-month percent change of 3-month moving average, SAAR)



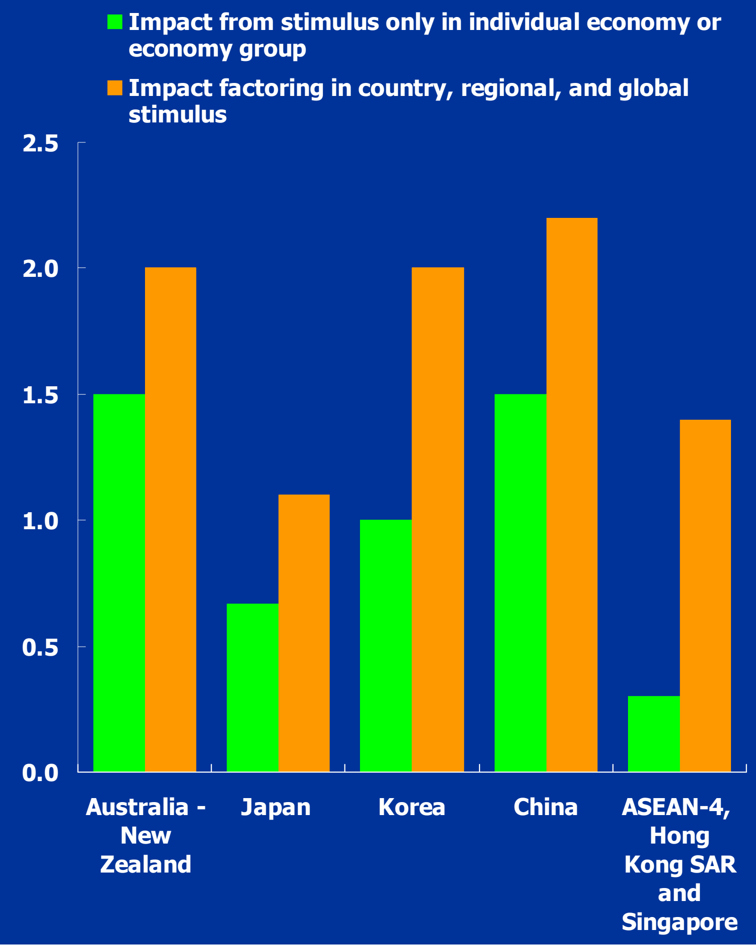
Domestic demand also contributed to Asia's rebound, thanks to the large fiscal stimulus...

Asia: Contribution to Growth – Recent Trough to 2009Q2
(percent; seasonally adjusted; non-annualized)



1/ Excludes China, India, Indonesia and Vietnam due to absence of a cycle and/or non-availability of data.

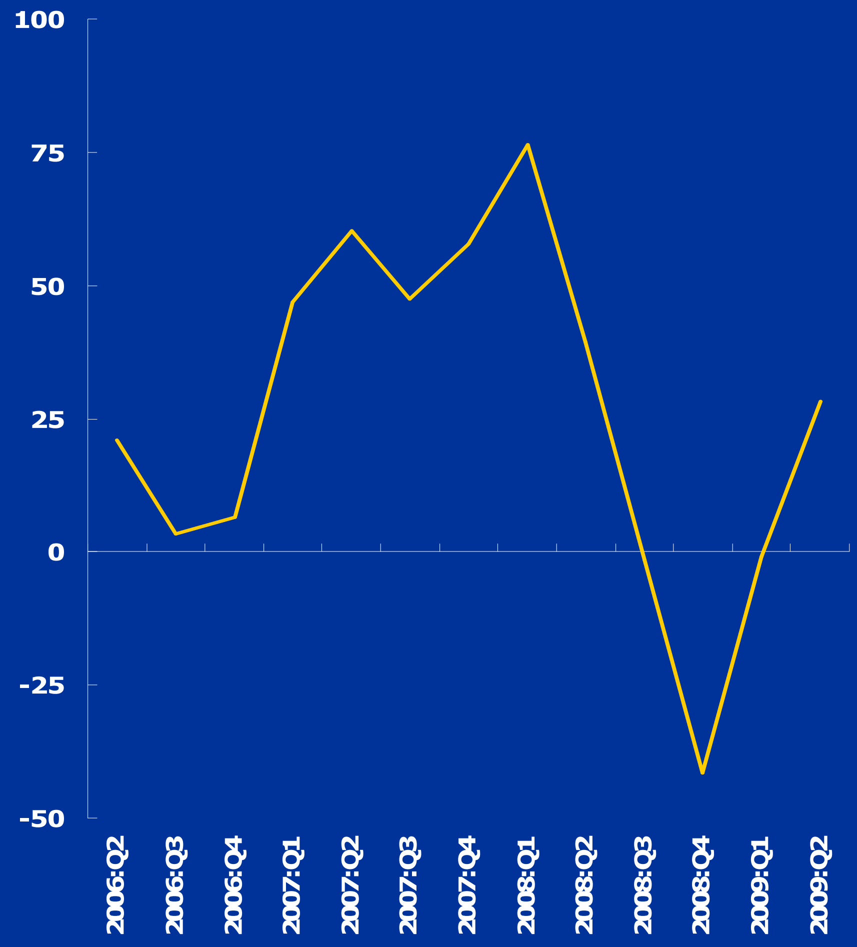
Asia: Impact of Fiscal Stimulus on 2009H1 Real GDP
(percent deviation from baseline)



...and a rapid normalization of both external and domestic financial conditions

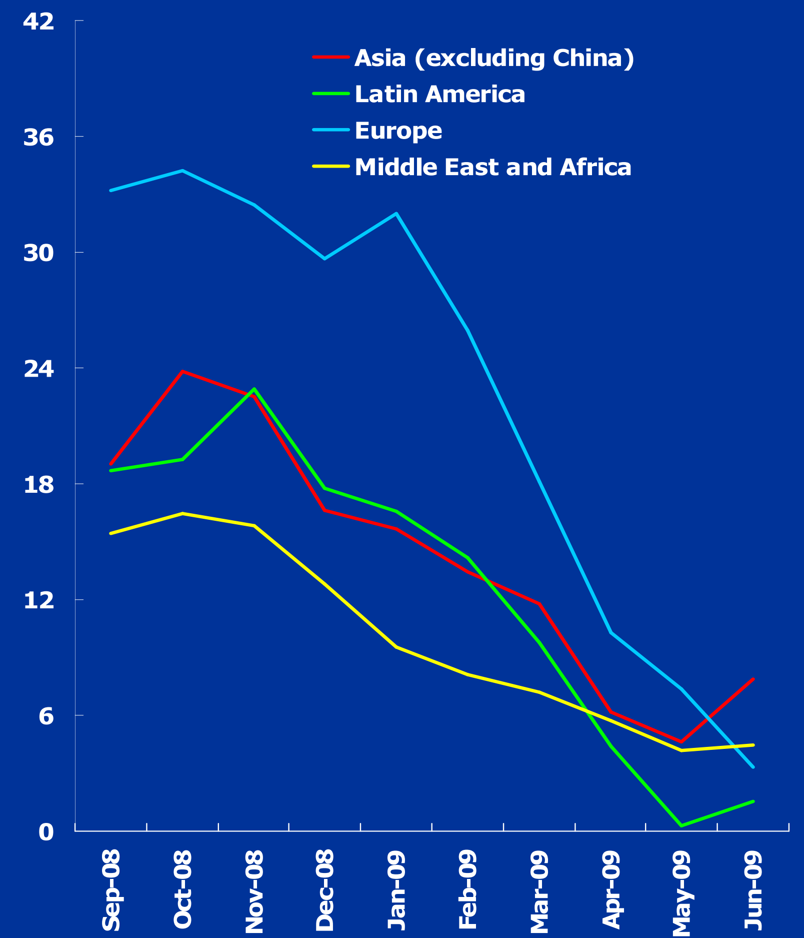
Emerging Asia: Net Capital Inflows

(In billions of U.S. dollars)

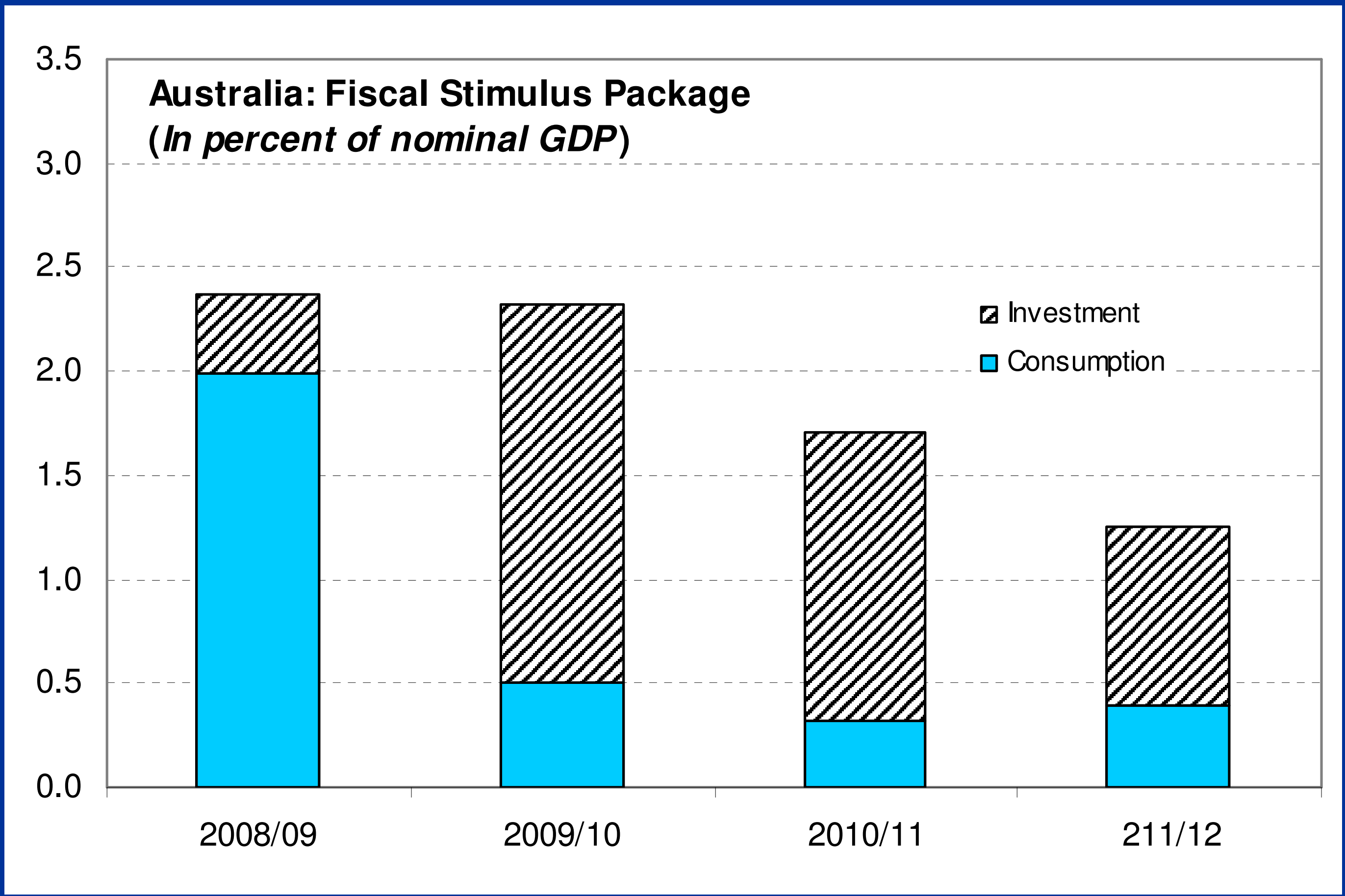


Emerging Markets: Bank Credit to Private Sector

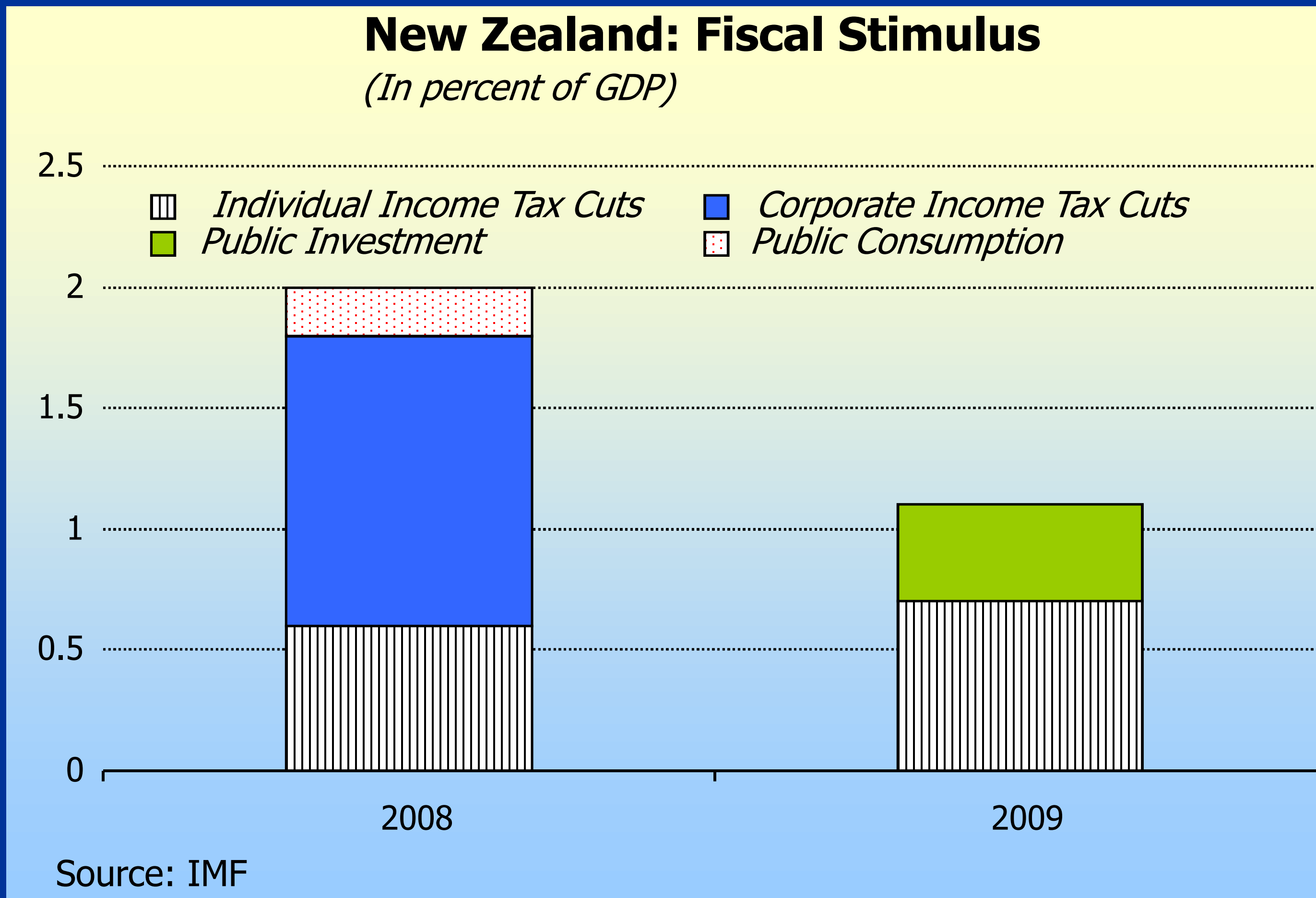
(Six-month percent change, annualized rate)



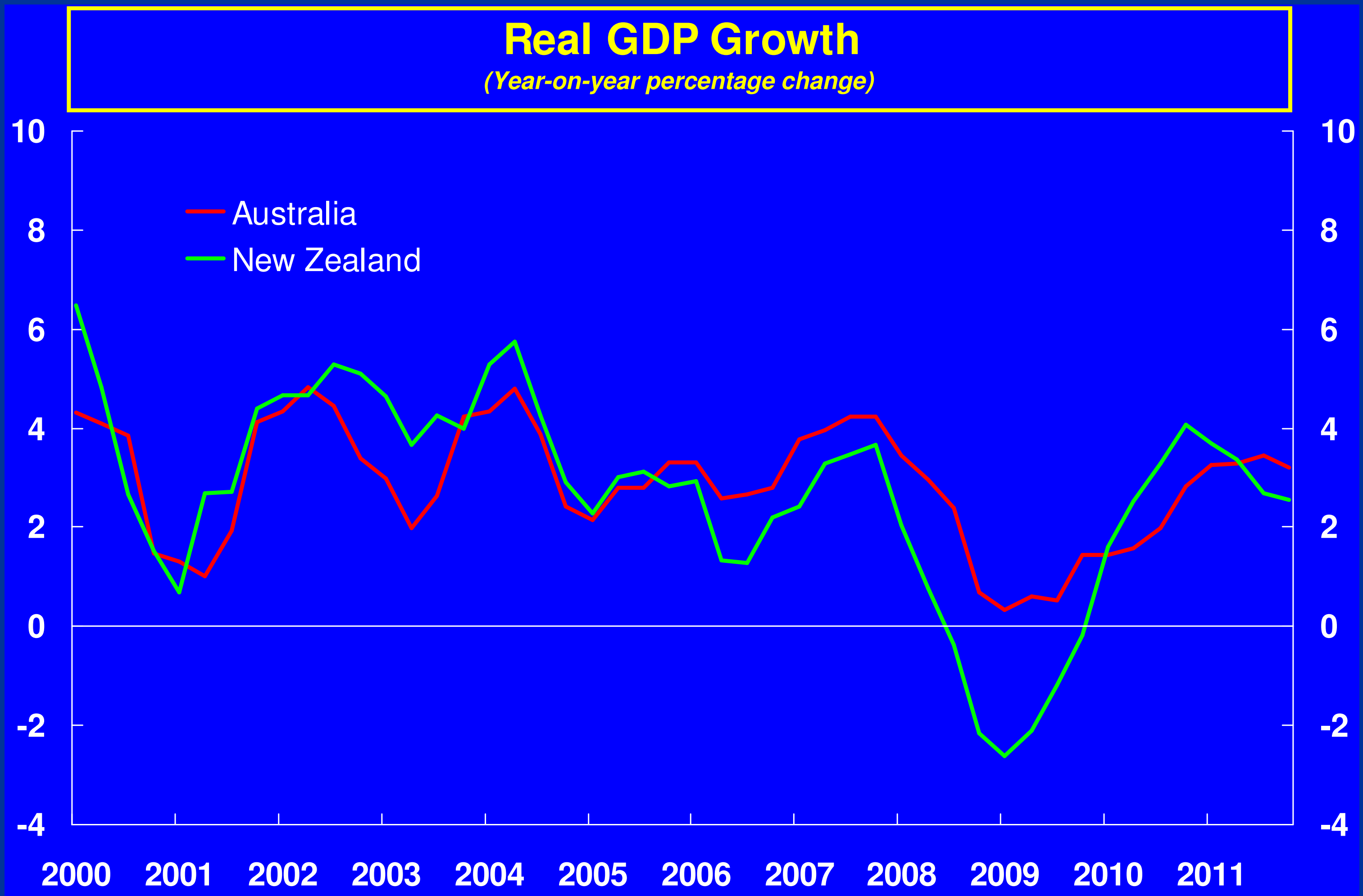
Moreover, both Australia and New Zealand (important for PICs) have implemented stimulus packages. Australia was able to implement stimulus due to no net public debt at start of crisis. Australian stimulus is estimated to raise total growth potential by between 5 ¼ and 12 ¾ percent over 2008 – 12



New Zealand composition of fiscal stimulus

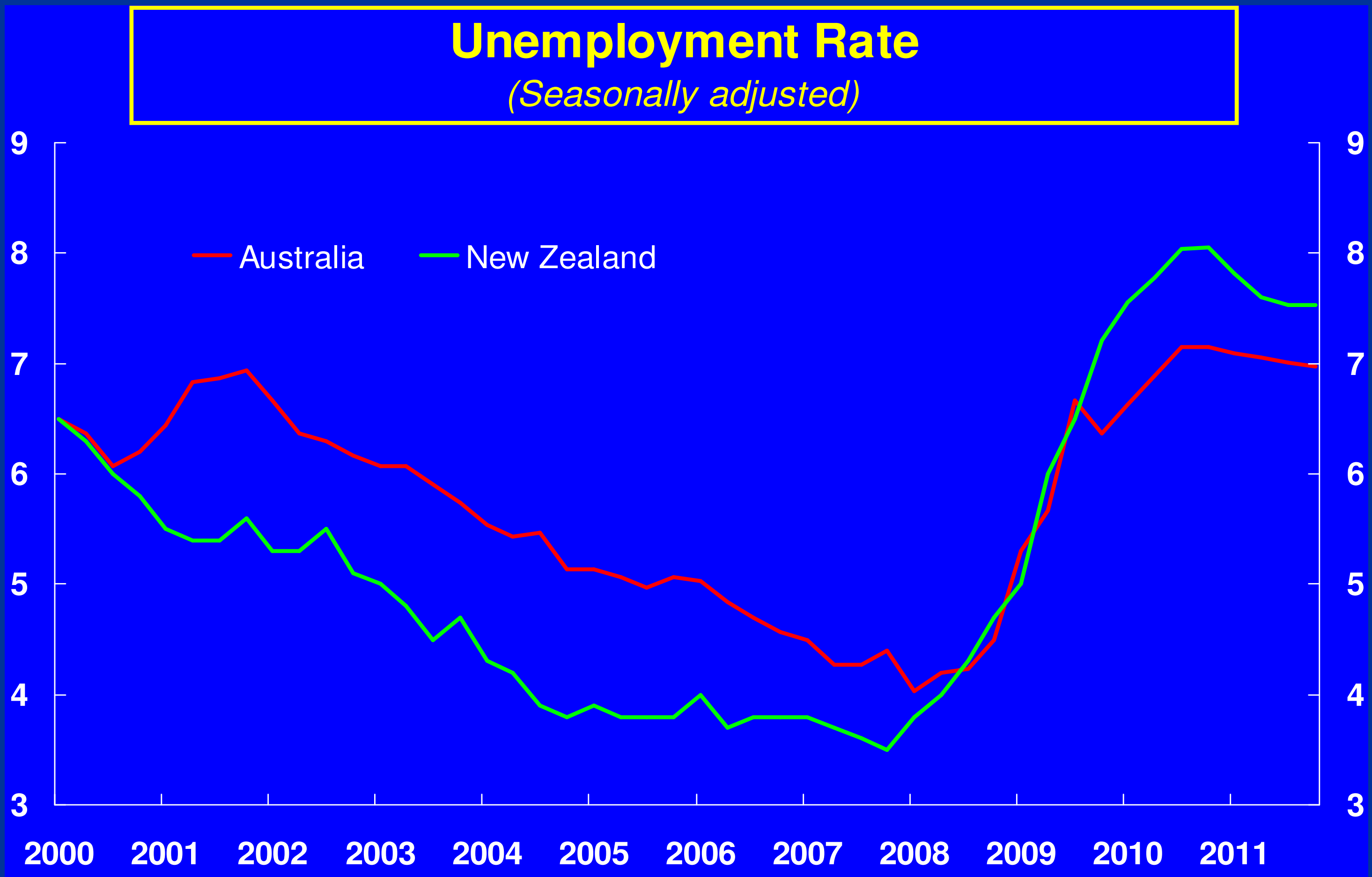


Growth in Australia and New Zealand is projected to rebound



Sources: Australian Bureau of Statistics; Statistics New Zealand; and Fund staff estimates.

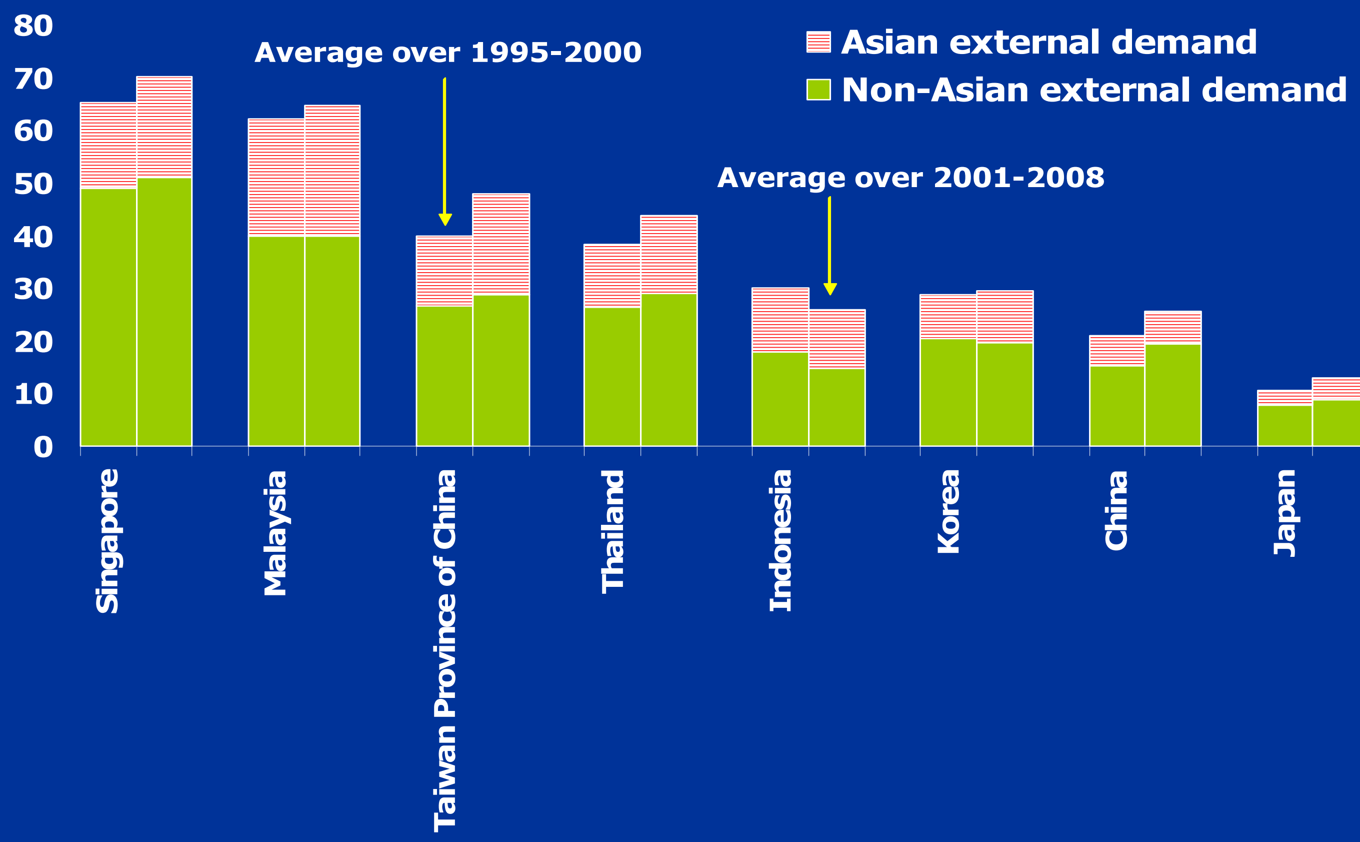
… and unemployment is expected to peak at relatively low rates



Sources: Australian Bureau of Statistics; Statistics New Zealand; and Fund staff estimates.

No decoupling: Asia's exporting economies remain highly dependent on external demand…and their suppliers of raw materials are, in turn, reliant on them

Selected Asia: Contribution of Final External Demand to Total Value Added
(percent)



The recovery is expected to continue into 2010, but growth will remain below pre-crisis standards

Asia: Real GDP
(Year-on-year percent change)

	2008	2009	2010	2009	2010
		Latest projections		Difference from May 2009 forecast	
Industrial Asia	**-0.2**	**-4.4**	**1.7**	**1.0**	**1.2**
Japan	-0.7	-5.4	1.7	0.8	1.2
Australia	2.4	0.7	2.0	2.2	1.3
New Zealand	0.2	-2.2	2.2	-0.2	1.7
Emerging Asia	***6.8***	**5.1**	**7.0**	**1.8**	**1.6**
NIEs	***1.5***	***-2.3***	***3.7***	***3.3***	***2.8***
Hong Kong SAR	2.4	-3.6	3.5	0.9	3.0
Korea	2.2	-1.0	3.6	3.0	2.0
Singapore	1.1	-1.7	4.3	8.3	4.4
Taiwan Province of China	0.1	-4.1	3.7	3.3	3.7
China	9.0	8.5	9.0	2.0	1.5
India	7.3	5.4	6.4	0.8	0.8
ASEAN-5	***4.8***	***0.7***	***4.0***	***0.7***	***1.7***
Indonesia	6.1	4.0	4.8	1.5	1.3
Malaysia	4.6	-3.6	2.5	-0.1	1.2
Philippines	3.8	1.0	3.2	1.0	2.2
Thailand	2.6	-3.5	3.7	-0.5	2.7
Vietnam	6.2	4.6	5.3	1.3	1.4
Emerging Asia (excluding China)	**4.8**	**1.7**	**4.9**	**1.6**	**1.7**
Emerging Asia (excluding China and India)	**3.1**	**-0.8**	**3.8**	**2.0**	**2.3**
Asia	**5.1**	**2.8**	**5.8**	**1.6**	**1.5**

Main risks to the outlook for Asia

- The tentative recovery in advanced economies could stall. Benefits from "cash-for-clunker" schemes and other overseas stimulus measures could wane, though recent G20 commitment indicates stimulus will continue.
- A return of risk aversion could lead to capital outflows, with knock on effects on equity prices and confidence. Also, Asian corporate refinancing needs remain significant.
- Asian corporations could reassess their medium-term growth prospects, shedding labor and keeping investment low. This could reduce demand for raw materials.
- Australian growth could taper off if rate hikes continue to erode consumer confidence, if stimulus is insufficient, and/or if growth in China slows after inventories are rebuilt.
- Upside risks: possibility of faster improvement in global financial conditions, diminishing "fear" could boost consumption and investment.

III. Impact of the Global Crisis on the Pacific Island Countries

Key transmission channels for PICs during the crisis up to mid 2009

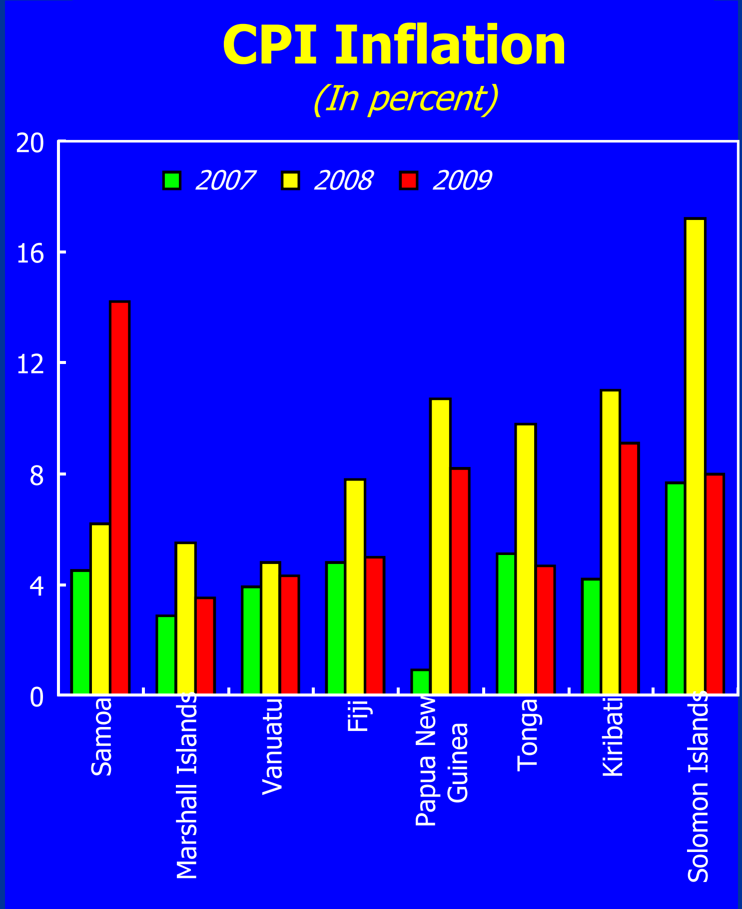
- Lower commodity prices generally helped to contain inflation and improve external balances and terms of trade.

  But…

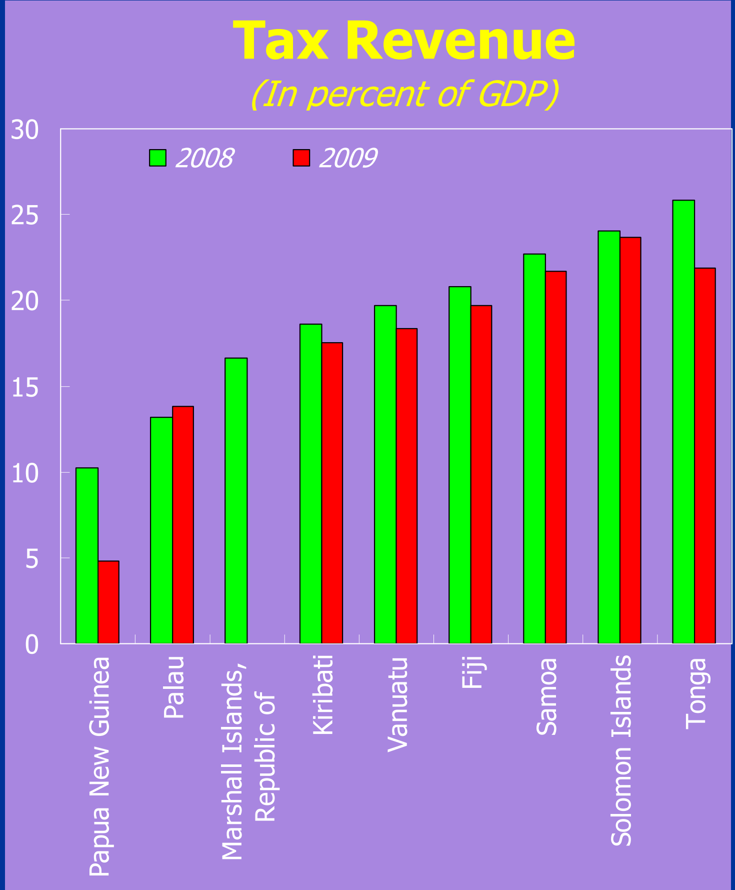
- Reduced external demand led to falling remittances, tourism receipts and exports.
- Lower trade volumes reduced tax revenue and raised fiscal deficits.
- Capital losses of between 10-20 percent for Trust Funds in 2008 (affecting Kiribati, Tuvalu and the Compact Trust Fund).

Impact on macroeconomic stability

- Drop in commodity prices helped ease inflationary and external pressures
- But lower trade volumes and value affect tax revenue putting pressure on fiscal balances

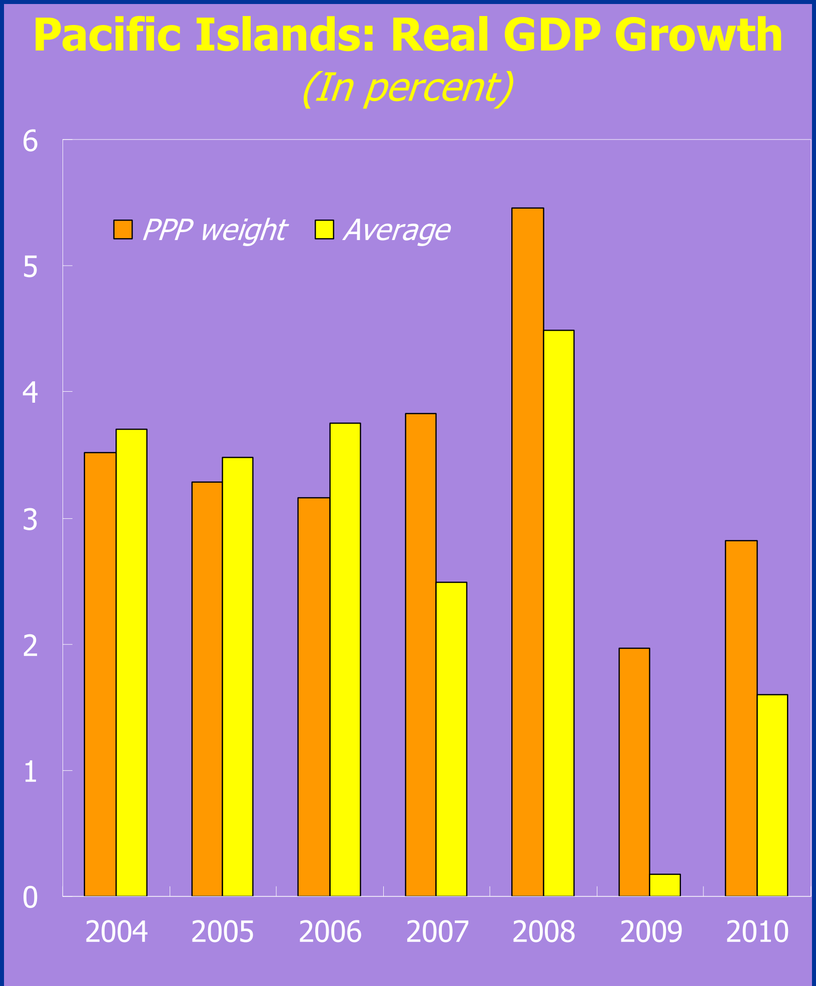


Source: IMF APDLISC database.



Source: IMF APDLISC database.

Nonetheless, growth in most PICs stayed positive and is expected to remain so in view of rebounding global and Asian growth

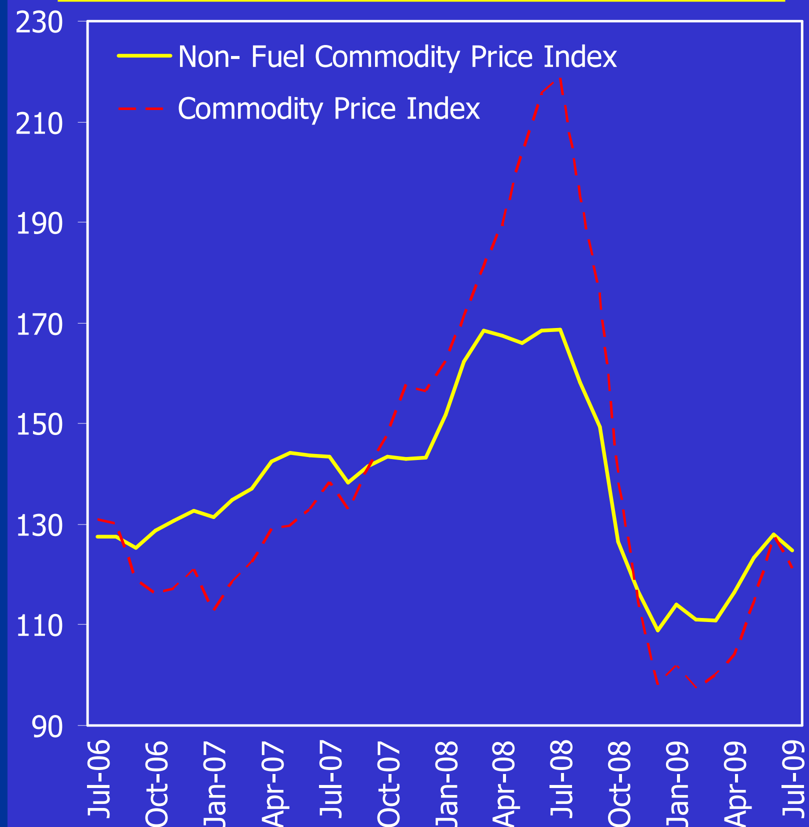


Sources: World Economic Outlook; IMF APDLISC database.

Source: IMF APDLISC database.

Commodity prices have rebounded strongly and this is helping drive growth in Australia; good for tourism but, on balance, a downside risk to PICs' external positions

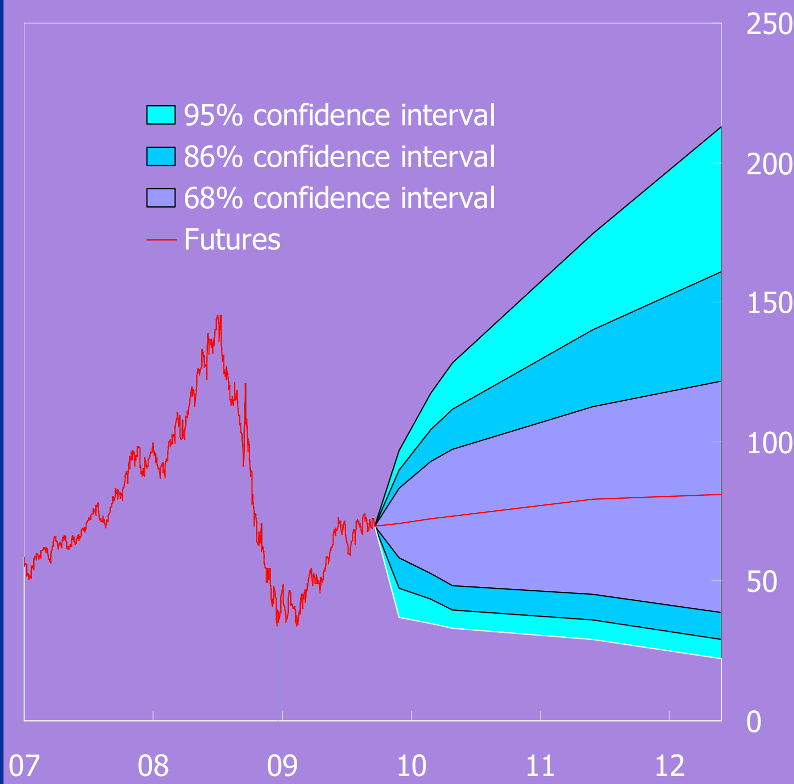
Commodity Price Index



Source: World Economic Outlook.

WTI Oil Price Prospects

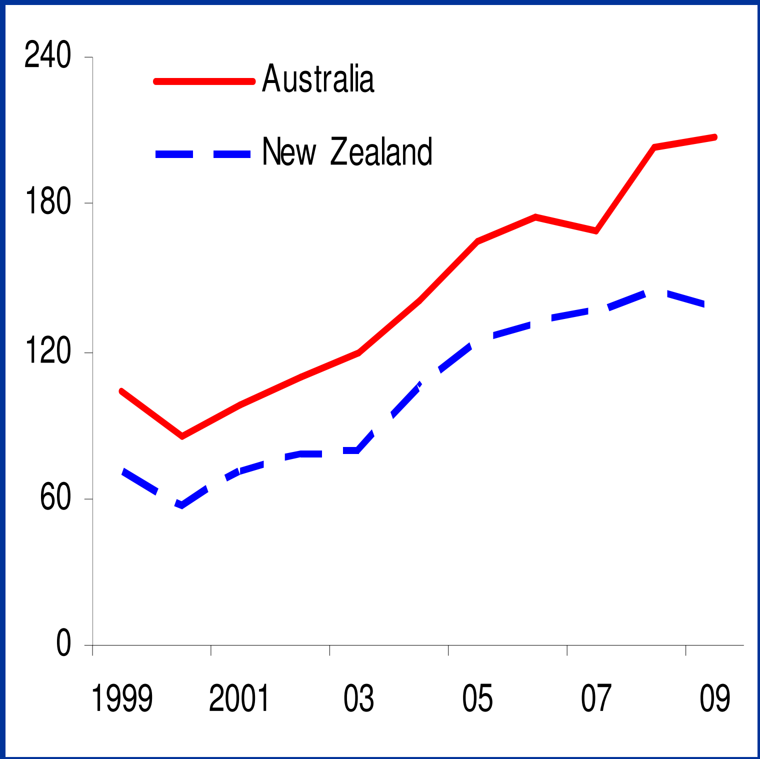
(In US dollars per barrel)



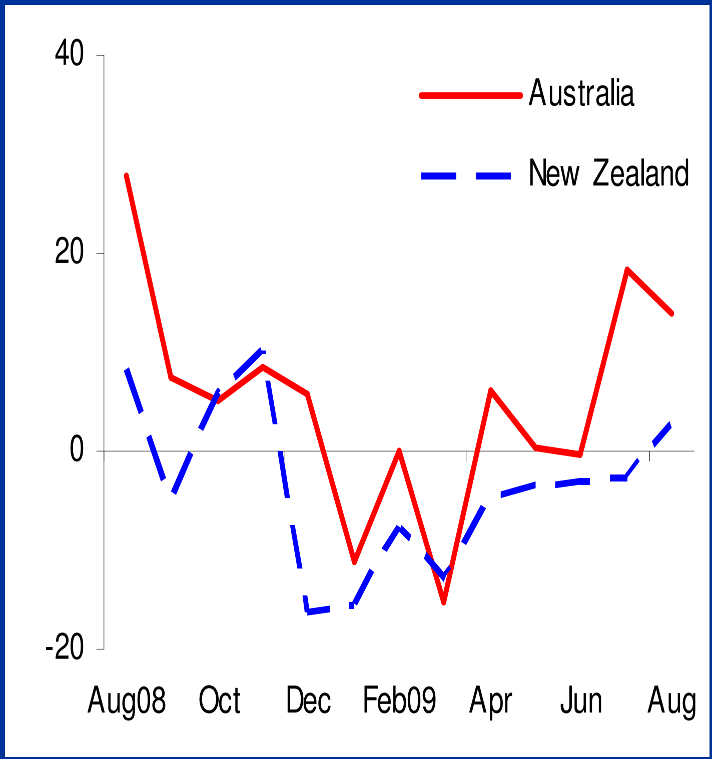
Sources: Bloomberg; and IMF staff calculations.

Tourism departures to the Pacific have picked up recently from key source countries

Departures for the Pacific
('000 persons, Jan to Aug totals)

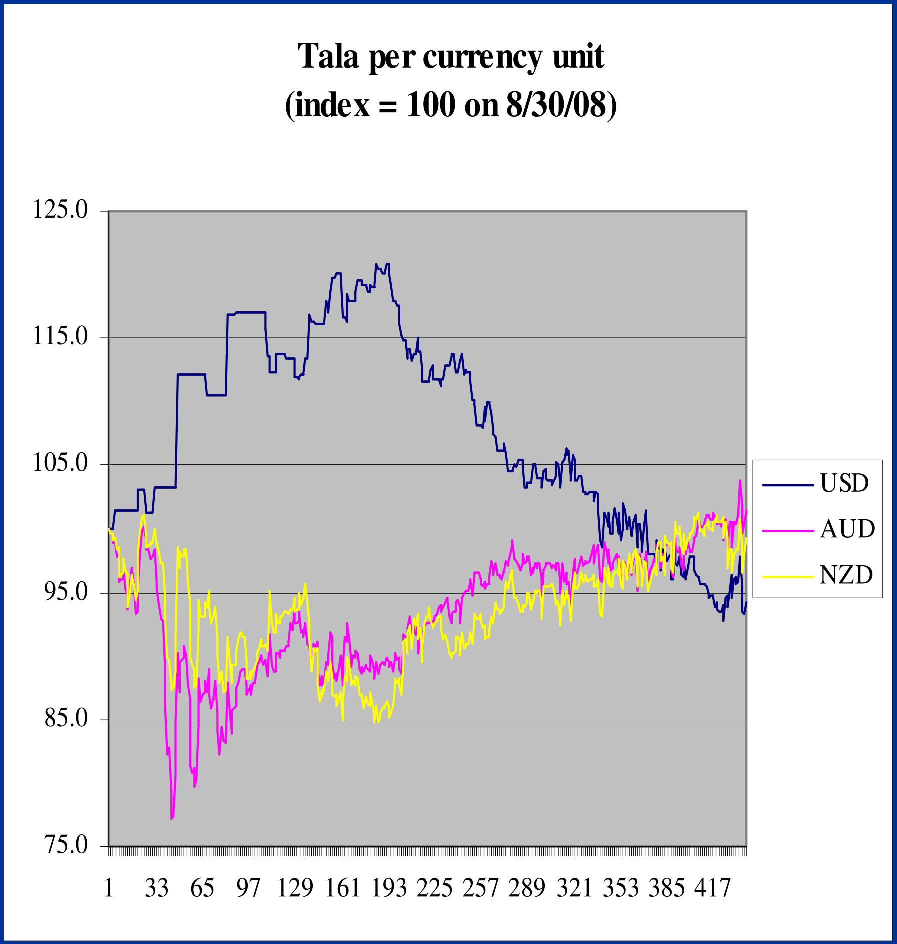


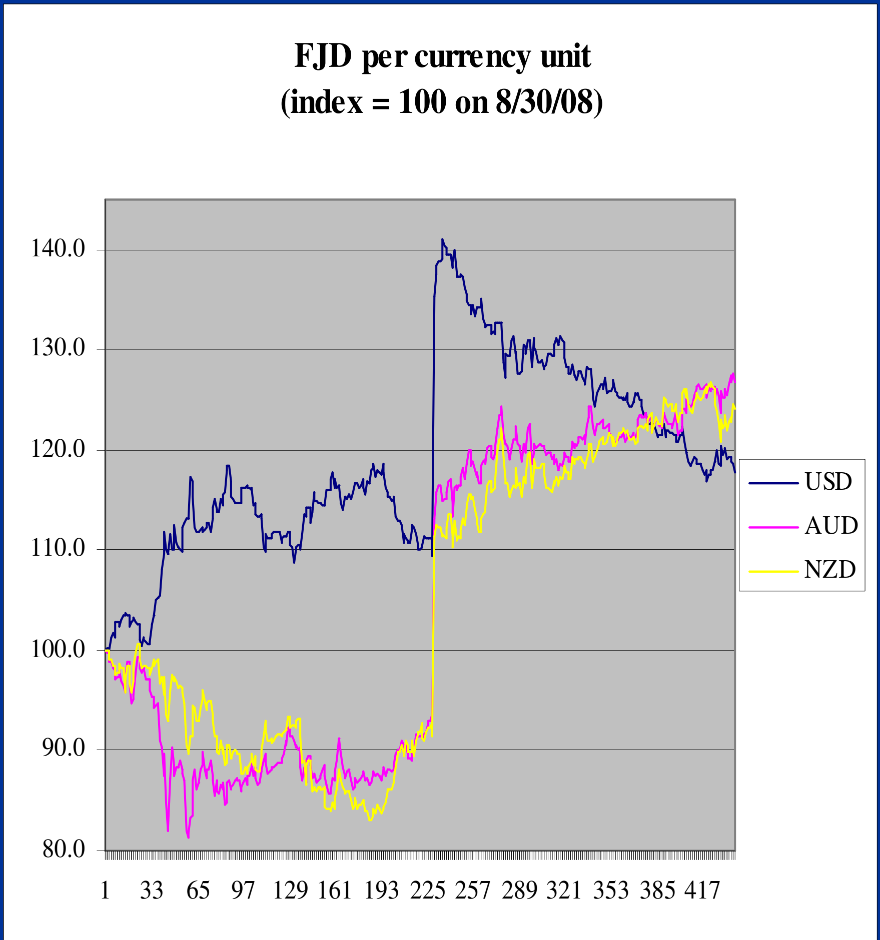
Departures for the Pacific
(persons; monthly, y-o-y% change)

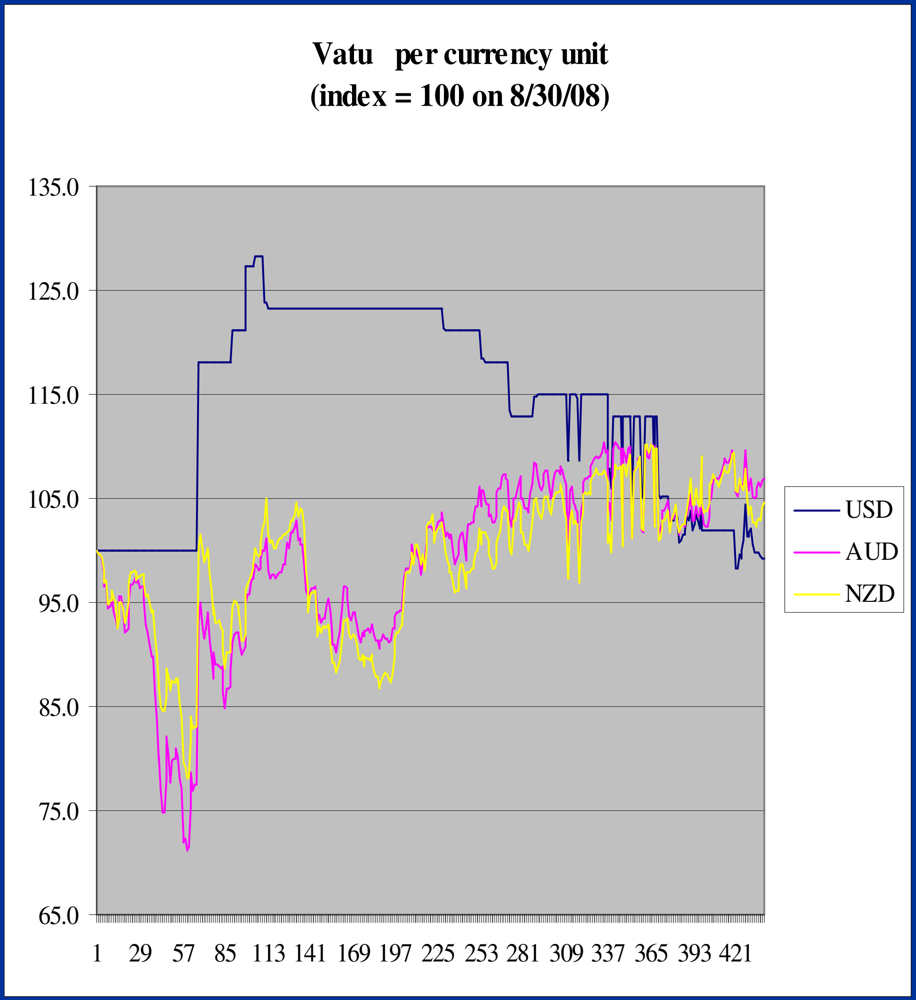


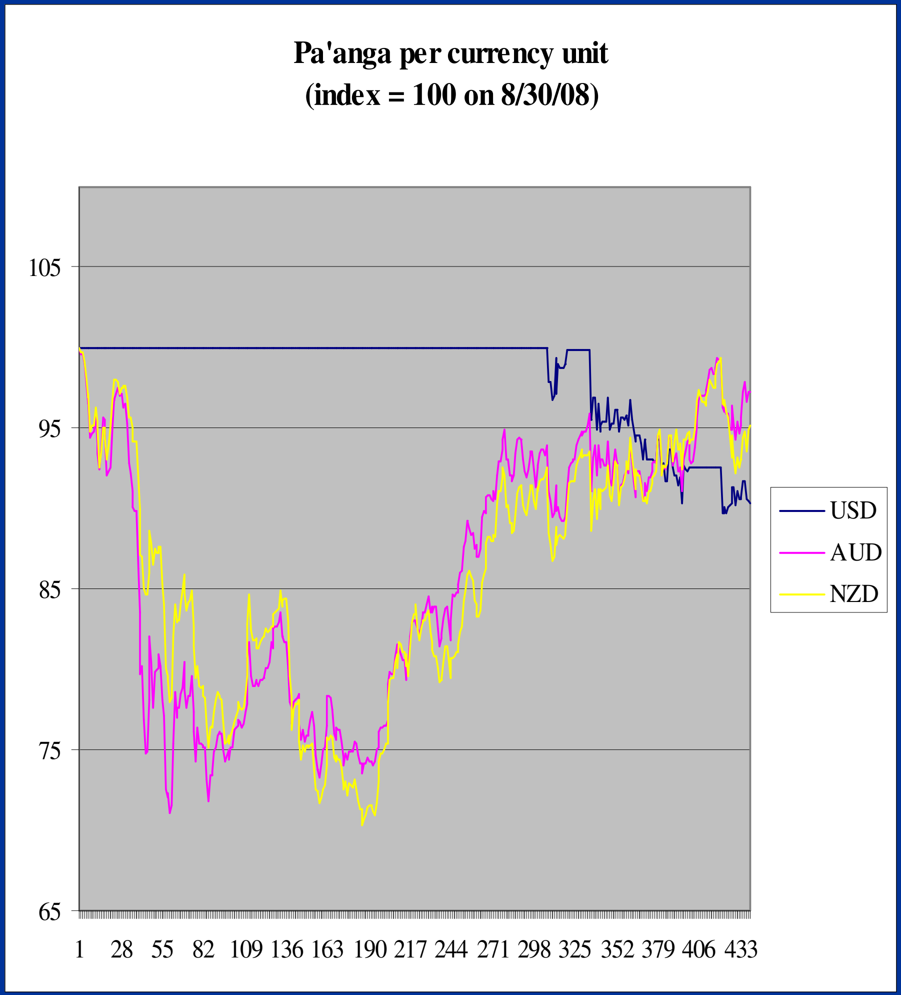
Sources: ADB, ABS and New Zealand Ministry of Tourism.

Pacific Island nominal exchange rates vis-à-vis bulk tourist markets are depreciating steadily…

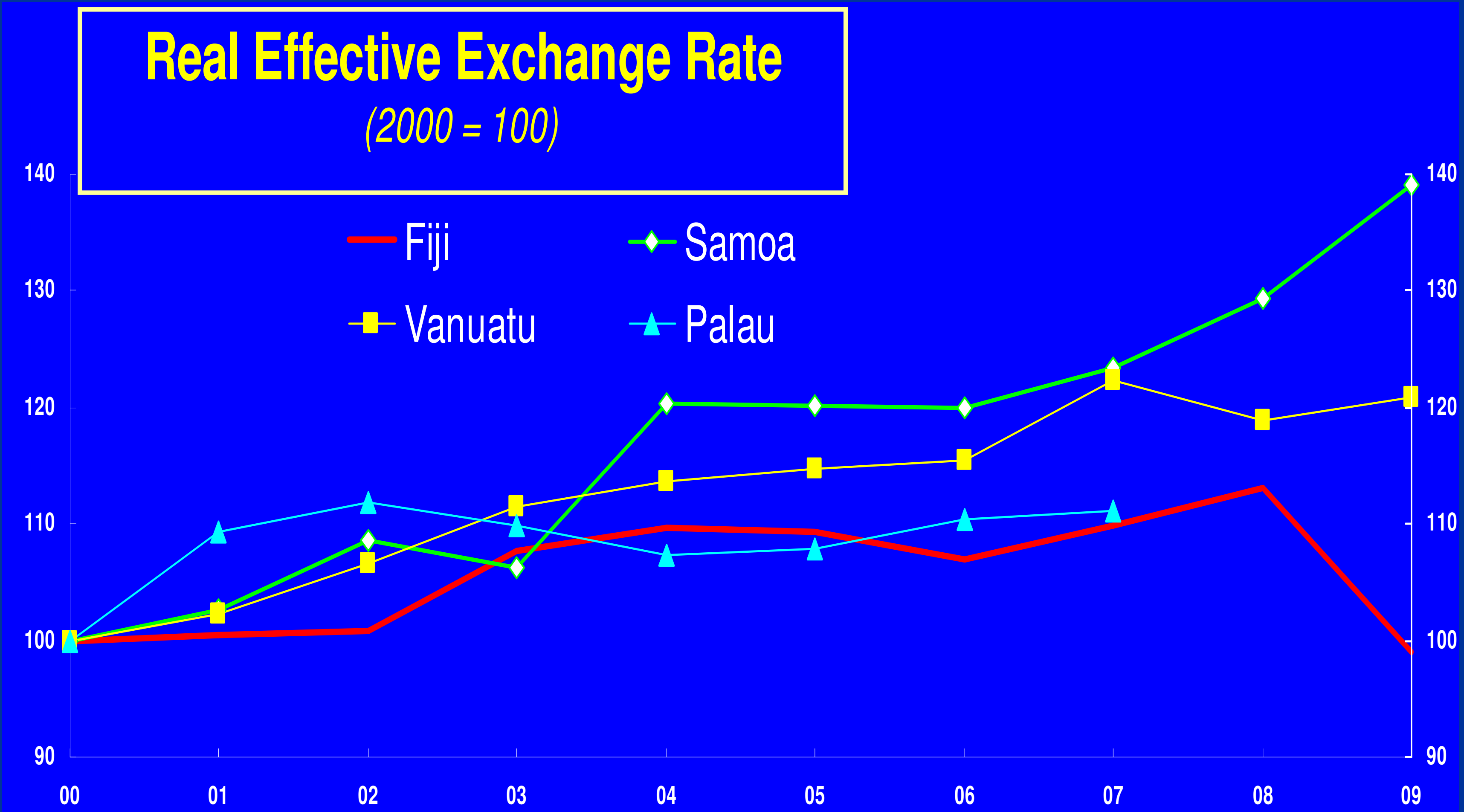





Vatu per currency unit
(index = 100 on 8/30/08)
135.0
125.0
115.0
105.0
95.0
85.0
75.0
65.0
1 29 57 85 113 141 169 197 225 253 281 309 337 365 393 421
USD
AUD
NZD

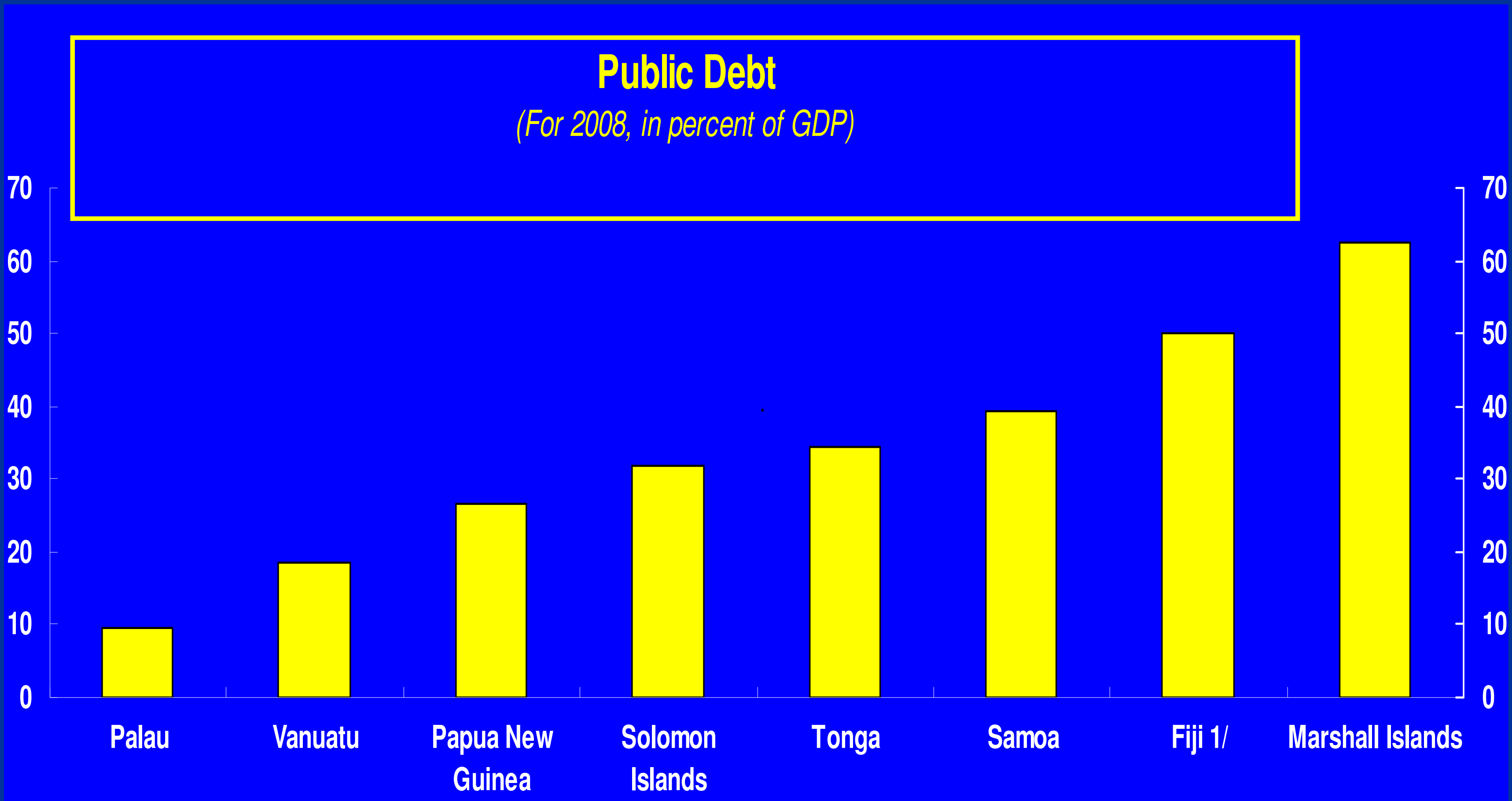

Pa'anga per currency unit
(index = 100 on 8/30/08)
105
95
85
75
65
1 28 55 82 109 136 163 190 217 244 271 298 325 352 379 406 433
USD
AUD
NZD

But…REERs have been appreciating for years and may pose risks for competitiveness



Sources: IMF, *Information Notice System*; APDLISC database; and Fund staff estimates.

And public debt is high in many Pacific countries, thereby constraining options for stimulus



Source: APDLISC database.
1/ For Fiji, Central government debt.

Conclusion: The Pacific Island Countries face a very mixed picture

- Uncertainty about growth prospects globally and in Asia/Oceania remains high.
- The benefits of lower commodity prices have been offset by falling exports, remittances, and tourism receipts, and rising fiscal deficits.
- Current rebound globally and particularly in Asia-extending to Australia and New Zealand-is improving growth prospects for PICs, assuming that stimulus packages are not withdrawn prematurely, growth becomes self-sustaining, and rising unemployment eases soon.
- Tourism, which is key to the PICs, is showing signs of recovering.
- Real exchange rate appreciation in PICs with pegged exchange rates have eroded competitiveness for years.
- Policy options are constrained in those PICs with high public debt and low reserve cover, and by the facts that financial markets are very thin and the monetary transmission mechanism is weak.