INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/260

REPUBLIC OF THE MARSHALL ISLANDS

July 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF THE MARSHALL ISLANDS

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with Republic of the Marshall Islands, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 25, 2016 consideration of the staff report that concluded the Article IV consultation with Republic of the Marshall Islands.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 25, 2016, following discussions that ended on May 18, 2016, with the officials of Republic of the Marshall Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 8, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association.
- A **Statement by the Executive Director** for Republic of the Marshall Islands.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

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International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2016 Article IV Consultation with the Republic of the Marshall Islands

On July 25, the Executive Board of the International Monetary Fund (IMF) concluded the 2016 Article IV consultation[1] with the Republic of the Marshall Islands.

The Republic of the Marshall Islands is an isolated and thinly-populated island state that is vulnerable to climate change owing to its low elevation. Its economy is highly dependent on external aid, as the base for private sector growth is limited by its small size, remoteness, and dispersion over a vast ocean area.

Overcoming the contraction of the previous year, the Marshallese economy is estimated to have expanded by about 0.5 percent in FY2015 (ending September 30), as the fishery sector recovered. Following a moderate inflation of 1.1 percent in FY2014, headline inflation dropped to -2.2 percent in FY2015 amid falling oil and utility prices. The fiscal balance is estimated to have recorded a surplus of about 3 percent of GDP in FY2014–15, due to record-high fishing license fees.

Growth is expected to rise to about 1.5 percent and inflation to about 0.5 percent in FY2016, as the effects of the drought earlier this year are offset by the resumption of infrastructure projects. The fiscal balance is projected to decline to a smaller surplus in FY2016 but, without reforms, would deteriorate to a sizable deficit over the medium term owing to the steady decline in Compact grants until FY2023. After an expected growth rebound fueled by the implementation of delayed infrastructure projects, GDP is projected to grow at the potential rate of 1–1.5 percent over the medium term, absent structural reforms.

[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.

Executive Board Assessment[2]

Executive Directors welcomed the improvement in economic activity, but noted that the Republic of the Marshall Islands continues to face significant challenges arising from the scheduled decline in Compact grants, extreme weather-related events due to climate change, and limited private sector activity. Directors underscored the importance of sound macroeconomic policies to ensure long-term fiscal sustainability, safeguard financial stability, reduce vulnerabilities to external shocks, and promote sustainable growth.

Directors emphasized that fiscal consolidation over the medium-term is key to building adequate buffers against existing fiscal vulnerabilities. They agreed that implementation of adjustment efforts envisioned in the Decrement Management Plan will be important. Accordingly, Directors recommended steps to contain expenditure, especially current spending while avoiding delays in infrastructure spending, further reducing subsidies to state-owned enterprises (SOEs), enhancing tax administration, and strengthening tax and social security systems. Accelerating the pace of public financial management reforms will be critical in implementing the needed fiscal adjustment and in addressing the existing weaknesses in budget execution, reporting and planning.

Directors emphasized the need for continued efforts to mitigate climate change risks, including explicit budget provisions for adaptation costs. They also encouraged the authorities to sustain the reform of SOEs to facilitate private sector development. In this regard, Directors highlighted that clarifying community service obligations of SOEs and establishing a centralized monitoring unit, building on the legislation of the SOE Act, will be important.

Directors emphasized the need to strengthen the capacity and oversight authority of the Banking Commission to safeguard financial stability, including the challenges posed by withdrawal of correspondent banking relationships. Efforts should also be made to address the regulatory gaps, including in the AML/CFT framework. Directors encouraged the Banking Commission to consider a ceiling on the allowed household debt service ratio, and introduce stricter criteria on non-performing loan classification. Directors supported the authorities' plans to refocus the Marshall Island Development Bank to its core mandate of providing commercial lending.

Directors emphasized that structural reforms are needed to facilitate private sector growth. Reform effort should be aimed at increasing competiveness and reducing impediments to doing business, notably by improving access to credit and strengthening the property registration and bankruptcy framework. Enhancing statistics will help strengthen policy planning and analysis.

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[2] 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.

Marshall Islands: Selected Economic Indicators, FY2012–2021 1/

Nominal GDP for FY2015 (in millions of U.S. dollars): 184.6

Population (2015 est.): 52,900

GDP per capita for FY2015 (in U.S. dollars): 3489.6

Quota: SDR 3.5 million

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Est.	Proj.					
Real sector										
Real GDP (percent change)	4.0	1.9	-1.1	0.4	1.4	1.7	1.8	1.6	1.6	1.3
Consumer prices (percent change)	4.3	1.9	1.1	-2.2	0.7	1.1	1.8	1.9	2.1	2.1
Central government finances (in percent of GDP)										
Revenue and grants	51.4	53.7	52.2	57.0	66.2	66.4	65.1	63.4	61.5	60.3
Total domestic revenue	19.3	21.4	23.4	26.4	29.0	26.7	26.5	25.9	25.2	25.0
Grants	32.1	32.2	28.8	30.6	37.2	39.8	38.6	37.4	36.3	35.3
Expenditure	52.2	53.9	49.0	54.2	63.9	64.7	64.4	63.4	62.4	61.6
Expense	48.2	50.1	46.1	50.2	54.9	52.5	51.9	51.3	50.8	50.4
Net acquisition of nonfinancial assets	4.0	3.8	2.9	4.0	9.0	12.2	12.5	12.1	11.6	11.2
Net lending/borrowing	-0.7	-0.2	3.2	2.7	2.3	1.7	0.7	-0.1	-0.9	-1.3
Compact Trust Fund (in millions of US$; end of period)	165.6	206.2	240.1	247.1	279.4	311.7	346.2	383.0	422.2	464.0
Commercial banks (in millions of US$)										
Foreign assets	62.1	65.6	64.7	90.2	…	…	…	…	…	…
Private sector claims	59.4	67.2	79.4	89.9	…	…	…	…	…	…
Total deposits	85.0	98.4	118.9	155.5	…	…	…	…	…	…
Consumer loans (in percent of total loans)	79.0	71.0	72.2	70.8	…	…	…	…	…	…
One-year time deposit rate (in percent)	1.6	1.3	1.6	1.4	…	…	…	…	…	…
Average consumer loan rate (in percent)	13.8	14.2	13.3	13.2	…	…	…	…	…	…
Balance of payments (in millions of US$)										
Trade balance	-49.8	-66.8	-67.5	-77.2	-82.9	-87.4	-89.3	-91.2	-93.4	-95.6
Net services	-43.7	-47.7	-40.9	-45.4	-45.9	-48.3	-49.1	-50.4	-51.3	-52.3
Net income	29.3	36.1	45.3	58.5	54.2	55.1	58.1	59.6	60.6	61.6
Unrequited transfers (private and official)	57.8	59.6	54.9	58.1	60.2	62.5	61.4	62.3	62.2	62.0
Current account including official grants 2/	2.3	-2.9	1.4	-2.9	-1.3	-0.7	-0.5	-2.3	-4.6	-6.9
(In percent of GDP)	1.2	-1.5	0.7	-1.6	-0.7	-0.4	-0.2	-1.1	-2.2	-3.2
External PPG debt (in millions of US$; end of period) 3/	96.9	98.4	95.5	90.6	85.7	80.4	75.1	76.7	79.1	83.0
(In percent of GDP)	52.6	51.8	51.1	49.1	45.6	41.7	37.8	37.5	37.5	38.3
External debt service (in millions of US$)	7.2	6.3	6.8	7.2	7.2	7.3	7.3	8.1	8.0	7.4
(In percent of exports of goods and services)	8.6	7.6	9.1	10.9	10.8	10.7	10.3	11.0	10.4	9.3
Exchange rate										
Real Effective Exchange Rate (2010 =100)	100.5	102.0	102.7	106.3	…	…	…	…	…	…
Memorandum Item:										
Nominal GDP (in millions of US$)	184.4	190.2	186.7	184.6	188.0	192.8	198.6	204.5	210.8	216.7

Sources: RMI authorities; and IMF staff estimates and projections.

1/ Fiscal year ending September 30.

2/Includes capital grants.

3/ Public and publicly-guaranteed external debt.

INTERNATIONAL MONETARY FUND

REPUBLIC OF THE MARSHALL ISLANDS

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

July 7, 2016

KEY ISSUES

Context. The Republic of the Marshall Islands (RMI) is an isolated and thinly-populated fragile state vulnerable to climate change. Its economy is highly dependent on external aid, as private sector growth is constrained by its small size and remoteness, dispersion over a vast ocean area, and regulatory weakness. The country needs to adapt to climate change, prepare for a sharp reduction in the U.S. grants in FY2023, and enhance the platform for sustainable private-sector growth. Although the economy is expected to expand modestly in FY2016, the fiscal balance will likely fall into deficit in the medium term without a sustained adjustment, undermining long-term self-sufficiency.

Key Policy Recommendations.

- A medium-term fiscal surplus of 3 percent of GDP is needed to build adequate buffers ahead of the FY2023 reduction of Compact grants, entailing a gradual fiscal adjustment of about 5 percentage points of GDP over seven years to be achieved by consolidating expenditures and reforming the tax and social security systems.
- Continued efforts to adapt to climate change are recommended, including the explicit budgeting of fiscal provisions. Funding should be sought from diverse sources, including grants and disaster risk insurances.
- To facilitate private sector development, state-owned enterprise (SOE) reform should continue. Building on the SOE Act of October 2015, the authorities should clarify community service obligations and establish a centralized monitoring unit.
- The capacity and oversight authority of the Banking Commission should be strengthened to safeguard financial stability, including the challenges posed by withdrawal of correspondent banking relationships (CBRs).

Approved By
Ranil Manohara Salgado (APD) and Andrea Richter Hume (SPR)

Discussions took place in Majuro on May 9–18, 2016. The staff team comprised Mr. Jaewoo Lee (Head), Mr. Serkan Arslanalp, and Ms. Mari Ishiguro (all APD), joined by Ms. Nancy Lelang (OED) and Mr. Tubagus Feridhanusetyawan (APD). Representatives from the World Bank and the Asian Development Bank also participated in the mission. The mission met with the Speaker of the Parliament Kedi, Finance Minister Wase, other senior government officials, private sector representatives, donors and the press.

CONTENTS

APPENDICES