



IMF Staff Completes 2023 Article IV Mission to Palau

FOR IMMEDIATE RELEASE

End-of-Mission press releases include statements of IMF staff teams that convey preliminary findings after a visit to a country. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF's Executive Board for discussion and decision.

- *Palau has emerged from the pandemic with significant output loss, high external debt, and inflation. After contracting for three years, economic activity has started to recover. Inflation has spiked to historical highs driven by import prices for food and fuel, the introduction of the Palau Goods and Services Tax (PGST) and a sizeable one-off utility tariff increase.*
- *We commend the authorities for important reforms to enhance fiscal responsibility and modernize the tax system, and for taking steps to reform the pension system. While subject to approval in the U.S. Congress, the renewal of the COFA Agreement (CRA-23) on May 22, 2023, under improved financial terms, improves Palau's macroeconomic prospects. The uncertainty around the timing of its approval calls for fiscal prudence.*
- *Dependence on tourism, exposure to climate events, and recent increases in outward migration pose significant challenges and raise vulnerabilities. Going forward, reforms to attract investment, diversify the economy, improve the infrastructure and its climate resilience, and reskill the labor force, will raise growth and make it more sustainable.*

Washington, DC – September 12, 2023: An International Monetary Fund (IMF) team led by Ms. Elif Arbatli Saxegaard conducted discussions on the Palauan economy for the 2023 Article IV Consultation from August 30 to September 12, 2023. At the end of the mission, Ms. Saxegaard issued the following statement:

“Palau is at the onset of a gradual recovery from the pandemic that left significant scarring, as output fell by a fifth of its pre-pandemic level. Economic activity is expected to have stalled in FY2023, growing by 0.8 percent, reflecting weaknesses in the construction sector and a slow pick-up in tourism.”

“Inflation is projected at 13 percent in FY2023, driven by higher import prices for food and fuel, the one-off impact of the introduction of the value-added tax (PGST) in January 2023 and utility tariff adjustment for households in May 2023.”

“The new Compact Review Agreement (CRA-23) improves Palau's macroeconomic prospects, including through higher grants and transfers to the Compact Trust Fund. Growth is expected to accelerate in FY2024 to 12.4 percent, driven by positive trends in tourism along with a strong rebound in construction activity. Inflation is projected to moderate to 5.4 percent in FY2024, as the impact of one-off price increases subsides.”

“Near-term risks remain tilted to the downside. They include potential delays in the US Congress’s approval of the new COFA, weakness in tourism recovery and potential droughts related to El Nino. Global downside risks involve an abrupt global slowdown and commodity price volatility.”

“We commend the authorities for their reforms to modernize the tax system, including the introduction of a value added tax (PGST), which started to bear fruit, and their social assistance programs to mitigate the impact of the reforms on low-income households.”

“Due to the tax reform and higher grants under CRA-23, the fiscal balance is projected to return to a surplus in FY2024, as before the pandemic. Given the uncertainty around CRA-23 approval and lingering inflationary environment, a contractionary fiscal stance is appropriate. Further efforts should be made to protect the most vulnerable.”

“The mission recommends the adoption of a medium-term fiscal strategy that supports Palau’s development objectives, and targets rebuilding fiscal buffers, while enhancing expenditure efficiency, improving public financial management, and solidifying the recent tax reforms. Public sector employment and compensation policies should be reviewed to better reflect the skills required by the government, including a remuneration structure that promotes skill retention and performance-based seniority.”

“The IMF team commends the government for the social security (ROPSSA) reform bill, which, if passed swiftly, will bring the system in line with good practice. Ongoing efforts to reform the civil service pension scheme (CSPP) remains a key priority going forward.”

“As the pandemic-related support measures expire, asset quality in the financial sector, including in the National Development Bank of Palau, warrants close monitoring. There is scope to enhance Palau’s financial system’s contribution to growth and stability by lifting structural impediments, including lack of collateral and record keeping practices. The establishment of a credit bureau could help banks better manage credit risk.”

“The IMF team recommends a cautious and gradual approach to digital initiatives. The authorities should close existing gaps in the regulatory and governance frameworks and strengthen the country’s AML/CFT framework, before exposing the financial system to new risks.”

“Advancing structural reforms will help diversify the economy and boost private investment. The government’s National Development Plan (NDP) is a good step forward. Given the limited scope to diversify exports, it is important to pivot to higher value tourism, by expanding tourism offering and its linkages to other sectors. Climate change adaptation strategies will need to render infrastructure more climate resilient and facilitate retreat from low-lying areas.”

“A strategic national plan that identifies development priorities and actions, can help guide the careful balancing of different development needs and tradeoffs, in the context of Palau’s enhanced macro-fiscal envelope under the CRA-23.”

“The team would like to thank the authorities and other interlocutors for the constructive discussions and excellent logistical support in this first in-person Article IV consultation since the pandemic.”