



REPUBLIC OF NAURU

April 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF NAURU

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 2017 Article IV consultation with the Republic of Nauru, 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 March 24, 2017 consideration of the staff report that concluded the Article IV consultation with the Republic of Nauru.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 24, 2017, following discussions that ended on January 27, 2017, with the officials of the Republic of Nauru on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 7, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Nauru.

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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IMF Executive Board Concludes 2017 Article IV Consultation with the Republic of Nauru

On March 24, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the first Article IV consultation¹ with Nauru after the country became the 189th IMF member country in April 2016 (see [Press Release No. 16/167](#)).

Nauru's growth and government revenue have improved substantially in recent years owing to the Australian Regional Processing Center (RPC) to process asylum seekers, in addition to fishing license fees, and residual phosphate mining. In the near term, GDP growth is projected to moderate to 4 percent in FY2017 (ending June 30) mainly due to a slowdown in phosphate exports and limited expansion of the RPC. Inflation is projected to decline to around 6 percent along with moderating economic activities and stable food and fuel prices.

Despite the improved economic performance in recent years, Nauru continues to face challenges in sustaining growth and ensuring fiscal sustainability due to its limited sources of growth and income. The country is also vulnerable to climate change, its antiquated infrastructure hampers trade and growth, and its health indicators are below those of peers due to high incidence of non-communicable diseases.

The medium-term outlook is vulnerable to the scaling down of the RPC as refugees are expected to be transferred to other countries, entailing a substantial decline in RPC revenue. With limited access to borrowing, fiscal spending would have to adjust accordingly. Inflation is projected to remain low, in line with the economic slowdown, inflation in Australia, and low commodity prices.

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 Assessment²

Executive Directors welcomed the first Article IV consultation with Nauru. They noted that economic growth and government revenue improved substantially in recent years, owing to the Regional Processing Center (RPC), fishing license fees, and residual phosphate mining. They commended the authorities for using the fiscal surplus to build up fiscal buffers, contribute to the new trust fund, and clear arrears. At the same time, Directors recognized that Nauru faces substantial challenges over the medium and long terms arising from the limited sources of growth and income, and climate change. In this regard, they welcomed the authorities' commitment to undertake the necessary reforms.

Directors agreed that Nauru's medium-term outlook is vulnerable to the expected scaling down of the RPC, which will entail a substantial decline in revenue. With limited access to borrowing, fiscal spending would need to adjust. Directors emphasized that maintaining fiscal buffers and continuing to build the new trust fund with donor support will be critical to ensure fiscal liquidity and sustainability. They urged continued tax and public financial reforms to support fiscal adjustment and help control spending, and a further strengthening of public debt management to preserve debt sustainability and improve market access.

Directors noted that Nauru faces long-term climate change challenges and emphasized the importance of a medium-term fiscal framework that enhances resilience to climate change. They welcomed the adoption of practical approaches in the near term, such as matching planned capital projects with Nauru's climate change strategy, meeting climate proofing standards, and incorporating the projects into a multi-year budget plan.

Directors highlighted the importance of structural reforms in promoting inclusive growth and private sector development. They welcomed the plan to build a new seaport and improve the performance of the public utility company, and urged the authorities to strengthen the governance, transparency, and accountability of state-owned enterprises. They welcomed the return of banking services, which will help promote financial inclusion. They emphasized that a strong framework for combating money laundering and the financing of terrorism, and enhancing tax transparency would support confidence and financial stability, and help regain access to international transfer facilities. Directors encouraged the authorities to continue to address health-related challenges by maintaining adequate health spending and implementing plans to combat non-communicable diseases. Directors also underscored the importance of improving the quality and timeliness of macroeconomic data for surveillance.

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>.

Table 1. Nauru: Selected Economic Indicators, FY2012–17 1/

I. Social and Demographic Indicators 2/						
GDP (FY2015 est.) (in millions of Australian dollars):	120.1			Poverty rate:	24 percent (2013)	
Per capita GDP (FY2015 est.) (in Australian dollars):	9,631			Live expectancy at birth:	60.4 years (2011)	
Population (FY2015 est.):	12,475			Adult literacy rate:	96.5 (2011)	
II. Economic Indicators						
	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
				Preliminary		Proj.
Real sector						
Real GDP growth (percent change)	10.1	34.2	36.5	2.8	10.4	4.0
Consumer price index (period average, percent change)	0.3	-1.1	0.3	9.8	8.2	6.0
Population (thousand)	10.3	10.8	11.9	12.5	13.0	13.3
In percent of GDP						
Government finance						
Total revenue and grants	52.6	58.9	76.8	81.2	115.2	110.3
Revenue	31.9	39.1	60.0	64.6	94.1	92.6
Grants	20.7	19.9	16.8	16.6	21.0	17.7
Total expenditure	44.7	57.4	51.8	72.3	91.6	99.9
Net lending (+) / borrowing (-)	7.9	1.5	25.0	8.9	23.5	10.4
Stock of government deposits	6.7	5.5	16.3	21.5	9.9	6.7
Stock of Trust Fund	...	...	...	...	22.7	33.4
(In millions of Australian dollars, unless otherwise indicated)						
Balance of payments						
Current account balance	38.4	19.9	-17.2	-11.4	2.4	0.8
(In percent of GDP)	38.1	18.8	-13.5	-9.5	1.7	0.5
Trade balance	33.8	4.6	-34.6	-51.6	-52.9	-61.5
Exports	67.4	58.2	50.7	25.0	34.4	32.0
Imports	33.6	53.6	85.3	76.5	87.3	93.5
Capital account balance	0.9	2.5	3.2	4.3	5.9	5.3
Financial accounts balance and other flows	39.2	22.3	-13.9	-7.1	8.3	6.1
Government debt indicators 3/						
External debt	54.4	50.8	48.1	47.2	48.1	48.9
(In percent of GDP)	54.0	48.0	37.7	39.3	34.3	32.4
Domestic debt	66.1	66.1	52.5	46.1	42.9	41.9
(In percent of GDP)	65.6	62.4	41.2	38.4	30.6	27.8
Exchange rates						
Australian dollar per U.S. dollar (period average)	0.97	0.98	1.09	1.20	1.37	...
Real Effective Exchange Rate (period average)	103.0	100.1	93.4	98.2	104.9	...
Nominal GDP (in millions of Australian dollars)	100.7	105.9	127.5	120.1	140.2	151.0
Sources: Nauru authorities and IMF staff estimates and projections.						
1/ Nauru uses the Australian dollar as the legal tender, and the fiscal year ends in June.						
2/ The social indicators are taken from United Nations Development Program and Secretariat of the Pacific Community.						
3/ Including the defaulted Yen bonds and the estimated government liability related to Bank of Nauru's liquidation.						



REPUBLIC OF NAURU

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

March 7, 2017

KEY ISSUES

Context. This is the first Article IV Consultation since Nauru became the 189th Fund member in April 2016. Nauru's growth and government revenue have improved substantially in recent years owing to the Australian Regional Processing Center (RPC) to process asylum seekers, fishing license fees, and residual phosphate mining. However, Nauru faces daunting challenges in sustaining growth and ensuring fiscal sustainability due to its limited sources of growth and income. The country is also vulnerable to climate change, its antiquated infrastructure hampers trade and growth, and its health indicators are below those of peers due to high incidence of non-communicable diseases.

Outlook and risks. Economic activity is moderating in FY2017, while the medium-term outlook remains challenging due to the RPC scaling down which entails a substantial decline in government revenue. With limited access to borrowing, fiscal spending will have to adjust accordingly. The downside risks to the outlook include a more rapid process of RPC scaling down, weaker-than-expected global growth, climate change, and delays in implementing fiscal and structural reforms.

Key policy recommendations:

- **Fiscal policy.** Ensure fiscal liquidity and sustainability by maintaining adequate cash buffers and contributing to the trust fund, which was recently established to provide long-term fiscal financing. The build-up in savings should start from FY2017 while RPC revenue remains high. Implement tax and public financial management reforms to control spending and support the fiscal adjustment. Strengthen public debt management to ensure fiscal and debt sustainability, and improve access to credit markets.
- **Climate change.** Develop a fiscal policy framework that would enhance economic resilience by integrating climate change strategies in budget planning. Practical approaches should be adopted in the near term to match capital projects already in the pipeline with Nauru's climate change strategies, meet the climate proofing standards, and incorporate the projects in a multi-year budget plan.
- **Structural reforms.** Successful implementation of structural reforms would promote inclusive growth, economic diversification, and private sector development. The priorities include rebuilding the seaport and energy infrastructure, reforming the state owned enterprises, developing the financial sector, and addressing health-related challenges.

Approved By
Alison Stuart (APD)
and Peter Allum (SPR)

Discussions were held in Nauru during January 16–27, 2017. The staff team included Tubagus Feridhanusetyawan (Resident Representative for Pacific Island Countries (RR-PIC, head), Reshika Singh (RR-PIC), Alexander Massara (STA), and Antoinette Kanyabutembo (APD), assisted in the preparation of this report. Heenam Choi and Gemma Preston (OED) participated in the discussions. The mission met with the President, the Cabinet, members of parliament, senior government officials, and representatives from public enterprises, the private sector, and development partners.

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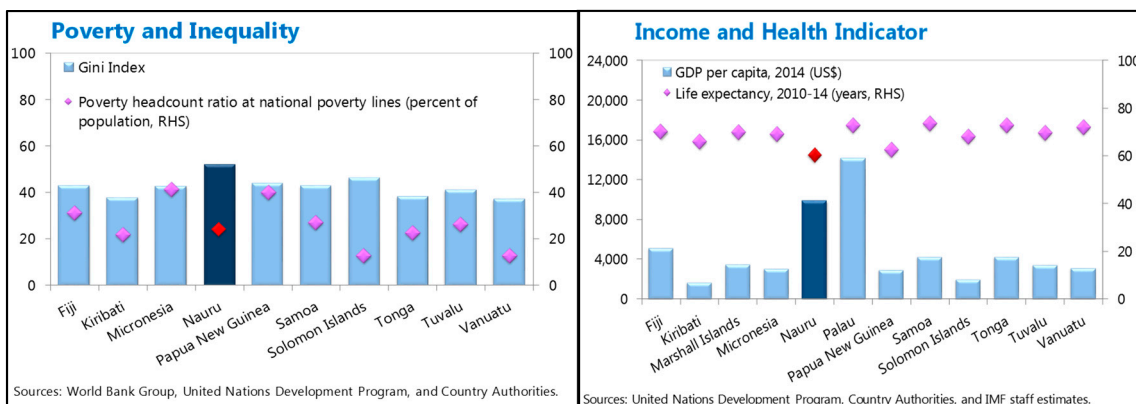
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BACKGROUND: DEVELOPMENT CHALLENGES

1. Background. Nauru is an island state in the Pacific with a land area of about 8 square miles and population of around 12,500 in FY2015. The island is remote, surrounded by deep sea and coral reefs, making it difficult to build a seaport. Before joining the IMF and World Bank Group in April 2016, Nauru became a member of the Asian Development Bank (AsDB) in 1991 and the United Nations in 1999. The country has a parliamentary system, and during the last election in July 2016, thirteen out of nineteen parliament members were reelected. The parliament reelected President Baron Waqa, and all ministers returned to the cabinet. Nauru has no central bank, and uses the Australian dollar as the legal tender.

2. Economic setting. Nauru’s economy followed the phosphate mining boom-and-bust cycle over the past decades. After the phosphate boom in the 1980s, Nauru became one of the rich nations in the 1990s with the Nauru Phosphate Royalty Trust (NPRT) fund worth more than A\$1 billion (A\$1 million per-capita). However, the decline in phosphate production and weak management of public finances led to economic deterioration during the 1990s–2000s. During the economic slump, the government defaulted on public debt and accumulated arrears. Most state owned enterprises (SOEs) including the Bank of Nauru collapsed. The NPRT assets were also depleted due to excessive spending and bad investments, and most of the remaining assets were returned to landowners by FY2014. The economy was mostly cash-based with no bank operating in the country until June 2015. Nauru’s economic performance has improved substantially since FY2012 driven by the Australian Regional Processing Center (RPC) for asylum seekers (Box 1), residual phosphate mining, and revenues from fishing license fees. With donor support, Nauru established a new trust fund in FY2016 aimed at providing long-term fiscal financing (Box 2).

3. Development challenges. Despite its improved economic performance, Nauru is facing daunting challenges in sustaining growth and ensuring fiscal sustainability over the medium term. The RPC is expected to scale down and the primary phosphate deposits are almost exhausted, while below-surface mining requires substantial investment. Nauru is also facing challenges common to small islands: a narrow production base, remote location, high cost of public goods, small population, insufficient infrastructure, and climate change. Despite its relatively high per capita income, Nauru’s income inequality and health indicators are worse than peers. Nauru is classified as a fragile state by AsDB.

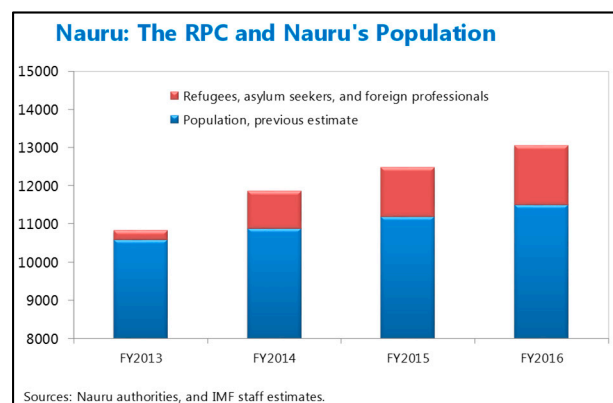


4. **Focus.** Against this background, the consultation focused on: (1) ensuring fiscal sustainability, (2) improving resilience to climate change, and; (3) promoting inclusive growth.

Box 1. The Australian Regional Processing Center (RPC)

RPC operation. The first RPC in Nauru was opened in 2001 but it was closed in 2007. The current RPC was opened in late 2012, and under the agreement with Australia, Nauru would process asylum seekers that arrive to Australia by boat and provide temporary settlement for refugees. By mid-2014, the total number of asylum seekers (living inside the RPC) and refugees (living in the Nauru community) increased to around 1,300, and this level has been broadly constant since then. Because of the conversion to refugee status, the number of asylum seekers declined from 1,170 in June 2014 to 440 in June 2016 (including those under medical treatment in Australia) and the refugees increased to 920. Since October 2015, the RPC has become an “open center” as the asylum seekers are allowed to travel around the island.

The refugees work and operate businesses, such as restaurants. The RPC has raised Nauru’s population by more than 20 percent since FY2013 with the increasing number of asylum seekers, refugees, and foreign workers living in Nauru.



Economic impact. The share of RPC-related services is estimated at around 35 percent of GDP. The RPC-related fiscal revenues comprise of visa fees (A\$2,000/person/month for refugees and A\$1,000/person/month for asylum seekers), withholding employment and services taxes on expatriates, and other taxes on RPC-related trade and services. In FY2017, the RPC revenue is estimated at nearly A\$50 million (about 35 percent of revenue excluding grants). The medium-term impact of the RPC scaling down is uncertain and will depend on the magnitude and timing, and the potential additional support that Nauru might receive to compensate for revenue shortfalls.

RECENT DEVELOPMENTS AND OUTLOOK

5. **Growth and inflation.** Nauru’s economy has performed relatively well compared to its peers for the past five years (Table 1, Figures 1 and 4). Real GDP grew by more than 20 percent annually on average during FY2011–14 boosted by phosphate mining, trade and services sectors related to the RPC, and rapid population growth. After moderating to around 3 percent in FY2015 due to seaport problems that lowered phosphate exports, growth is estimated to have rebounded to around 10 percent in FY2016 thanks to temporary seaport repair, robust service sectors, and a large increase in government spending. Inflation was generally low until FY2014, and mostly mirrored that of Australia, the main source of imports. However, inflation increased to about 9 percent on average during FY2015–16 owing to strong domestic demand, large cash payouts (A\$78 million) to landowners from the liquidated NPRT assets in FY2014, and supply shortages caused by the seaport problem.

Box 2. The New Trust Fund

In April 2016, the Government of Nauru (GoN) established a new intergenerational trust fund with support from development partners. The goal is to save windfall income over the medium term into a trust fund that will generate revenue streams over the long term. The trust fund is designed to be perpetual, and cannot be withdrawn during the build-up period of 2016-33 unless the trust fund committee determines otherwise.

The trust fund is managed by a committee comprising the GoN and bilateral donors that contributed to the fund (Australia and Taiwan Province of China). The Asian Development Bank also contributed to the trust fund but it is not a committee member. The initial GoN contribution was A\$20.4 million, followed by annual contributions ranging from 8 to 12 percent of domestic revenues in the previous year. The initial donors' contributions amounted to A\$10.5 million, and these contributions are expected to continue during the life of the fund, although the amount may vary. Based on the trust fund documents, the principal value is expected to reach A\$400 million by 2033, and a private company in Australia (Mercer) manages the assets.

After the trust fund is fully established by 2033, the payments from the trust fund's income streams will be provided based on a program and budget prepared by the GoN. This will be reviewed periodically based on the investment performance, contributions, and the fiscal situation. The distributed funds are expected to finance investments in education, health, environment, and infrastructure with sound monitoring and evaluation frameworks.

6. Outlook. In the near term, growth is projected to moderate to 4 percent in FY2017 due to weakened phosphate recovery, limited expansion of the RPC, and stabilized population growth. Average inflation would also moderate to 6 percent in line with slowing economic activities and stable food and fuel prices. Over the medium term, Nauru's outlook is vulnerable to the expected scaling down of the RPC as the refugees would be gradually transferred from Nauru to third countries. However, the magnitude and speed of the scaling down remain uncertain and subject to continued negotiations between Nauru and Australia, and between Australia and other countries. In view of this uncertainty, the mission and the authorities agreed that the Article IV Consultation prepare a baseline projection in which 350 refugees (about one third) would be transferred to other countries in FY2018, while the remaining refugees (about 600) and asylum seekers (about 250) would stay in Nauru over the medium term. Although the RPC-related revenue is projected to decline substantially in FY2018, total fiscal revenue and grants as well as total expenditure are projected to decline by about 9–10 percent in real terms thanks to larger disbursement of budget support and grants for infrastructure projects.¹ On balance, growth is projected to dip to minus 4 percent in FY2018 before rebounding to 2 percent over the medium term. Average inflation is projected to remain low in line with the economic slowdown, inflation in Australia, and stable commodity prices (Table 2).

7. External sector assessment. The current account deteriorated in FY2014 owing to lower phosphate exports and strong imports driven by buoyant domestic demand and the private inflows

¹ AsDB is projected to raise its grants including A\$5 million budget support in FY2018 and about A\$50 million infrastructure projects (for example, seaport construction (co-financed with Australia), internet connectivity, renewable energy, and urban development) during FY2018–21.

(NPRT cash payout), but it has improved since then thanks to exports recovery, fishing license fees, and RPC-related revenues (Table 3). The current account is projected to deteriorate in FY2018 as RPC-related inflows would decline along with the expected scaling down, but RPC-related imports would partially offset the decline in inflows, serving as an automatic stabilizer. Over the medium term, the scaling up of infrastructure projects would raise imports, but it would be compensated by larger grant disbursements to finance the projects and robust fishing license fees. As a result, the current account is projected to be in a small surplus in terms of GDP during FY2019–21 in line with the projected fiscal position and continued build-up of the trust fund. The external sustainability assessment indicates that the real exchange rate is moderately stronger than implied fundamentals due to elevated inflation, although factors other than the exchange rate plays greater roles in determining the external sector balance (Appendix I). The Australian dollar as the legal tender remains appropriate given strong economic linkages and limited capacity to run independent monetary operations.

8. Risks. Nauru's medium-term outlook is subject to downside risks (Appendix II). A more rapid RPC scaling down would lower growth and fiscal revenue, although on the upside, a slower scaling down and a potentially larger grant disbursement from donors to compensate for the RPC revenue shortfalls would provide some fiscal space. In addition, weaker-than-expected global growth and climate change shocks would hamper trade and growth and reduce Nauru's exports, remittances, and fiscal revenues. On the domestic side, delays in implementing fiscal reforms, infrastructure projects, and SOE reforms would lower growth prospect and jeopardize fiscal sustainability.

9. The authorities' views. The authorities agreed with the outlook and risks. They shared the view that despite strong economic performance in recent years, the economy is driven by limited sources of growth and income. They confirmed that refugee settlement in Nauru is only temporary, and the RPC is expected to scale down. They are aware of the potential adverse impact on the economy and the associated risks, but the timing and magnitude of the RPC scaling down are difficult to predict. Therefore, they appreciated that the Article IV consultation discussed a scenario in which some refugees would be transferred to other countries next year, so that they could prepare for any adjustments and policy responses. The authorities noted that discussions are ongoing with Australia to prepare for the refugee transfers, including on the proposal to shift from per-capita-based payments towards transitional grants to provide more certainty of revenues particularly when the refugee transfers start. They also plan to take more control of the RPC administration from Australia to provide more value added to the economy.

ENSURING FISCAL SUSTAINABILITY

10. Recent developments. Fiscal revenue has increased substantially since FY2012 supported by RPC-related revenues, fishing license fees, and increased tax collection, which has been driven by the implementation of employment and services tax and improvement in administrations since 2014. RPC-related revenues (excluding reimbursement of RPC expenses) have been particularly large at about 40 percent of revenues excluding grants starting in FY2016. In the meantime, non-RPC spending also increased substantially, particularly the wage bill as the authorities tried to retain key public employees, although goods and services and social benefits have also increased rapidly. As

a result, the non-RPC current balance (non-RPC revenue plus current grants minus non-RPC expenses) deteriorated. Nonetheless, the overall fiscal balance remained in surplus and this has been used to clear arrears, build-up government deposits (cash buffers), and contribute to the trust fund. Total cash buffers and Nauru's trust fund contribution reached nearly 25 percent of GDP in FY2016 (Table 4, Figure 2).

11. Near-term fiscal outlook. The revised FY2017 budget increased substantially from the estimated FY2016 outturns, but non-RPC expenses increased by about 2 percentage points of GDP. The latest data indicate that the revenue targets would be broadly met. However, spending pressures remain strong, particularly on the wage bill and miscellaneous expenses such as special projects. The fiscal balance, after incorporating Nauru's contribution to the trust fund, is expected to be in deficit of about one percent of GDP, financed by a decline in cash buffers to about one month of non-RPC current spending.

12. Medium-term fiscal outlook. The transfer of refugees is projected to reduce RPC-related revenue from about A\$50 million in FY2017 to around A\$35 million during FY2018–21. Under this baseline scenario, domestic revenue is projected to decline by 20 percent in FY2018. Provided that the RPC-related revenues (for example, visa fees) stay broadly unchanged afterwards, domestic revenue will remain broadly constant at around 75 percent GDP over the medium term. Since Nauru has limited access to borrowing, current spending will have to adjust to the sharp decline in revenue. Current spending is projected to decline to slightly less than 70 percent of GDP over the medium term, which is broadly comparable to the average spending in FY2015–16. The fiscal position would be in surplus just enough to contribute to the trust fund that cannot be withdrawn before 2033, but the cash buffers would be depleted, jeopardizing fiscal sustainability and, therefore, further fiscal policy actions are needed (Figure 3).

13. Maintaining fiscal buffers. In view of this, staff recommended maintaining cash buffers of at least 2 months of non-RPC current spending (about 10 percent of GDP) in addition to the contribution to the trust fund following the trust fund rule (see text table below). This would provide funds to meet liquidity needs and ensure fiscal sustainability although, considering the uncertainty surrounding the magnitude and speed of the RPC scaling down, the appropriate level of buffers should continue to be reviewed. The authorities should start by replenishing the buffers to reach at least A\$16 million by end-FY2017 while the RPC revenue remains high. The cash buffers could be maintained by cutting unnecessary spending, such as ad-hoc subsidies, travels, and special projects, while protecting priority spending on health and education. Spending restraint is also important to provide space for capital spending, maintenance costs of infrastructure projects, potential climate change adaptation costs, and clearing debt arrears. To minimize the impact on growth, the authorities could accelerate the implementation of grant-financed infrastructure projects. The commitment to preserve cash buffers and to contribute to the trust fund would also be critical in discussions with development partners for possible budget support. Staff agreed with the authorities that continued consultation with Australia during the period of fiscal adjustment would be important for macroeconomic management.

Nauru: Central Government Operations, Maintaining Fiscal Buffers Scenario, FY2015-21							
	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
	Prelim.		Proj.				
	(In millions of Australian dollars)						
Total revenue and grants	97.6	161.4	169.1	154.8	148.8	151.9	151.7
Expenditure	86.9	128.5	147.2	134.2	129.5	131.4	132.2
RPC expenses	6.0	16.6	27.9	20.8	20.9	21.1	21.2
Non-RPC expenses	68.3	97.2	99.6	82.9	80.7	83.1	88.4
Net acquisition of non-financial assets	12.6	14.6	19.7	30.5	27.9	27.2	22.6
Net lending (+) / borrowing (-)	10.7	33.0	21.9	20.7	19.4	20.6	19.5
Including trust fund contribution	10.7	2.1	4.7	0.1	2.1	3.1	1.7
Net acquisition of financial assets	5.1	18.9	19.1	17.7	16.5	17.7	18.3
Of which: Changes in government deposit	5.1	-12.0	1.9	-2.9	-0.8	0.3	0.5
Net incurrence of financial liabilities	-7.6	-4.6	-2.7	-3.0	-2.9	-2.8	-1.2
Statistical discrepancy	-2.0	9.4	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>							
Non-RPC current balance (in percent of GDP)	-11.6	-21.2	-16.7	-9.0	-9.4	-8.8	-9.4
Stock of government deposits	25.9	13.9	16.2	13.8	13.4	14.1	15.0
In months of non-RPC current spending	4.5	1.7	2.0	2.0	2.0	2.0	2.0

Sources: Nauru authorities and IMF staff estimates and projections.

14. Structural fiscal reforms. Tax and public financial management (PFM) reforms are critical to help control spending and support the needed fiscal adjustment. Staff welcomed good progress in building the tax system, including the introduction of employment and services tax and business profit tax, and improvement in customs and tax administration. Staff emphasized that ensuring consistent implementation of the new tax system would help mobilize revenues and encouraged broadening the tax base over the medium term. For example, after the tax system is fully implemented, the authorities could consider lowering the tax-free threshold for residents.² On the spending side, staff advised implementing the recommendations of the 2016 Public Expenditure and Financial Accountability self-assessments (Box 3). Staff welcomed the submission of the FY2015 government financial statement for internal audit.

15. Public debt management. The latest data in June 2016 show that public external debt is estimated at about A\$48 million (34 percent of GDP), comprising mostly of loans from Taiwan Province of China, overdue fees and obligations to international organizations, and the Yen bonds that were defaulted in the 1990s.³ Public domestic debt is estimated at around A\$43 million (31 percent of GDP), mostly longstanding liabilities related to the Bank of Nauru liquidation in the mid-2000s. Staff welcomed the continued reconciliation of public external debt and arrears including the liabilities to the Bank of Nauru's private creditors.⁴ Most debt is in the form of old debt or arrears and, therefore, staff encouraged the authorities to resolve them including through good

² The tax-free thresholds are set sufficiently high to exempt Nauru citizens partly due to their strong resistance when the tax system was introduced in 2014. Therefore, the tax reform strategy is to build the new tax system first and lower the threshold to broaden the tax base later after the system is fully established and implemented.

³ The bonds of about A\$16 million face value were issued in Japan in the late 1980s but were subsequently defaulted and sold in the market in the mid-1990s. The estimated current value is subject to negotiations.

⁴ Bank of Nauru's liabilities to NPRT (estimated at about A\$26 million) are not fully reconciled and consolidated in the government's accounts partly because both Bank of Nauru and the NPRT have been liquidated. The government holds the remaining assets of the NPRT estimated at about A\$25 million that are still in the process of liquidation.

faith negotiation with creditors. Nauru's access to credit markets remains limited and no substantial new borrowing is expected over the medium term. The Debt Sustainability Analysis indicates that Nauru's debt is sustainable (Appendix III). Staff emphasized that sound public debt management, including the reconciliation and resolution of old debt, is critical to ensure debt sustainability and improve Nauru's access to credit markets.

Box 3. Public Financial Management (PFM) Reforms

Nauru has been reforming PFM supported by technical assistance (TA) from development partners.

With donor support, Nauru acquired a Financial Management Information System (FMIS) in 2011 that is capable of basic budget control, management, accounting, and reporting, although not all basic features have been fully implemented. The Public Expenditure and Financial Accountability (PEFA) self-assessment took place in 2010 and 2016, supported by Australia, Pacific Financial Technical Assistance Center (PFTAC), and the Asian Development Bank.

The 2016 PEFA assessment identified areas of improvements and weaknesses. Good progress has been made in: (1) FMIS implementation; (2) Budget preparation, credibility and reliability; (3) Revenue administration and accounting, and; (4) Submission to audit for the first time of the annual financial statements for the year 2013–14. However, major weaknesses remain, including: (1) Absence of fiscal strategy, and macroeconomic and fiscal forecasts; (2) Absence of multi-year planning and budgeting; (3) Weak debt management; (4) Absence of fiscal risks assessment and monitoring; (5) Absence or delays in external audit, and (6) Lack of legislative scrutiny in Parliament.

Based on these assessments, the PFM TA developed a PFM reform roadmap. The sequence involves: (1) Establishing basic financial policies, rules, and regulations; (2) Improving basic internal control procedures such as debt and bank reconciliation, accounting and reporting; and (3) Catching up with the audit of the financial statements. The specific reform areas include:

- Revising budget classification and charts of account in line with Government Financial Statistics;
- Developing a comprehensive Medium-term Expenditure Framework (MTEF);
- Strengthening external and internal audit units;
- Establishing asset and debt management strategies;
- Improving reconciliation of government bank accounts;
- Identifying and monitoring fiscal risks especially arising from the state owned enterprises;
- Improving transparency, accountability, and auditing of financial reports/accounts.

16. The authorities' views. The authorities reiterated their commitment to fiscal and debt sustainability, and welcomed the recommendation to maintain fiscal discipline. They agreed to maintain adequate cash buffers, continue to contribute to the trust fund, and control spending, particularly on ad-hoc expenditures not related to infrastructure, health, and education. The authorities also plan to use their fiscal responsibility targets, such as tax to GDP ratio, public wages as a share of revenue, and the fiscal balance, to guide fiscal policy. On tax policy, the authorities would focus on implementing the current tax system including building administrative capacity before considering lowering tax-free thresholds, which would require public education and consultation. The authorities are also discussing with Australia how to better manage the RPC reimbursable expenses and ensure sufficient cash flows, by moving away from a reimbursement system to upfront payment. Trust fund contributions would also be paid quarterly instead of in a

lump-sum to ensure sufficient liquidity. To improve transparency, the authorities will publish the FY2014 audited government financial statement and the details of the new trust fund, and will continue to work with the Organization for Economic Cooperation and Development on the automatic exchange of tax information.

IMPROVING RESILIENCE TO CLIMATE CHANGE

17. Challenges and strategies. Due to its location, Nauru is less vulnerable to cyclones than other small island states in the Pacific. However, Nauru is facing a number of long-term challenges such as rising sea levels, extreme tides, and coastal erosion, that threaten infrastructure in the coastal areas and reduce the land area for agriculture. Rising sea temperatures may threaten revenue from fishing license fees, while rising air temperatures will also increase energy demand. The costs of mitigating these challenges will weigh on fiscal balances, increasing the need to develop long-term planning. Nauru has incorporated these challenges in the National Sustainable Development Strategy (NSDS) 2005–25, and published the 2014 Framework for Climate Change Adaptation and Disaster Risk Reduction (RONAdapt) to provide a roadmap to address climate change vulnerabilities.⁵ Nauru has also completed a study on climate change finance assessment to help make informed decisions and measures to improve access and manage climate change resources.⁶ However, more work is needed to integrate these climate change strategies into medium-term budget planning.

18. Improving economic resilience. Staff welcomed the authorities' climate change efforts and encourages them to address weaknesses identified by the Pacific Island Forum study, such as improving information between line ministries, clarifying their roles and responsibilities on the climate change program, and quantifying financing needs. Since there is no estimate of climate change spending in the budget so far, staff encouraged the authorities to integrate climate change strategies into medium-term budget planning through PFM reforms in order to help implement the strategies. This could be the start of a long-haul process, and the authorities could make use of technical assistance (TA) from donors to increase capacity. Recognizing that first best practices may take years to implement, in the interim, the authorities and staff agreed on practical approaches that could be implemented immediately. These actions include identifying capital projects already in the pipeline, matching them with the climate strategies, determining the implementation sequence, and working with donors to ensure that these projects meet climate-proofing standards. The authorities should also make a multi-year budget plan that covers both current and capital spending, and incorporates these projects, including their maintenance costs, in the budget. Staff emphasized that transparent budget management would help secure financing from donors.

19. The authorities' views. The authorities shared the views that addressing climate change challenges is critical for Nauru's sustainable development. They agreed that matching various development projects in the pipeline with Nauru's climate change strategies would be the starting

⁵ The RONAdapt priorities are: water, energy, and food security; healthy environment; healthy people, and productive and secure land resources. It identifies multiple avenues to achieve its objectives, including infrastructure development, policy reforms, and capacity development, and it will be updated every five years.

⁶ Pacific Island Forum (2013) *Pacific Climate Change Finance Assessment: Nauru Case Study*.

point to integrate the climate change strategy in medium-term budget planning. In view of this, the authorities have reestablished the National Development Planning Committee to advise Cabinet on the NSDS review incorporating the new Sustainable Development Goals and climate change strategies. With the support of the Global Climate Fund, the authorities are also developing the climate change National Adaptation Plan, which will provide inputs in updating the NSDS.

PROMOTING INCLUSIVE GROWTH

20. Priorities. Discussion focused on critical reforms that could support growth and make it more inclusive during the period of fiscal adjustment over the medium term, namely: rebuilding antiquated infrastructure; reforming SOEs; developing the financial sector; and addressing health-related challenges. Successful implementation of these reforms would provide more opportunity for economic diversification and private sector development.

21. Rebuilding infrastructure. Constructing a new seaport facility and continuing energy sector reforms are critical to address infrastructure bottlenecks. The current seaport based on mooring system is antiquated and has suffered from climate change, hampering trade and creating supply shortages. Staff welcomed the authorities' plan to develop a new seaport financed by grants, and recommended to integrate the maintenance cost in budget planning. Staff also welcomed recent improvements to Nauru's power generation system despite ongoing fuel subsidies. The Nauru Utility Corporation (NUC) has increased revenue and cut costs, resulting in a more financially sustainable operation. The authorities should continue to work with development partners to further transform the NUC into an independent SOE that operates based on commercial principles, including by reforming the tariff system and reducing government subsidies.

22. Reforming state owned enterprises. The SOEs play an important role in the economy, contributing about half of GDP and one third of employment, but SOE governance and monitoring remain a challenge. Staff emphasized that SOE reforms will reduce fiscal burdens, safeguard fiscal sustainability, and facilitate private sector development, and encouraged the authorities to improve SOE governance, accountability, and transparency. In line with the AsDB's TA recommendations, the priorities include appointing Boards that are best suited to assist SOEs achieve their mandates, producing timely annual accounts, and holding the Board accountable for the SOEs' performance (Box 4).

Box 4. State Owned Enterprises (SOEs)

Nauru's SOEs play a major role in various economic sectors. The main SOEs are: (1) Nauru Utilities Corporation (NUC); (2) Nauru Air Corporation; (3) Republic of Nauru Phosphate Corporation (RONPHOS); (4) Nauru Rehabilitation Corporation (NRC); and (5) Eigigu Holdings Corporation. Other SOEs include the Nauru Port Authority (NPA), Cenpac Net Incorporated (internet services), and Nauru Phosphate Royalties Trust (NPRT), of which most of its assets have been liquidated.

Based on limited information available, SOE performance is mixed. The NUC's performance has recently improved by expanding the coverage of the electrical grid, reducing theft, and increasing the share of solar power. The main challenges are reforming the tariff system and reducing fuel subsidies. Nauru Air Corporation, which operates Nauru Airlines, has improved its performance partly reflecting elevated passenger traffic linked to the Regional Processing Center. RONPHOS and NRC, which operate phosphate exporting and mining activities respectively, are reporting financial losses. The NRC is also responsible for land rehabilitation, sanitation, and road maintenance, which are community-service oriented activities. Eigigu Holdings Corporation has several subsidiaries including hotel, retail, and construction.

The governance and performance monitoring of SOEs remain a challenge. Responsibilities for specific SOEs are assigned to individual ministers, while government officials are prominent on SOE boards. There is no central unit for monitoring the performance of the SOE portfolio. Only Nauru Air Corporation and the NUC produce annual financial statements.

The authorities requested technical assistance (TA) from the Asian Development Bank to develop an SOE reform agenda. Based on preliminary TA recommendations, the priorities include: (1) Appointing Boards that are best suited to assist SOEs achieve their mandates, (2) Produce timely annual accounts, and (3) Hold the Board accountable for the SOEs' performance. The authorities should also consider an SOE reform policy that:

- Clarify why the government owns SOEs, establish unambiguous commercial mandate, and define a robust community service obligation framework;
- Appoint one minister responsible for all SOEs, and require all directors to be appointed through skill-based selection process;
- Establish an accountability framework that requires current audited accounts and forward-looking performance-based business plans;
- Define the role of an effective SOE ownership monitoring agency.

Source: Asian Development Bank

23. Developing the financial sector. Staff welcomed the good progress made in developing the financial sector by setting up a Bendigo bank agency that has promoted financial inclusion by providing basic deposit-taking services on behalf of Bendigo Bank of Australia (Box 5). Compliance with the requirements of the Australian financial supervision authorities is important to maintain financial stability. Staff agreed that the inability to transfer funds to and from countries other than Australia has hampered the flow of remittances and forced some trade-related payments processed through informal channels, creating a challenge for customs verification. The authorities consider

that Bendigo agency has implemented a sound know-your-customer framework and monitored money transfers. Nonetheless, staff emphasized that continued strengthening the Anti Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework would help regain access to international transfer facilities. In addition, the authorities should expedite the steps in improving tax transparency to ensure that Nauru is not listed as a non-cooperative jurisdiction by G20.

Box 5. Bendigo Bank Agency

Since opening in June 2015, Bendigo agency is the first bank operating in Nauru for more than a decade. The other financial institution was Western Union, and most transactions on the island were cash-based. Bendigo runs as a special project under the Ministry of Finance and Bendigo and Adelaide Bank Limited of Australia (Bendigo Bank).

The agency provides basic financial services on behalf of Bendigo Bank, promoting financial inclusion in the country. The agency provides ATM access, checking, savings, and time deposits equivalent to those in Australia, but it does not extend loans or wealth-management products. Within 18 months, the number of accounts increased to more than 7,600 and the deposits grew to A\$67million (about 50 percent of GDP) by end-2016. The agency aims to expand electronic payments provided the telecommunication network becomes more reliable. Another challenge on financial inclusion is limited financial literacy, partly due to prolonged cash-based economy during the past decade.

The agency indicated that it operates in accordance with the Australian financial regulation but it continues to face challenges in transferring funds internationally. The agency noted that it adheres to the Australian-standard AML/CFT requirements and the parent branch in Australia carries out regular internal audits. For example, it implements transaction monitoring by Bendigo's financial crimes department, which is in regular contact with Nauru's Financial Intelligence Unit. Nonetheless, the agency continues to face restrictions imposed by correspondence banks that prevent transferring funds to and from countries other than Australia.

24. Addressing health-related challenges. Although there is no food poverty, Nauru has high levels of hardship and vulnerability, inequality, and non-communicable diseases (NCDs) (Box 6). Public spending on health is relatively higher than those in other Pacific island countries, and the authorities should continue to protect public spending on health during the period of fiscal adjustments over the medium term.⁷ Staff welcomed the completion of hospital development financed by grants, and recommended to ensure adequate funding for future maintenance including by seeking donor support. Nauru has recently adopted the NCD Strategic Action Plan 2015-20 to reduce NCD incidence over the medium term. In this context, the mission also encouraged them to prioritize spending towards preventive measures and strengthen the monitoring and evaluation of health-related spending in line with the 2014 Pacific NCD Roadmap.

⁷ Government spending on health is about A\$13 million (9 percent of GDP) in FY2016-17, while Australia provides additional funding up to A\$5.5 million through various health programs.

Box 6. Nauru: Public Health Developments and Policies

The 2012–13 Household Income and Expenditure Survey indicates that Nauru has relatively high levels of hardship and vulnerability. The survey showed that 24 percent of the population have consumption levels below the national basic-needs poverty line (BNPL) and an additional 28.5 percent are classified as ‘highly vulnerable’ or ‘vulnerable’ to falling below this benchmark. Less than half of people aged 15–29 are employed and high proportion of the remainder (student, unemployed, or unpaid worker) live below the BNPL.

The survey also found that Nauru’s inequality is high by global standards, and there appears to be a linkage between inequality and poor nutrition. For example, households in the bottom three deciles allocate a significantly higher proportion of their total food expenditure to imported and unhealthy food. Although there is no evidence of food poverty, poor nutrition is widespread. The high level of inequality and the reliance on unhealthy food imports, partly due to limited arable land, have contributed to high incidence of non-communicable diseases (NCDs).

Nauru has recently adopted the NCD Strategic Action Plan (2015–20) to reduce NCD incidence. The plan indicates that the prevalence of NCD risk factors (for example, poor diet, inactivity) in Nauru is among the highest in the world. To reduce these risk factors, the plan outlines action areas such as improving leadership and governance for NCD prevention and control, strengthening health systems, and improving monitoring and surveillance. The plan aims for a 15 percent reduction in NCD mortality rates by 2020.

Public health policies need to address the NCDs through multiple channels. Both the Nauru NCD strategy and the World Bank 2014 Pacific NCDs Roadmap emphasize a multi-sectoral approach and set out a number of affordable strategies to combat NCDs. These policies include: reducing consumption of unhealthy food; reallocating health resources toward prevention measures; and strengthening the evidence base to improve investment planning and program effectiveness.

Sources: The World Bank; *Nauru: Hardship and Poverty Report – Analysis of the 2012/13 Household Income and Expenditure Survey* by the Government of Nauru and UNDP; *Nauru NCD Strategic Action Plan (2015-20)* by the Government of Nauru.

25. The authorities’ views. The authorities recognized the challenge in diversifying the economy and the importance of implementing structural reforms. They indicated that the estimated cost of the new seaport is larger than expected, partly due to climate-proofing, but remain cautiously optimistic in securing additional funding. While the privatization of fuel purchasing and distribution operations has provided more reliable supply and improved efficiency, the reform of public utilities will continue. The authorities agreed that SOE reform will reduce fiscal burdens and expected to start receiving dividends from the SOE profits. The operation of Bendigo agency has increased the level of financial inclusion, although the difficulties in transferring money to and from countries other than Australia remain a challenge. Health and education will continue to be their top priorities. They recognized the challenges, and shared some initiatives to address them, including

developing the Nauru healthy household standard, establishing health centers for prevention measures across the island, and incorporating health issues in school curriculum.

OTHER ISSUES

26. Exchange arrangement. Nauru has accepted the obligations of Article VIII, Sections 2, 3, and 4, and there are no changes in the exchange arrangement since last year.

27. Statistics. Nauru's economic statistics have improved substantially although serious shortcomings remain. For example, the statistics compilation suffers from the lack of actual data, and the reliance on external support creates delays in data update and prevents timely analysis. In this context, the authorities requested further Fund TA on national accounts and balance of payments statistics, government financial statistics, and PFM. Staff urged the authorities to implement TA recommendations, strengthen data sharing among government institutions, publish data regularly, and participate in the IMF's enhanced General Data Dissemination System.

STAFF APPRAISAL

28. Recent developments. Growth and government revenue improved substantially in recent years owing to RPC operations, fishing license fees, and residual phosphate mining. The use of fiscal surpluses to build up fiscal buffers, contribute to the new trust fund, and clear some arrears is welcome. Despite its improved economic performance, Nauru faces daunting challenges in sustaining growth and ensuring fiscal sustainability due to limited sources of growth and income.

29. Outlook and risks. Economic activity is expected to moderate in the near term due to weakened phosphate recovery and limited RPC expansion. The medium-term outlook is vulnerable to the scaling down of the RPC as refugees are expected to be transferred to other countries, entailing a substantial decline in RPC revenue. With limited access to borrowing, fiscal spending would have to adjust accordingly. The outlook is also subject to downside risks including weaker-than-expected global growth, climate change, and delays in implementing fiscal and structural reforms.

30. Fiscal sustainability. Maintaining sufficient fiscal cash buffers while continuing to build the new trust fund with donors' support will be critical to ensure fiscal liquidity and sustainability. The authorities should continue to implement tax and PFM reforms to help control spending and support the needed fiscal adjustment, and strengthen public debt management to preserve fiscal and debt sustainability.

31. External sector policy. Prudent fiscal policy and successful implementation of structural reforms would help ensure external sustainability. The use of the Australian dollar as the legal tender remains appropriate.

32. Climate change. Nauru faces a number of long-term climate change challenges and developing a medium-term fiscal framework that would enhance economic resilience to climate change is important. Since this may take a number of years, the authorities could adopt practical approaches in the meantime to match capital projects in the pipeline with Nauru's climate change

strategy, meet the climate proofing standards, and incorporate the projects in a multi-year budget plan.

33. Structural reforms. Successful structural reforms will promote inclusive growth and provide opportunity for economic diversification and private sector development. The plan to build a new seaport and the improved performance of public utility company are welcome. The authorities should continue to reform the SOEs to strengthen their governance, transparency, and accountability. The return of banking services in Nauru has improved financial inclusion, and strengthening of AML/CFT and tax transparency frameworks would promote confidence and financial stability. The authorities would be well advised to continue addressing health-related challenges by maintaining adequate public spending on health and implementing the action plans to combat NCDs.

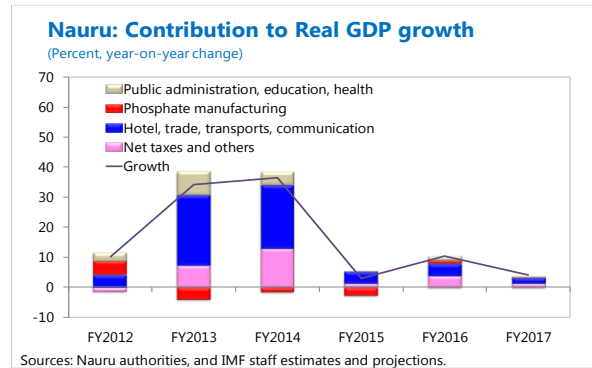
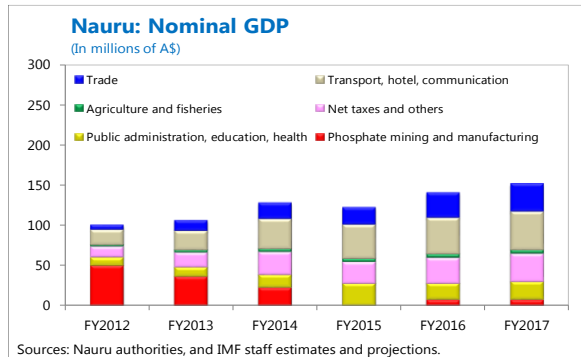
34. Statistics. Nauru's data quality has improved substantially in recent years, but it suffers from shortcomings that prevent timely analysis and hamper surveillance, and the statistical capacity remains weak. Technical assistance will continue to play an important role.

35. It is recommended that the next Article IV consultation take place on the 24-month cycle.

Figure 1. Nauru: Real and External Sector Developments

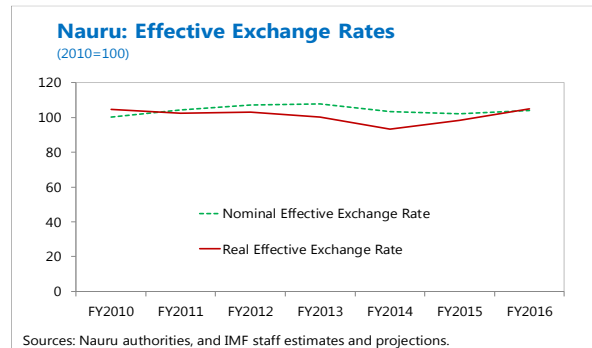
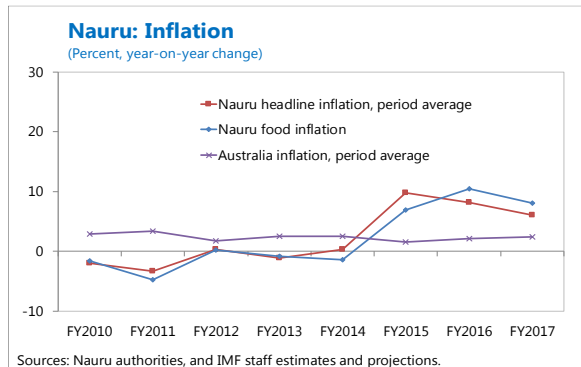
The economy expanded for the past five years driven by trade and service sectors related to the operation of the Regional Processing Center (RPC).

The services sectors have replaced the phosphate industry as the main source of growth.



Inflation picked up during FY2015-16 owing to robust domestic demand, large cash payouts from the phosphate trust funds, and supply shortages due to seaport problems.

As a result, the real effective exchange rate increased to its 2010 level despite the depreciation of the Australian dollar.



Phosphate exports declined in FY2014/15 partly due to seaport problems, while imports remain strong owing to buoyant domestic demand and the RPC operation...

... but the current account balance has improved supported by large RPC-related inflows and fishing license fees.

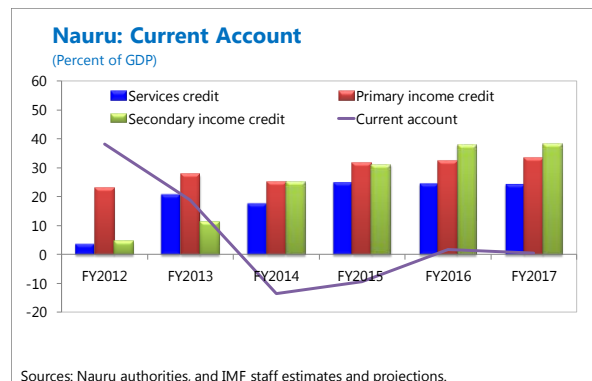
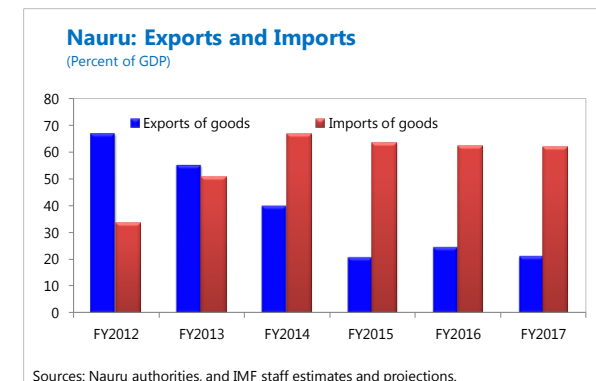
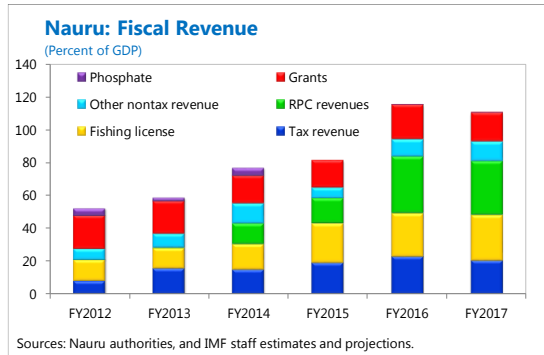
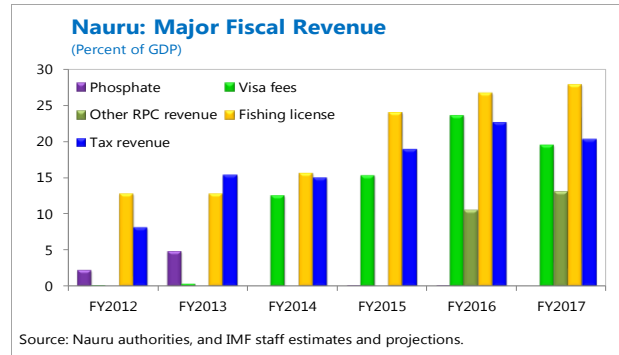


Figure 2. Nauru: Fiscal Sector Developments

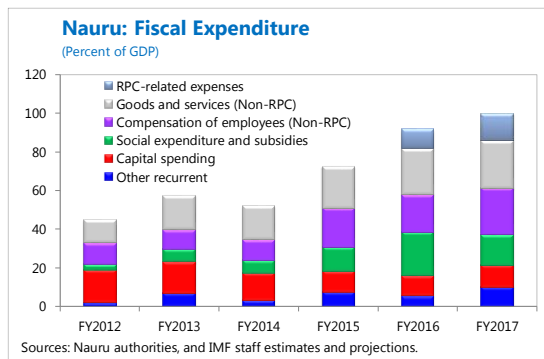
Revenues have increased substantially for the past five years owing to ...



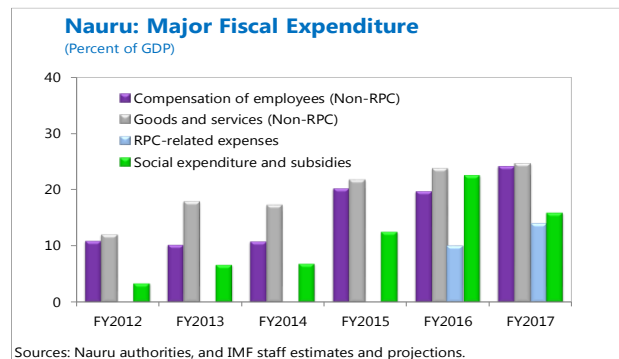
... large RPC-related revenues and fishing license fees, while phosphate-related revenues have diminished.



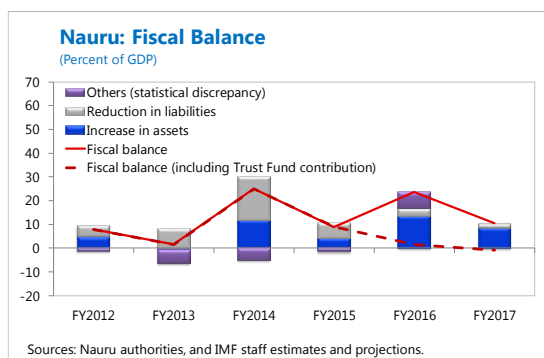
Government spending has also increased rapidly since FY2015 ...



... driven by the wage bill in order to retain public sector employees, goods and services, and social expenditure.



Despite large spending increase, the fiscal balance has recorded large surpluses that have been used to ...



... build up government deposits, contribute to new Nauru trust fund, and reduce government debt by clearing arrears.

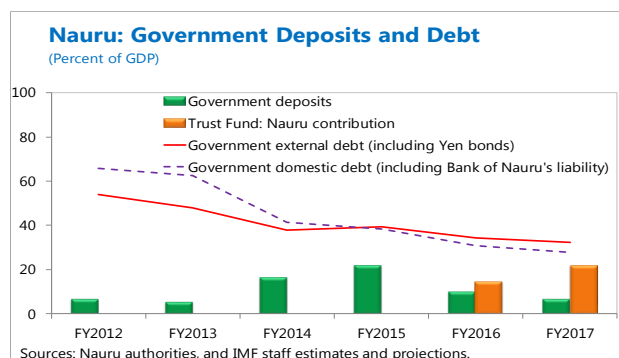
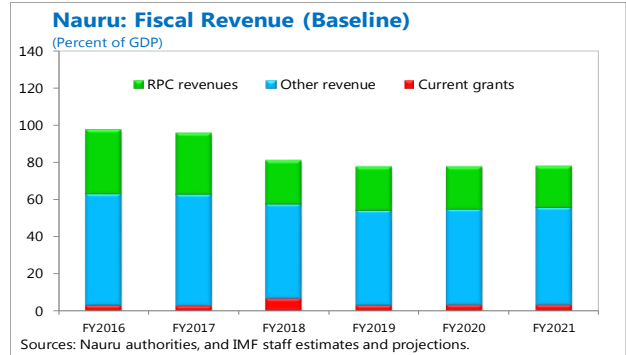
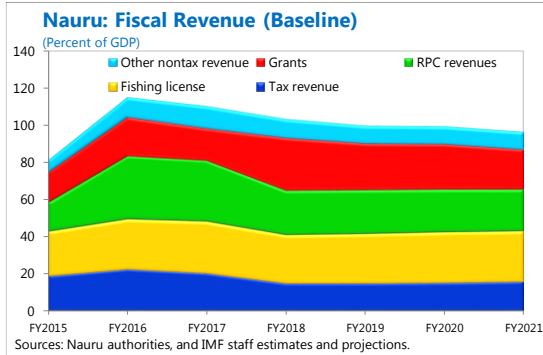


Figure 3. Nauru: Medium-term Fiscal Outlook

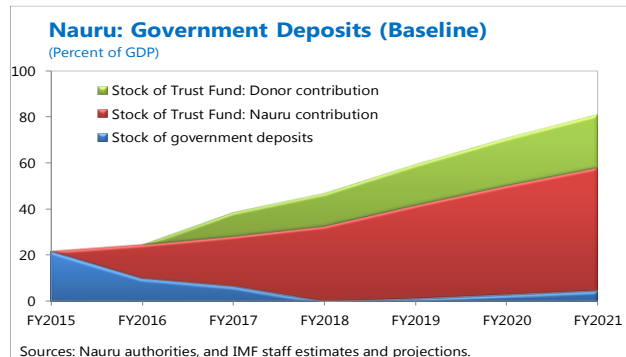
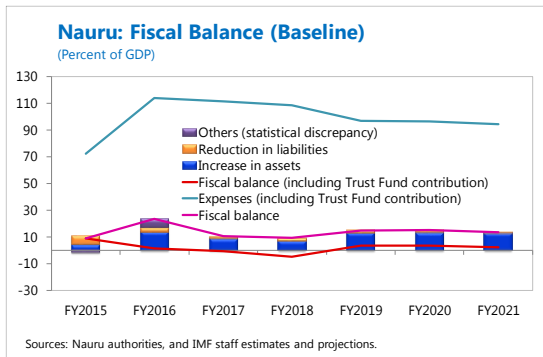
Fiscal revenues are projected to remain robust over the medium term driven by fishing license fees, tax collection, and grants, although the RPC revenue is ...

... projected to decline starting in FY2018 due to the resettlement of some refugees to other countries.



Without spending restraint, the fiscal surplus would be just enough to build the trust fund...

... but insufficient to maintain cash buffers over the medium term.



By controlling spending growth, starting from FY2017 when the RPC revenue remains high, ...

...the cash buffers could be raised to provide fiscal space and ensure short-term liquidity.

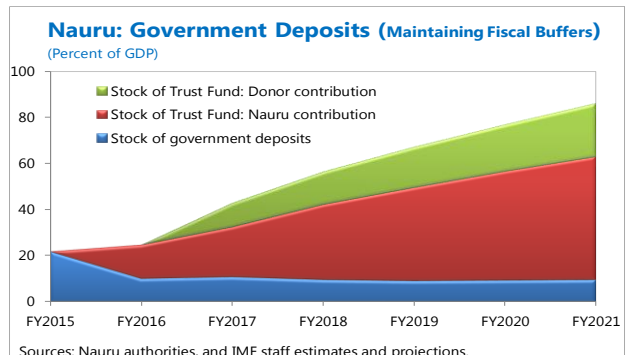
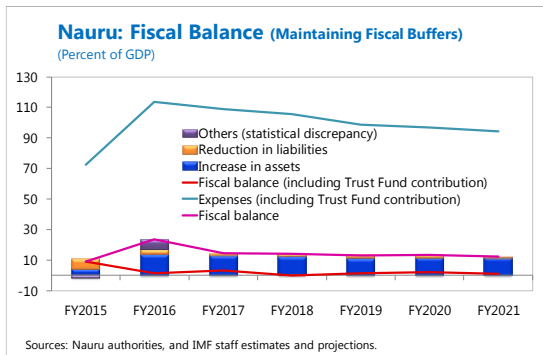
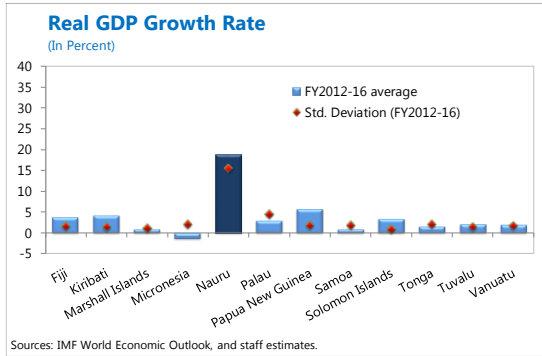
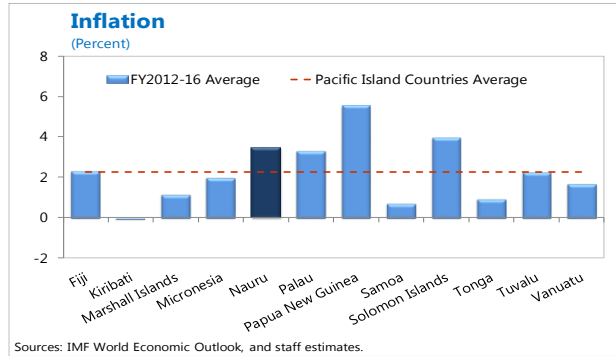


Figure 4. Nauru: Recent Economic Developments in the Regional Context

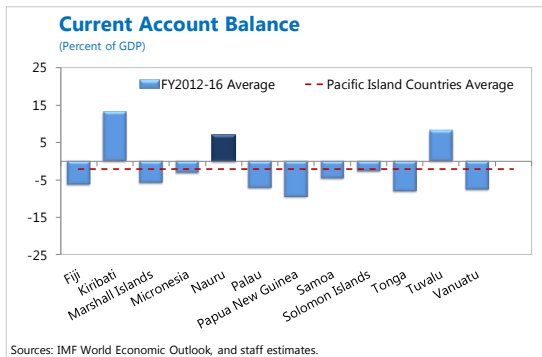
Nauru's growth over the past decade was stronger than peers, but it was also the most volatile due to its reliance on limited sectors.



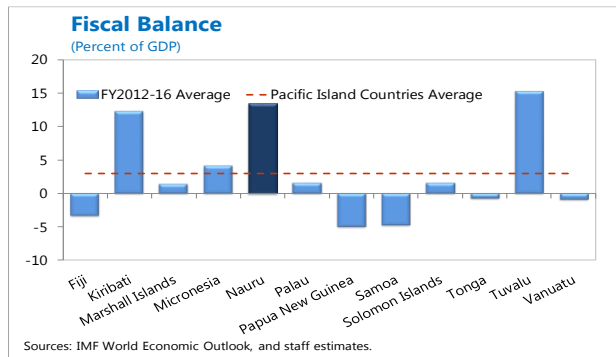
Nauru's inflation was above the Pacific average mainly due to the increase in inflation over the past two years.



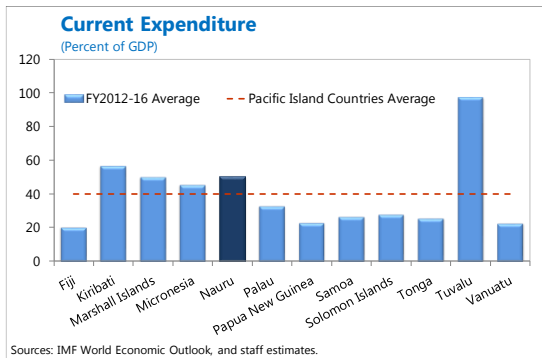
Nauru's strong economic performance over the past five years is reflected by relatively large current account surplus ...



... and large fiscal surplus compared to other Pacific island countries.



The government current expenditure is slightly above the Pacific average.



Nauru's public debt is relatively high compared to peers, although three quarters of it comprises of longstanding arrears.

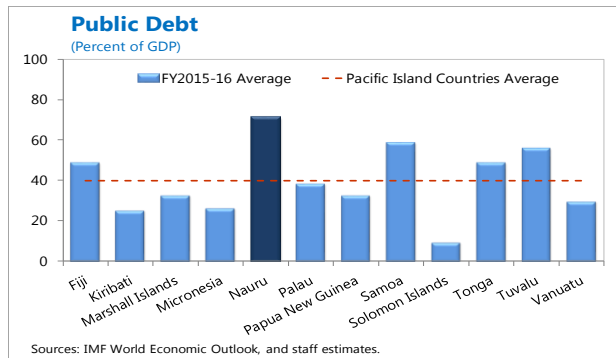


Table 1. Nauru: Selected Social and Economic Indicators, FY2012–17 1/

I. Social and Demographic Indicators 2/						
GDP (FY2015 est.) (in millions of Australian dollars)	120.1		Poverty rate	24 percent (2013)		
Per capita GDP (FY2015 est.) (in Australian dollars)	9,631		Life expectancy at birth	60.4 years (2011)		
Population (FY2015 est.)	12,475		Total fertility rate	4.3 births per woman (2011)		
			Infant mortality rate	29.9 per 1,000 live births (2013)		
			Adult literacy rate	96.5 (2011)		
II. Economic Indicators						
	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
				Preliminary		Proj.
Real sector						
Real GDP growth (percent change)	10.1	34.2	36.5	2.8	10.4	4.0
Consumer price index (period average, percent change)	0.3	-1.1	0.3	9.8	8.2	6.0
Population (thousand)	10.3	10.8	11.9	12.5	13.0	13.3
			(In percent of total)			
Structure of the economy						
Agriculture	4.9	4.7	4.2	2.5	4.4	4.3
Manufacturing	49.2	35.3	20.9	6.6	11.7	11.6
Services	43.2	52.6	63.4	81.6	74.7	74.6
			(In percent of GDP)			
Government finance						
Total revenue and grants	52.6	58.9	76.8	81.2	115.2	110.3
Revenue	31.9	39.1	60.0	64.6	94.1	92.6
Grants	20.7	19.9	16.8	16.6	21.0	17.7
Total expenditure	44.7	57.4	51.8	72.3	91.6	99.9
Net lending (+) / borrowing (-)	7.9	1.5	25.0	8.9	23.5	10.4
Including Trust Fund contribution	7.9	1.5	25.0	8.9	1.5	-1.0
Stock of government deposits	6.7	5.5	16.3	21.5	9.9	6.7
Stock of Trust Fund	...	...	...	...	22.7	33.4
			(In millions of Australian dollars, unless otherwise indicated)			
Balance of payments						
Current account balance	38.4	19.9	-17.2	-11.4	2.4	0.8
(In percent of GDP)	38.1	18.8	-13.5	-9.5	1.7	0.5
Trade balance	33.8	4.6	-34.6	-51.6	-52.9	-61.5
Exports	67.4	58.2	50.7	25.0	34.4	32.0
Imports	33.6	53.6	85.3	76.5	87.3	93.5
Capital account balance	0.9	2.5	3.2	4.3	5.9	5.3
Financial accounts balance and other flows	39.2	22.3	-13.9	-7.1	8.3	6.1
Government debt indicators						
External debt 3/	54.4	50.8	48.1	47.2	48.1	48.9
(In percent of GDP)	54.0	48.0	37.7	39.3	34.3	32.4
Domestic debt 4/	66.1	66.1	52.5	46.1	42.9	41.9
(In percent of GDP)	65.6	62.4	41.2	38.4	30.6	27.8
External debt service	5.9	4.7	3.6	3.0	1.9	2.2
(In percent of exports of goods and services)	8.2	5.9	5.0	5.6	2.8	3.2
Exchange rates						
Australian dollar per U.S. dollar (period average)	0.97	0.98	1.09	1.20	1.37	...
Real Effective Exchange Rate (period average)	103.0	100.1	93.4	98.2	104.9	...
Nominal GDP (in millions of Australian dollars)	100.7	105.9	127.5	120.1	140.2	151.0
Nominal GNI (in millions of Australian dollars)	120.7	129.5	152.1	148.9	175.8	191.6
Nominal GNI per capita (in US dollars)	12,104	12,270	11,783	9,978	9,811	...
Sources: Nauru authorities and IMF staff estimates and projections.						
1/ Nauru uses the Australian dollar as the legal tender, and the fiscal year ends in June.						
2/ The social indicators are taken from United Nations Development Program and Secretariat of the Pacific Community.						
3/ Including the defaulted Yen bonds.						
4/ Including the estimated government liability related to Bank of Nauru's liquidation.						

Table 2. Nauru: Illustrative Medium-term Baseline Scenario, FY2014–21 1/

	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
		Preliminary				Proj.		
Real sector								
Real GDP growth (percent change)	36.5	2.8	10.4	4.0	-4.0	0.2	1.5	2.0
Consumer price index (period average, percent change)	0.3	9.8	8.2	6.0	2.0	2.0	2.0	2.0
(In percent of GDP)								
Government finance								
Total revenue and grants	76.8	81.2	115.2	110.3	103.5	100.1	99.7	96.7
Total expenditure	51.8	72.3	91.6	99.9	94.5	85.2	84.7	83.2
Current expenditure	37.7	61.8	81.2	88.5	75.7	66.5	66.3	67.7
Net acquisition of non-financial assets	14.2	10.5	10.4	11.4	18.8	18.7	18.4	15.5
Net lending (+) / borrowing (-)	25.0	8.9	23.5	10.4	9.0	14.8	14.9	13.5
Including trust fund contribution	25.0	8.9	1.5	-1.0	-5.0	3.2	3.6	2.3
Stock of government deposits	16.3	21.5	9.9	6.7	0.0	1.3	3.0	4.5
Stock of Trust Fund	...	...	22.7	33.4	49.9	62.7	74.3	85.4
(In millions of Australian dollars, unless otherwise indicated)								
Balance of payments								
Current account balance	-17.2	-11.4	2.4	0.8	-2.6	0.2	2.5	3.2
(In percent of GDP)	-13.5	-9.5	1.7	0.5	-1.8	0.1	1.6	2.0
Exports	50.7	25.0	34.4	32.0	32.2	32.6	32.5	33.2
Imports	85.3	76.5	87.3	93.5	93.2	93.8	94.8	95.7
Capital account balance	3.2	4.3	5.9	5.3	8.5	7.6	7.7	7.0
Financial accounts balance and other flows	-13.9	-7.1	8.3	6.1	5.8	7.8	10.2	10.2
Government debt indicators								
External debt 2/	48.1	47.2	48.1	48.9	49.6	50.6	51.8	54.9
(In percent of GDP)	37.7	39.3	34.3	32.4	33.8	34.0	33.8	34.5
Domestic debt 3/	52.5	46.1	42.9	41.9	40.9	39.9	38.9	37.9
(In percent of GDP)	41.2	38.4	30.6	27.8	27.9	26.8	25.4	23.9
External debt service	3.6	3.0	1.9	2.2	2.3	2.1	2.0	0.4
(In percent of exports of goods and services)	5.0	5.6	2.8	3.2	3.8	3.5	3.2	0.6
Exchange rates								
Australian dollar per U.S. dollar (period average)	1.09	1.20	1.37	...	...	...	...	...
Real Effective Exchange Rate (period average, 2010=100)	93.4	98.2	104.9	...	...	...	...	...
Nominal GDP (in millions of Australian dollars)								
Nominal GDP (in millions of Australian dollars)	127.5	120.1	140.2	151.0	146.7	148.7	153.4	159.0
Nominal GNI (in millions of Australian dollars)	152.1	148.9	175.8	191.6	190.3	196.2	204.1	212.3

Sources: Nauru authorities and IMF staff estimates and projections.

1/ Nauru uses the Australian dollar as the legal tender, and the fiscal year ends in June.

2/ Including the defaulted Yen bonds.

3/ Including government liability related to Bank of Nauru's liquidation.

Table 3. Nauru: Balance of Payments, FY2012-21 1/

	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
				Preliminary				Proj.		
	(In millions of Australian dollars)									
Current account balance	38.4	19.9	-17.2	-11.4	2.4	0.8	-2.6	0.2	2.5	3.2
Goods (f.o.b.)	33.8	4.6	-34.6	-51.6	-52.9	-61.5	-61.1	-61.3	-62.2	-62.5
Credit	67.4	58.2	50.7	25.0	34.4	32.0	32.2	32.6	32.5	33.2
Debit	33.6	53.6	85.3	76.5	87.3	93.5	93.2	93.8	94.8	95.7
Services balance	-13.6	-7.8	-29.9	-16.1	-21.3	-22.9	-30.6	-30.7	-30.9	-31.0
Credit	3.7	21.8	22.3	29.5	34.1	36.5	28.1	28.5	29.3	30.4
Debit	17.3	29.6	52.2	45.6	55.3	59.4	58.7	59.2	60.2	61.4
Primary income balance	20.0	23.6	24.7	28.7	35.6	40.6	43.6	47.4	50.7	53.3
Credit	23.0	29.2	32.1	38.0	45.1	50.1	51.4	55.4	58.8	61.6
Debit	3.0	5.6	7.4	9.3	9.5	9.5	7.8	8.0	8.1	8.4
Secondary income balance	-1.8	-0.5	22.6	27.5	41.0	44.5	45.5	44.8	44.9	43.5
Credit	4.6	12.1	32.0	37.2	53.1	57.6	58.2	57.6	58.2	57.2
Debit	6.4	12.6	9.3	9.6	12.1	13.1	12.7	12.9	13.3	13.8
Capital account balance	0.9	2.5	3.2	4.3	5.9	5.3	8.5	7.6	7.7	7.0
Credit	0.9	2.5	3.2	4.3	5.9	5.3	8.5	7.6	7.7	7.0
Debit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending / borrowing	39.2	22.3	-13.9	-7.1	8.3	6.1	5.8	7.8	10.2	10.2
Financial account balance	35.0	17.7	2.3	9.9	19.1	6.1	5.8	7.8	10.2	10.2
Assets	31.9	16.2	1.2	9.7	20.0	16.7	12.4	24.0	26.9	28.7
Liabilities	-3.1	-1.6	-1.1	-0.2	0.9	10.6	6.6	16.2	16.7	18.5
Errors and omissions	-4.2	-4.6	16.3	17.0	10.8	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>										
Nominal GDP	100.7	105.9	127.5	120.1	140.2	151.0	146.7	148.7	153.4	159.0
Current account balance (in percent of GDP)	38.1	18.8	-13.5	-9.5	1.7	0.5	-1.8	0.1	1.6	2.0
Stock of external assets	18.4	24.3	38.5	53.5	79.9	94.5	107.0	129.0	152.4	176.7
Government deposits	6.8	5.8	20.8	25.9	13.9	9.8	-0.4	1.5	4.1	6.6
Trust Fund	...	...	...	...	31.8	50.5	73.2	93.2	114.0	135.8
Others, including donor funds	11.6	18.5	17.7	27.7	34.2	34.2	34.2	34.2	34.2	34.2
Change in external assets	9.0	5.9	14.2	15.1	26.4	14.6	12.5	21.9	23.4	24.3
External debt (in millions of Australian dollars) 2/	54.4	50.8	48.1	47.2	48.1	48.9	49.6	50.6	51.8	54.9
Medium-and long-term debt	46.4	43.1	40.9	40.4	41.3	42.8	43.9	45.3	46.9	50.1
Informal debt (overdue fees and obligations)	7.9	7.7	7.2	6.9	6.9	6.1	5.6	5.3	5.0	4.7
External debt service	5.9	4.7	3.6	3.0	2.0	2.2	2.3	2.1	2.0	0.4
Principal	4.6	3.7	2.8	2.4	1.5	1.7	2.0	1.9	1.8	0.2
Interest	1.3	1.0	0.8	0.6	0.5	0.5	0.4	0.3	0.2	0.1
International Investment Position	105.1	126.4	116.4	121.6	138.2	152.1	161.0	180.7	202.5	223.7
Assets	164.1	182.8	170.7	175.6	193.1	207.7	217.3	238.0	261.0	285.3
Liabilities	59.0	56.4	54.3	54.0	54.8	55.6	56.3	57.3	58.5	61.6

Sources: Nauru authorities and IMF staff estimates and projections.

1/ The fiscal year ends in June.

2/ Including the defaulted Yen bonds.

Table 4. Nauru: Central Government Operations, FY2012-21 1/

	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017		FY2018	FY2019	FY2020	FY2021
						Preliminary	Budget	Proj.		Proj.	
(In millions of Australian dollars)											
Total revenue and grants	52.9	62.4	97.9	97.6	161.4	160.0	166.6	151.8	148.8	152.9	153.7
Revenue	32.1	41.4	76.5	77.7	131.9	138.5	139.8	109.6	111.1	114.6	118.9
Of which: RPC revenue 2/	...	...	24.0	30.7	54.1	...	50.1	34.6	34.2	34.9	35.3
Tax revenue	8.1	16.2	19.0	22.6	31.6	28.4	30.6	21.8	22.4	23.7	25.3
Nontax revenue	24.0	25.2	57.5	55.1	100.4	110.1	109.2	87.8	88.7	90.9	93.5
Of which: Fishing license fees	12.8	13.5	19.9	28.9	37.4	42.1	42.1	38.4	39.7	41.4	43.3
Visa fees	0.1	0.3	16.0	18.4	33.1	29.6	29.6	19.8	19.8	19.8	19.8
Grants	20.8	21.0	21.4	19.9	29.5	21.5	26.7	42.3	37.8	38.3	34.9
Budget support (current)	4.0	4.0	3.4	7.3	4.4	4.3	4.3	9.5	4.7	4.9	5.1
Development fund (capital)	16.8	17.0	18.1	12.6	14.6	17.2	27.5	27.5	27.9	28.2	24.6
Trust fund: Donor contribution	...	...	...	...	10.5	...	5.2	5.2	5.2	5.2	5.2
Expenditure	45.0	60.8	66.0	86.9	128.5	152.6	150.8	138.6	126.8	130.0	132.2
Expenses	28.2	43.8	48.0	74.3	113.8	135.4	133.7	111.1	98.9	101.8	107.7
Of which: Non-RPC expenses	...	...	48.0	68.3	97.2	107.5	105.8	90.3	78.0	80.7	86.4
Compensation of employees	10.9	10.7	13.7	24.2	33.9	49.5	49.5	42.9	43.1	44.0	45.6
Goods and services	12.0	18.8	21.9	26.0	40.8	45.8	45.3	40.3	34.7	35.8	37.1
Social expenditure	2.6	4.7	7.6	11.7	20.5	14.5	14.4	13.5	13.2	13.6	14.1
Subsidies and donations	0.7	2.2	1.0	3.2	11.0	9.4	9.4	5.8	3.6	3.7	3.8
Other	2.0	7.4	3.9	9.1	7.6	16.1	15.0	8.6	4.3	4.8	7.0
Net acquisition of non-financial assets	16.8	17.0	18.1	12.6	14.6	17.2	17.2	27.5	27.9	28.2	24.6
Net lending (+) / borrowing (-)	7.9	1.6	31.8	10.7	33.0	7.4	15.7	13.2	22.1	22.9	21.5
Including trust fund contribution	7.9	1.6	31.8	10.7	2.1	-4.5	-1.4	-7.4	4.8	5.5	3.6
Net financing	7.9	1.6	31.8	10.7	33.0	7.4	15.7	13.2	22.1	22.9	21.5
Net acquisition of financial assets	4.7	-1.0	15.0	5.1	18.9	6.4	13.0	10.3	19.2	20.1	20.3
Changes in government deposit	4.7	-1.0	15.0	5.1	-12.0	-5.5	-4.2	-10.3	1.9	2.7	2.4
Trust fund: Nauru contribution	0.0	0.0	0.0	0.0	20.4	11.9	11.9	15.4	12.1	12.2	12.6
Trust fund: Donor contribution	...	...	...	...	10.5	...	5.2	5.2	5.2	5.2	5.2
Net incurrence of financial liabilities	-4.6	-8.5	-23.3	-7.6	-4.6	-1.0	-2.7	-3.0	-2.9	-2.8	-1.2
Statistical discrepancy	-1.4	-6.0	-6.4	-2.0	9.4	0.0	0.0	0.0	0.0	0.0	0.0
(In percent of GDP)											
Total revenue and grants	52.6	58.9	76.8	81.2	115.2	105.9	110.3	103.5	100.1	99.7	96.7
Revenue	31.9	39.1	60.0	64.6	94.1	91.7	92.6	74.7	74.7	74.7	74.8
Of which: RPC revenue 2/	...	...	18.8	25.5	38.6	...	33.2	23.6	23.0	22.7	22.2
Tax revenue	8.1	15.3	14.9	18.8	22.5	18.8	20.3	14.9	15.0	15.4	15.9
Nontax revenue	23.8	23.8	45.1	45.8	71.6	72.9	72.3	59.8	59.6	59.3	58.8
Grants	20.7	19.9	16.8	16.6	21.0	14.2	17.7	28.8	25.4	25.0	21.9
Expenditure	44.7	57.4	51.8	72.3	91.6	101.0	99.9	94.5	85.2	84.7	83.2
Expenses	28.0	41.3	37.7	61.8	81.2	89.7	88.5	75.7	66.5	66.3	67.7
Of which: Non-RPC expenses	...	...	37.7	56.8	69.4	71.2	70.0	61.6	52.4	52.6	54.4
Compensation of employees	10.8	10.1	10.7	20.2	24.2	32.8	32.8	29.3	29.0	28.7	28.7
Goods and services	11.9	17.7	17.1	21.7	29.1	30.4	30.0	27.4	23.3	23.3	23.3
Social expenditure	2.6	4.4	6.0	9.8	14.6	9.6	9.6	9.2	8.9	8.9	8.9
Subsidies and donations	0.7	2.1	0.8	2.7	7.9	6.2	6.2	3.9	2.4	2.4	2.4
Other	2.0	7.0	3.0	7.6	5.4	10.7	10.0	5.9	2.9	3.1	4.4
Net acquisition of non-financial assets	16.7	16.1	14.2	10.5	10.4	11.4	11.4	18.8	18.7	18.4	15.5
Net lending (+) / borrowing (-)	7.9	1.5	25.0	8.9	23.5	4.9	10.4	9.0	14.8	14.9	13.5
Including trust fund contribution	7.9	1.5	25.0	8.9	1.5	-3.0	-1.0	-5.0	3.2	3.6	2.3
Net acquisition of financial assets	4.7	-0.9	11.8	4.2	13.5	4.2	8.6	7.0	12.9	13.1	12.7
Net incurrence of financial liabilities	-4.5	-8.1	-18.3	-6.3	-3.3	-0.7	-1.8	-2.0	-1.9	-1.8	-0.8
Statistical discrepancy	-1.3	-5.7	-5.0	-1.6	6.7	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>											
Nominal GDP (in millions of Australian dollars)	100.7	105.9	127.5	120.1	140.2	151.0	151.0	146.7	148.7	153.4	159.0
Non-RPC balance (in percent of GDP) 3/	...	...	6	-12	-21.2	...	-20.8	-14.0	-7.6	-7.3	-8.2
Stock of government deposit	6.8	5.8	20.8	25.9	13.9	...	10.1	0.1	1.9	4.7	7.2
In percent of GDP	6.7	5.5	16.3	21.5	9.9	...	6.7	0.0	1.3	3.0	4.5
In months of non-RPC current spending	2.9	1.6	5.2	4.5	1.7	...	1.1	0.0	0.3	0.7	1.0
Stock of Trust Fund	...	...	...	...	31.8	...	50.5	73.2	93.2	114.0	135.8
In percent of GDP	...	...	...	...	22.7	...	33.4	49.9	62.7	74.3	85.4
Stock of government debt (percent of GDP) 4/	119.6	110.4	79.0	77.7	65.0	...	60.1	61.7	60.8	59.1	58.4
External debt	54.0	48.0	37.7	39.3	34.3	...	32.4	33.8	34.0	33.8	34.5
Domestic debt	65.6	62.4	41.2	38.4	30.6	...	27.8	27.9	26.8	25.4	23.9

Sources: Nauru authorities and IMF staff estimates and projections.

1/ The fiscal year ends in June.

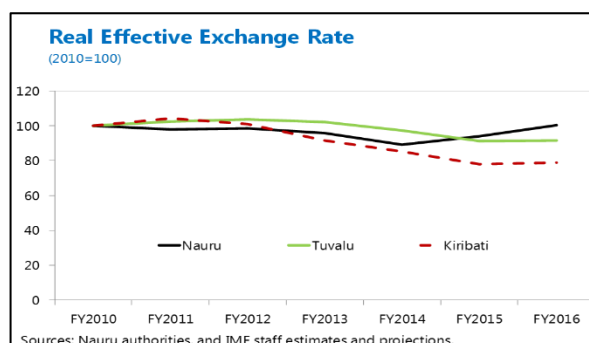
2/ Excluding reimbursement for RPC expenses

3/ Non-RPC revenue plus current grants or budget support minus non-RPC expenses.

4/ Including the defaulted Yen bond and the government's liability to Bank of Nauru's liquidation.

Appendix I. External Sustainability Assessment

Real Effective Exchange Rate (REER). Nauru is using the Australian dollar as the legal tender. Nauru’s REER depreciated by nearly 10 percent in FY2013-14 following the Australian dollar, and then appreciated by 12 percent during FY2015-16 due to inflation. This recent appreciation marks the deviation from the trend of REER in other Pacific island countries that use the Australian dollar as legal tender. The EBA lite assessment suggests that the REER is moderately stronger, or the external balance weaker, than implied by fundamentals due to elevated inflation. Nonetheless, the REER plays a limited role in determining external sustainability since the current account balance is mostly driven by exogenous factors such as the RPC operation, fishing license fees, well-functioning seaport, and donor inflows.



Approaches	ER Misalignment
Current Account (CA) Model	5.6
Underlying CA	1.7
CA Norm	3.2
CA Gap	-1.5
External Sustainability (Scenario 1)	4.9

Ensuring external sustainability. Without monetary and exchange rate policies, Nauru relies on fiscal policies and structural reforms to ensure external sustainability. The strong fiscal performance in recent years has raised government deposits to about A\$34 million (4 months of non-RPC spending) in FY2016, including trust fund contribution of about A\$20 million. Over the medium term, maintaining prudent fiscal policy is critical to ensure fiscal and external sustainability. In line with fiscal policy recommendations, Nauru should continue to build up the trust fund and maintain fiscal cash buffers of about 2 months of non-RPC spending. Containing the growth of current spending, particularly the wage bill, will help control inflation and lower the REER. Despite the expected decline in RPC-inflows, the current account is projected to remain sustainable thanks to lower imports, larger grant disbursements, the projected fiscal surplus, and continued build-up of Nauru trust fund. Successful implementation of structural reforms is also important to improve competitiveness and external balance. Rebuilding the seaport and improving utility infrastructure would prevent supply shortages and reduce costs, while reforming state owned enterprises would improve their efficiencies and help preserve fiscal sustainability.

Appendix II. Risk Assessment Matrix 1/

Likelihood and Sources of Risk	Potential Impact	Policies to Minimize Impact
<p>Weaker than expected global growth: (1) Low-Medium. Significant China slowdown and its spillovers;</p> <p>(2) High/Medium. Structurally weak growth in key advanced and emerging economies.</p>	<p>Medium. Slower global growth and reduced demand in Asia and the Pacific could reduce Nauru's phosphate exports, fiscal revenues, and remittances, although a weak Australian dollar would help improve Nauru's competitiveness.</p>	<p>Expedite infrastructure spending financed by donors to address infrastructure bottlenecks, stimulate domestic demand in the short term, and generate employment. Accelerate structural fiscal reforms to help preserve fiscal sustainability.</p>
<p>Medium. Global climate change.</p>	<p>High. Extreme weather conditions could damage the seaport and other infrastructure, hampering trade and growth. Global climate change could lead to relocation of tuna stock, reducing revenues from fishing license. Coping with climate-change effects would further strain the budget.</p>	<p>Enhance ex-ante adaptation measures (improving infrastructure, fiscal buffers, and planning), improve ex-post disasters management, and seek global/regional climate-change financing opportunities.</p>
<p>Medium. Changes in the Australian policy on the Regional Processing Center (RPC) in Nauru.</p>	<p>High. Policy changes that lead to more rapid process the RPC scaling down would reduce growth and fiscal revenues. On the upside, a slower process or larger grant disbursements from Australia would provide some policy space to minimize its adverse impact on the economy.</p>	<p>Maintain prudent fiscal policy and build sufficient fiscal buffers to minimize the adverse impact on growth and mobilize donor support if needed. Accelerate structural reforms and expedite the implementation of grant-financed infrastructure projects to support growth.</p>
<p>Medium. Delays in fiscal reforms.</p>	<p>High. Delays in implementing tax and public financial management reforms would jeopardize fiscal sustainability.</p>	<p>Seek technical assistance from donors, and monitor the reform progress on a regular basis in consultation with development partners.</p>
<p>Medium. Delays in implementing structural reforms.</p>	<p>High. Delays in implementing infrastructure projects and reforming state owned enterprises would lower growth prospect and threaten fiscal sustainability.</p>	<p>Work with development partners to prioritize reform agenda, project selection and implementation, and improve business climate to stimulate private sector development.</p>
<p>1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.</p>		

Appendix III. Debt Sustainability Analysis (DSA)

Nauru's public debt. During the economic downturn in the 1990s-2000s, Nauru defaulted on most of its public debt and accumulated arrears. Since FY2012, the economic situation has improved substantially, and the government has been using fiscal surpluses to accumulate deposits and clear some domestic arrears. The reconciliation of external and domestic public debt is ongoing, and the latest data in June 2016 show that the total public debt is estimated at about A\$91 million (65 percent of GDP). External public debt is estimated at A\$48 million (34 percent of GDP), mostly comprising of loans from Taiwan Province of China, overdue membership obligations to international organizations, and the defaulted Yen bonds in the 1990s. The estimated value of the Yen bonds is subject to negotiations with bond holders. Domestic debt is estimated at A\$43 million (31 percent of GDP), mostly unpaid deposits related to Bank of Nauru's liquidation.

Medium-term outlook. Nauru's medium-term outlook is vulnerable to the RPC scaling down as the refugees would be transferred to other countries, entailing a substantial decline in RPC revenue. With limited access to borrowing, Nauru is not expected to tap substantial amount of new borrowing for financing, and fiscal spending will have to adjust accordingly. Under this baseline scenario, total public debt would decline to about 58 percent of GDP. The stock of public debt would be lower over the medium term if the ongoing negotiation with creditors, such as the Yen bonds holders, would be able to reduce the amount of Nauru's longstanding arrears. The results of the DSA (below) indicate that Nauru's public debt is sustainable over the medium term.

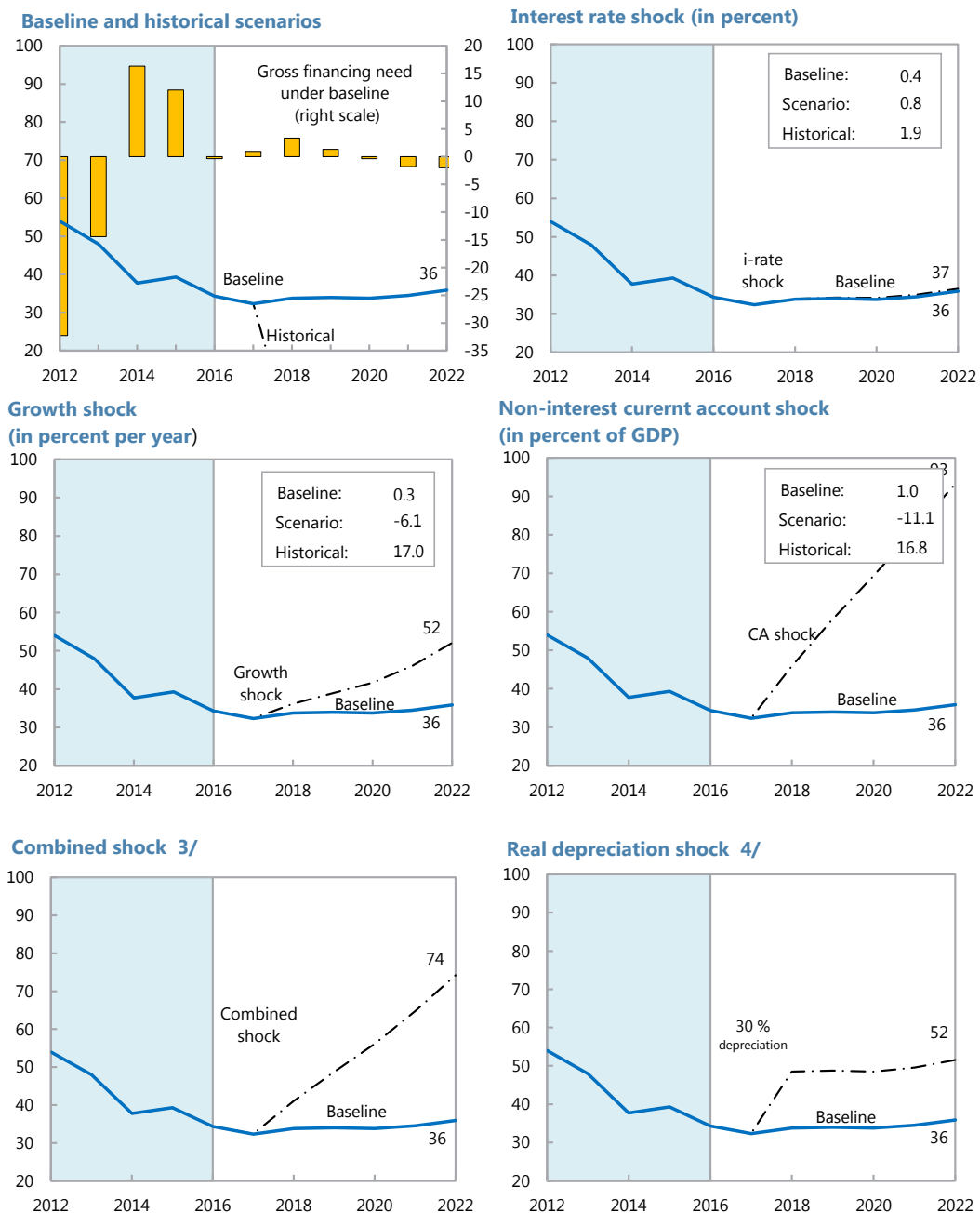
Policy implications. Maintaining prudent fiscal policy by contributing to the trust fund and preserving sufficient cash buffers will be critical to ensure fiscal and debt sustainability. Since most of Nauru's debt is in the form of long-standing arrears, continued good-faith negotiations with creditors could lower debt levels, reduce uncertainty, and help regain access to credit markets. Developing capacity to reconcile and manage debt, and to analyze debt sustainability will be important before taking on new public debt.¹

¹ The authorities plan to recognize the Nauru Phosphate Royalty Trust (NPRT) losses during the 1980s-2000s as public debt to landowners although the details including the repayment plan remain unclear. Since the amount could be potentially large and subject to reconciliation and negotiations between the government and landowners, the mission and the authorities agreed that any future plan to convert the NPRT losses into government debt should be considered carefully in order to preserve Nauru's debt sustainability.

Nauru: External Debt Sustainability Framework, 2012–2022
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ 15.8		
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022			
	54.0	48.0	37.7	39.3	34.3	32.4	33.8	34.0	33.8	34.5	35.9			
Change in external debt	-26.7	-6.0	-10.2	1.6	-5.0	-2.0	1.4	0.2	-0.2	0.7	1.4			
Identified external debt-creating flows (4+8+9)	-54.3	-15.6	-48.4	20.6	22.1	12.0	20.5	15.5	13.9	13.8	14.2			
Current account deficit, excluding interest payments	-39.4	-19.7	12.9	9.0	-2.1	-0.8	1.5	-0.3	-1.7	-2.1	-2.3			
Deficit in balance of goods and services	-20.0	3.0	50.6	56.3	52.9	55.9	62.5	61.8	60.7	58.8	57.6			
Exports	70.6	75.5	57.3	45.4	48.8	45.4	41.1	41.0	40.3	40.0	39.4			
Imports	50.6	78.6	107.8	101.7	101.8	101.2	103.6	102.9	101.0	98.8	97.0			
Net non-debt creating capital inflows (negative)	7.9	5.6	-58.5	4.9	24.5	13.8	17.4	15.7	16.1	16.5	17.0			
Automatic debt dynamics 1/	-22.9	-1.4	-2.8	6.7	-0.2	-0.9	1.6	0.1	-0.4	-0.6	-0.6			
Contribution from nominal interest rate	1.3	1.0	0.6	0.5	0.4	0.3	0.2	0.2	0.1	0.1	0.1			
Contribution from real GDP growth	-5.7	-17.7	-16.3	-1.2	-4.0	-1.2	1.4	-0.1	-0.5	-0.7	-0.7			
Contribution from price and exchange rate changes 2/	-18.4	15.3	12.8	7.5	3.4	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	27.7	9.5	38.2	-19.0	-27.1	-14.0	-19.1	-15.3	-14.2	-13.1	-12.8			
External debt-to-exports ratio (in percent)	76.4	63.5	65.9	86.7	70.3	71.3	82.3	82.9	83.7	86.3	91.2			
Gross external financing need (in billions of US dollars) 4/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
in percent of GDP	-32.3	-14.4	16.3	12.0	-0.3	7-Year	7-Year	1.0	3.4	1.3	-0.4	-1.8	-2.0	
Scenario with key variables at their historical averages 5/						32.4	-3.6	-30.3	-51.8	-69.3	-83.6	10.5		
Key Macroeconomic Assumptions Underlying Baseline														
						Historical Average	Standard Deviation							
Real GDP growth (in percent)	10.1	34.2	36.5	2.8	10.4	17.0	13.0	4.0	-4.0	0.2	1.5	2.0	2.0	
GDP deflator in US dollars (change in percent)	29.6	-22.1	-21.1	-16.5	-7.9	-1.1	23.0	7.2	0.4	1.0	1.3	1.0	1.6	
Nominal external interest rate (in percent)	2.3	1.9	1.4	1.2	1.0	1.9	0.8	1.0	0.7	0.5	0.3	0.3	0.2	
Growth of exports (US dollar terms, in percent)	79.7	11.8	-18.3	-32.0	9.4	11.7	44.8	3.5	-12.8	1.2	1.1	2.1	2.0	
Growth of imports (US dollar terms, in percent)	18.6	62.4	47.9	-19.1	1.7	27.0	43.1	10.9	-1.4	0.6	1.0	0.7	1.7	
Current account balance, excluding interest payments	39.4	19.7	-12.9	-9.0	2.1	16.8	24.2	0.8	-1.5	0.3	1.7	2.1	2.3	
Net non-debt creating capital inflows	-7.9	-5.6	58.5	-4.9	-24.5	-0.5	26.9	-13.8	-17.4	-15.7	-16.1	-16.5	-17.0	
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2017-2022 4/								32.4	-3.6	-30.3	-51.8	-69.3	-83.6	10.5
B. Bound Tests														
B1. Nominal interest rate is at historical average plus one standard deviation								32.4	33.9	34.3	34.2	35.0	36.5	16.0
B2. Real GDP growth is at historical average minus one standard deviations								32.4	36.1	38.9	41.7	46.1	52.1	25.5
B3. Non-interest current account is at historical average minus one standard deviations								32.4	45.9	58.1	69.4	81.2	93.2	14.0
B4. Combination of B1-B3 using 1/2 standard deviation shocks								32.4	41.0	48.7	56.1	64.7	74.2	20.1
B5. One time 30 percent real depreciation in 2017								32.4	48.5	48.8	48.5	49.5	51.6	22.9
1/ Derived as $[r - g - r(1+g) + ea(1+r)]/(1+g+r)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.														
2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)]/(1+g+r)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).														
3/ For projection, line includes the impact of price and exchange rate changes.														
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.														
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.														
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.														

Nauru: External Debt Sustainability: Bound Tests 1/ 2/ (External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
 2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
 3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
 4/ One-time real depreciation of 30 percent occurs in 2017.

Nauru Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

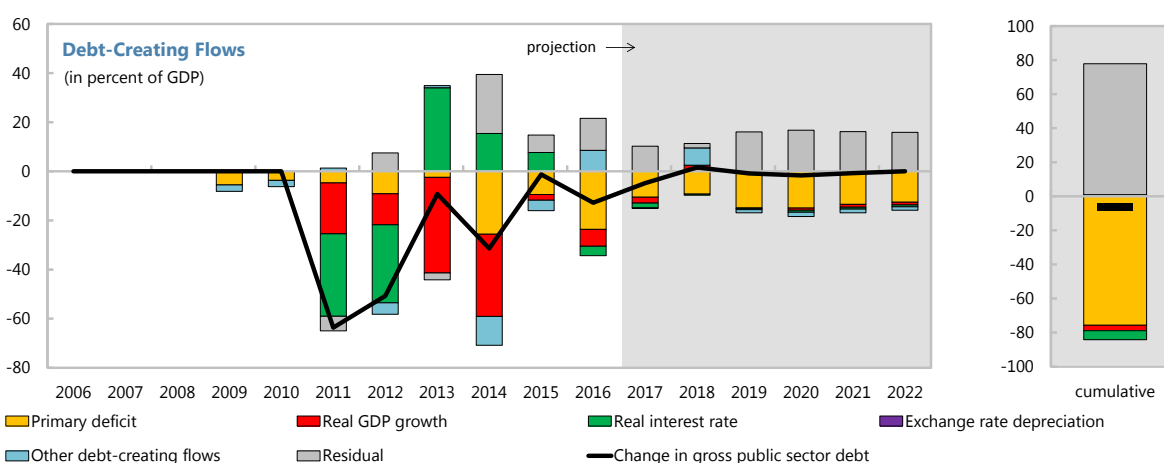
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of January 31, 2017		
	2011-2014 ^{2/}	2015	2016	2017	2018	2019	2020	2021	2022			
Nominal gross public debt	119.8	77.7	65.0	60.1	61.7	60.9	59.3	58.5	58.5	Sovereign Spreads		
Of which: guarantees	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	EMBIG (bp) ^{3/}		
Public gross financing needs	-0.3	-2.6	-20.3	-8.6	-7.0	-12.9	-13.0	-12.6	-11.7	5Y CDS (bp)		
Real GDP growth (in percent)	23.1	2.8	10.4	4.0	-4.0	0.2	1.5	2.0	2.0	Ratings		
Inflation (GDP deflator, in percent)	2.2	-8.3	5.7	3.6	1.2	1.2	1.6	1.6	1.6	Moody's		
Nominal GDP growth (in percent)	23.5	-5.7	16.7	7.7	-2.9	1.4	3.1	3.6	3.6	S&P's		
Effective interest rate (in percent) ^{4/}	1.0	0.6	0.6	0.5	0.4	0.3	0.3	0.3	0.3	Fitch		
										Foreign	Local	
										n.a.	n.a.	
										n.a.	n.a.	
										n.a.	n.a.	

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2011-2014	2015	2016	2017	2018	2019	2020	2021	2022		
Change in gross public sector debt	-38.7	-1.3	-12.8	-4.8	1.6	-0.8	-1.6	-0.7	0.0	-6.4	
Identified debt-creating flows	-44.4	-8.3	-25.8	-15.1	-0.2	-16.9	-18.4	-16.9	-15.8	-83.3	
Primary deficit	-10.5	-9.4	-23.6	-10.5	-9.3	-15.0	-15.0	-13.5	-12.5	-75.7	-3.3
Primary (noninterest) revenue and grants	57.8	81.2	114.9	110.1	103.5	100.0	99.6	96.6	94.5	604.3	
Primary (noninterest) expenditure	47.3	71.8	91.3	99.6	94.3	85.1	84.6	83.1	82.0	528.6	
Automatic debt dynamics ^{5/}	-30.4	5.3	-10.7	-4.4	2.0	-0.7	-1.7	-1.9	-1.9	-8.5	
Interest rate/growth differential ^{6/}	-30.4	5.3	-10.7	-4.4	2.0	-0.7	-1.7	-1.9	-1.9	-8.5	
Of which: real interest rate	-4.0	7.7	-3.8	-2.0	-0.5	-0.5	-0.8	-0.8	-0.8	-5.3	
Of which: real GDP growth	-26.4	-2.4	-6.9	-2.4	2.5	-0.1	-0.9	-1.2	-1.1	-3.2	
Exchange rate depreciation ^{7/}	0.0	0.0	0.0	...	...	...	...	...	...	...
Other identified debt-creating flows	-3.6	-4.2	8.6	-0.2	7.1	-1.3	-1.7	-1.5	-1.4	0.9	
Fiscal: Net acquisition of financial assets	-3.6	-4.2	8.6	2.8	7.1	-1.3	-1.7	-1.5	-1.4	3.9	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroare)	0.0	0.0	0.0	-3.0	0.0	0.0	0.0	0.0	0.0	-3.0	
Residual, including asset changes ^{8/}	5.7	7.1	13.0	10.3	1.8	16.1	16.7	16.2	15.9	76.9	



Source: IMF staff.

1/ Public sector is defined as central government and includes public guarantees, defined as Arrears.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+gn)]$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

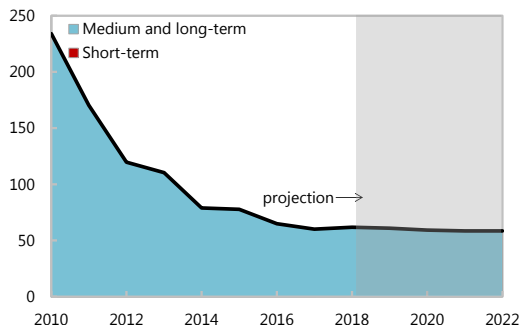
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Nauru Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

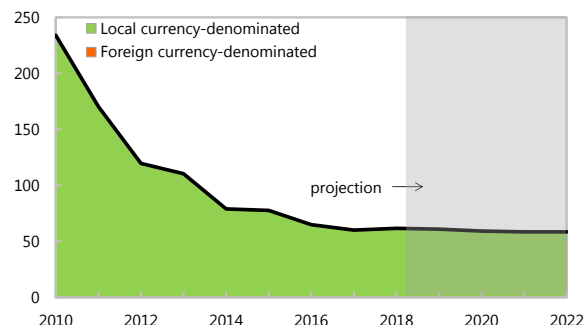
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)



Alternative Scenarios

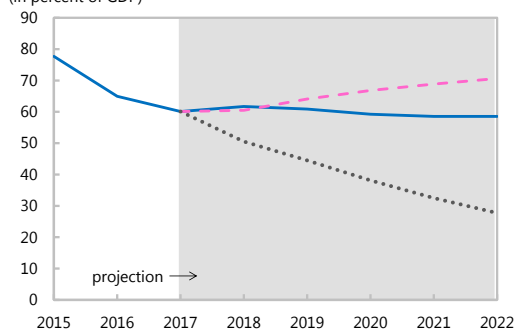
— Baseline

..... Historical

- - - Constant Primary Balance

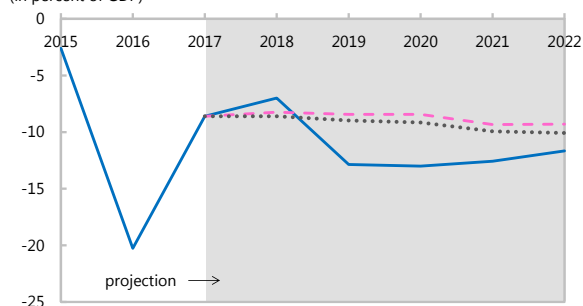
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	4.0	-4.0	0.2	1.5	2.0	2.0
Inflation	3.6	1.2	1.2	1.6	1.6	1.6
Primary Balance	10.5	9.3	15.0	15.0	13.5	12.5
Effective interest rate	0.5	0.4	0.3	0.3	0.3	0.3

Constant Primary Balance Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	4.0	-4.0	0.2	1.5	2.0	2.0
Inflation	3.6	1.2	1.2	1.6	1.6	1.6
Primary Balance	10.5	10.5	10.5	10.5	10.5	10.5
Effective interest rate	0.5	0.4	0.3	0.3	0.4	0.4

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	4.0	13.7	13.7	13.7	13.7	13.7
Inflation	3.6	1.2	1.2	1.6	1.6	1.6
Primary Balance	10.5	10.5	10.5	10.5	10.5	10.5
Effective interest rate	0.5	0.4	0.3	0.4	0.5	0.5

Source: IMF staff.



REPUBLIC OF NAURU

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

March 7, 2017

Prepared By

The Asia and Pacific Department
(In consultation of other departments)

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FUND RELATIONS

As of January 31, 2017

Membership Status

Joined April 12, 2016; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	2.80	100.00
Total holdings of currency	2.12	75.71
Reserve position in the Fund	0.68	24.32

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	0.86	100.00
Holdings	0.18	21.06

Outstanding Purchases and Loans

None

Financial Arrangements

None

Projected Obligations to Fund

None

Exchange Arrangements

Nauru's legal tender is the Australian dollar. There is no central monetary institution. Nauru has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Resident Representative:

The Regional Resident Representative Office for Pacific Islands is based in Suva, Fiji and was opened on September 13, 2010. The office covers Fiji, Kiribati, Marshall Islands, Micronesia, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. Mr. Tubagus Feridhanusetyawan is the current resident representative.

WORLD BANK—IMF COLLABORATION

As of January 31, 2017

The World Bank (WB) and the IMF teams maintain a close working relationship and continues to have ongoing dialogue on Nauru's economic developments and policies. The joint IMF-WB membership mission to Nauru took place in May 2015, and the WB team has provided inputs for the first IMF Article IV consultations in January 2017. The teams agreed that Nauru's economic performance has improved in recent years driven by the Australian Regional Processing Center (RPC) to process asylum seekers, revenues from fishing license fees, and residual phosphate mining. However, Nauru continues to face daunting challenges in sustaining growth and ensuring fiscal sustainability due its limited sources of growth and income. The country is also vulnerable to climate change, its antiquated infrastructure hampers trade and growth, and its health indicators are worse than peers due to the high incidence of non-communicable diseases. In view of these, Nauru's policy priorities should focus on the following:

- **Ensuring fiscal sustainability.** In the absence of monetary policy, sound fiscal policy plays a critical role in preserving macroeconomic stability. Nauru's medium-term fiscal outlook is vulnerable to the RPC scaling down, which could entail a substantial decline in RPC revenue. With limited access to borrowing, government spending will have to adjust accordingly. Maintaining adequate cash buffers (in addition to the trust fund) is critical to ensure fiscal space to respond to shocks.
- **Implementing structural fiscal reforms.** The priorities include implementing tax and public finance management reforms to help support the needed fiscal adjustment and improve the efficiency of spending, and strengthening public debt management to ensure fiscal and debt sustainability and improve access to credit markets.
- **Improving resilience to climate change.** Nauru faces a number of long-term climate change challenges. These include rising sea levels, extreme tides, and coastal erosion, which threaten essential infrastructure and reduce the land area for agriculture. Therefore, developing a fiscal policy framework that can enhance economic resilience by integrating Nauru's climate change strategies in budget planning over the medium term is important.
- **Promote inclusive growth.** While Nauru's average per-capita income is higher than that of other Pacific Island Countries, it also has high levels of hardship and vulnerability, largely due to a lack of economic opportunities for the poorest and most vulnerable. The following reforms could be prioritized to promote inclusive job-creating growth, economic diversification, and private sector development: (1) rebuilding the seaport and energy infrastructure, (2) reforming the state owned enterprises, and (3) developing the financial sector. There is also scope to benefit more from labor mobility opportunities, although this will likely require reforms in both Nauru and in receiving countries. Addressing health-related challenges is critical to reduce economic and social burdens of non-communicable diseases in Nauru, including by disincentivizing the consumption of tobacco, alcohol, and sugary and salty foods, and by reallocating scarce health resources toward targeted preventative measures and primary care.

Nauru: Bank and Fund Implemented/Planned Activities in Macro-Critical Areas, 2016-18		
	Product	Expected/Actual Delivery
World Bank Work Program	<ul style="list-style-type: none"> Seasonal Worker Programme Development Evaluation 	<ul style="list-style-type: none"> June 2017
IMF Work Program	<ul style="list-style-type: none"> National Accounts Statistics Technical Assistance (TA) mission External Sector Statistics TA Mission Public Financial Management TA Mission Government Financial Statistics TA Mission 2017 Article IV Consultation 	<ul style="list-style-type: none"> June and September 2016 September 2016, planned follow-up in 2017/18 August 2016, December 2016 Planned in 2017 Mission in January 2017, Board Discussion in March 2017.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

As of January 31, 2017

The Asian Development Bank (AsDB) has been supporting the Government of Nauru with approved loans, grants, and technical assistance amounting to over US\$29 million. As of 31 December 2016, currently active grant projects amount to US\$14.8 million.

Partnerships

AsDB is a major development partner for Nauru in terms of infrastructure financing and supporting economic reform. AsDB continues to significantly scale up its program in Nauru, including through mobilizing significant co-financing. AsDB has enhanced its relationship with Nauru through the establishment in 2016 of a Development Coordination Office on island and works collaboratively with other development partners active in Nauru.

AsDB's approach and operations in Nauru are guided by the government's National Sustainable Development Strategy (NSDS) 2005-2025 and the AsDB Pacific Approach 2016-2020, which acts as the AsDB country strategy for Nauru. The AsDB program in Nauru contributes to the objectives of the Pacific Approach by: (i) reducing costs through infrastructure development; (ii) managing risk by strengthening public sector management; and (iii) enabling value creation through improving connectivity.

AsDB Supported Projects and Programs

AsDB continues to significantly scale up its program in Nauru through the increased Asian Development Fund (ADF) country base allocation, regional ADF financing, and co-financing. The Country Operations Business Plan 2017-2019 has a total envelope of US\$50.8 million, including co-financing.

Current AsDB activities include:

- **Port Development Project:** Developing a modern, safe and reliable port facility is the centerpiece of the AsDB program in Nauru. Project design work is currently being completed and the project is expected to go to the AsDB board for approval in 2017.
- **Electricity Supply Security and Sustainability Project:** A\$10.6 million grant-finance project, co-financed by the European Union and Australia, was approved in 2014 and is providing the Nauru Utilities Corporation (NUC) with two new fuel efficient generators and assisting to construct a new roof for the powerhouse. Following a first phase of institutional strengthening TA which corporatized the NUC, a second phase of TA for institutional strengthening and tariff reform is also under implementation.
- **Fiscal Sustainability Reform Program:** A\$3.9 million policy-based grant program, co-financed by the Australian Government, provided budget support to the government during 2016 and supported public finance reforms including, together with AsDB technical assistance, the establishment of the new Nauru trust fund.

- Financial Inclusion: A\$350,000 technical assistance project was approved in 2016 and will provide support to strengthen financial literacy and help bring new financial services to Nauru.
- Regional programs: AsDB provides a variety of support through its regional programs, which currently includes supporting the review and update of the National Development Strategy, preparing a new infrastructure strategy, and supporting public finance reform and SOE reform.

Future directions

The Port Development Project, which is expected to be submitted for board approval in 2017, will be the key focus of the AsDB country program going forward. A sub-regional undersea fiber optic cable project, which Nauru is pursuing in cooperation with the World Bank and the governments of the Federated States of Micronesia and Kiribati, is also planned for 2017 and will bring cheaper, faster, and more reliable internet to Nauru.

AsDB plans to continue to support fiscal sustainability with a policy-based grant program planned for 2018. AsDB is also preparing, and seeking co-financing for, a Solar Power Development Program planned for 2018. Finally, an urban development program is planned for 2019, contingent on mobilizing sufficient co-financing.

PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTRE (PFTAC) COUNTRY STRATEGY 2016–17

As of January 31, 2017

Nauru has been benefitting from the Pacific Financial Technical Assistance Centre's (PFTAC) technical assistance (TA) in recent years. In phase IV (FY2012–16) there were 24 missions, with the largest concentration in the public financial management (PFM) sector. Methodologies for producing more comprehensive and timely national income and balance of payments statistics were also developed.

Strategy 2017–19

PFTAC's TA strategy is guided by the APD regional strategy note and is planned within the results framework for the current PFTAC (Phase V) FY2017–22 funding cycle.

Public Financial Management

PFTAC has provided TA that included missions on: improving the budgeting process, asset management, accounting, valuation, and reporting; revising the financial instructions; and facilitating the 2016 PEFA self-assessment. PFTAC was also requested to assist Nauru in developing its PFM roadmap and adopting international public sector accounting standards in financial reporting.

Tax Administration

Technical assistance provided by PFTAC has assisted with the introduction of a Revenue Administration Act and an Employment and Services Tax Act, both of which became effective from October 1, 2014. Further legal TA, by way of PFTAC funding, facilitated the introduction of a Business Tax Act (BTA) effective from July 1, 2016. The new BTA imposes a business profits tax, small business tax, non-residents tax, and an international transportation business tax.

Financial Supervision

No technical assistance was provided to Nauru for the last 3 years.

Economic Statistics

During June–September 2016, PFTAC twice assisted the Nauru Bureau of Statistics in its compilation of GDP estimates. There was a more comprehensive collection of annual source data for FY2014–15 and compilation of draft GDP by production estimates. Various aspects of methodology were also reviewed and improved. In September 2016, there was also a more comprehensive collection of annual source data for FY2014–15 and compilation of draft BOP estimates.

Macroeconomics

No technical assistance was provided to Nauru for the last 3 years.

STATISTICAL ISSUES

Nauru: Table of Common Indicators Required for Surveillance	
As of January 31, 2017	
I. Assessment of Data Adequacy for Surveillance	
<p>General: Data provision has serious shortcomings that significantly hamper surveillance. Nauru became an IMF member in April 2016, and during the membership preparation in 2014-15, the authorities compiled data with the support of Pacific Financial Technical Assistance Centre technical assistance (PFTAC TA). Most macroeconomic data remain unpublished even though they are provided to staff. Despite additional recruitment, the capacity of the National Bureau of Statistics (NBS) is limited, and Nauru has continued to rely on technical assistance and donor support in compiling data.</p>	
<p>National accounts: Annual GDP estimates have improved with the support of PFTAC TA during 2014-15 as part of the IMF membership preparation. The latest TA mission in September 2016 updated the GDP estimates, including by revising the deflators to reflect the fluctuation in phosphate prices, and produced new estimates of the resident population by incorporating refugees, asylum seekers, and expatriates living in Nauru. The TA report indicated some weaknesses, including the absence of activity surveys, sporadic or incomplete data collection, and limited data-sharing among agencies.</p>	
<p>Price statistics: The quarterly retail price index (2010=100) is produced with 3-month lag and derived based on a survey. There are no producer, wholesale, or trade price indices.</p>	
<p>Government finance statistics (GFS): Fiscal data are compiled monthly from the Financial Management Information System but they are not presented based on the standard GFS format. The authorities have indicated that improving GFS is their top priority as a new IMF member in order to meet the IMF standards. A GFS TA mission is scheduled for early 2017.</p>	
<p>Monetary and financial statistics: There are no monetary and financial data statistics available since the financial sector is still in early stage of development. Nauru uses the Australian dollar as legal tender and does not have a central bank. There was no bank in Nauru over the past decade until Bendigo Bank agency opened in Nauru in June 2015. The agency provides financial services (mainly deposits, but no loans and no foreign exchange transactions) on behalf of Bendigo and Adelaide Bank Limited of Australia.</p>	
<p>External sector statistics (ESS): The annual balance of payments and international investment position statistics were compiled for the first time in 2014 with the support of PFTAC as part of the IMF membership preparation. The latest TA in September 2016 updated some estimates, and found that the lack of actual data has continued to hamper data compilation and contribute to errors and omissions.</p>	
II. Data Standards and Quality	
At present, Nauru does not participate in any of the IMF's Data Standards Initiatives.	No data ROSC are available.
III. Reporting to STA	
Nauru does not report data to STA for publication in <i>International Financial Statistics</i> or other data publications.	

Nauru: Table of Common Indicators Required for Surveillance
(As of January 31, 2017)

	Date of Latest Observation	Date Received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange rates ¹	01/30/2017	01/31/2017	D	NA	NA
International reserve assets and reserve liabilities of the monetary authorities ²	12/2016	01/2017	M	Q	NA
Reserve/base money ³	NA	NA	NA	NA	NA
Broad money ³	NA	NA	NA	NA	NA
Central bank balance sheet ³	NA	NA	NA	NA	NA
Consolidated balance sheet of the banking system	NA	NA	NA	NA	NA
Interest rates	NA	NA	NA	NA	NA
Consumer price index	09/2016	01/2017	Q	Q	Q
Revenue, expenditure, balance and composition of financing ⁴ —general government ⁵	NA	NA	NA	NA	NA
Revenue, expenditure, balance and composition of financing ⁴ —central government	11/2016	01/2017	M	Q	NA
Stocks of central government and central government-guaranteed debt ⁵	FY2015	01/2017	A	A	NA
External current account balance	FY2015	10/2016	A	A	NA
Exports and imports of goods and services	FY2015	10/2016	A	A	NA
GDP/GNP	FY2015	10/2016	A	A	NA
Gross external debt	FY2016	10/2016	A	A	NA
International investment position ⁶	FY2015	10/2016	A	A	NA

¹ Nauru uses the Australian dollar as its legal tender.

² Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) state and local governments.

⁵ Including currency and maturity composition.

⁶ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁷ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

**Statement by Heenam Choi, Executive Director of Nauru, and Gemma Preston,
Advisor to the Executive Director of Nauru
March 24, 2017**

As the Fund's newest member, our Nauruan authorities thank the IMF Mission team for the constructive dialogue, engaging policy discussions and comprehensive assessment of the challenges facing the Nauruan economy, in the first IMF Article IV consultation for Nauru. Authorities broadly agree with the staff's assessment of policy challenges and welcome suggested policy actions to ensure fiscal sustainability, enhance resilience to climate change and promote inclusive growth. We would like to convey our Nauruan authorities' appreciation to the Fund for policy advice and ongoing support. The authorities look forward to continued close engagement with the IMF.

Context:

With a population of around 12,500, Nauru is the world's smallest island nation and one of the most isolated countries in the world. Located in the Pacific Ocean, 42 kilometers south of the equator, Nauru is a significant distance from international markets. A coral reef surrounds the entire island, which is dotted with pinnacles. A rich deposit of phosphate was discovered in the early 1900s and phosphate mining has been a significant source of economic wealth over previous decades, but the economic life of phosphate mining is reaching its final stages. With support from development partners, authorities have established a new Nauru Trust Fund, aimed at supporting fiscal sustainability by saving windfall income and investing it in a trust that will generate revenue to support future generations.

The coral reef and significant volatility in sea levels make construction and repair of a seaport difficult. The seaport in Nauru is relied upon as a key gateway to facilitate access to international markets for exports of phosphate and to service demand for imported goods – critical, given the coastal soils make it difficult to produce food for domestic consumption. Problems with the seaport have impacted economic growth in recent years, lowering the volume of phosphate exports and causing supply shortages, which has added to higher inflation. A climate proof seaport remains critical to future development and sustainability in Nauru. Authorities are hopeful that they will be able to secure the financing needed from donors and development partners to begin construction.

Nauruan authorities are actively searching for other avenues to diversify their economy and support future incomes and growth, noting staff's assessment that options are limited. With phosphate resources diminishing, and the scaling back of the Regional Processing Centre (RPC), future incomes to a large extent depend on the fortunes of the fishing industry and the long term success of the Nauru Trust Fund. Authorities have also been actively seeking to increase tourism to Nauru, working with Air Nauru to provide flights that link Nauru with the South Pacific.

Despite these challenges, the authorities are committed to a strong development and sustainability agenda for Nauru. Building on recent reforms, including in implementing a taxation system, the Government has committed to ongoing reforms to ensure fiscal sustainability and promote growth. Capacity constraints are considerable and continued progress on reforms requires ongoing support and technical assistance from donors and partners. The Government is committed to taking a prudent approach to economic management, as evidenced by their recent membership of the IMF and World Bank Group.

Economic Outlook:

Authorities welcome staff's positive assessment of Nauru's economic performance over the past few years. Real GDP grew at 20 percent annually on average during FY2011-14 and at around 10 per cent in FY 2016.

Looking ahead, authorities agree that the underlying drivers of economic growth are declining and risks are generally to the downside. Given the uncertainty over the timing and magnitude of the RPC scale down, authorities are considering policy options to assist with the adjustment. Authorities agree with staff recommendations to build additional fiscal buffers. They recognize the impact on growth and revenue and understand they will need to reduce spending as revenues decline given they have no ability to borrow from external markets and limited cash reserves. Authorities are continuing discussions with Australia about the nature of transitional support that could be provided as RPC operations are scaled down.

Fiscal Policy:

The authorities welcome the IMF's analysis of the fiscal position and will carefully consider its advice to ensure liquidity and sustainability. Reflecting on history, the current Government has underscored the importance of fiscal sustainability for Nauru over the medium term. Authorities agree that it is important to maintain adequate cash buffers and continue to make sufficient contributions to the Trust Fund. On debt management, authorities will take steps towards ensuring future debt sustainability by reconciling and resolving legacy debts.

Authorities recognize the importance of saving more in FY 2017 while revenues from the RPC remain high. They agree with staff that expenditure restraint and prioritization is an important element of fiscal sustainability. Recently established fiscal responsibility targets will help guide decision making and monitor progress towards fiscal goals. Authorities note staff's suggestion that expenditure should be prioritized towards supporting health and education programs, while reducing spending on ad-hoc subsidies, travel, miscellaneous and special projects.

Authorities have recently made good progress in implementing a new tax system and are committed to the public financial management reforms outlined in their 2016 Public Expenditure and Financial Accountability assessment. The Nauru Revenue Office, Tax Division was re-established in 2014 and tax compliance and enforcement has increased. Several new taxes have been introduced to broaden the tax base including an employment and services tax and a business tax. Authorities recognize that to ensure long term sustainability of the tax system they will need to lower the personal tax-free threshold but consider this will take time

and require community consultation and education. Authorities continue to focus on public financial management reform and recently implemented a new financial management information system to record financial transactions.

Transparency is improving with both the 2013-14 and 2014-15 government financial statements recently being submitted for audit and publication. Nauru has reactivated its membership of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes and has committed to meeting the requirements of the Automatic Exchange of Information (AEOI) by September 2018. The Multilateral Agreement has been signed and ratified and Nauru currently is undertaking a 'Fast Track Phase 2' review to avoid a G20 black listing in July 2017.

Structural Reforms:

The authorities remain committed to their reform efforts and welcome staff's acknowledgement of the progress made in recent years, much of which has been made possible by the technical assistance provided by donors. Reforms to State Owned Enterprises (SOEs) have already had a noticeable effect. For example, the number, frequency and duration of power shortages on the island has declined due to increased operational efficiencies and targeted investments. In line with recommendations from ADB technical assistance, authorities will continue to pursue SOE reform priorities to ensure all SOEs can transition towards operating on a commercial basis and reduce fiscal risks and burdens. Financial sector reforms such as the establishment an agency of the Bendigo Bank in Nauru, have partially restored access to financial services. However, authorities remain concerned about financial inclusion and note that it is challenging for residents to transfer money outside of Australia given Nauru's legacy black listing. This is impacting private sector development, trade and Nauru's ability to attract foreign skilled workers. Authorities are alive to the challenges associated with education and health outcomes for citizens in Nauru and developing policies to improve outcomes in these areas remains a top priority.

Authorities are at the forefront of challenges associated with Climate Change. Financing and investment are needed to ensure that Nauru can review and implement climate strategies to ensure Nauru's sustainable development. The challenges associated with climate change can be overwhelming for a country as small and isolated as Nauru. Authorities thank staff for their practical approach in recommending actions that are achievable and readily implemented. Authorities agree that matching pipeline donor projects to Nauru's climate strategy would be a useful first step and would help identify priority areas for future investment and financing gaps. Authorities have re-established the National Development Planning Committee to advise Cabinet on climate priorities.

The Nauruan authorities thank staff for the policy advice and recommendations and look forward to continued engagement with the IMF.