



KIRIBATI

January 24, 2019

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR KIRIBATI

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 2018 Article IV consultation with Kiribati, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 11, 2019, following discussions that ended on October 31, 2018, with the officials of Kiribati on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 19, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA).
- A **Statement by the Executive Director** for Kiribati.

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IMF Executive Board Concludes 2018 Article IV Consultation with Kiribati

On January 11, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Kiribati.

Kiribati is one of the most remote countries in the world, which creates significant economic challenges. The population of about 112,000 lives on 21 islands, spread over an ocean area of 3.5 million square kilometers. This geography raises the cost of public service delivery, leading to an infrastructure gap. It limits opportunities for private sector development and diversification. Weaknesses in governance, business regulations, and access to credit exacerbate the geographical challenges. Long-run prospects are clouded by climate change.

Economic performance has been strong, both relative to Kiribati's history and to its peers. The economy grew at an average annual pace of 5¼ percent in 2015–17, compared to 1½ percent in 2000–14. The stronger growth reflects in large part higher public spending financed by record-high fishing revenue, and donor-financed infrastructure investment. Inflation remained subdued, in line with low inflation in trading partners and international food prices but also reflecting one-off domestic factors. Credit to the private sector is estimated to have remained broadly stable.

The near-term outlook is expected to feature some moderation of recent trends. The economy is estimated to grow at a slower pace of 2¼ percent in 2018, as fishing volumes normalize. Inflation is expected to remain around 2 percent this year and increase in the medium term to 2½ percent—a pace consistent with major trading partners. The current account surplus is projected to narrow, as fishing license fees decline and imports related to development spending remain high.

Risks to the outlook are skewed to the downside. The favorable weather conditions underpinning strong fishing catches have lasted unusually long. A cyclical reversal could threaten revenues, with implications for the fiscal balance and the current account. Tighter global financial conditions could adversely affect the economy through the exposure of the RERF. Given Kiribati's high reliance on imported goods, commodity price shocks and exchange rate volatility could have an outsized impact on imports, inflation, and growth.

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

In concluding the 2018 Article IV consultation with Kiribati, Executive Directors welcomed Kiribati's strong economic performance, including an improved fiscal position. However, Directors noted that Kiribati faces significant challenges stemming from its geographical remoteness, vulnerability to climate change, and a narrow production and export base. Directors encouraged the authorities to maintain strong policies and leverage the recent gains to ensure inclusive and sustainable growth.

Directors underscored that reinforcing the fiscal framework is a key priority. They encouraged the authorities to focus on the controllable portion of the budget as a useful tool to promote expenditure stability, given the volatile fishing revenue. Directors also encouraged the authorities to adopt a rules-based, transparent mechanism that reflects social preferences and adjusts to structural changes to govern withdrawals from the Revenue Equalization Reserve Fund. They underscored the importance of limiting the increase in the public wage bill and copra subsidies as well as avoiding a supplementary budget and instead evaluating projects in a comprehensive medium-term framework.

Directors recognized the authorities' efforts to improve Kiribati's resilience to climate change. They highlighted that having an explicit provision for climate change adaptation in the budget would help mobilize resources more effectively, including from donors.

Directors emphasized that facilitating the development of a dynamic private sector is important for economic growth. They encouraged continued efforts to reform the state-owned enterprises. Directors also recommended further improvement in connectivity through infrastructure investment, enhancement of human capital with training opportunities and employment opportunities through diversification of the economy. Facilitation of private sector access to credit by improving land registration and dispute resolution while strengthening supervision and risk management in public financial institutions is also critical. Directors considered that technical assistance from the Fund and other donors will be important in implementing the reforms as well as in enhancing the compilation of the needed data and statistics, taking into account capacity constraints.

Directors emphasized that addressing governance deficiencies would help improve efficiency, reduce vulnerabilities to corruption, and catalyze donor support. They underscored that public investment projects should be prioritized based on socio-economic returns and encouraged implementation of public investment management assessment recommendations. Directors also highlighted the importance of transparency on fisheries management and of improved business regulations.

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. Kiribati: Selected Economic Indicators, 2013–19

	2013	2014	2015	2016	2017	2018	2019
					Est.	Proj.	
Real GDP (percent change)	4.2	-0.7	10.4	5.1	0.3	2.3	2.3
Real GNI (percent change)	14	14	19	-7.8	6.0	-0.5	-3.8
Consumer prices (percent change, average)	-1.5	2.1	0.6	1.9	0.4	2.1	2.3
Central government finance (percent of GDP)							
Revenue and grants	104	158	151	118	131	123	114
Total domestic revenue	64	89	109	84	92	91	72
<i>Of which: fishing revenue</i>	47	72	91	66	72	70	51
External Grants	39	69	42	34	38	32	42
Expenditures	91	113	102	115	119	143	137
Current	55	60	60	69	88	88	76
Development	36	53	42	46	31	55	61
Domestic recurrent balance 1/	-38	-43	-41	-51	-68	-66	-55
Recurrent fiscal balance (incl. budget grants)	12	34	52	19	12	9	1
Overall balance 2/	13	45	49	3	12	-20	-23
Financing	-13	-45	-49	-3	-12	20	23
<i>Of which: Revenue Equalization Reserve</i>	-4	-9	0	0	0	0	0
RERF							
Closing balance (in millions of A\$)	661	679	756	868	934	994	1030
Per capita value (in 2006 A\$)	5,118	5,062	5,482	6,132	6,382	6,533	6,496
Cash reserve buffer 3/							
Closing balance (in millions of A\$)	...	...	133	145	188	234	180
In excess of 3-months of current spending	...	...	99	103	134	178	130
Balance of payments							
Current account including official transfers	36	96	79	36	26	25	16
(In percent of GDP)	19	53	46	20	14	13	8
External debt (in millions of US\$)	14	14	33	42	43	42	47
(In percent of GDP)	8	9	20	24	23	22	23
External debt service (millions of US\$)	3	8	1	1	1	1	2
(In percent of exports of goods and services)	12	37	4	4	6	3	7
Exchange rate (A\$/US\$ period average)	1.0	1.1	1.3	1.3	1.3	...	...
Real effective exchange rate (period average)	105	100	93	93	96	...	...
Memorandum item:							
Nominal GDP (millions of A\$)	192	199	228	240	242	253	264
Nominal GDP (millions of US\$)	186	180	178	186	193	200	210

Sources: Data provided by the Kiribati authorities; and Fund staff estimated and projections.

1/ Domestic recurrent balance excludes fishing revenue, grants, and capital expenditure.

2/ Overall balance in the table is different from official budget because loans are classified as financing.

3/ Cash reserve buffer includes the government's custodial and cash account.



KIRIBATI

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

December 19, 2018

KEY ISSUES

Context. Growth has been strong in recent years and some moderation is expected, with risks skewed to the downside. High fishing revenues improved the fiscal position, but generated pressure to increase spending. There has been progress on fiscal and structural reforms. Yet, public spending needs are large, driven by an infrastructure gap and climate adaptation costs, and the country remains at high risk of debt distress.

Key policy recommendations. Kiribati should leverage its recent gains to ensure inclusive, sustainable growth in the long run. This requires further progress in reforms, as well as securing support from development partners.

- **Reinforcing the fiscal framework.** Focusing on the controllable portion of the budget by abstracting from volatile, exogenous components (fishing revenue and grants, plus their associated capital spending) would promote expenditure stability and medium-term planning. A rules-based, transparent mechanism that reflects social preferences and adjusts to structural changes should govern withdrawals from the sovereign wealth fund. There should be an explicit provision for climate change adaptation in the medium-term budget.
- **Creating an environment for a dynamic private sector.** Strengthening the commercial mandate of SOEs and divesting and outsourcing their activities should continue. Infrastructure investment should further improve connectivity. Human capital should be enhanced with training opportunities and employment possibilities through diversification of the economy into infrastructure maintenance, renewable energy, and tourism. Access to credit should be facilitated by improving land registration and dispute resolution, while strengthening supervision and risk management in public financial institutions.
- **Enhancing governance.** Addressing governance deficiencies would help improve efficiency, reduce vulnerabilities to corruption, and catalyze donor support. Public investment should be prioritized based on expected economic and social returns. Implementation of the PIMA recommendations should be a prerequisite for approving a surge in public investment projects. Transparency on fisheries management needs to be improved. Regulatory practices and trade facilitation efforts should be streamlined, and the rulemaking process should be made more transparent and consultative.

Approved By
James Daniel (APD)
and Kevin Fletcher
(SPR)

Discussions were held in South Tarawa during October 22–31, 2018. The staff team included Deniz Igan (head, RES), Luigi Briamonte (SEC), and Mareta Kaiteie (APD). Anna Park (OED) also joined the mission. Tijds de Bie (MCM short-term expert) and staff from the World Bank participated in many of the discussions. Antoinette Kanyabutembo, Chau Nguyen, and Simon Paroutzoglou (all APD) assisted in preparing this report.

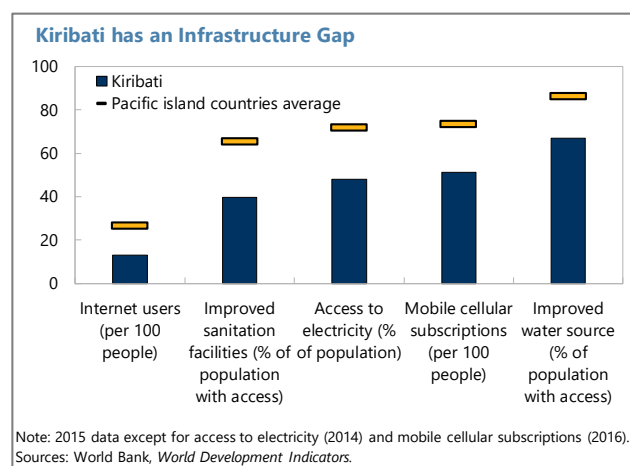
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CONTEXT

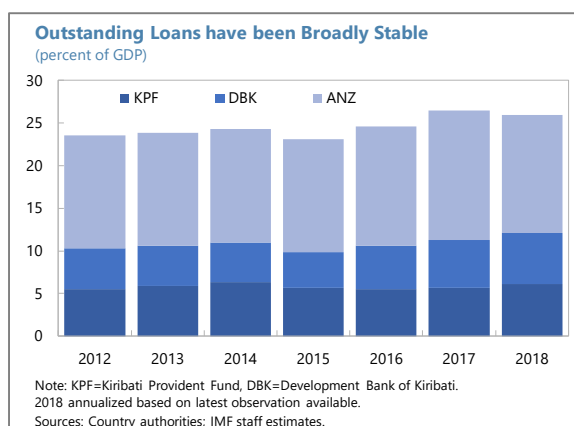
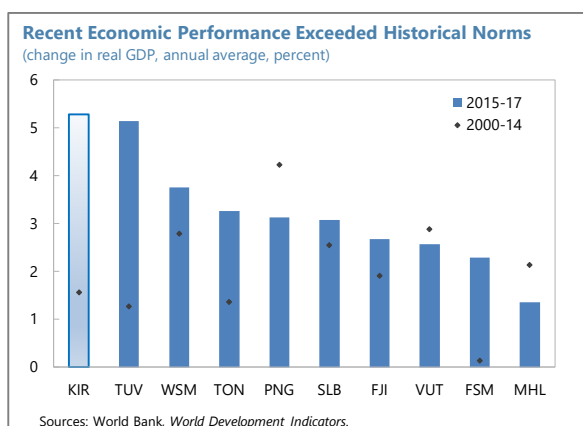
1. Kiribati is one of the most remote countries in the world, which creates significant economic challenges. The population of about 112,000 lives on 21 islands, spread over an ocean area of 3.5 million square kilometers. This geography raises the cost of public service delivery, leading to an infrastructure gap. It limits opportunities for private sector development and diversification—economic activity primarily consists of fisheries and copra. Weaknesses in governance, business regulations, and access to credit exacerbate the geographical challenges.

2. Long-run prospects are clouded by climate change. Kiribati's low-lying atolls are vulnerable to rising sea levels. Storm surge, coastal erosion, and saltwater intrusion further jeopardize the country's limited resources. Higher ocean surface temperatures will potentially disrupt Kiribati's largest economic resource—the tuna fishery—through the impact on migration and spawning patterns.



RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

3. Economic performance has been strong, both relative to Kiribati's history and to its peers. The economy grew at an average annual pace of 5¼ percent in 2015–17, compared to 1½ percent in 2000–14.¹ The stronger growth reflects in large part higher public spending financed by record-high fishing revenue and donor-financed infrastructure investment. Inflation remained subdued, in line with low inflation in trading partners and international food prices but also reflecting



¹ Given the volatility of growth, the discussion focuses on averages over several years to capture broader trends.

one-off domestic factors.² Credit to the private sector is estimated to have remained broadly stable. Lack of regularly-reported, system-wide data greatly hinders financial sector analysis.

4. Strong fishing revenue improved the fiscal position, but also generated political pressure to increase public spending. For the fifth year in a row, the recurrent balance registered a surplus in 2017, reaching 12 percent of GDP.³ The recurrent surplus could have been larger but for the offset to the fishing revenue windfall (26 percent of GDP) from current spending overruns (12 percent of GDP was appropriated for the outer islands development program while copra subsidies exceeded projections by 2 percent of GDP). The balance of the sovereign wealth fund (Revenue Equalization Reserve Fund, "RERF") was 386 percent of GDP at end-2017, cash reserves reached 77 percent, and public debt stood at 23 percent. The government's net financial worth—calculated as the balances of the RERF and cash reserves minus public debt—rose to 440 percent of GDP.

5. The fishing revenue windfall prompted a reassessment of the cash management strategy. The government has committed to no drawdowns from the RERF at least until a target balance of A\$1 billion (about 400 percent of GDP) is reached—the balance stood at A\$994 million as of November 2018. Furthermore, cash reserves now are more than four times staff's recommended buffer (three months of recurrent spending), and about half are in a non-interest-bearing account with the local branch of ANZ. The authorities have recently approved a program to transfer a component of these cash holdings to an interest-bearing account with State Street.

6. External balances have been stable. The current account surplus is estimated at 14 percent of GDP in 2017. The real effective exchange rate (REER) has tracked the weakening of the Australian dollar against the US dollar since early 2018 but remains within historical norms. Staff assesses the underlying external position in 2017 to be broadly in line with the level implied by medium-term fundamentals and desirable policies (Annex I). Given the idiosyncratic features of the Kiribati economy and data quality, the uncertainty around this assessment is substantial.

7. The near-term outlook is expected to feature some moderation of recent trends. Growth is estimated to grow at a slower pace of 2¼ percent in 2018, as fishing volumes normalize. Inflation is expected to remain around 2 percent this year and increase in the medium term to 2½ percent—a pace consistent with major trading partners. The current account surplus is projected to narrow, as fishing license fees decline, and imports related to development spending remain high.

8. The fiscal position is expected to worsen under current policies.

- The 2018 budget envisaged a modest recurrent surplus, notwithstanding a sharp increase in the public wage bill (amounting to 6 percent of GDP) offset by a reduction in other recurrent expenditures. However, fishing revenue exceeded projections again—this time by 16 percent of GDP—and additional spending amounting to 9 percent of GDP has been authorized under

² The very low inflation reading in 2017 (0.4 percent annual average) is in large part attributable to a reduction in electricity tariffs, as the Public Utilities Board (PUB)—a reformed SOE—passed on efficiency gains to customers.

³ The overall balance also recorded a surplus of 12 percent, as large capital expenditures were offset by external grants.

supplementary budgets. Three-fourths of the additional spending is to cover the initial upfront cost of and down payment for aircraft acquisition as part of Air Kiribati Limited (AKL)'s plans for establishing independent international transportation services (Box 1). With these layouts incorporated in the baseline, the overall balance would register a deficit of 20 percent in 2018 and 23 percent in 2019.

- In the medium run, both recurrent and capital expenditures are projected to decline from their 2016–18 peaks but remain high by historical standards at 69 percent and 38 percent of GDP, respectively. With conservative assumptions on fishing revenues and grant rollover, the overall deficit is projected to be around 11 percent of GDP by 2025, causing net financial worth to decline from its 2018 peak. Staff's DSA indicates that Kiribati remains at high risk of debt distress. While the large size of the RERF relative to external debt limits immediate risks, the RERF could be significantly depleted over the longer run in downside scenarios to fishing revenue (see Box 2 in 2017 Article IV Staff Report). The RERF would also be subject to withdrawals if current spending policies are maintained and reliance on grants is eventually reduced (as staff's baseline conservatively assumes).

Improvement in the Fiscal Position Unlikely to last Under Current Spending Plans								
(percent of GDP unless otherwise noted)	2015	2016	2017	2018	2019	2020	2025	2030
Recurrent fiscal balance 1/	52	19	12	9	1	2	-3	-8
Overall balance 2/	49	3	12	-20	-23	-21	-11	-15
Domestic recurrent balance 3/	-41	-51	-68	-66	-55	-51	-49	-49
Net financial worth 4/	370	399	440	464	434	406	349	291
RERF balance	332	362	386	393	390	384	371	357
Cash reserves 5/	58	60	77	93	68	50	33	5
Public debt	20	24	23	22	23	28	55	72
Net financial worth excl. RERF	38	37	54	71	45	22	-22	-66
RERF real per capita value (2006 A\$)	5482	6132	6382	6533	6496	6438	6293	6218
1/ Revenue plus budget grants minus current expenditure.								
2/ Revenue and grants minus total expenditure.								
3/ Revenue excluding grants and fishing revenue minus current expenditure.								
4/ Balances of RERF, custodial, and cash accounts minus public debt.								
5/ Custodial and cash accounts.								

9. Risks to the outlook are substantial and skewed to the downside (Annex II). The favorable weather conditions underpinning strong fishing catches have lasted unusually long. A cyclical reversal could threaten revenues, with implications for the fiscal balance and the current account. Tighter global financial conditions could adversely affect the economy through the exposure of the RERF. Given Kiribati's high reliance on imported goods, commodity price shocks and exchange rate volatility could have an outsized impact on imports, inflation, and growth.

Authorities' Views

10. The authorities broadly shared staff's assessment of the economic outlook. They agreed that a growth moderation is to be expected and that the volatility of fishing revenue poses a significant risk. Any fluctuations in fishing revenue—either negative or positive—would have a significant impact on the fiscal position and the current account. Regarding external risks, they noted that they anticipate the RERF balance to reduce somewhat in reflection of the global equity market correction in late 2018. They also noted that, despite strong growth in recent years, large gaps in meeting basic needs remain.

POLICY DISCUSSIONS

11. Kiribati should leverage its recent gains to ensure inclusive, sustainable growth in the long run. The government has an ambitious 20-year development agenda—the Kiribati Vision 20 (KV20)—initiated in 2016. Public spending needs—driven primarily by the infrastructure gap and climate adaptation costs—are large.

Implementing KV20 and meeting these needs requires further progress in fiscal and structural reforms, as well as securing support from development partners.

12. Priority should be given to three action areas: reinforcing the fiscal framework, creating an environment for a dynamic private sector, and enhancing governance.

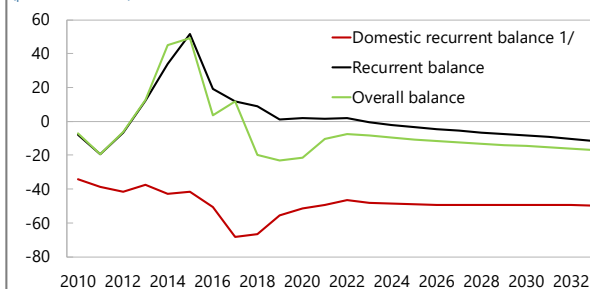
A. Reinforcing the Fiscal Framework

13. The authorities' commitment to fiscal discipline should be reinforced by using the domestic recurrent balance as an operational target.

- Focusing on the controllable portion of the budget by abstracting from volatile, exogenous components (fishing revenue and grants, plus their associated capital spending) would promote expenditure stability and medium-term planning. Indeed, the deterioration in 2016 and 2017 in this measure of the fiscal stance underscores the potentially unsustainable increase in subsidies and wages.
- Instead, spending should be consistent with a “safe” level of net financial worth. Under an illustrative scenario where the government reduces the domestic recurrent deficit by ½ percent of GDP each year until 2028, the deficit would stabilize around 44 percent of GDP compared to 49 percent in the baseline.

Domestic Recurrent Balance Worsened in Recent Years and the Deficit Projected to Remain Wide in the Baseline

(percent of GDP)

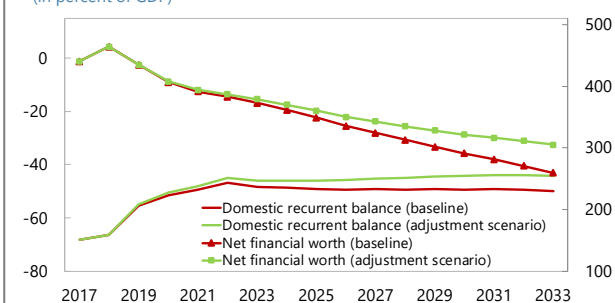


Sources: IMF staff estimates.

1/ Domestic recurrent balance is the overall balance minus fishing revenue and grants plus capital expenditures.

Modest Current-spending-based Consolidation would Maintain the Net Financial Worth at a Safer Level

(in percent of GDP)

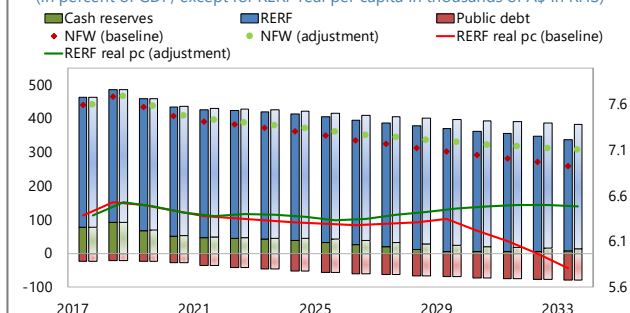


Note: Domestic recurrent balance on left-hand-side axis, net financial worth on the right-hand-side axis.

Sources: IMF staff calculations.

Savings in an Illustrative Adjustment Scenario could be used to Prop up the RERF

(in percent of GDP, except for RERF real per capita in thousands of A\$ in RHS)



Note: Lighter columns show values in the adjustment scenario. NFW: net financial worth = RERF + cash reserves - public debt. RERF real pc: RERF balance per capita in 2006 A\$. Sources: IMF staff calculations.

- Net financial worth would be maintained at 321 percent of GDP in 2030, providing an additional buffer over the 291 percent forecast in the baseline. That would be sufficient to roughly cover one year of climate change adaptation costs (estimated to gradually increase and reach 12 percent of GDP by 2040⁴) and a sharp decline in fishing revenue (21 percent of GDP, corresponding to one standard deviation in the 2012–17 period), while keeping the RERF balance as a percent of GDP constant.

14. Strengthening the fiscal framework would help contain spending pressures. In the event of a surge in fishing revenue, the authorities should avoid issuing a supplementary budget, with the windfall being allocated only after evaluating alternatives in a comprehensive framework and considering medium-term sustainability. The objective should be to keep the controllable portion of the budget unchanged and only adjust insofar as permanent wealth increases. Short-run revenue shortfalls could be met by transfers from the cash reserve buffer. Withdrawals from the RERF should be governed by a rules-based, transparent mechanism that reflects social preferences on intergenerational redistribution and adjusts to structural changes in returns on assets and potential growth (see Annex III in the 2017 Article IV Staff Report).

RERF Balances would Stabilize Under an Illustrative Adjustment Scenario 1/								
(percent of GDP unless otherwise noted)	2015	2016	2017	2018	2019	2020	2025	2030
Domestic recurrent balance 2/	-41	-51	-68	-66	-55	-51	-46	-44
Net financial worth 3/	370	399	440	464	435	408	360	321
RERF balance	332	362	386	393	389	383	373	373
Cash reserves 4/	58	60	77	93	69	53	43	20
Public debt	20	24	23	22	23	28	55	72
RERF real per capita value (2006 A\$)	5482	6132	6382	6533	6487	6415	6331	6484
1/ For illustrative purposes only. Assumes accumulation (in RERF and cash reserve accounts) of savings, which could instead be used to pay down debt.								
2/ Revenue excluding grants and fishing revenue minus current expenditure.								
3/ Balances of RERF, custodial, and cash accounts minus public debt.								
4/ Custodial and cash accounts.								

15. The fiscal framework should more fully consider the toll climate change will take on Kiribati's finances. The medium-term budget should include an explicit provision for climate change adaptation, up to 2 percent of GDP annually to cover the recurrent costs (including infrastructure damage repair). Longer-run plans should provide for further increase to reach 6 percent of GDP (the remaining half of annual costs (f113) is assumed to be financed by development partners⁵). To ensure fiscal room for climate change adaptation, it is crucial to limit increases in public wages and copra subsidies—including by replacing them with targeted social transfers where necessary. Financing from multilateral platforms, such as the Green Climate Fund and the Adaptation Fund, should be pursued actively. In this context, the establishment of the Climate Finance Division—whose mission is to coordinate climate-change-related expenditures funded through the budget or by donors—is a welcome step forward. Adequate staff resources should be allocated to this division.

16. The medium-term fiscal planning challenge is compounded by the reliance on highly volatile fishing revenue, underscoring the usefulness of the domestic recurrent balance as an operational target. The current practice has been to err on the conservative side and forecast

⁴ This estimate is based on [Climate Change and Disaster Management \(The World Bank, 2016\)](#).

⁵ The DSA makes the same assumption.

fishing revenue to remain constant in nominal terms roughly at its 2014 level.⁶ The authorities should explore ways to improve fishing revenue projections, including through PFTAC-assisted information sharing with other countries in the region.

17. The cash management strategy should be formalized and better coordinated with the investment strategy. Foregone interest on large cash reserves does not fit well with prudent public financial management (PFM) objectives. A lower level of cash reserves in the non-interest-bearing account would maximize returns to public assets while still ensuring healthy functioning of the banking system. For the former, the government could take the governance mechanism for the RERF as a guide and establish a cash management committee that sets clear benchmarks in coordination with the investment unit at the Ministry of Finance. For the latter, the authorities should monitor and take all risk factors (credit, liquidity, and market) into account when assessing the financial stability implications of their cash management strategy—which requires capacity development.

Authorities' Views

18. There was broad agreement on the need to maintain a prudent fiscal position. The strategy laid out for the 2019 budget aims to ensure that top priorities are met in a sustainable way. The strategy makes three pledges: balanced budget, no withdrawal from the RERF, and no new debt. These pledges, taken together with conservative projections on fishing license fees, imply that expenditures would need to be kept within the country's means. While the authorities noted that the domestic recurrent balance could serve as a useful analytical tool, they saw a balanced overall budget target as easier to communicate. They recognized that it is desirable to limit the need for supplementary budgets and to commit to meeting shortfalls with cash reserve buffers without recourse to the RERF. To this end, the government is working on setting a new strategy for the RERF, likely featuring a commitment to preserve the real value of the fund and to limit withdrawals for projects that benefit both current and future generations.

B. Creating an Environment for a Dynamic Private Sector

19. A more dynamic private sector would help achieve the goal of inclusive prosperity. Specific policies to boost the private sector include:

- Further strengthening the commercial mandate of the SOEs and developing a medium-term plan for operationally and financially sustainable delivery of electricity, water, and sanitation services;
- Continuing divestment and outsourcing of SOE activities, to help improve efficiency and strengthen public finances;
- Further improvement in connectivity through infrastructure investment in air transportation and shipping services;

⁶ Specifically, in the authorities' budget projections, fishing license fees are assumed to be constant at the nominal level of A\$130 million and transshipment and other fishing revenues to hover around A\$6 million in the medium term. It is notable, however, that the KV20 targets higher levels (A\$227 million in 2019 and A\$427 million in 2023).

- Building human capital by enhancing training opportunities and creating employment possibilities through improved natural resource utilization and diversification of the economy;
- Facilitating private sector access to credit by improving land registration and dispute resolution, while strengthening financial supervision of public financial institutions.

20. The SOE reform momentum should continue. The reform started slowly but accelerated in 2017. The authorities made progress in consolidating and downsizing the copra-linked SOEs and completed the sale of the telecom SOE. An overall strategy for setting the SOEs on a more commercial and sustainable footing should be articulated. This should include recalibration of tariffs in water and sanitation services (also considering the environmental impact of water usage), while protecting the most vulnerable. Formal guidelines on dividends and retention of earnings for self-funding capital expenditures should be established. Efforts to improve the timeliness and quality of SOE financial reporting should continue, including those to transform the audited statements into a database and maintain that database for ongoing monitoring and analyses. Past staff advice to phase out SOE exemptions from the VAT should be implemented without further delay to level the playing field.

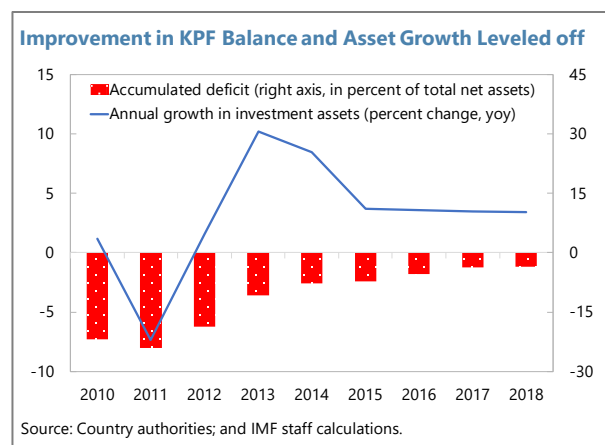
21. The outer islands development program should be better designed. The 2017 supplementary budget allocated 13 percent of GDP to develop the periphery's infrastructure without mention of specific projects. Some of the funds have been allocated to improvement of air transportation infrastructure, yet disbursement of funds has been delayed due to capacity constraints and logistical challenges. Also last year, the doubling of the copra subsidy further distorted incentives: virgin coconut oil (which Kiribati could export competitively without a subsidy) is now not as remunerative for households as copra. Current export prices and projected yields paint a picture where the distortion of incentives is leading to overharvesting and potentially threatening the sustainability of this important natural resource. The authorities should consider alternatives to the copra subsidy scheme in providing support to outer-island residents (for example, recalibrating other social transfer programs).

22. Opportunities for better utilizing natural resources and diversifying the economy should be explored actively. The conservation measures undertaken by Kiribati and its neighbors under the Parties to the Nauru Agreement (PNA) to promote sustainable fisheries have benefits but also carry costs. Further, there is a premium on information sharing and cooperation when it comes to combating illegal fishing that can hurt all countries in the region. An equitable regional distribution of the benefits and costs and compliance with international rules and regulations are needed to preserve the spirit of the PNA (Box 2). Transforming the economy to foster growth in the services sector (particularly in infrastructure maintenance, renewable energy, and tourism) could open up diversification opportunities and increase resilience (Box 3). Enhancing training opportunities, including through participation in overseas work schemes, would complement the employment possibilities generated through better natural resource utilization and diversification.

23. Financial deepening needs to be implemented in a sustainable way. Facilitating private sector access to credit would be best achieved by improving land access procedures and dispute resolution mechanisms (to enhance property rights and enable lending against collateral). Building

on the donor-funded investment in ICT infrastructure, mobile connectivity and mobile banking should be promoted more, as experience in the region has demonstrated their job-creation and financial-deepening benefits. Potential to develop credit unions, which tend to be better at understanding the information needed for lending to small borrowers, could also be explored. In line with the PFTAC recommendation, a comprehensive regulatory and supervisory framework that provides the necessary legal powers to authorize and supervise banks with a complete suite of prudential standards is needed.⁷ Against this background, improving financial sector statistics (for example, compiling a consolidated banking system balance sheet) is a priority. The authorities should strengthen the institutional capacity to report these statistics in a timely manner to enable effective surveillance and policy formulation.

24. Supervision of public financial institutions should be strengthened. The Development Bank of Kiribati (DBK) and the Kiribati Provident Fund (KPF—a national compulsory savings scheme) play an important role for access to finance. Steps should be taken to ensure that the DBK remains adequately capitalized, including a full assessment of its current capital buffers against the legacy nonperforming loans. Further, its risk monitoring and liquidity management ability should be improved. Progress has been made to enhance the long-run sustainability of the KPF by closing the accumulated deficit from 24 percent of total net assets to 4 percent. However, its investment strategy continues to feature relatively ambitious promised returns and active fund managers. A more prudent, passive strategy would not only reduce management costs but also mitigate the fiscal risk posed to the government. More generally, consideration should be given to explicitly task the investment unit at the Ministry of Finance to oversee the RERF, the KPF, and the cash reserves with a unified lens and to devise a comprehensive strategy to manage the country's public financial assets.



Authorities' Views

25. The authorities recognized many of the points raised by staff as areas where continued action is planned, but pointed out that capacity and political constraints sometimes slow progress. There is no specific timeline to phase out the VAT exemption for the SOEs, yet there is recognition that it is important to level the playing field. In certain areas, the cost of public service delivery is so high that it is not realistic to imagine that the SOE subsidies would be fully phased out. The copra subsidy has served an important objective to ensure that households in the outer islands are able to meet basic needs (and reduce incentives for migration to Tarawa, given overcrowding problems) and, more recently, share the wealth from fishing revenue. While there are many issues

⁷ The withdrawal of correspondent banking relationships has, so far, had less impact on Kiribati given its limited reliance on remittances compared to neighboring countries.

with the program (misaligned incentives, overharvesting, fraud), it is politically difficult to discuss alternatives. Financial sector development is important, and a regulatory and supervisory framework would help foster competition—a priority for the authorities. While they agreed that credit unions could play some role with household credit and small business loans, these institutions would not be able to fulfill the other, payment-related services that commercial banks can provide.

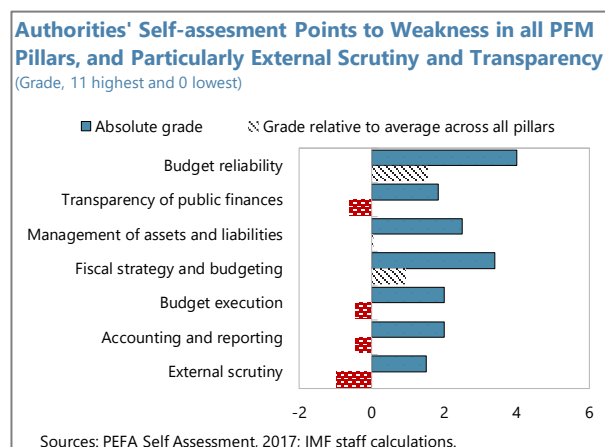
C. Enhancing Governance

26. Several initiatives have been launched recently as part of a national anticorruption strategy. Kiribati ratified the UN Convention against Corruption in 2013. A regional summit on anti-corruption is planned to be held in Kiribati in June 2019. Recent initiatives to prevent corruption focus on:

- Implementation of measures recommended by staff and the donors to strengthen PFM;
- Fostering the integrity and independence of institutions whose mandate is to promote good governance and eliminate corruption (including through development of an anti-corruption code of conduct and its integration with the Public Service Act);
- Strengthening strategic partnerships and institutionalizing anti-corruption and good governance principles in the public service and education systems (including through establishment of an anti-corruption committee with an oversight role to be executed in cooperation with the appropriate agencies and in engagement with civil society).

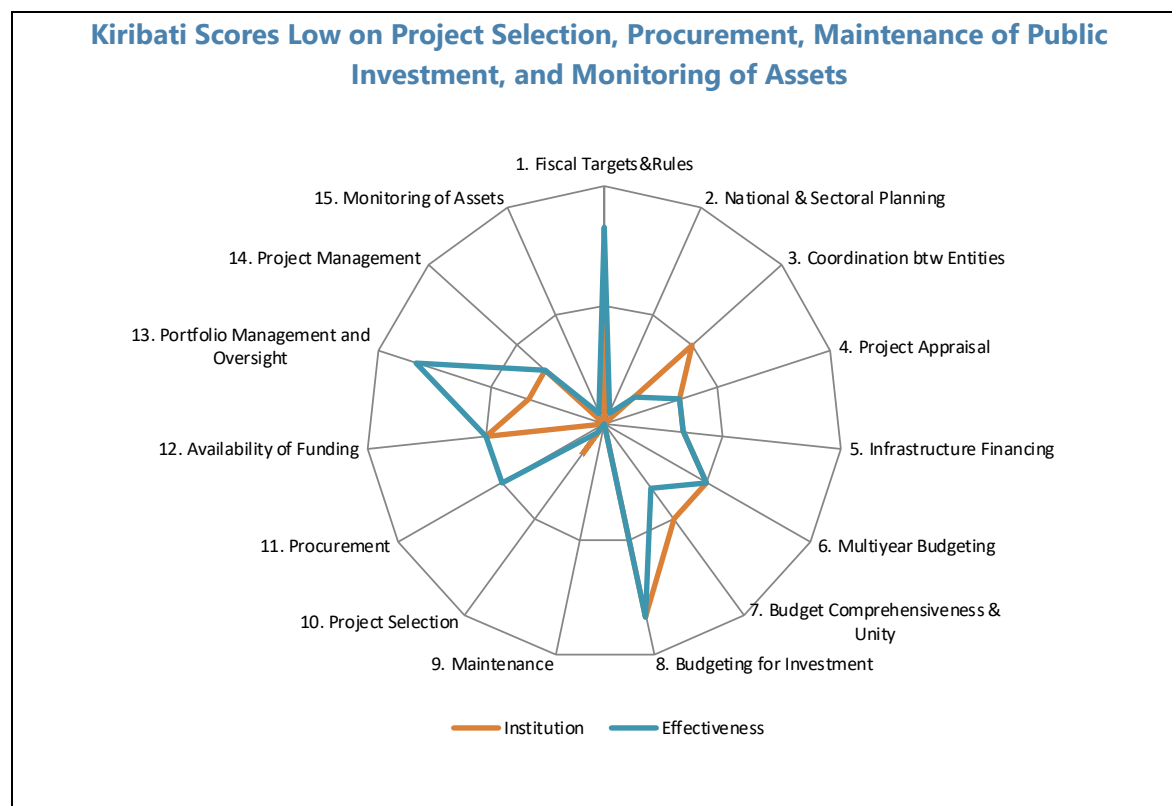
27. Addressing governance deficiencies in budget outcomes and institutions would help improve efficiency, reduce vulnerabilities to corruption, and catalyze donor support. Past

consultations, TA missions, and the authorities' self-assessment have consistently noted the main areas of weakness as spending and revenue outcomes, procurement, fiscal transparency, and PFM controls. Against the backdrop of an ambitious public investment agenda, it is crucial to strengthen the fiscal framework so that the most beneficial projects are selected, execution is not disrupted by misaligned incentives, fiscal sustainability is ensured, and the best financing terms are obtained.



28. A key policy challenge is to meet public investment needs in the absence of comprehensive identification of the upcoming infrastructure priorities and financing needs.

Public investment should be prioritized based on expected economic and social returns. Consideration should be given to making implementation of the PIMA recommendations—which focus on procurement, project selection, and maintenance—a prerequisite for approving a surge in



public investment projects. A case in point is the planned expansion of AKL operations, which could bring important benefits by improving connectivity but pose significant fiscal risks (Box 1).

29. Transparency on fisheries management needs to be improved. The authorities have published an annual report for the purpose of monitoring fishing license fees since 2014. Yet, the report lacks crucial information such as how many fishing days are allocated to Kiribati and how these days are sold to domestic and foreign vessels. The report would greatly benefit from including detailed information, both to facilitate information sharing with stakeholders that can use such information to improve the accuracy of their forecasts and to boost public trust in the sound management of the country's key economic resource.

30. Economic governance would also be enhanced by better business regulations. Regulatory practices associated with getting construction permits and registering property should be streamlined. Trade facilitation efforts should primarily focus on information availability (establishing a national customs website) and formalities (simplification and harmonization of documents as well as automation and streamlining of procedures). The regulatory rulemaking process should be made more transparent and consultative.

31. Filling in data and information gaps would allow for a more comprehensive assessment and help track progress. For example, survey-based fiscal transparency indicators are not available. More generally, data provision—while broadly adequate for surveillance—has shortcomings that impair policymaking. The authorities should strengthen the institutional capacity to report accurate and timely statistics.

Similar to Infrastructure and Credit Gaps, Regulations for Registration and Permits make doing Business Difficult

(Percentile of rank, higher is better)

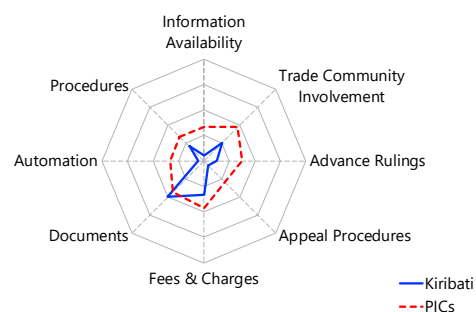


Note: There is uncertainty around point estimates.

Sources: World Bank, *Doing Business* (2018).

Lack of Information Availability and Complexity of Formalities Hinder Trade Facilitation

(Farthest from center = best performance that can be achieved)



Source: OECD Trade Facilitation Indicators.

Authorities' Views

32. The authorities agreed that improving the PFM framework and enhancing business regulations would help boost economic performance. They noted that the PIMA has not been disseminated widely or discussed internally yet, but acknowledged that staff's summary of the findings resonate with their self-assessment. A procurement unit has been established recently and the authorities are seeking TA to implement additional reforms in this area. They concurred that business regulations can be improved and transparency on fisheries is important. They appreciated the recognition that Kiribati takes anti-corruption efforts seriously. On data gaps, the authorities underlined that they are already stretched in their capacity to develop the main macroeconomic indicators and would appreciate assistance from international institutions and donors in compiling the needed statistics as well as better coordination across international agencies to reduce the burden on their limited resources from duplication of data requests.

STAFF APPRAISAL

33. Kiribati has made considerable economic progress in the last few years and the near-term outlook remains favorable. Growth has exceeded historical norms, thanks to higher public spending supported by record-high fishing revenues and donor-financed infrastructure investment. Fiscal and structural reforms, most notably in SOEs, have advanced. The government's net financial worth rose to four times the GDP.

34. Risks to the outlook are substantial and skewed to the downside. A cyclical reversal of favorable weather conditions could threaten fishing revenue, with implications for the fiscal balance and the current account. Tighter global financial conditions could adversely affect the economy through the exposure of the RERF. Commodity price shocks and exchange rate volatility could have an outsized impact on imports, inflation, and growth. Kiribati remains at high risk of debt distress, given volatile fishing revenue and considerable spending needs.

35. The country has a historic opportunity to leverage its recent gains to ensure inclusive growth in the long run. Implementing KV20 and meeting the significant public investment needs in a sustainable way requires further progress in fiscal and structural reforms, as well as securing support from development partners.

36. Policies should:

- Reinforce the fiscal framework to maintain buffers and to meet public spending needs in a sustainable way;
- Create an environment for a dynamic private sector, with continued reform momentum, well-selected infrastructure projects, human capital development, and prudent financial deepening;
- Enhance governance to improve outcomes, reduce vulnerabilities, and catalyze donor support.

37. The authorities' commitment to fiscal discipline could usefully be reinforced by:

- Focusing on the controllable portion of the budget to promote expenditure stability and medium-term planning;
- Limiting the increase in the public wage bill and in copra subsidies, and by replacing them with targeted social transfers where necessary;
- Avoiding a supplementary budget in the event of a surge in fishing revenue, and instead evaluating projects in a comprehensive medium-term framework and adjusting the controllable portion of the budget insofar as permanent wealth increases, while meeting any revenue shortfall by transfers from the cash reserve buffer;
- Adopting a rules-based, transparent mechanism to govern withdrawals from the RERF, that reflects social preferences on intergenerational redistribution and adjusts to structural changes in returns on assets and potential growth;
- Incorporating the toll climate change will take on Kiribati's finances through an explicit provision for climate change adaptation in the medium-term budget.

38. Specific policies to boost the private sector include:

- Further strengthening the commercial mandate of the SOEs and developing a medium-term plan for sustainable delivery of electricity, water, and sanitation services;
- Continuing divestment and outsourcing of SOE activities, to help improve efficiency and strengthen public finances;
- Further improvement in connectivity through infrastructure investment in air transportation and shipping services, and building on the donor-funded investment in ICT infrastructure;
- Building human capital by enhancing training opportunities and creating employment possibilities through improved natural resource utilization and diversification of the economy into infrastructure maintenance, renewable energy, and tourism;

- Facilitating private sector access to credit by improving land registration and dispute resolution, while strengthening financial supervision and risk management in public financial institutions.

39. Staff supports the authorities' anti-corruption initiatives and calls for further action to improve governance by:

- Prioritizing public investment projects based on expected socio-economic returns, and making implementation of the PIMA recommendations a prerequisite for approving a surge in spending;
- Improving transparency in the fisheries report through coverage of crucial information such as fishing day allocations;
- Streamlining regulatory practices, improving trade information availability, and making the regulatory rulemaking process more transparent and consultative.

40. It is recommended that the next Article IV consultation takes place on the standard 12-month cycle.

Box 1. Air Connectivity: Risky Business

Air connectivity can be one of the keys to unlocking a country's economic potential. It can boost business development by enabling access to a wider marketplace. It can also spur tourism, vital to many countries with narrow production bases. In countries where there are few viable alternatives to air travel (for example, islands), air connectivity is even more important for growth.

Kiribati's air connectivity is very limited. AKL is an SOE and its current operations are primarily domestic, notwithstanding service to Honiara in partnership with Solomon Airways and short-haul international service to Tuvalu. Fiji Airways operates flights to Tarawa and Kiritimati.

AKL plans to expand its operations, in line with the government's strategy to reap benefits of improved air connectivity. In 2017, a Dash 8 aircraft was purchased by the government for the Gilberts and Tuvalu route, costing roughly 3 percent of GDP. In October 2018, Cabinet approved the purchase of two brand-new Embraer E190-E2 jets for delivery in December 2019 and March 2020. These will operate flights to and from Brisbane, Fiji, and Kiritimati. The funds for the down payment (8½ percent of GDP) have been appropriated in supplementary budgets. Capex funding over 2019–20 is likely to reach 20 percent of GDP per year.

Currently, AKL is not profitable. Despite subsidies, AKL has been incurring losses (amounting to A\$3 million over 2014–17). It reported positive equity of A\$10.5 million at end-2017, but only through aircraft provided by the government being accounted as equity.

Operating losses may grow. The new routes involve an established competitor (Fiji Airways), and the E190-E2 model is a high-value aircraft that may have low utilization in the proposed routes. AKL will need to obtain the approvals necessary for operating the proposed routes. Timely completion of this depends not only on AKL's management capabilities but also on domestic aviation regulators' capacity to establish and enforce rules in line with international standards (for example, on safety and maintenance).

Close monitoring of AKL will be essential as the fiscal risk is very substantial. The government has committed to provide the necessary support for AKL to establish its own international operations. Staff estimates annual fiscal costs to be around 1 percent of GDP, if none of the downside risks materialize. There is great uncertainty surrounding this estimate.

Box 2. Fisheries Management: Risks and Actions

Fisheries are Kiribati's main natural resource and economic driver. Historically, fishing revenue was low and highly volatile, but the implementation of the Vessel Day Scheme (VDS) under the Parties to Nauru Agreement (PNA) in 2012—which sets a maximum number of annual fishing vessel days and a minimum benchmark daily price per vessel—allowed Kiribati to more effectively tap its fisheries. Fishing revenue has been outperforming and now provides about three-quarters of total domestic fiscal revenue. In 2014 alone, Kiribati waters supplied one quarter of the global tuna catch.

High concentration of revenue poses significant risks. Fish stocks can fluctuate wildly, due to weather patterns and water temperatures. This inherent volatility renders projecting catch volumes difficult and hinders efforts to develop a robust medium-term fiscal strategy. Another challenge in developing a sound revenue strategy is the tuna price, which is driven by supply and demand forces in a globally competitive market. Moreover, because of overfishing and illegal activity, fishing operators can face diminishing marginal catches, despite favorable weather and water conditions.

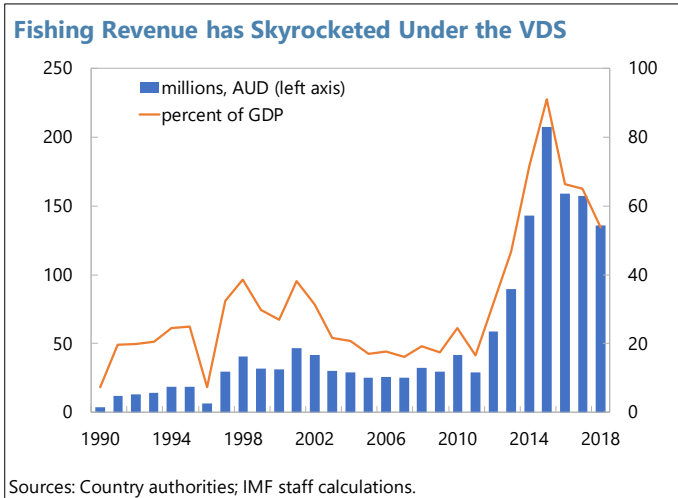
VDS agreements can be unstable.

- Since not all risk is pooled, nations with narrow-based economies—such as Kiribati—are still exposed to the sudden large fluctuations from El Niño. This could create incentives to re-negotiate, but reaching consensus among PNA members to change the benchmarks may be difficult since some members tend to benefit from the very weather events from which the other members suffer. Kiribati's VDS has never been tested in low-yield years, which could pose a challenge when the El Niño conditions reverse.
- Enforcement of sustainable fishing practices benefit all in the long run, but costs can sometimes be distributed unevenly, or there may be incentives to deviate from the collaborative equilibrium if short-run rewards—in the form of temporarily higher catch volumes—for doing so are high.
- Climate change is projected to lead to a general shift of tuna biomass eastward until 2050—initially benefiting Kiribati—followed by a marked decline between 2050 and 2100. Such shifts may also put pressures on VDS agreements.

Maximizing the returns from Kiribati's fisheries in a sustainable way is a top priority. A first step could be private-sector or SOE-led expansion of the current fishing fleet to bolster near-shore and off-shore fishing by allocating vessels to the outer islands. The viability of alternative fishing activities—such as transshipment, aquaculture, and fish farming—could also be explored. The government could survey the development of transshipment and processing facilities in the periphery, such as a transshipment hub in Kiritimati that would leverage the island's location and encourage private sector engagement. In the same vein, further synergies linked to the islands' location or resources, such as the excess supply of salt found on Kiritimati, could be explored in collaboration with KFL (a joint venture of the government with a Chinese and Fijian company).

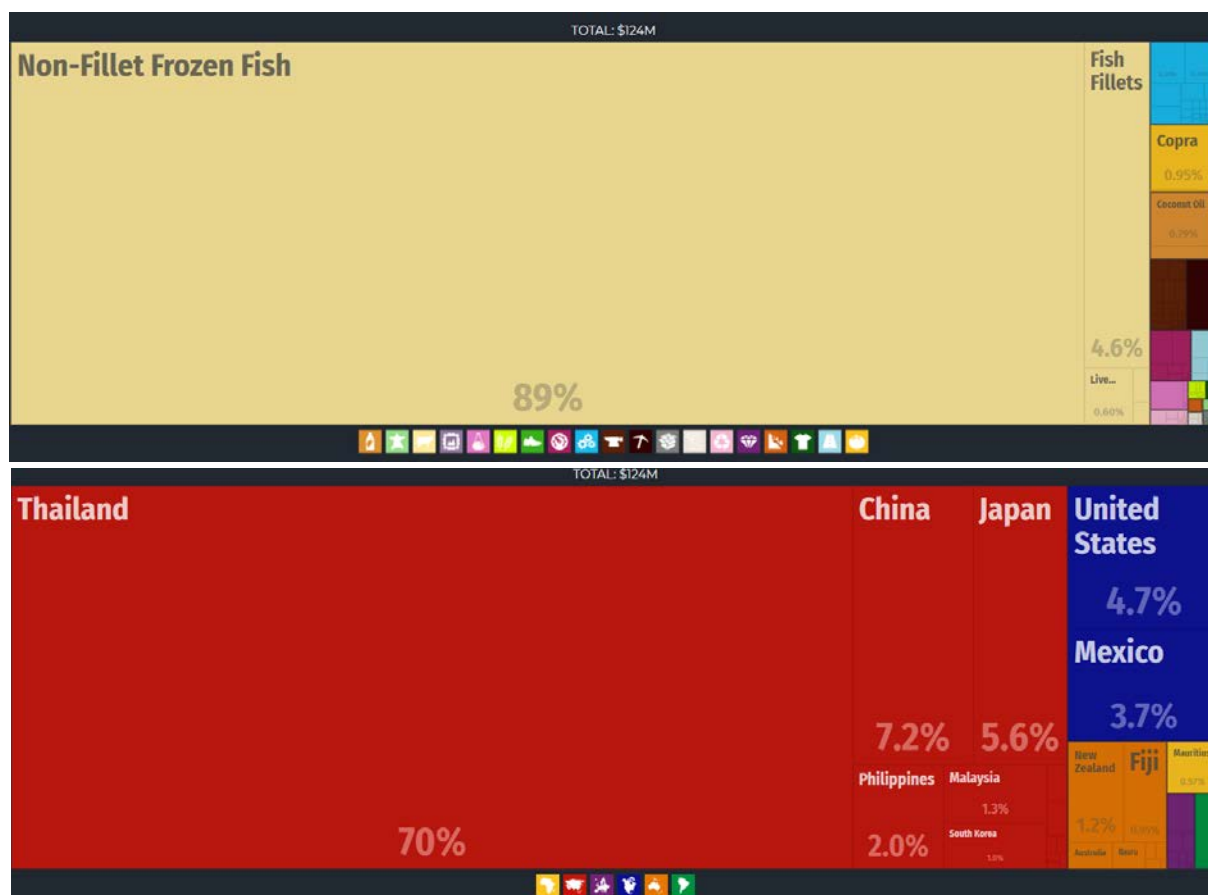
Domestically-oriented efforts should be accompanied with those on the international front.

Implementation of the Fisheries Amendment Act of 2017—which defines illegal, unreported, and unregulated (IUU) fishing and raises the penalty for serious offenses—should proceed swiftly. This would avoid being labeled a non-cooperating country in the global fight against IUU fishing and losing access to international markets in the short run. It would also improve the viability of Kiribati's fisheries in the longer run. The authorities could also invest in negotiating a side-payment system to complement the VDS for broader risk sharing or in enforcing a quota system on volumes of fish caught as an additional mechanism for sustainability.



Box 3. Economic Diversification: Possible Directions

Kiribati's export structure is one of the most concentrated in the world. In the latest available data from UN COMTRADE, fish and coconut products make up almost the entirety of Kiribati's exports.¹ In terms of destination, Thailand alone accounted for 70 percent of exports. The degree of concentration in Kiribati's goods exports has also been higher than its peers.

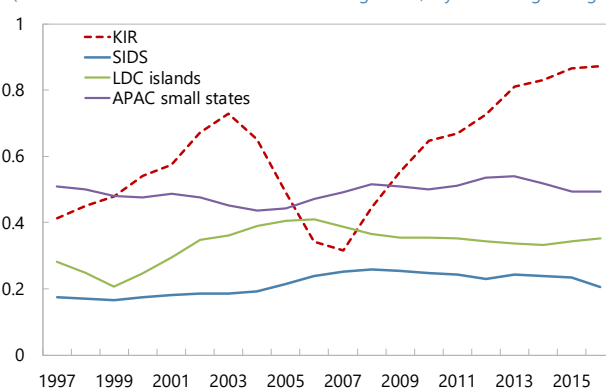


Incorporating diversification objectives to the overall development strategy could provide substantial benefits. Export diversification can guard against sharp terms-of-trade shocks and, hence, cushion against excessive growth volatility. This is especially important in economies characterized by a high level of trade openness—such as Kiribati.

New product lines, or quality upgrades, and new trade partners would create opportunities for a more diversified export base. The quality of fish exports is low (with an average index value of 0.52 from 1990 to 2010, down from 0.67 in the 1970s and 1980s).² Investing in sustainable fishing methods and in state-of-the-art processing facilities could help improve quality.

Concentration of Goods Exports

(Herfindahl-Hirschman index at the SITC 3-digit level, 3-year moving average)



Sources: UNCTAD; IMF staff calculations.

Box 3. Economic Diversification: Possible Directions (Concluded)

Expanding the product lines into higher-value-added categories would complement this upgradation efforts. An underappreciated area of strength could be copra and other coconut products such as coconut oil, which score relatively high in the quality index (0.98 and 0.87, respectively). Further leveraging Kiribati's comparative edge on this front could involve launching a quality-focused marketing campaign. European and Latin American markets could also be explored further.

On the services side, tourism can be developed to secure a robust share in emerging niche markets.

Offering activities closely linked to the atolls' natural and cultural history could be the key to attracting high-end travelers seeking unique experiences. KV20 takes steps in this direction, through investment in eco-tourism, training opportunities for service providers in the hospitality sector with a focus on high-end travelers, and improved infrastructure and connectivity. Further options could involve targeted campaigns for the Phoenix Islands Protected Area (PIPA) and facilities to enable sports fishing and other water activities.

Renewable energy could be another niche to explore. Heavy reliance on imported fossil fuels is not only costly but also exposes the country to abrupt changes in external factors. Innovative technologies that can leverage Kiribati's natural resources to meet its energy needs would support growth and help increase resilience. For instance, ocean thermal energy conversion (OTEC) plants could generate power and supply cold ocean water for use in refrigeration or aquaculture as well as desalinated water for drinking. The authorities, in cooperation with the Korea Research Institute of Ships and Ocean Engineering, plan to deploy a plant in 2019–21. This will be one of the first grid-connected OTEC systems in the world, creating a potential to export to the onshore power grids.

¹ There is a large discrepancy between the exports data reported by Kiribati and the mirror data reported by its trading partners. This is because the methods used by countries somewhat differ on treatment of fish catch. In this case the data we use includes fishing license fees for reconciliation with partner country data. This captures commodity flow and the source of external revenues for Kiribati better.

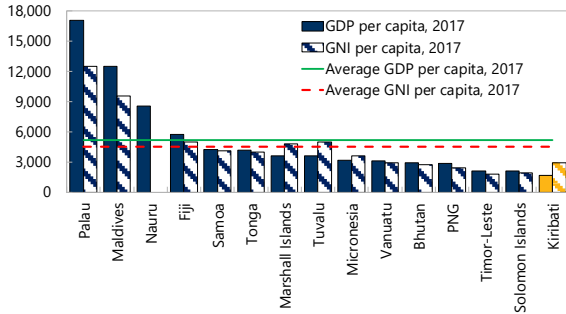
² Based on the export quality index developed by the IMF for 4-digit products "Fish, fresh, chilled or frozen" and "Fish, salted, dried or smoked". An index value of 1 corresponds to the 90th percentile of all exporters of a given commodity. The database is available for download at <https://www.imf.org/external/np/res/dfidimf/diversification.htm>.

Figure 1. Cross-Country Setting: Economic Fundamentals

Kiribati has the lowest per capita income in the region...

Per capita Income, 2017

(In current U.S. dollars)

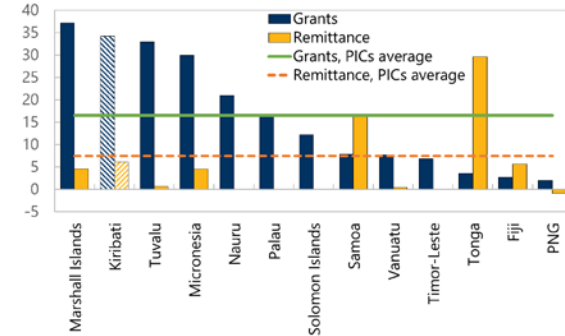


Sources: Kiribati authorities; World Bank, *World Development Indicators*; IMF, *World Economic Outlook*; and IMF staff estimates.

... as well as higher reliance on donor support.

Grants and remittances, 2016

(In percent of GDP)

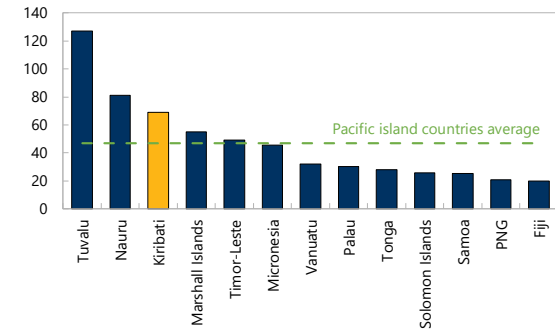


Sources: IMF, latest Article IV Staff Reports; and staff calculations.

Public sector is large by regional standards...

Current Government Expenditure, 2016

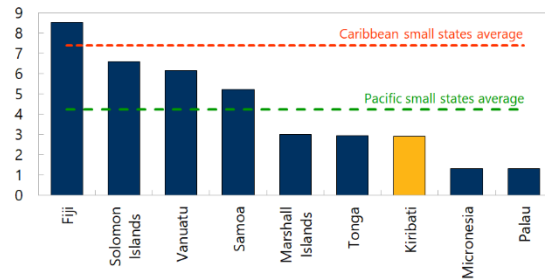
(In percent of GDP)



Sources: IMF, latest Article IV Staff Reports; and staff calculations.

...partly due to the country's remoteness.

Liner Shipping Connectivity Index



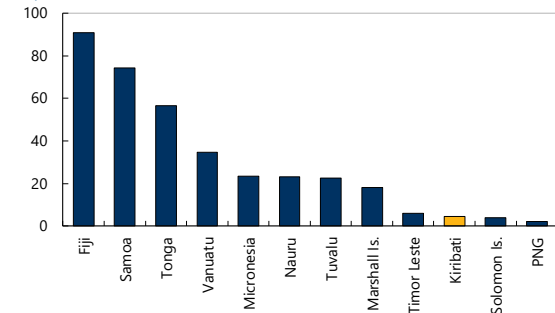
Notes: A smaller number indicates lower connectivity and higher transportation costs. 100 is the maximum index value. 2016 data for all countries.

Sources: World Bank, *World Development Indicators*.

Tourism industry has room for improvement...

Visitor Arrivals to Population Ratio, 2016

(In percent)

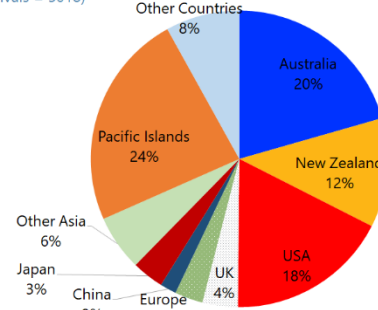


Sources: South Pacific Tourism Organisation, *Annual Review of Visitor Arrivals in Pacific Island Countries 2016*; and IMF staff calculations.

... with majority of visitors coming from nearby countries.

Kiribati: Tourist Arrivals by Source Market, 2016

(Total Arrivals = 5018)



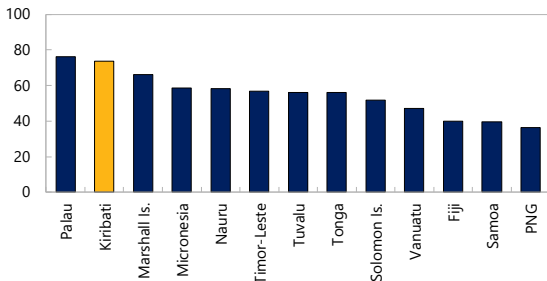
Sources: South Pacific Tourism Organisation, *Annual Review of Visitor Arrivals in Pacific Island Countries 2016*; and IMF staff calculations.

Figure 2. Cross-Country Setting: Structural Indicators

Kiribati is one of the most vulnerable to climate change.

Vulnerability to climate change and natural disasters

(Economic Vulnerability Index, 2018 1/)

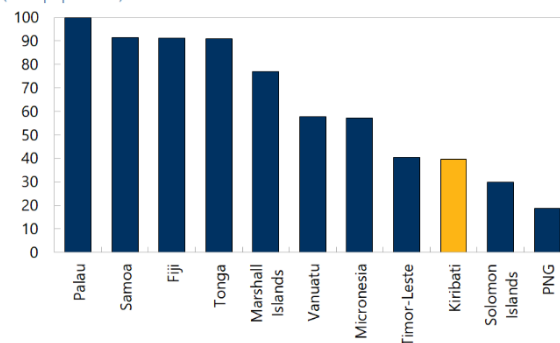


Sources: United Nations - Committee for Development Policy, 2018 triennial review. 1/ The index is a composition of eight indicators, including population, remoteness, export concentration, impact of natural disasters, etc.

Basic infrastructure is also poor by regional standards.

Access to improved sanitation facilities

(% of population)

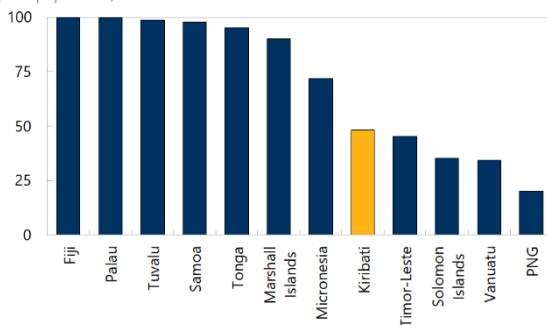


Notes: 2015 data for all countries. Sources: World Bank, World Development Indicators.

Access to electricity is low...

Access to electricity

(% of population)

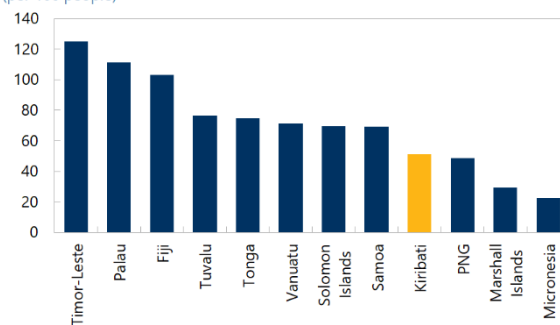


Notes: 2014 data for all countries. Sources: World Bank, World Development Indicators.

... contributing to low penetration of cellular phone usage ...

Mobile cellular subscriptions

(per 100 people)

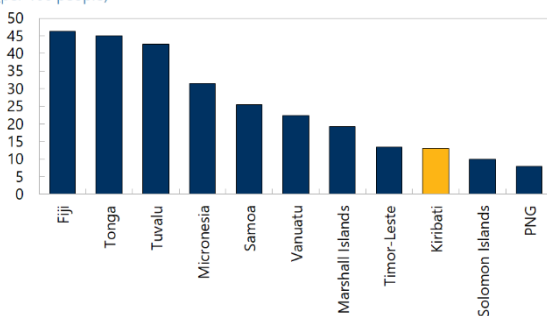


Notes: 2015 data for Palau and Marshall Islands; 2016 for remaining countries. Sources: World Bank, World Development Indicators.

... and to low internet access.

Internet usage

(per 100 people)

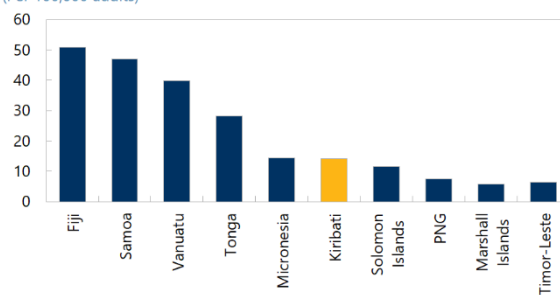


Notes: 2015 data for all countries. Sources: World Bank, World Development Indicators.

Improved connectivity could help with financial inclusion.

ATM Access

(Per 100,000 adults)



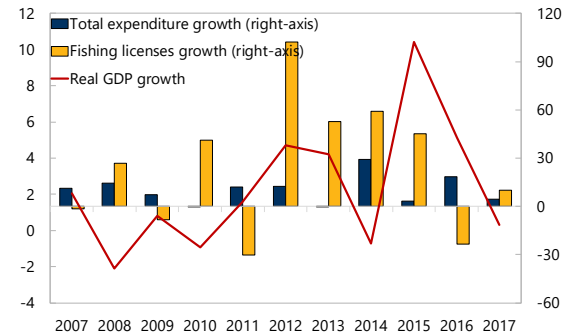
Notes: 2013 data for Kiribati; 2015 for Vanuatu, Tonga and PNG; 2016 for remaining countries. Sources: IMF, Financial Access Survey.

Figure 3. Recent Developments

Growth strengthened since 2013 on the back of rising fishing revenue.

Growth rates

(In percent, year-on-year)

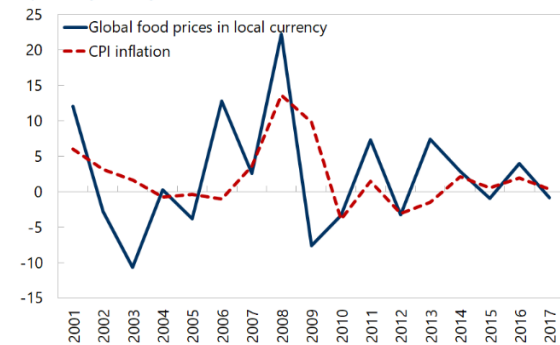


Sources: Country authorities; and staff calculations.

Inflation has remained contained, in line with global food prices.

Inflation rates

(In percent, year-on-year)

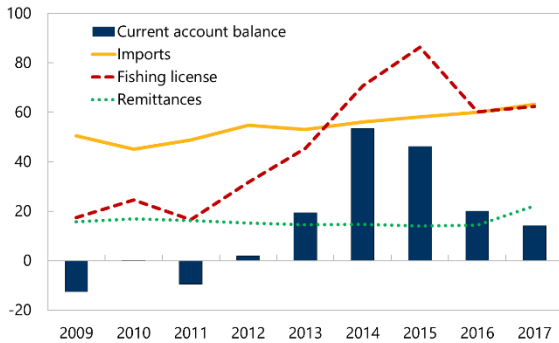


Sources: Country authorities; IMF, Global Assumptions; and staff calculations.

Strong fishing revenue led to significant improvement in the current account...

Current account balance

(In percent of GDP)

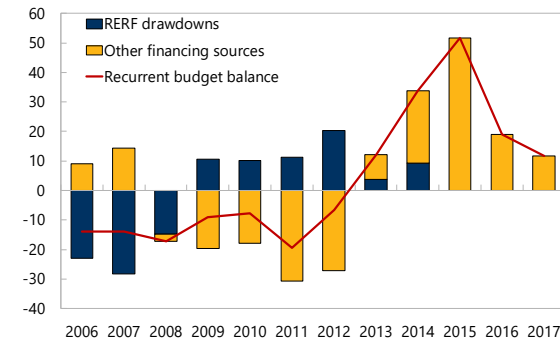


Sources: Country authorities; and staff estimates.

... and the fiscal stance, thus enabling net savings into the RERF...

Fiscal balance and financing

(In percent of GDP)

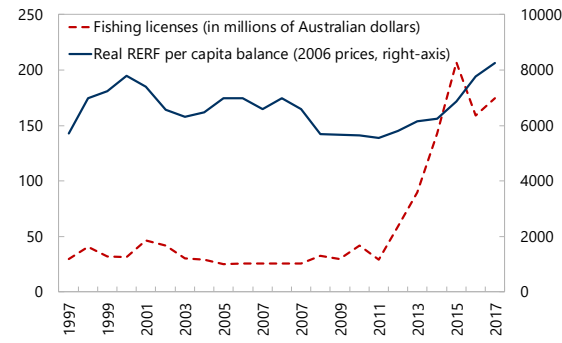


Sources: Country authorities; and staff estimates.

... and helping the real per capita value of the RERF recover to pre-crisis levels.

Evolution of Fishing License Fees and RERF Balance

(in Australian dollars)

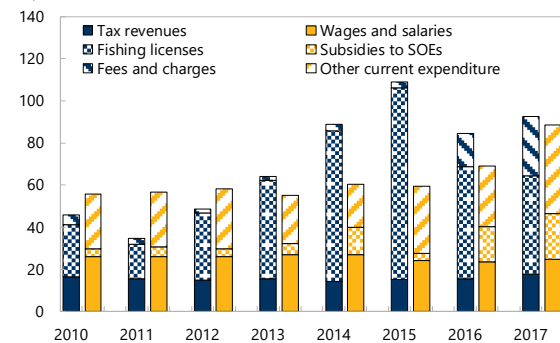


Sources: Country authorities; and staff calculations

But, more recently, strong fishing revenue coincided with a sharp rise in public recurrent expenditure.

Revenue and Expenditure

(In percent of GDP)



Sources: Country authorities; and staff calculations.

Table 1. Kiribati: Selected Economic Indicators, 2013–19

	2013	2014	2015	2016	2017	2018	2019
					Est.	Proj.	
Real GDP (percent change)	4.2	-0.7	10.4	5.1	0.3	2.3	2.3
Real GNI (percent change)	14	14	19	-7.8	6.0	-0.5	-3.8
Consumer prices (percent change, average)	-1.5	2.1	0.6	1.9	0.4	2.1	2.3
Central government finance (percent of GDP)							
Revenue and grants	104	158	151	118	131	123	114
Total domestic revenue	64	89	109	84	92	91	72
<i>Of which: fishing revenue</i>	47	72	91	66	72	70	51
External grants	39	69	42	34	38	32	42
Expenditures	91	113	102	115	119	143	137
Current	55	60	60	69	88	88	76
Development	36	53	42	46	31	55	61
Domestic recurrent balance 1/	-38	-43	-41	-51	-68	-66	-55
Recurrent fiscal balance (incl. budget support grants)	12	34	52	19	12	9	1
Overall balance 2/	13	45	49	3	12	-20	-23
Financing	-13	-45	-49	-3	-12	20	23
<i>Of which: Revenue Equalization Reserve Fund (RERF)</i>	-4	-9	0	0	0	0	0
RERF							
Closing balance (millions of A\$)	661	679	756	868	934	994	1030
Per capita value (2006 A\$)	5,118	5,062	5,482	6,132	6,382	6,533	6,496
Cash reserve buffer 3/							
Closing balance (millions of A\$)	...	...	133	145	188	234	180
In excess of 3-months of current spending (millions of A\$)			99	103	134	178	130
Balance of payments							
Current account including official transfers (millions of US\$)	36	96	79	36	26	25	16
(In percent of GDP)	19	53	46	20	14	13	8
External debt (millions of US\$)	14	14	33	42	43	42	47
(In percent of GDP)	8	9	20	24	23	22	23
External debt service (millions of US\$)	3	8	1	1	1	1	2
(In percent of exports of goods and services)	12	37	4	4	6	3	7
Exchange rate (A\$/US\$ period average)	1.0	1.1	1.3	1.3	1.3	...	...
Real effective exchange rate (period average)	105	100	93	93	96	...	...
Memorandum items:							
Nominal GDP (millions of A\$)	192	199	228	240	242	253	264
Nominal GDP (millions of US\$)	186	180	178	186	193	200	210

Sources: Data provided by the Kiribati authorities; and Fund staff estimates and projections.

1/ Domestic recurrent balance excludes fishing revenue, grants, and capital expenditure.

2/ Overall balance in the table is different from official budget because loans are classified as financing.

3/ Cash reserve buffer includes the government's custodial account and cash account.

Table 2. Kiribati: Medium-Term Projections, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
			Est.	Proj.					
Real sector									
Real GDP (percentage change)	10.4	5.1	0.3	2.3	2.3	2.3	2.0	1.9	1.9
Inflation (end of period)	0.6	0.7	2.5	1.8	2.0	2.2	2.2	2.3	2.4
Nominal GDP at market prices (millions of A\$)	228	240	242	253	264	277	289	302	315
Government finance									
	(In percent of GDP)								
Total revenue and grants	151	118	131	123	114	109	105	100	98
Revenue	109	84	92	91	72	70	68	66	64
External grants	42	34	38	32	42	39	37	34	33
Total expenditure	102	115	119	143	137	130	115	108	106
Current expenditure	60	69	88	88	76	72	70	68	69
Development expenditure	42	46	31	55	61	58	45	40	38
Domestic recurrent balance 1/	-41	-51	-68	-66	-55	-51	-49	-47	-48
Recurrent fiscal balance (excl. grants)	50	15	4	3	-4	-3	-2	-2	-4
Recurrent fiscal balance (incl. budget support grants)	52	19	12	9	1	2	2	2	-1
Overall balance	49	3	12	-20	-23	-21	-10	-7	-9
Net financial worth 2/	370	399	440	464	434	406	391	383	373
RERF balance	332	362	386	393	390	384	380	379	376
Cash reserves	58	60	77	93	68	50	46	45	42
Public debt 3/	20	24	23	22	23	28	35	41	46
Balance of payments									
	(In percent of GDP)								
Current account balance	46	20	14	13	8	4	2	1	0
Trade balance	-53	-54	-58	-59	-60	-61	-63	-64	-65

Sources: Data provided by the Kiribati authorities; and Fund staff estimates and projections.

1/ Domestic recurrent balance excludes fishing revenue, grants, and capital expenditure.

2/ Balances of RERF and cash reserves minus public debt.

3/ In this table, it is assumed that Kiribati will continue to benefit from its grants-only status. This assumption is consistent with MDB's grant decision rules given the DSA rating and even assuming the realization of such grants and their impact on the DSA. On the other hand, in the LIC-DSA, for World Bank (IDA) and other MDBs, regular credit terms on all lending is assumed for all years in the projection period for which grant finance has not already been committed. This is because the DSA serves to test a country's capacity to take on WB and ADB financing on credit terms.

Table 3a. Kiribati: Summary of Government Operations, 2015–23
(in millions of Australian dollars)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
			Est.				Proj.		
	(In millions of Australian dollars)								
Total revenue and grants	344	284	317	312	301	302	303	303	308
Revenue	249	203	224	231	190	193	196	199	203
Tax revenue	35	38	43	45	47	49	51	54	54
Nontax revenue	214	165	181	186	143	144	145	145	149
<i>Of which: fishing revenue</i>	207	159	175	176	135	135	136	136	139
Project grants	91	72	74	66	97	97	95	92	93
Budget support grants	5	9	19	14	14	12	12	11	11
Total expenditure	232	275	288	362	362	361	333	325	335
Current expenditure 1/	136	166	214	223	201	200	203	204	216
Wages and salaries	55	56	60	80	85	85	85	85	87
Subsidies and grants	8	41	53	57	55	55	55	56	60
Other current expenditure	72	68	100	85	58	54	50	46	47
<i>Of which: local contribution to development fund</i>	23	36	61	44	17	14	14	14	14
Contingency and maintenance rel. to climate change adaptation	...	...	...	...	1	3	6	9	11
Infrastructure maintenance	...	...	...	...	1	3	4	6	6
Other climate change adaptation costs	...	...	...	...	...	...	1	3	5
Development expenditure 2/	97	110	74	139	161	160	130	121	118
Net lending	0	0	0	0	0	0	0	0	0
Domestic recurrent balance 3/	-94	-122	-165	-168	-146	-142	-143	-141	-152
Recurrent fiscal balance (excl. grants)	113	37	10	8	-11	-7	-7	-5	-13
Recurrent fiscal balance (incl. budget support grants)	118	46	28	22	3	5	5	6	-2
Overall balance 4/	112	8	28	-50	-61	-59	-30	-23	-27
Financing	-112	-8	-28	50	61	59	30	23	27
Domestic financing	-131	-21	-28	50	53	42	5	-2	2
Revenue Equalization and Reserve Fund (RERF)	0	0	0	0	0	0	0	0	0
Custodial account 5/	-97	-14	-16	52	48	42	5	-2	5
Cash account 6/	-34	-7	-12	-2	5	0	-1	0	-3
Project loans (net)	20	13	0	0	8	17	26	25	25
Memorandum items (percent of GDP unless otherwise noted):									
Net financial worth incl. RERF 7/	370	399	440	464	434	406	391	383	373
Net financial worth excl. RERF	38	37	54	71	45	22	11	4	-4
RERF balance	332	362	386	393	390	384	380	379	376
RERF real per capita value (2006 A\$)	5482	6132	6382	6533	6496	6438	6379	6355	6332
Cash reserve buffer 8/	58	60	77	93	68	50	46	45	42
Cash reserve buffer in excess of 3-months of current spending	44	43	55	70	49	32	29	28	25
Public debt 9/	20	24	23	22	23	28	35	41	46
Nominal GDP (millions of A\$)	228	240	242	253	264	277	289	302	315

Sources: Data provided by the Kiribati authorities; and staff estimates and projections.

1/ Projections for the current expenditure for 2017 included the supplementary budget.

2/ Development expenditure equals grants plus loans for development projects.

3/ Domestic recurrent balance excludes fishing revenue, grants, and capital expenditure.

4/ Overall balance in the table is different from official budget because loans are classified as financing.

5/ The custodial account is government's fund managed by State Street.

6/ The cash account is the government's deposit account at ANZ.

7/ Balances of RERF, custodial, and cash accounts minus public debt.

8/ Cash reserve buffer includes the custodial account and the cash account.

9/ In this table, it is assumed that Kiribati will continue to benefit from its grants-only status. This assumption is consistent with MDB's grant decision rules given the DSA rating and even assuming the realization of such grants and their impact on the DSA. On the other hand, in LIC- DSA, for World Bank (IDA) and other MDBs, regular credit terms on all lending is assumed for all years in the projection period for which grant finance has not already been committed. This is because the DSA serves to test a country's capacity to take on WB and ADB financing on credit terms.

Table 3b. Kiribati: Summary of Government Operations, 2015–23
(in percent of GDP)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
			Est.				Proj.		
	(In percent of GDP)								
Total revenue and grants	151	118	131	123	114	109	105	100	98
Revenue	109	84	92	91	72	70	68	66	64
Tax revenue	15	16	18	18	18	18	18	18	17
Nontax revenue	94	69	75	74	54	52	50	48	47
<i>Of which: fishing revenue</i>	91	66	72	70	51	49	47	45	44
Project grants	40	30	31	26	37	35	33	31	30
Budget support grants	2	4	8	6	5	4	4	4	4
Total expenditure	102	115	119	143	137	130	115	108	106
Current expenditure 1/	60	69	88	88	76	72	70	68	69
Wages and salaries	24	24	25	32	32	31	29	28	28
Subsidies and grants	3	17	22	23	21	20	19	18	19
Other current expenditure	32	28	41	34	22	20	17	15	15
<i>Of which: local contribution to development fund</i>	10	15	25	17	6	5	5	5	4
Contingency and maintenance rel. to climate change adaptation	...	...	...	...	1	1	2	3	4
Infrastructure maintenance	...	...	...	...	1	1	2	2	2
Other climate change adaptation costs	...	...	...	...	...	...	...	1	2
Development expenditure 2/	42	46	31	55	61	58	45	40	38
Net lending	0	0	0	0	0	0	0	0	0
Domestic recurrent balance 3/	-41	-51	-68	-66	-55	-51	-49	-47	-48
Recurrent fiscal balance (excl. grants)	50	15	4	3	-4	-3	-2	-2	-4
Recurrent fiscal balance (incl. budget support grants)	52	19	12	9	1	2	2	2	-1
Overall balance 4/	49	3	12	-20	-23	-21	-10	-7	-9
Financing	-49	-3	-12	20	23	21	10	7	9
Domestic financing	-58	-9	-12	20	20	15	2	-1	1
Revenue Equalization and Reserve Fund (RERF)	0	0	0	0	0	0	0	0	0
Custodial account 5/	-43	-6	-7	21	18	15	2	-1	2
Cash account 6/	-15	-3	-5	-1	2	0	0	0	-1
Project loans (net)	9	5	0	0	3	6	9	8	8
Memorandum items (percent of GDP unless otherwise noted):									
Net financial worth incl. RERF 7/	370	399	440	464	434	406	391	383	373
Net financial worth excl. RERF	38	37	54	71	45	22	11	4	-4
RERF balance	332	362	386	393	390	384	380	379	376
RERF real per capita value (2006 A\$)	5482	6132	6382	6533	6496	6438	6379	6355	6332
Cash reserve buffer 8/	58	60	77	93	68	50	46	45	42
Cash reserve buffer in excess of 3-months of current spending	44	43	55	70	49	32	29	28	25
Public debt 9/	20	24	23	22	23	28	35	41	46
Nominal GDP (millions of A\$)	228	240	242	253	264	277	289	302	315

Sources: Data provided by the Kiribati authorities; and staff estimates and projections.

1/ Projections for the current expenditure for 2017 included the supplementary budget.

2/ Development expenditure equals grants plus loans for development projects.

3/ Domestic recurrent balance excludes fishing revenue, grants, and capital expenditure.

4/ Overall balance in the table is different from official budget because loans are classified as financing.

5/ The custodial account is government's fund managed by State Street.

6/ The cash account is the government's deposit account at ANZ.

7/ Balances of RERF, custodial, and cash accounts minus public debt.

8/ Cash reserve buffer includes the custodial account and the cash account.

9/ In this table, it is assumed that Kiribati will continue to benefit from its grants-only status. This assumption is consistent with MDB's grant decision rules given the DSA rating and even assuming the realization of such grants and their impact on the DSA. On the other hand, in LIC- DSA, for World Bank (IDA) and other MDBs, regular credit terms on all lending is assumed for all years in the projection period for which grant finance has not already been committed. This is because the DSA serves to test a country's capacity to take on WB and ADB financing on credit terms.

Table 4. Kiribati: Balance of Payments, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
			Est.				Proj.		
	(In millions of Australian dollars)								
Current account balance	105	48	34	33	20	10	5	4	0
Trade balance	-121	-130	-142	-148	-159	-169	-181	-193	-206
Exports, f.o.b.	12	14	12	15	15	16	17	17	18
Imports, f.o.b.	133	144	153	163	174	185	197	210	224
Balance on services	-89	-77	-76	-78	-79	-80	-81	-82	-83
Credit	10	13	14	15	16	17	18	19	20
Debit	99	90	90	92	94	96	98	100	102
Balance on factor income 1/	241	193	219	216	197	205	213	218	226
Credit	244	195	221	218	199	207	216	222	229
Fishing license fees	197	144	151	150	131	131	131	134	137
Investment income	32	35	54	51	50	57	64	66	69
Remittances and compensation of employees	16	16	16	17	18	20	21	21	23
Debit	4	2	2	2	3	3	3	3	3
Balance on current transfers	74	62	33	43	61	54	55	60	63
Credit	75	64	34	44	62	56	56	62	64
Debit	1	1	1	1	1	1	1	1	1
Financial and capital account balance	70	-17	8	4	15	32	42	45	50
Government	41	29	12	19	25	33	42	40	41
Capital transfers	22	17	12	19	17	16	16	15	16
Loans (net)	20	13	0	0	8	17	26	25	25
Direct investment	-1	-3	-3	-3	-3	-3	-3	-3	-4
Financial institutions	29	-44	-2	-12	-7	2	4	8	13
Errors and omissions	-3	14	0	0	0	0	0	0	0
Overall balance	67	136	42	38	36	42	48	48	50
Change in official external assets	172	45	-42	-38	-36	-42	-48	-48	-50
	(In percent of GDP)								
Current account balance	46	20	14	13	8	4	2	1	0
Trade balance	-53	-54	-58	-59	-60	-61	-63	-64	-65
Exports, f.o.b.	5	6	5	6	6	6	6	6	6
Imports, f.o.b.	58	60	63	65	66	67	68	70	71
Balance on services	-39	-32	-32	-31	-30	-29	-28	-27	-26
Credit	5	5	6	6	6	6	6	6	6
Debit	44	37	37	36	36	35	34	33	32
Balance on factor income 1/	106	80	90	85	74	74	74	72	72
Credit	107	81	91	86	75	75	75	73	73
Fishing license fees	86	60	62	59	49	47	45	44	44
Investment income	14	14	22	20	19	21	22	22	22
Remittances	7	7	7	7	7	7	7	7	7
Debit	2	1	1	1	1	1	1	1	1
Balance on current transfers	33	26	14	17	23	20	19	20	20
Credit	33	27	14	18	24	20	19	20	20
Debit	0	0	0	0	0	0	0	0	0
Financial and capital account balance	31	-7	3	2	6	12	15	15	16
Government	18	12	5	8	9	12	14	13	13
Capital transfers	9	7	5	8	6	6	6	5	5
Loans (net)	9	5	0	0	3	6	9	8	8
Direct investment	0	-1	-1	-1	-1	-1	-1	-1	-1
Financial institutions	13	-18	-1	-5	-3	1	1	3	4
Errors and omissions	-1	6	0	0	0	0	0	0	0
Overall balance	29	57	17	15	14	15	16	16	16
Change in official external assets	-75	-19	-17	-15	-14	-15	-16	-16	-16
Net international investment position	441	295							

Sources: Data provided by the Kiribati authorities; and Fund staff estimates and projections.

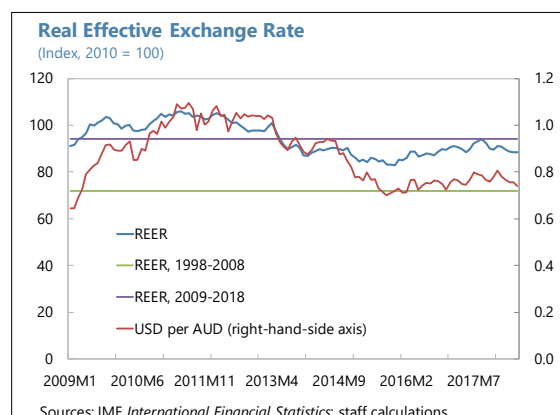
1/ Includes fishing license fees, which would be shown as current transfers under conventional international guidelines.

Appendix I. External Sector Assessment

Kiribati's external sector developments are driven by exogenous, volatile factors. Current account inflows are dominated by fishing license fees, RERF investment income, seafarers' remittances, and donor contributions. The outflows largely relate to infrastructure investment, financed by project grants and loans. Volatile flows, data limitations, and other characteristics make standard approaches for external sector assessment (such as the EBA current account and real effective exchange rate models) less suitable or unfeasible.

Notwithstanding the caveats, staff assesses the underlying external position in 2017 to be broadly in line with the level implied by medium-term fundamentals and desirable policies.

- The real effective exchange rate (REER) has been stable within the bands implied by historical averages. That said, given the narrow export base, the real exchange rate has limited impact on the current account.
- The EBA external sustainability (ES) approach suggests that the projected medium-term current account balance is in line with the level that would stabilize the net international investment position (NIIP) as a share of GDP at its estimated 2017 level.



			CA norm (% of GDP)	Underlying CA (% of GDP)	CA gap	REER gap
Scenario 1: Stabilizing net IIP at	315 % of GDP	next year	0.5	0.0	-0.5	1.5
Scenario 2: Stabilizing net IIP at	320 % of GDP	next year	0.7	0.0	-0.7	2.2
Scenario 3: Reaching net IIP at	320 % of GDP	in 2027	1.1	0.0	-1.1	3.4

- Taking all of these factors into account and giving the most weight to the ES approach, staff assesses the underlying external position to be broadly in line with the level implied by medium-term fundamentals and desirable policies. However, there is substantial uncertainty around this assessment, given the idiosyncratic features of the Kiribati economy and data quality.

Removing the long-standing structural impediments would help improve competitiveness and ensure external sustainability. While the large size of the RERF relative to external debt limits immediate risks, the RERF could be significantly depleted over the longer run in downside scenarios to fishing revenue. Closing the infrastructure gap and addressing governance weaknesses would expand the country's export capacity while increasing efficiency. In this context, securing donor grants for development spending is critical and borrowing through concessional loans should be closely monitored.

The use of Australian dollar as the legal tender remains appropriate. It provides a strong nominal anchor given close trade and financial linkages with Australia (a high share of RERF assets is invested in Australian markets) and limited capacity to run an independent monetary institution.

Appendix II. Risk Assessment Matrix ^{1/}

Sources of Risks	Likelihood and Transmission Channels	Potential Impact and Policy Response
Global risks		
Sharp tightening of global financial conditions	High A sharper-than-expected increase in U.S. interest rates (prompted by higher-than-expected inflation) or the materialization of other risks could have investors minimize exposure to Australian assets.	Medium The lion's share of the RERF and the KPF assets is invested in the global financial markets, primarily Australian markets. This exposure constitutes a significant channel through which a disruptive event in global markets could feed into the domestic economy. Prudent public financial management would soften the impact.
Rising protectionism and retreat from multilateralism	High Escalating and sustained trade actions threatens the global trade system, regional integration, labor mobility, as well as international collaboration. This increases uncertainty about growth as well as financial market volatility.	Medium Given Kiribati's high reliance on imported goods, disruptions to trade and exchange rate volatility could have an outsized impact on inflation and growth. Prudent management of public resources and, in the longer run, seeking to diversify the economy would help resilience.
Weaker-than-expected global growth	Medium A slowdown in major emerging markets over the medium term and/or disappointing growth in key advanced economies due to binding capacity constraints or a slowing/reversal of improvement in structural reforms.	Medium Reduced demand for Kiribati exports would be reflected in lower fishing license fees and seamen's remittances. Negative impact on the domestic economy could also manifest through the financial channel if weak global growth is reflected in a decline in global returns, affecting RERF/KPF assets. Prudent public financial management would soften the impact.
Domestic risks		
Reversal in strong fishing catches	Medium Fishing license fees decline more than projected due to less favorable weather conditions.	High The hit to fiscal revenues would lead to higher deficits. If sustained, the decline in fishing revenue may jeopardize long-run fiscal sustainability. The cash reserve buffer can mitigate the shock if the decline is temporary.
Natural disasters and climate change	Low/Medium While the probability of occurrence of natural disaster is less than 10 percent for Kiribati, adverse effects of climate change on the country's low-lying atolls are sizeable.	High Volatile weather conditions caused by global warming can lead to large losses and damages to production and potential growth. Contingency plans should include maintaining a strong cash buffer, seeking cost-effective insurance, and establishing contingent financing plans with development partners.

^{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.

Appendix III. Main Recommendations of the 2017 Article IV Consultation

Fund Recommendations	Policy Actions
<i>Fiscal Policy</i>	
Commit to a structurally balanced budget based on the projected fishing revenue.	The 2018 Budget envisaged a balanced budget. But revenue overperformance is likely to be offset by the supplementary budget (currently in preparation).
Set rolling, multi-year expenditure paths consistent with a balanced budget target in the medium term and implement a rule-based withdrawal mechanism for the RERF.	The 2018 Budget includes a new table on the medium-term fiscal framework. A rule for withdrawals from the RERF is under consideration.
Maintain an appropriately-sized cash reserve buffer and transfer the excess cash reserves to the RERF (or another custodian account).	The authorities transferred A\$70 million from cash reserves to the RERF in 2016 and are exploring ways to manage cash balances more effectively.
Introduce budget provisions to recognize infrastructure maintenance needs and climate change adaptation costs.	Budget allocation to maintenance increased, but it did not cover infrastructure maintenance cost. Climate change adaptation remains to be largely financed by external resources.
Phase out SOE exemptions of the VAT.	Not implemented.
Strengthen PFM framework.	A Public Expenditure and Financial Accountability (PEFA) self-assessment was undertaken in 2017. A Public Investment Management Assessment (PIMA) was conducted during a TA mission on May 8–21, 2018.
<i>Other Policies</i>	
Maintain the momentum of SOE reforms.	Progress has been made to improve the performance of a number of SOEs. However, there is no comprehensive strategy on setting the SOEs on a more commercial, sustainable footing.
Addressing deficiencies in financial supervision.	The authorities have taken steps to address the financing gap of the KPF. However, work on a comprehensive supervision framework has stalled.

Appendix IV. SDG and Strategic Surveillance Matrix

Key Priority Areas	Corresponding SDGs	Key Outcomes	Role of the IMF
1. Human Resource Development	4. Quality Education	<p>1. Strengthen the Ministry's leadership and management capability</p> <p>2. Develop a committed, competent, and effective education work force</p> <p>3. Establish the skills and capability to progress to a productive future for all students leaving the school system</p> <p>4. Provide a conducive learning environment in Kiribati schools</p> <p>5. Ensure Ministry support services efficiently match the needs of schools</p> <p>6. Effective implementation of the Inclusive Education Policy</p> <p>7. Establish an enabling legal environment for the development of the Kiribati Education Sector</p> <p>8. Foster the development of early childhood education</p> <p>9. Strengthen the commitment and collaboration of stakeholders vital to the delivery of ESSP goals and strategies</p>	<p>Policy advice on human capital development</p> <p>Coordination with the World Bank and development partners</p>
2. Economic Growth and Poverty Reduction	<p>1. No Poverty</p> <p>2. Zero Hunger</p> <p>8. Decent Work & Economic Growth</p> <p>10. Reduced Inequalities</p>	<p>1. Increase sustainable economic development and improved standards of living for all I-Kiribati</p> <p>2. Ensure efficiency and sustainability in Government finances</p> <p>3. Raise efficiency of State Owned Enterprises</p> <p>4. Improve information available to the Government including through the production of accurate and timely statistics</p> <p>5. Enhance delivery of public service through effective use of development budget funds</p>	<p>Surveillance and policy advice on macroeconomic policies</p> <p>Technical assistance on public investment management</p> <p>Technical assistance and training on statistics</p>
3. Health	3. Good Health and Well-being	<p>1. Strengthen initiatives to reduce the prevalence of risk factors for non-communicable diseases (NCDs), and to reduce morbidity, disability and mortality from NCDs</p> <p>2. Increase access to and use of high quality, comprehensive family planning services, particularly for vulnerable populations, including women whose health and wellbeing will be at risk if they become pregnant</p> <p>3. Improve maternal, newborn, and child health</p> <p>4. Prevent the introduction and spread of communicable diseases, strengthen existing control programmes, and ensure Kiribati is prepared for any future outbreaks</p> <p>5. Address gaps in health service delivery and strengthen the pillars of the health system</p> <p>6. Improve access to high quality and appropriate health care services for victims of gender-based violence, and services that specifically address the needs of youth</p> <p>7. Strengthen road safety awareness</p>	<p>Coordination with the World Bank and development partners</p>
4. Environment	<p>11. Sustainable Cities and Communities</p> <p>12. Responsible Consumption and Production</p> <p>13. Climate Action</p> <p>14. Life Below Water</p> <p>15. Life on Land</p>	<p>1. Strengthen national capacity to effectively respond to the impacts of global climate change</p> <p>2. Promote food and nutrition diversity</p> <p>3. Improve biodiversity including by identifying pest and disease problems, developing and promoting control methods, and strengthening capacity to respond to pest problems</p> <p>4. Enhance measures to address land development issues</p> <p>5. Foster behavioral change through education, awareness raising, and research that promotes best waste management and pollution prevention practices</p> <p>6. Improve quality of the environment in urban areas</p>	<p>Surveillance and policy advice on climate-change-related vulnerabilities</p> <p>Analytical framework on how to incorporate climate change adaptation costs into the macroframework</p>
5. Governance	<p>5. Gender Equality</p> <p>16. Peace, Justice and Strong Institutions</p>	<p>1. Improve national governance systems to promote the principles of good governance including accountability, transparency, and inclusiveness</p>	<p>Surveillance and policy advice on fiscal institutions and on governance of fisheries</p>
6. Infrastructure	<p>7. Affordable and Clean Energy</p> <p>6. Clean Water and Sanitation</p> <p>9. Industry, Innovation, and Infrastructure</p>	<p>1. Improve access to quality, climate-change-resilient infrastructure in urban and rural areas</p>	<p>Surveillance and policy advice on diversification, including through renewable energy and infrastructure maintenance</p> <p>Technical assistance on public investment management with a focus on improving project selection and procurement</p>

Source: Kiribati Development Plan 2016-19; and Kiribati Voluntary National Review and Kiribati Development Plan Mid-Term Review July 2018.



KIRIBATI

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 19, 2018

Prepared By

Asia and Pacific Department
(in consultation with other departments)

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FUND RELATIONS

(As of December 10, 2018)

Membership Status: Joined June 3, 1986; accepted Article VIII.

General Resources Account:

	SDR Million	Percent Quota
Quota	11.20	100.00
Fund holdings of currency	9.80	87.51
Reserve tranche position	1.41	12.59

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	5.32	100.00
Holdings	3.99	74.96

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Obligations to Fund: None

Implementation of HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

Exchange Rate Arrangements: The Australian dollar circulates as legal tender. Kiribati has accepted the obligations under Article VIII of the IMF's Articles of Agreement and maintains an exchange rate system that is free of restrictions on the making of payments and transfers for current international transactions. Kiribati also agrees to notify the Fund of any exchange restrictions imposed solely for security reasons.

Article IV Consultation: Kiribati is on a 12-month consultation cycle. The 2017 Article IV consultation discussions were held in Tarawa during September 11–20, 2017. The Executive Board concluded the 2017 Article IV consultation on December 18, 2017.

Technical Assistance (TA), 1995–2018: STA, LEG, MCM, FAD, and PFTAC have provided TA on statistics, tax administration and policy, budget management, public financial management, Revenue Equalization Reserve Fund (RERF) and Pension Fund (KPF) management, financial sector reform and supervision, and combating financial crime and financial system abuse.

Resident Representative: The resident representative office for Pacific Island Countries opened in September 2010 in Suva, Fiji. Ms. Leni Hunter has been the Resident Representative since March 2018.

RELATIONS WITH OTHER IFIS

- World Bank Group:
http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=KI
- Asian Development Bank:
<https://www.adb.org/countries/kiribati/main>
- Pacific Financial Technical Assistance Center:
https://www.pftac.org/content/PFTAC/en1/reports11.html#tab_5

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance

(As of December 2018)

General: Data provision has some shortcomings, but is broadly adequate for surveillance. Financial sector statistics (e.g., compiling a consolidated banking system balance sheet and a select list of financial stability indicators) is a priority. Balance of Payments and, to some extent, Government Finance Statistics could also be further improved.¹

National accounts: With PTFAC and STA assistance, GDP estimates have improved. There was one TA mission in August 2018 to improve the national data accounting system, with updates and revisions to GDP data for 2012–17. However, further capacity building would be needed to continue to improve the quality of GDP estimates, particularly expenditure-based GDP estimates. Presently, only current and constant 2006 prices GDP data is compiled using the value-added approach.

Price statistics: The monthly retail price index (2006 = 100) is produced with a short lag (about a month), based on a survey in South Tarawa (a national index is not available). There are no producer, wholesale, or trade price indices.

Government finance statistics: A GFS mission in August 2018 continued to assess data sources and discussed a strategy for expanding the institutional coverage. The mission analyzed public corporation data to expand coverage to the public sector. The volume of flows and debt stocks are concentrated on a few large units and it was recommended to prioritize the processing of financial data from these units in detail to start compiling unconsolidated public corporation data. Collection and compilation of donor-financed projects can be further improved. Challenges exist with respect to the collaboration of data providing units and the quality of underlying accounting data. A unit-by-unit strategy should be developed and assistance in providing accounting knowledge may be required to process financial data. Expanding coverage in both areas would significantly improve the analytical value of GFS for policymakers and domestic and international stakeholders, specifically the quality of information on public investment, financial relationships between the government and public corporations, and the measurement of public sector debt will be improved at the same time.

Monetary statistics: The balance sheets of the public financial institutions (Development Bank of Kiribati, Kiribati Provident Fund, and Kiribati Insurance Corporation) are available with lags, but the consolidated balance sheet of the financial sector is not available. Data on interest rates are reported with a very long lag.

Balance of payments: The results of the JSA Project on the Improvement of ESS in the Asia and Pacific Region (last mission was in 2015) were proved to be non-sustainable due to lack of staff resources, staff knowledge, and inadequate automatization of statistical and accounting processes. The 2018 TA mission assessed reliability of produced data, calibrated discrepancies with government accounts for grants, loans, revenues, and reserves; validated data in various government reports; and suggested improvements in compilation techniques. The recommendations were made on improved compilation practices for direct investments and for donor-financed government projects. Periodicity and timeliness of BOP and IIP data are to be improved. To ensure sustainable results, the country needs to receive regular technical assistance.

II. Data Standards and Quality

Kiribati has been a participant in the General Data Dissemination System (GDDS) since 2004. No data ROSC is available.

III. Reporting to STA (Optional)

Data is reported to STA for publication in the *Government Finance Statistics Yearbook*, the *Balance of Payments Statistics Yearbook*, and the *IFS*. Kiribati does not report monetary and financial statistics based on the standardized report forms (SRFs) for publication as part of the *International Financial Statistics* (IFS) and financial soundness indicators (FSIs) for publication on the IMF's website.

^{1/}While Article VIII, Section 5 excuses members when they are unable to provide the information required for capacity reasons, it also places upon such members an obligation over time to improve their reporting systems and the accuracy of the information they provide to the Fund. Furthermore, until a member is in a position to provide final data to the Fund, a member is obliged to provide the Fund with provisional data to the best of its ability.

Kiribati: Table of Common Indicators Required for Surveillance					
	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting 7/	Frequency of Publication 7/
Exchange Rates	10/22/2018	10/22/2018	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities /1	NA	NA	NA	NA	NA
Reserve/Base Money	NA	NA	NA	NA	NA
Broad Money	NA	NA	NA	NA	NA
Central Bank Balance Sheet	NA	NA	NA	NA	NA
Consolidated Balance Sheet of the Banking System	NA	NA	NA	NA	NA
Interest Rates /2	10/22/2018	10/22/2018	A	A	I
Consumer Price Index	12/2016	07/11/2018	M	Q	Q
Revenue, Expenditure, Balance and Composition of Financing/3 - General Government /4	FY2017	10/22/2018	A	A	I
Stocks of Central Government and Central Government-Guaranteed Debt /5	FY2017	10/22/2018	A	A	I
External Current Account Balance	12/2016	07/11/2018	A	A	I
Exports and Imports of Goods and Services	12/2016	07/11/2018	A	A	I
GDP/GNP	2017	10/18/2018	A	A	I
Gross External Debt	FY2017	10/22/2018	A	A	I
International Investment Position /6	12/2016	07/11/2018	Q	A	I
<p>1/ 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.</p> <p>2/ Both market-based and officially-determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.</p> <p>3/ Foreign, domestic bank, and domestic nonbank financing.</p> <p>4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.</p> <p>5/ Including currency and maturity composition.</p> <p>6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.</p> <p>7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).</p>					



KIRIBATI

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

December 19, 2018

Approved By
**James Daniel (IMF) and
John Panzer (IDA)**

Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)¹

The 2018 Debt Sustainability Analysis (DSA) indicates that Kiribati remains at high risk of debt distress, although the debt burden indicators improved somewhat thanks to the improved fiscal position and associated increase in fiscal buffers over the last few years.² Further progress in structural and fiscal reforms is needed to improve debt trajectories. The ratios of the present value (PV) of external public and publicly-guaranteed (PPG) debt to GDP and to exports are currently below their respective policy dependent indicative thresholds. However, these ratios are increasing and expected to exceed their indicative thresholds in the medium to the long term. Stress tests confirm the vulnerability of the debt position to plausible shocks. Although Kiribati does not currently face debt servicing risks, helped by historically high revenue from fishing license fees and large cash buffers, risks from a possible reversal of favorable weather or global market conditions and from contingent liabilities call for continued fiscal prudence. Containing the risk of debt distress requires continuation of grants to support the country's large development needs, and implementation of fiscal and structural reforms to promote fiscal sustainability and inclusive growth.

Kiribati: Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	High
Overall risk of debt distress	High
Application of Judgment	N.A.

¹ This DSA was prepared jointly with the World Bank, and it is the first prepared under the revised Debt Sustainability Framework (DSF), approved by the Executive Boards of the IMF and the IDA in September 2017 and effective since July 2018. Debt sustainability is assessed in relation to policy-dependent debt burden thresholds.

² Kiribati's Composite Indicator (CI) is 2.85 based upon both the April and the October 2018 WEOs, including an update to 2017 values for the CPIA index; the "debt-carrying capacity" has been upgraded from "weak" to "medium."

BACKGROUND

1. Kiribati is a small state in the South Pacific, with limited opportunities for diversification and vulnerable to climate change. Impediments such as Kiribati's narrow production/export base (mainly limited to tuna fishing and copra) makes the country highly dependent on revenues from selling fishing licenses under various fisheries agreements and donor support. Kiribati has a sovereign wealth fund—the Revenue Equalization Reserve Fund (RERF)—which was established in 1956 from phosphate mining proceeds. Mining ceased in 1979 and, in recent years, fishing revenues have been used to replenish the fund. Sound management has seen the RERF's net capitalization value rise just above A\$1 billion in August 2018—a target that was expected to be reached in 2020.

2. The country's coverage of public sector debt is the central government and social security fund. Data availability limits debt coverage: a regularly updated balance sheet for all subsectors (most notably, the SOEs) does not currently exist but recent and planned technical assistance aim to provide improvement over time. Debt guaranteed by the government is 6 percent of GDP (not included in the baseline). Public debt doubled since 2014 but has been stable around 23 percent of GDP as of end-2017. The definition of external/domestic debt is "residency-based" as local currency denominated debt (i.e., debt in Australian dollars, which is the legal tender in Kiribati) is held entirely by non-residents (see table on "Public Debt Balance as of end-2017" below).

Subsectors of the public sector		Sub-sectors covered
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	X
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	
7	Central bank (borrowed on behalf of the government)	
8	Non-guaranteed SOE debt	

1 The country's coverage of public debt		The central government plus social security, government-guaranteed debt		
	Default	Used for the analysis	Reasons for deviations from the default settings	
2 Other elements of the general government not captured in 1.	0 percent of GDP	0.0		
3 SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	6.0	Debt guaranteed by government 6 percent	
4 PPP	35 percent of PPP stoc	0.0		
5 Financial market (the default value of 6 percent of GDP is the minimum value)	5 percent of GDP	5.0		
Total (2+3+4+6) (in percent of GDP)		11.0		

1/ The default shock of 2% of GDP will be triggered for countries, whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

Kiribati: Public Debt Balance as of End-2017	
Creditor	Balance
Asian Development Bank	AUD 32,225,287
International Cooperation and Development Fund, Taiwan Province of China	AUD 20,227,983

Source: Kiribati Ministry of Finance, 2018 Budget.

3. **“Debt-carrying capacity” has been upgraded to “medium.”** Kiribati’s Composite Indicator (CI) is 2.85 in both the April and the October 2018 WEOs, with an update to the CPIA index for 2017.

Consequently, the requirement that two consecutive signals are needed to change the status of a country is met,³ and these CI readings put the country in the medium debt-carrying capacity classification.⁴ The relevant indicative thresholds for this category are: 40 percent for the PV of debt-to-GDP ratio, 180 percent for the PV of debt-to-exports ratio, 15 percent for the debt service-to-exports ratio, and 18 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt. The benchmark for the PV of total public debt for medium debt-carrying capacity is 55 percent.⁵ The upgrade of the debt-carrying capacity is mainly the result of a change in methodology under the new Debt Sustainability Framework.

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintages
Medium	Medium 2.85	Medium 2.85	Weak 2.95

UNDERLYING ASSUMPTIONS

4. Key assumptions are consistent with the macroeconomic framework based on data

provided by the authorities and estimates by staff. The 2018 real growth projection is broadly in line with projections in the last DSA. The long-term growth moderation is due to lower-than-expected infrastructure projects implementation and the worsening impact of climate change related events. Some near- to medium-term fiscal indicators have moderately improved mainly due to the upward revisions to fiscal revenues (notably further increases in fishing license fees). Regarding external finance, project support from IDA and ADF has been revised upward, reflecting the World Bank’s and the ADB’s planned scale-up for Pacific Island Countries. The following are the key macroeconomic assumptions used for the baseline scenario:

Kiribati: Baseline Macroeconomic Assumptions (in percent of GDP, unless otherwise noted)		
	2018 DSA: 2018-28 average	2017 DSA: 2017-27 average
Real GDP growth (change in percent)	1.9	2.1
Inflation (change in percent)	2.4	2.5
Non-interest current account deficit	-3.5	-5.4
Net FDI (negative = inflow)	1	1.2
Primary deficit	15.1	12.4

Source: IMF staff projections.

- **Real GDP and population growth** are projected to moderate over the long run. After posting a robust annual average of 5¼ percent in 2015–17, economic growth is expected to decline to around 2¼ percent in 2018 and slow down to 1¾ percent in the medium run and to slightly above 1½ percent in the long run. This reflects both the moderation of fishing revenue as the

³ See the new “Guidance Note on the Bank-Fund Debt Sustainability Framework for Low-income Countries,” available at <http://www.imf.org/en/Publications/PolicyPapers/Issues/2018/02/14/pp122617guidance-note-on-lic-dsf>.

⁴ It is worth noting that the CI has components that might not best reflect the characteristics of Kiribati’s economy: for instance, import coverage of reserves has little relevance since Kiribati uses the Australian dollar as legal tender.

⁵ The revised DSF no longer features remittance-adjusted thresholds, but rather it accounts for remittances in the CI.

current favorable conditions reverse and the potential worsening impact of climate-change-related events (further details on how the effect of climate change is incorporated in the analysis are below). Population growth is envisaged to average about 1.6 percent over the projection period (broadly in line with the United Nations' World Population Prospects).

- **Inflation** fell to 0.4 percent in 2017 (period average), primarily due to a one-off adjustment to the electricity tariff schedule but is anticipated to rise to 2.1 percent in 2018. Compared to the previous DSA, inflation is slightly lower in the medium term to take into account the lower inflation readings in the past few years, driven by passing of SOE efficiency gains to consumers. In the medium to longer terms, consumer price increases are expected to remain around 2½ percent, in line with trading partner inflation and international food and fuel price dynamics given that the bulk of Kiribati's consumer price basket comprises imported items.
- **Fiscal revenue from the fisheries** has been strong over the past five years. After lackluster performance in the late 2000s, fishing license revenue grew at an average rate of 65 percent during 2012–15. This was primarily a result of the 2012 implementation of the Vessel Day Scheme and sound management thereafter; and a stronger U.S. dollar during the same period.⁶ As the effects of this boost diminished, fishing revenue declined from its 2015 peak of A\$207 million and is expected to stabilize around A\$135 million per year over 2019–21. Staff projections assume that fishing revenue will remain constant in real terms from 2022 onwards. This is a conservative assumption but carries a large degree of uncertainty, given unpredictability in weather conditions and migratory patterns of fish.
- The **fiscal position** improved significantly in 2013–17. In the medium to long term, however, the overall balance is expected to weaken. The deterioration would stem from lower revenue and higher expenditures. The primary balance is expected to worsen in 2019–20 due to the capex related to Air Kiribati's acquisition of two planes to expand international services. Recent double-digit growth in recurrent spending (excluding climate-change-related expenditures) is assumed to subside, with spending growing at an annual average rate of about 3 percent over the forecast horizon. The baseline scenario explicitly considers the impact of climate change on spending in line with the 2016 IMF Board Paper on "Small States' Resilience to Natural Disasters and Climate Change."⁷ Climate-change-related maintenance and contingency expenditures are assumed to be less than 1 percent of GDP in 2019 and gradually reach 6 percent of GDP in 2028 and remain at that level thereafter.⁸
- **Development expenditure** is assumed to gradually decline from 55 percent of GDP in 2018 to around 20 percent of GDP in the long term as ongoing infrastructure projects are completed and the infrastructure gap is narrowed. Financing is assumed to be covered by loans from IDA and ADF (as reflected in the projected allocations by the World Bank and the ADB, and

⁶ Fishing license fees are collected in U.S. dollars.

⁷ Available at: <https://www.imf.org/en/News/Articles/2016/12/12/PR16550-IMF-Discusses-Small-States-Resilience-to-Natural-Disasters-and-Climate-Change-and-IMF-Role>.

⁸ This assumption is informed by estimates from the literature. See *Climate Change and Disaster Management* (The World Bank, 2016), which estimates that the additional cost of coastal protection and infrastructure adaptation due to rainfall and temperature increases for Kiribati could amount to 12 percent of GDP annually by 2040. The DSA assumes that half of the costs will be borne by the budget while the rest is financed by development partners.

amounting to roughly 20 percent of development expenditure through the projection period), and by external grants until 2030 and by combinations of external grants and withdrawal of RERF resources starting in 2030.⁹ The previous DSA assumed that 80 percent of development expenditure was financed by external grants up to 2022, while starting in 2023 it was financed in equal parts by external grants and external loans for the remaining period of projection.

- Kiribati is heavily reliant on **external grants**.¹⁰ The baseline assumes that project-based grants will remain broadly stable in the near term (2018–20), in line with information from major development partners. Grants are assumed to reduce to about 15 percent of GDP (compared to a historical average of about 30 percent) in the long run.
- The **current account** surplus averaged around 30 percent of GDP in 2013–17, largely owing to the strong fishing license fees. As the growth in fisheries factor income slows down, the current account balance will narrow considerably and is expected to register an average deficit of around 1 percent of GDP in the long term.
- Kiribati's **current debt portfolio** is composed of external debt only, as all domestic debt was cleared in 2015. Therefore, the baseline and alternative scenarios do not assume any domestic debt in the short, medium, and long run.

5. The new realism tools suggest that the projections are reasonable (Figure 4). The primary balance is expected to deteriorate considerably in the next few years due to the exceptional capex noted above. However, this fiscal expansion is not expected to substantially boost growth because the spending is mainly on imports, resulting in a low multiplier. Changes to the contribution to real GDP growth from capital spending, compared to the previous DSA and as estimated by the template, again reflect the exceptional capex related to the aircraft acquisition. Public investment rates are higher while private investment rates are the same when compared to the previous DSA.

INCORPORATING NATURAL DISASTERS

6. Rising climate change challenges pose significant downside risks. Kiribati stands to lose the most from the negative effects of climate change, including but not limited to drought, higher incidences of natural disasters, loss of groundwater, and rising sea levels leading to coastal erosion. The costs of mitigating the adverse effects of climate change can partially be met by Kiribati's operating budget. Capital projects, however, require continued support from development partners.

⁹ In the baseline, cash reserves are assumed to be drawn down to 5 percent of GDP before recourse to the RERF in 2030. Despite the withdrawals, the nominal balance of the RERF would remain above the A\$1 billion target articulated in the authorities' fiscal strategy.

¹⁰ In the IMF's macroeconomic framework, it is assumed that Kiribati will continue to benefit from its grant-only status. This assumption is consistent with MDBs' grant decision rules given the DSA rating and even assuming the realization of such grants and their impact on the DSA. However, in preparing the LIC-DSA, for World Bank (IDA) and other MDBs (in the case of Kiribati, the ADB), regular credit terms on all lending is assumed for all years in the projection period for which grant finance has not already been committed. This is because the DSA serves to test a country's capacity to take on IDA and ADB financing on credit terms. Hence, a clean assessment without potential grants is needed. Grants committed, on the basis of the DSA, can then be captured at the next DSA cycle.

7. The DSA baseline incorporates the costs and risks of natural disasters, again in line with the 2016 IMF Board Paper on “Small States’ Resilience to Natural Disasters and Climate Change.” For FY2018–23, staff’s projections assume no natural disasters. This ensures that adjustment for natural disasters do not complicate near-term policy discussions. However, long-term growth projections are adjusted down by 0.1 percentage points to 1.6 percent, compared with non-disaster potential growth rate of 1.7 percent.¹¹ In addition, the near-term risk of a one-off extreme natural disaster is incorporated in the DSA through a tailored stress test which assumes that a one-off extreme natural disaster would decrease real GDP growth by 1.5 percent and exports by 3.5 percentage points. This aims to capture the possibility that the climate change adaptation costs (already incorporated in staff’s macroeconomic framework) may turn out to be optimistic or that Kiribati becomes prone to natural disasters more than it historically has been as a result of climate change.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

8. Under the baseline scenario, Kiribati’s external debt trajectory is projected to exceed the indicative threshold in the medium to long term.¹² The PV of debt-to-GDP ratio breaches the indicative benchmark (40 percent) after 2022 (Figure 1). The ratio of the PV of external-debt-to-exports ratio breaches the threshold (180 percent) at the end of the projection period. As the bulk of the projected external debt is on concessional terms, debt service will be relatively contained. However, the debt service-to-exports ratio will gradually approach the indicative threshold by the end of the projection period because of continued debt accumulation.

9. Stress tests confirm the vulnerability of debt dynamics to export market conditions as well as to macroeconomic shocks. Under the extreme test scenarios, the PV of debt-to-GDP and PV of debt-to-export ratios breach their thresholds by 2019 and 2021, respectively (Figure 1). These ratios are vulnerable to shocks emanating from exports.¹³ The other stress test scenarios, including the severe natural disaster scenario, and for PV of debt -to-GDP, the contingent liabilities test, illustrate the vulnerability of the debt trajectory to external and potential domestic shocks (Table 3).

PUBLIC DEBT SUSTAINABILITY ANALYSIS

10. Public debt follows the same dynamics as external debt, given that there is no domestic debt. The tapering of the windfall fishing revenue and contingent liabilities stemming from SOEs¹⁴

¹¹ The assumed reduction is informed by the literature, see Box 3 in the 2016 Article IV Staff Report. Note that this estimate is surrounded by great uncertainty and climate change may have much larger adverse impact on growth, which the natural disaster scenario of the DSA aims to capture.

¹² The large residual in Table 1 is attributable to several factors: quality of balance of payments data, accumulation of assets in the RERF, and the partial utilization assumption regarding IDA/ADF commitments (these enter the DSA in full, but development expenditures as reflected in the overall balance are not utilizing these funds in full).

¹³ For the purposes of the DSA, the exports data include fishing license fees, which would be counted as “other primary income” under conventional balance-of-payments definitions.

¹⁴ Currently, the Government of Kiribati explicitly guarantees any obligations that are unable to be met by the Kiribati Provident Fund, as provided under Section 10 of CAP78A (Provident Fund Act 1977).

pose risks and underscore the importance of commitment to maintaining a sound fiscal position. Under the baseline scenario, the PV of total public-debt-to-GDP ratio is projected to breach its indicative benchmark (55 percent) by 2025.¹⁵

11. Public debt is unsustainable under the extreme shock scenario. The most extreme stress test scenario predicts the PV of public-sector-debt-to-GDP ratio breaching the threshold by 2022; and tripling in the following decade. This might be attributed to lower growth rates triggered by lower fishing revenues and higher government external borrowing for project financing.

AUTHORITIES' VIEWS

12. The authorities broadly agreed with the DSA assessment. They expressed their strong commitment to a prudent fiscal policy stance. The main elements of the authorities' fiscal strategy for 2019 are: an overall balanced budget, zero new debt, and no withdrawals from the RERF. The authorities will continue to maintain a conservative estimate of fishing revenues in the budget so that expenditure is met within the government's means, without new debt issued and without withdrawals from the RERF. The authorities affirmed that they will continue to seek grants from bilateral donors and international financial institutions with a view to keep debt levels at prudent levels. In this context, they also recognized the need to comply with the non-concessional borrowing policies for securing grant support from the World Bank and the ADB.

CONCLUSION

13. As in previous Article IV consultations, the current DSA indicates that Kiribati is at high risk of debt distress. Under the baseline scenario, the PVs of PPG external debt-to-GDP and of public debt-to-GDP would breach the indicative thresholds during most of the projection period. Kiribati faces limited scope for external borrowing. Hence, meeting the significant public spending needs and reaching the development goals depends on using the available fiscal resources in a prudent way and securing support from development partners. Vulnerabilities are exacerbated by contingent liabilities from SOEs and by climate change. Facing these challenges while maintaining fiscal sustainability requires a reinforcement of the fiscal framework and improved governance of budget outcomes and institutions. At the same time, Kiribati's vulnerability to debt distress is mitigated by a number of factors: the decline of external support will be gradual, sheltering the country from the risk of a sudden stop in foreign financing; the government has large cash buffers and continues to accumulate resources in the RERF, which could be used in case of temporary shocks; and the country currently benefits from its grant-only status.

¹⁵ The residual in the public sector DSA table reflects the volatility of fishing revenue (and RERF withdrawals / deposits). Although the fiscal position has registered a large surplus in recent years thanks to strong revenue, the surplus was mainly saved in the RERF rather than used to repay government debt.

Table 1. Kiribati: External Debt Sustainability Framework, Baseline Scenario, 2015–38

	(In percent of GDP, unless otherwise indicated)												Average 8 ¹		Definition of external/domestic Is there a material difference between the two criteria?	Residency-based No
	Actual			Projections								Historical	Projections			
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028	2038					
External debt (nominal) 1/	18.5	21.6	21.0	27.9	36.9	48.7	62.9	75.3	86.5	128.0	150.4	7.6	82.2			
<i>of which: public and publicly guaranteed (PPG)</i>	18.5	21.6	21.0	27.9	36.9	48.7	62.9	75.3	86.5	128.0	150.4	7.6	82.2			
Change in external debt	3.1	3.1	-0.6	6.9	9.0	11.8	14.2	12.3	11.2	6.5	-0.6					
Identified net debt-creating flows	-44.5	-19.0	-13.3	-12.0	-6.9	-3.1	-1.7	-1.2	-0.3	6.2	24.7	-25.6	-1.1			
Non-interest current account deficit	-44.4	-19.4	-13.6	-13.3	-8.5	-4.6	-3.2	-2.7	-1.6	5.4	24.5	-13.2	-2.4			
Deficit in balance of goods and services	5.5	25.0	26.6	23.1	38.5	41.1	43.3	44.7	45.9	51.3	58.4	34.8	43.5			
Exports	92.2	68.7	70.1	68.3	58.2	56.6	54.8	53.9	53.1	43.6	43.0					
Imports	97.7	93.7	96.7	97.4	96.6	97.6	98.1	98.6	99.0	100.9	101.4					
Net current transfers (negative = inflow)	-31.3	-25.0	-13.1	-16.5	-22.0	-18.9	-18.1	-19.1	-19.0	-18.8	-11.0	-26.4	-18.7			
<i>of which: official</i>	-19.8	-22.3	-10.6	-14.2	-20.0	-17.1	-16.5	-17.7	-17.8	-17.1	-3.2					
Other current account flows (negative = net inflow)	-18.6	-13.4	-27.1	-25.9	-25.0	-26.8	-28.4	-28.3	-28.5	-27.0	-22.9	-21.6	-27.2			
Net FDI (negative = inflow)	0.4	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.0	0.7	0.0	1.1			
Endogenous debt dynamics 2/	-0.5	-0.6	-0.7	0.2	0.5	0.5	0.5	0.3	0.2	-0.2	-0.5					
Contribution from nominal interest rate	0.1	0.1	0.1	0.7	1.1	1.3	1.4	1.5	1.6	1.8	1.7					
Contribution from real GDP growth	-1.5	-0.9	-0.1	-0.5	-0.6	-0.8	-1.0	-1.2	-1.4	-1.9	-2.2					
Contribution from price and exchange rate changes	0.9	0.2	-0.7	...	...	...	...	...	...	...	...
Residual 3/	47.7	22.1	12.7	18.9	15.9	14.9	15.9	13.6	11.6	0.3	-25.3	27.5	11.2			
<i>of which: exceptional financing</i>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0					
Sustainability indicators																
PV of PPG external debt-to-GDP ratio	...	...	14.8	18.0	21.9	26.9	33.2	38.8	44.0	65.9	81.1				
PV of PPG external debt-to-exports ratio	...	...	21.1	26.3	37.7	47.6	60.6	71.9	82.8	132.7	188.6				
PPG debt service-to-exports ratio	0.5	0.7	0.4	1.0	2.5	2.9	3.2	3.5	3.7	4.7	10.8					
PPG debt service-to-revenue ratio	0.4	0.6	0.3	0.7	2.0	2.3	2.6	2.8	3.0	3.8	8.8					
Gross external financing need (Million of U.S. dollars)	-77.7	-33.2	-23.6	-23.1	-11.9	-3.4	0.0	1.6	4.6	28.2	146.4					
Key macroeconomic assumptions																
Real GDP growth (in percent)	10.4	5.1	0.3	2.3	2.3	2.3	2.0	1.9	1.9	1.7	1.6	2.3	2.1			
GDP deflator in US dollar terms (change in percent)	-5.7	-1.0	3.6	1.5	2.6	1.9	2.3	2.5	2.6	2.9	2.9	1.0	2.2			
Effective interest rate (percent) 4/	0.5	0.4	0.3	3.3	4.2	3.6	3.0	2.5	2.2	1.5	1.2	0.4	3.2			
Growth of exports of G&S (US dollar terms, in percent)	8.2	-22.5	6.1	1.0	-10.5	1.4	1.0	2.9	3.0	3.0	3.1	14.5	-0.2			
Growth of imports of G&S (US dollar terms, in percent)	-7.4	-0.2	7.2	4.4	4.2	5.3	4.8	5.0	5.0	4.9	4.6	5.7	4.8			
Grant element of new public sector borrowing (in percent)	...	...	...	52.8	52.8	53.6	54.3	54.3	54.3	54.3	54.3	...	53.7		
Government revenues (excluding grants, in percent of GDP)	106.8	84.6	96.4	93.6	73.5	71.1	63.0	66.7	65.1	60.2	52.8	66.8	73.2			
Aid flows (in Million of US dollars) 5/	68.2	53.8	56.7	64.9	35.7	102.0	103.4	105.8	106.9	123.2	113.3					
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	29.1	40.5	40.5	40.4	37.4	36.2	33.7	19.3	...	37.3		
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	83.6	89.0	86.9	84.4	84.5	84.5	85.3	83.0	...	86.5		
Nominal GDP (Million of US dollars)	178	186	193	200	210	219	229	239	250	314	487					
Nominal dollar GDP growth	4.1	4.0	3.9	3.7	5.0	4.3	4.4	4.5	4.6	4.6	4.5	3.3	4.4			
Memorandum items:																
PV of external debt 7/	...	...	14.8	18.0	21.9	26.9	33.2	38.8	44.0	65.9	81.1				
In percent of exports	...	...	21.1	26.3	37.7	47.6	60.6	71.9	82.8	132.7	188.6				
Total external debt service-to-exports ratio	0.5	0.7	0.4	1.0	2.5	2.9	3.2	3.5	3.7	4.7	10.8					
PV of PPG external debt (in Million of US dollars)	...	...	28.5	36.0	46.1	59.0	75.9	92.6	109.9	206.7	335.0				
(Pvt-Pvt-1)/GDPt-1 (in percent)	...	...	...	3.9	5.1	6.1	7.7	7.3	7.2	6.8	3.5				
Non-interest current account deficit that stabilizes debt ratio	-47.6	-22.5	-13.0	-20.2	-17.5	-16.4	-17.4	-15.0	-12.8	-1.1	25.1					

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \alpha(1+g) + \beta \Delta E] / (1+g+g_1)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate; α = growth rate of GDP deflator in U.S. dollar terms; β = nominal appreciation of the local currency, and ΔE = share of local currency-denominated external debt in total external debt.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as: grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

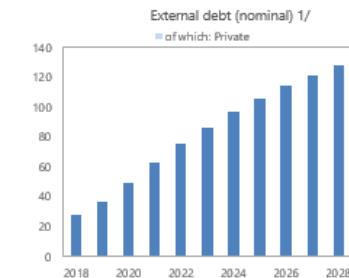
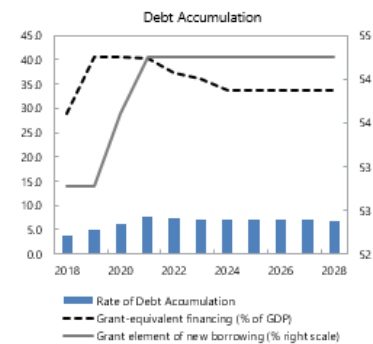


Table 2. Kiribati: Public Sector Debt Sustainability Framework, Baseline Scenario, 2015–38

	Actual			Projections							Average 6f		Historical		Projections	
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028	2038					
Public sector debt 1/	18.5	21.6	21.0	27.9	36.9	48.7	62.9	75.3	86.5	128.0	150.4	7.6	82.2			
of which: external debt	18.5	21.6	21.0	27.9	36.9	48.7	62.9	75.3	86.5	128.0	150.4	7.6	82.2			
Change in public sector debt	3.1	3.1	-0.6	6.9	9.0	11.8	14.2	12.3	11.2	6.5	-0.6					
Identified debt-creating flows	-48.3	-4.4	-12.2	19.1	21.6	20.4	9.3	6.0	6.5	9.2	24.1	-21.7	15.2			
Primary deficit	-47.1	-3.3	-11.3	19.1	22.1	20.5	10.0	7.2	8.2	12.8	28.8	-6.4	13.0			
Revenue and grants	145.1	113.6	125.8	118.9	108.5	104.6	100.5	96.0	93.4	87.3	67.4	100.5	96.8			
of which: grants	38.2	29.0	29.4	25.3	34.9	33.4	31.6	29.3	28.3	27.1	14.6					
Primary (noninterest) expenditure	98.0	110.3	114.5	137.9	130.6	125.1	110.5	103.1	101.5	100.1	96.3					
Automatic debt dynamics	-1.3	-1.1	-0.9	0.1	-0.5	-0.1	-0.7	-1.2	-1.7	-3.6	-4.7					
Contribution from interest rate/growth differential	-1.6	-1.2	-0.4	-0.2	0.0	-0.2	-0.5	-0.9	-1.3	-2.5	-3.4					
of which: contribution from average real interest rate	-0.2	-0.3	-0.3	0.3	0.6	0.6	0.5	0.3	0.1	-0.6	-1.1					
of which: contribution from real GDP growth	-1.4	-0.9	-0.1	-0.5	-0.6	-0.8	-1.0	-1.2	-1.4	-2.0	-2.3					
Contribution from real exchange rate depreciation	0.3	0.1	0.5	—	—	—	—	—	—	—	—					
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0					
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0					
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0					
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0					
Residual	51.5	7.5	11.7	-11.9	-13.2	-8.5	4.7	6.1	4.4	-3.7	-26.0	23.6	-2.0			
Sustainability indicators																
PV of public debt-to-GDP ratio 2/	---	---	14.8	18.2	21.9	27.0	33.2	38.8	44.0	65.9	81.1					
PV of public debt-to-revenue and grants ratio	---	---	11.8	15.3	20.2	25.9	33.0	40.4	47.1	75.5	120.3					
Debt service-to-revenue and grants ratio 3/	0.3	0.4	0.2	0.6	1.3	1.6	1.8	2.0	2.1	2.6	6.9					
Gross financing need 4/	-46.7	-2.9	-11.0	19.7	23.6	22.2	11.8	9.0	10.1	15.1	33.5					
Key macroeconomic and fiscal assumptions																
Real GDP growth (in percent)	10.4	5.1	0.3	2.3	2.3	2.3	2.0	1.9	1.9	1.7	1.6	2.3	1.9			
Average nominal interest rate on external debt (in percent)	0.6	0.4	0.3	3.3	4.3	3.6	3.0	2.5	2.2	1.5	1.2	0.5	2.5			
Average real interest rate on domestic debt (in percent)	4.9	—	—	—	—	—	—	—	—	—	—	—	—			
Real exchange rate depreciation (in percent, + indicates depreciation)	2.3	0.4	-2.5	—	—	—	—	—	—	—	—	—	—			
Inflation rate (GDP deflator, in percent)	13.1	0.1	0.5	1.9	3.5	1.6	2.5	2.5	2.6	2.9	2.9	2.0	2.7			
Growth of real primary spending (deflated by GDP deflator, in percent)	8.8	18.3	4.2	23.1	-3.1	-2.0	-9.9	-4.9	0.4	1.8	5.9	8.9	1.0			
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-50.2	-6.4	-10.7	12.1	13.2	8.7	4.2	-5.2	-3.1	6.2	28.4	-22.5	3.2			
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0					

Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government plus social security, government-guaranteed debt. Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

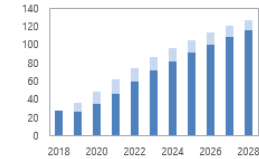
5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio (i.e., a primary surplus), which would stabilize the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	No

Public sector debt 1/

■ of which: local-currency denominated
■ of which: foreign-currency denominated



■ of which: held by residents
■ of which: held by non-residents

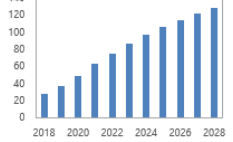
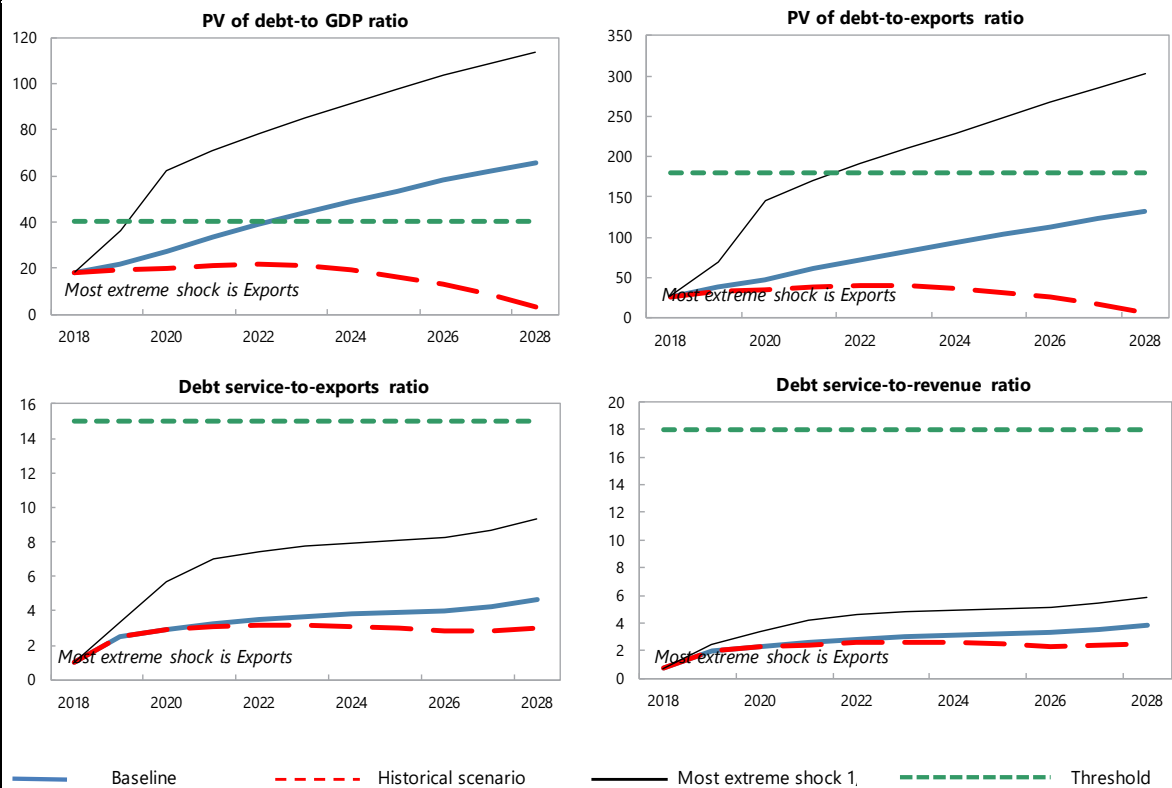


Figure 1. Kiribati: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2018–28 1/



Customization of Default Settings		
	Size	Interactions
Tailored Tests		
Combined CLs	No	
Natural Disasters	No	No
Commodity Prices ^{2/}	n.a.	n.a.
Market Financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing Assumptions for Stress Tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.0%	1.0%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	36	36
Avg. grace period	9	9

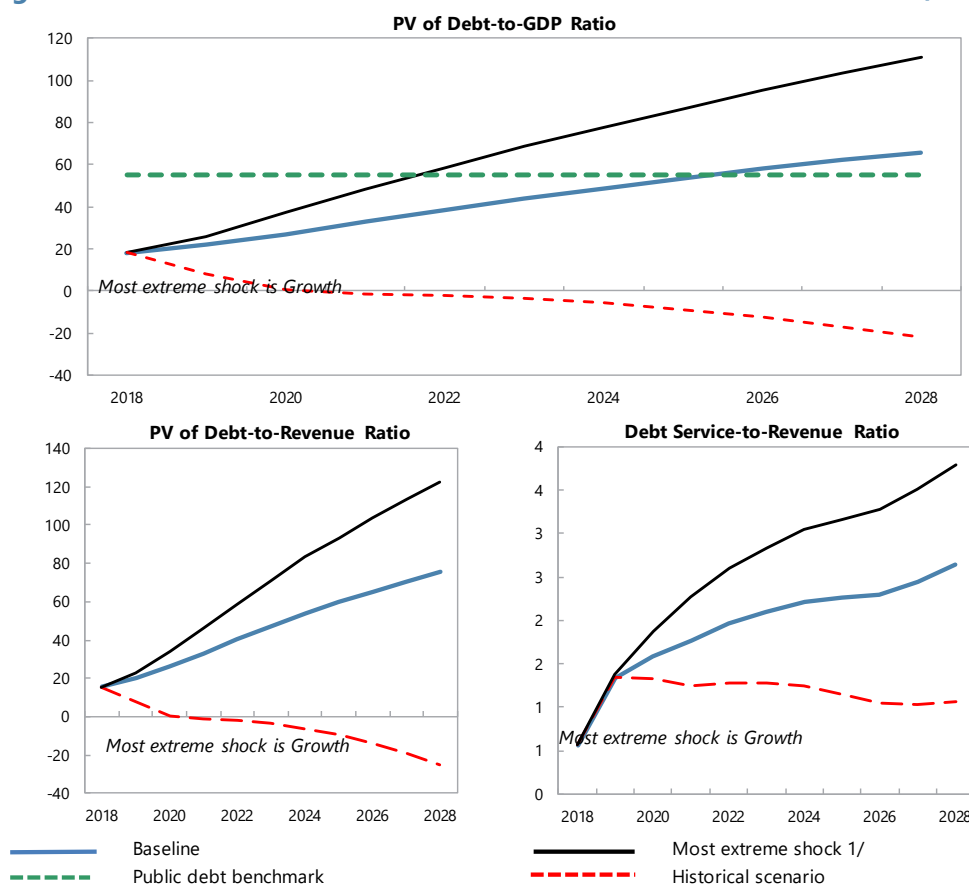
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2028. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Kiribati: Indicators of Public Debt Under Alternative Scenarios, 2018–28



Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	97%	97%
Domestic medium and long-term	0%	0%
Domestic short-term	0%	3%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.0%	1.0%
Avg. maturity (incl. grace period)	36	36
Avg. grace period	9	9
Domestic MLT debt		
Avg. real interest rate on new borrowing	0.0%	0.0%
Avg. maturity (incl. grace period)	1	1
Avg. grace period	0	0
Domestic short-term debt		
Avg. real interest rate	0%	0.0%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2028. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Table 3. Kiribati: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2018–28

	Projections 1/										
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
PV of debt-to-GDP ratio											
Baseline	18	22	27	33	39	44	49	54	58	62	66
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	18	19	20	21	21	21	19	16	13	8	3
B. Bound Tests											
B1. Real GDP growth	18	23	30	37	44	50	55	60	65	70	74
B2. Primary balance	18	33	50	56	62	67	71	76	80	84	88
B3. Exports	18	36	62	71	78	85	91	97	103	109	114
B4. Other flows 2/	18	29	40	47	52	57	62	67	71	75	79
B5. Depreciation	18	22	27	33	39	44	49	54	58	62	66
B6. Combination of B1-B5	18	36	43	50	57	63	69	75	80	85	90
C. Tailored Tests											
C1. Combined contingent liabilities	18	27	32	38	44	49	54	59	63	67	71
C2. Natural disaster	18	27	33	40	46	52	57	62	67	72	76
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	40	40	40	40	40	40	40	40	40	40	40
PV of debt-to-exports ratio											
Baseline	26	38	48	61	72	83	93	103	113	123	133
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	26	33	35	39	40	39	36	32	25	17	6
B. Bound Tests											
B1. Real GDP growth	26	38	48	61	72	83	93	103	113	123	133
B2. Primary balance	26	57	88	102	114	125	135	146	157	167	177
B3. Exports	26	69	146	171	191	211	229	248	267	285	303
B4. Other flows 2/	26	49	71	85	97	108	118	128	139	149	159
B5. Depreciation	26	38	48	61	72	83	93	103	113	123	133
B6. Combination of B1-B5	26	60	62	98	113	128	141	154	168	181	194
C. Tailored Tests											
C1. Combined contingent liabilities	26	47	57	70	82	93	102	113	123	133	143
C2. Natural disaster	26	48	60	75	88	100	111	123	135	146	157
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	180	180	180	180	180	180	180	180	180	180	180
Debt service-to-exports ratio											
Baseline	1	2	3	3	4	4	4	4	4	4	5
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	1	3	3	3	3	3	3	3	3	3	3
B. Bound Tests											
B1. Real GDP growth	1	2	3	3	4	4	4	4	4	4	5
B2. Primary balance	1	2	3	4	4	4	5	5	5	5	5
B3. Exports	1	3	6	7	7	8	8	8	8	9	9
B4. Other flows 2/	1	2	3	4	4	4	4	4	4	5	5
B5. Depreciation	1	2	3	3	4	4	4	4	4	4	5
B6. Combination of B1-B5	1	3	4	5	5	5	5	5	6	6	6
C. Tailored Tests											
C1. Combined contingent liabilities	1	2	3	3	4	4	4	4	4	4	5
C2. Natural disaster	1	3	3	4	4	4	4	4	4	5	5
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	15	15	15	15	15	15	15	15	15	15	15
Debt service-to-revenue ratio											
Baseline	1	2	2	3	3	3	3	3	3	4	4
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	1	2	2	2	3	3	3	2	2	2	2
B. Bound Tests											
B1. Real GDP growth	1	2	3	3	3	3	4	4	4	4	4
B2. Primary balance	1	2	3	3	3	4	4	4	4	4	4
B3. Exports	1	2	3	4	5	5	5	5	5	5	6
B4. Other flows 2/	1	2	3	3	3	3	3	4	4	4	4
B5. Depreciation	1	2	2	3	3	3	3	3	3	4	4
B6. Combination of B1-B5	1	2	3	3	4	4	4	4	4	5	5
C. Tailored Tests											
C1. Combined contingent liabilities	1	2	2	3	3	3	3	3	3	4	4
C2. Natural disaster	1	2	2	3	3	3	3	3	4	4	4
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Includes official and private transfers and FDI.

Table 4. Kiribati: Sensitivity Analysis for Key Indicators of Public Debt 2018–28

	Projections 1/										
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
PV of Debt-to-GDP Ratio											
Baseline	18	22	27	33	39	44	49	54	58	62	66
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	18	8	0	-1	-2	-3	-6	-9	-13	-17	-22
B. Bound Tests											
B1. Real GDP growth	18	25	37	48	59	69	78	87	95	104	111
B2. Primary balance	18	34	50	56	62	67	71	76	80	84	88
B3. Exports	18	29	46	52	58	63	68	72	77	81	84
B4. Other flows 2/	18	29	40	47	52	57	62	67	71	75	79
B5. Depreciation	18	24	24	24	25	25	26	26	27	28	28
B6. Combination of B1-B5	18	34	39	33	38	43	48	53	57	61	65
C. Tailored Tests											
C1. Combined contingent liabilities	18	27	32	38	44	49	54	59	63	67	71
C2. Natural disaster	18	28	33	40	46	52	57	62	67	72	76
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Revenue Ratio											
Baseline	15	20	26	33	40	47	54	60	65	71	75
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	15	8	0	(1)	(2)	(4)	(6)	(10)	(14)	(19)	(25)
B. Bound Tests											
B1. Real GDP growth	15	23	34	46	59	71	83	94	104	113	123
B2. Primary balance	15	31	48	56	64	71	79	85	90	96	101
B3. Exports	15	27	44	52	60	68	75	81	86	92	97
B4. Other flows 2/	15	26	39	46	54	61	69	74	80	85	90
B5. Depreciation	15	22	23	25	27	28	29	30	31	32	33
B6. Combination of B1-B5	15	31	37	33	40	47	54	59	65	70	75
C. Tailored Tests											
C1. Combined contingent liabilities	15	25	31	38	46	53	60	66	71	76	81
C2. Natural disaster	15	25	32	40	48	55	63	69	75	81	87
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	1	1	2	2	2	2	2	2	2	2	3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	1	1	1	1	1	1	1	1	1	1	1
B. Bound Tests											
B1. Real GDP growth	1	1	2	2	3	3	3	3	3	4	4
B2. Primary balance	1	1	2	3	2	3	3	3	3	3	3
B3. Exports	1	1	2	2	2	2	3	3	3	3	3
B4. Other flows 2/	1	1	2	2	2	2	2	3	3	3	3
B5. Depreciation	1	2	2	2	2	3	3	3	3	3	3
B6. Combination of B1-B5	1	1	2	2	2	2	2	2	2	2	3
C. Tailored Tests											
C1. Combined contingent liabilities	1	1	2	2	2	2	2	2	2	3	3
C2. Natural disaster	1	1	2	2	2	2	2	2	3	3	3
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

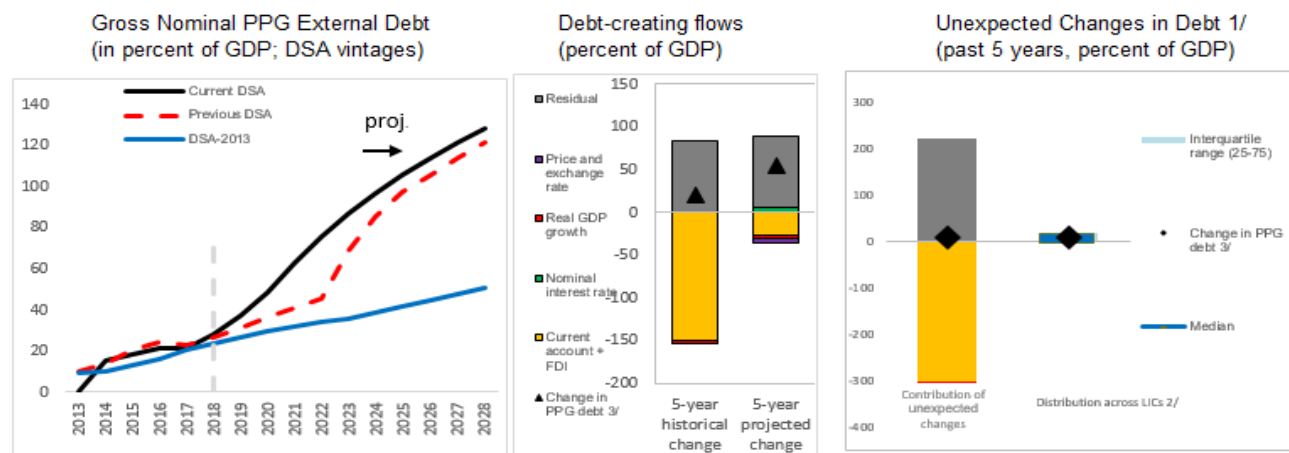
Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the benchmark.

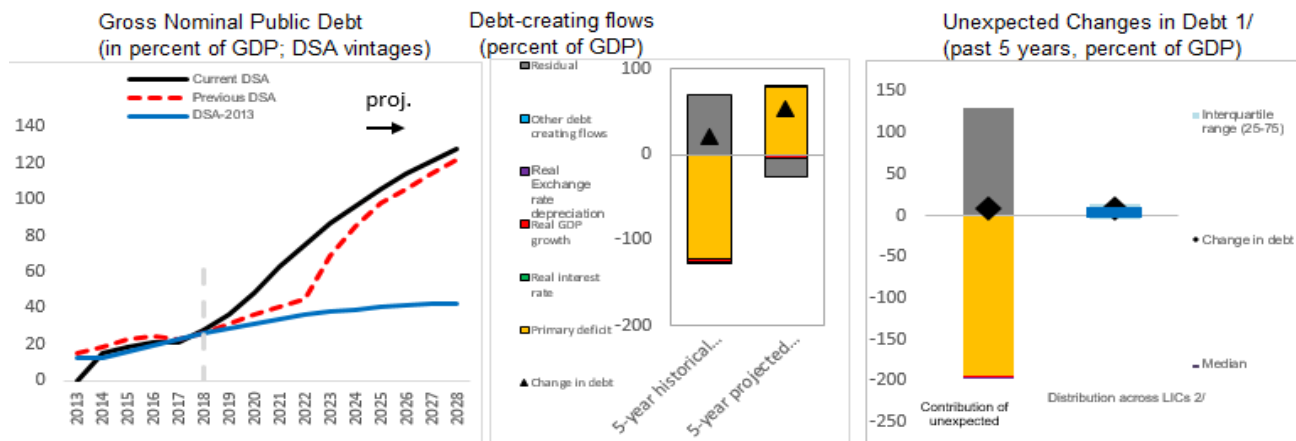
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

Figure 3. Kiribati: Drivers of Debt Dynamics—Baseline Scenario



Public debt



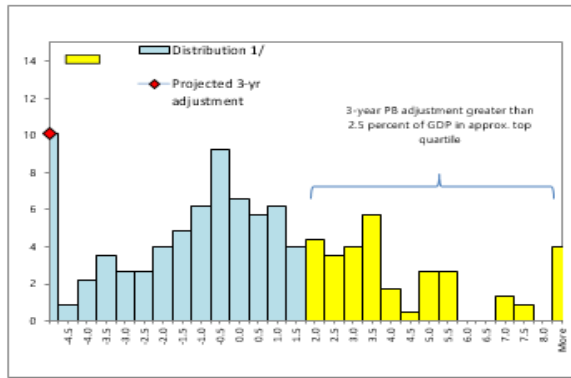
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

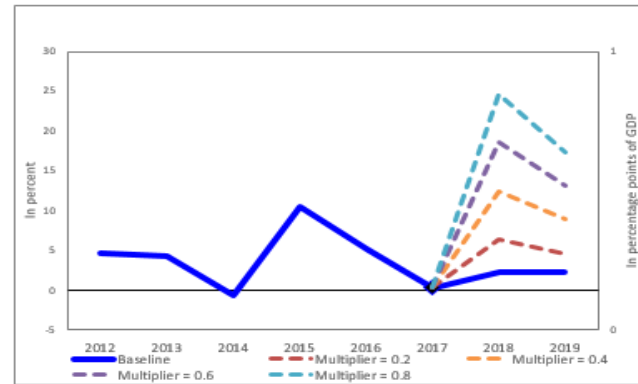
Figure 4. Kiribati: Realism Tools

3-Year Adjustment in Primary Balance(Percentage points of GDP)



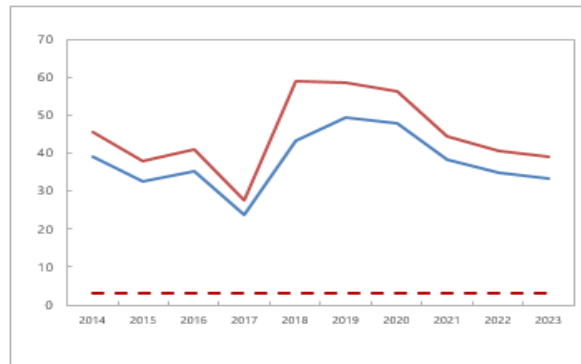
* Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 2000. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



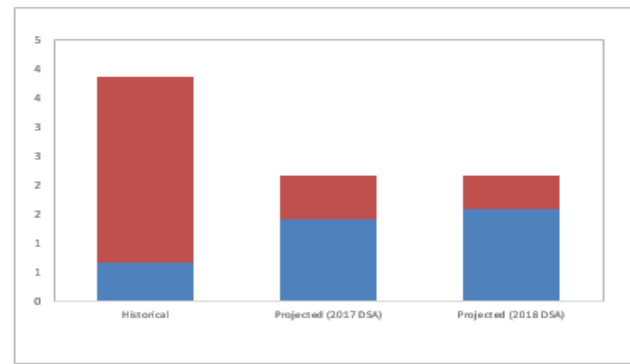
1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates (% of GDP)



— Gov. Invest. - DSA 2016 — Gov. Invest. - Current DSA
 - - - Priv. Invest. - DSA 2016 - - - Priv. Invest. - Current DSA

Contribution to Real GDP growth (percent, 5-year average)



■ Contribution of other factors
 ■ Contribution of government capital

**Statement by Mr. Nigel Ray, Executive Director of Kiribati, and Ms. Anna Park,
Advisor to the Executive Director of Kiribati
January 11, 2019**

Mr. Ray and Ms. Park submitted the following statement:

Kiribati consists of 33 small islands spread over an area of the Pacific Ocean roughly the size of India, and is the only country situated in all four hemispheres. Geographic dispersion and remoteness contribute to the high cost of infrastructure and public service delivery. As with many Pacific countries, the production and export base is narrow. The main sources of income are fishing licenses, remittances from seafarers and copra. Reliance on imported fuel and food is high, increasing vulnerability to exchange rate and commodity price movements. Kiribati will be one of the first countries affected by rising sea levels and the tuna fishery – its key economic resource – could be affected by higher ocean surface temperatures.

Despite these challenges, considerable progress has been made in recent years. Kiribati's economy has performed strongly owing to higher public spending supported by record fishing revenue and donor-financed infrastructure investment. The fiscal position has improved and the current account has shifted into surplus. The Government has supported the outer islands by doubling the copra subsidy, extended fee-free education, reduced the cost of access to electricity in South Tarawa, improved pay and working conditions for public servants and invested in better transport and telecommunications links – all within its current revenue envelope. Kiribati has a good record of stable democracy, orderly government transitions, social cohesion, and prudent economic management. The Kiribati Vision 20 (KV20) sets out a blueprint for sustainable and inclusive development, focusing on fisheries and tourism, as well as developing human capital, investing in infrastructure, and promoting good governance.

The authorities largely agree with the staff's analysis and outlook, and with the broad thrust of the advice. They thank staff for their thoughtful analysis and the open and collaborative approach taken by the team. The mission included a technical assistance component and ran alongside a World Bank mission, which allowed all involved to draw on each other's expertise and make best use of the authorities' time.

Prudent and sustainable fiscal management

Public spending needs are high. Kiribati has the lowest per capita income in the region and a fifth of the population lives below the poverty line. Infrastructure needs

are high – less than half the population has access to improved sanitation or electricity, or mobile phone and internet access.

The authorities are committed to prudent and sustainable fiscal management, alongside necessary investments in development and social programs. Kiribati has maintained fiscal surpluses over recent years, enabling contributions to the Revenue Equalization and Reserve Fund (RERF). For 2019, the Government has committed to running at least a balanced budget. This calls for using conservative estimates of fishing revenue and making no further step-change in public service salaries or copra subsidies. The government sees the copra subsidy as playing an important role in redistributing income and meeting basic needs for households in the outer islands. The authorities will carefully consider staff advice to focus on the controllable portion of the budget and limit use of supplementary budgets. But some flexibility in the framework is appropriate to respond to large and unpredictable variations in fishing license revenues. These fluctuations – either negative or positive – can have a significant impact on economic and fiscal outcomes.

The RERF is one of Kiribati's most important assets and it is critical that it is managed effectively to provide benefits to both present and future generations. As well as making an A\$70 million transfer to the RERF in 2016, the Government has implemented management reforms, including appointment of new asset managers and a new custodian through a competitive selection process. Cabinet recently approved the adoption of a clear set of objectives for the management of the RERF. These are designed to reach the KV20 target of an asset value of A\$1 billion by 2020, and – going forward – to maintain the real value of the fund while using a portion of RERF returns to finance development projects. High fisheries revenue in recent years has allowed Kiribati to accumulate significant cash reserves, which can now replace the traditional revenue stabilization role of the RERF. Cabinet recently adopted a cash management policy to ensure that these cash reserves are managed as efficiently as possible while still meeting the liquidity needs of the government and the banking system.

The authorities are aware of potential climate change mitigation and adaptation costs and are working to recognize these costs in the Budget. The new Climate Finance Division in the Ministry of Finance is developing a strategic framework and country program and is looking at enhancing reporting of spending on climate adaptation and mitigation.

Enhancing governance

The authorities are committed to improving public financial management. A new Central Procurement Unit in the Ministry of Finance and Economic Development was established in 2018, and the authorities look forward to working closely with

development partners to continue implementing the Kiribati Public Procurement Reform Program. In addition to the recent PIMA report, the Ministry of Finance are also carefully considering several other sets of recommendations. Capacity constraints can become an issue in this context. Staff make recommendations on project selection, for example. But it is difficult for the National Economic and Planning Office, an office of 13 people, to achieve best practice when they are also responsible for providing economic policy, compiling the Budget, monitoring expenditure and revenue, managing aid coordination, overseeing the performance of SOEs, managing the RERF, running the Economic Reform Taskforce and undertaking debt management.

Supporting private sector development

The private sector can be an engine of economic growth and development for Kiribati. Significant progress has been made with SOE reforms over recent years, including strengthening the commercial mandate of SOEs and further divestment and outsourcing of SOE activities. Air connectivity will be boosted by the recent purchase of two additional aircraft for Air Kiribati. Financial sector development is important, and the authorities look forward to further engagement with the Fund on this issue. Land registration is a long-running challenge for Kiribati and other Pacific island countries given the customary land system. Improved educational outcomes are a key plank of the Government's plan to foster private sector growth. The Government has committed to ensuring all I-Kiribati receive a high-quality education and the extension of the fee-free policy to senior secondary education is an important step forward, along with the new Early Childhood Care and Education Act.