



Republic
of Palau

August 2021

ECONOMIC BRIEF

PALAU FY 2021



Economic Performance

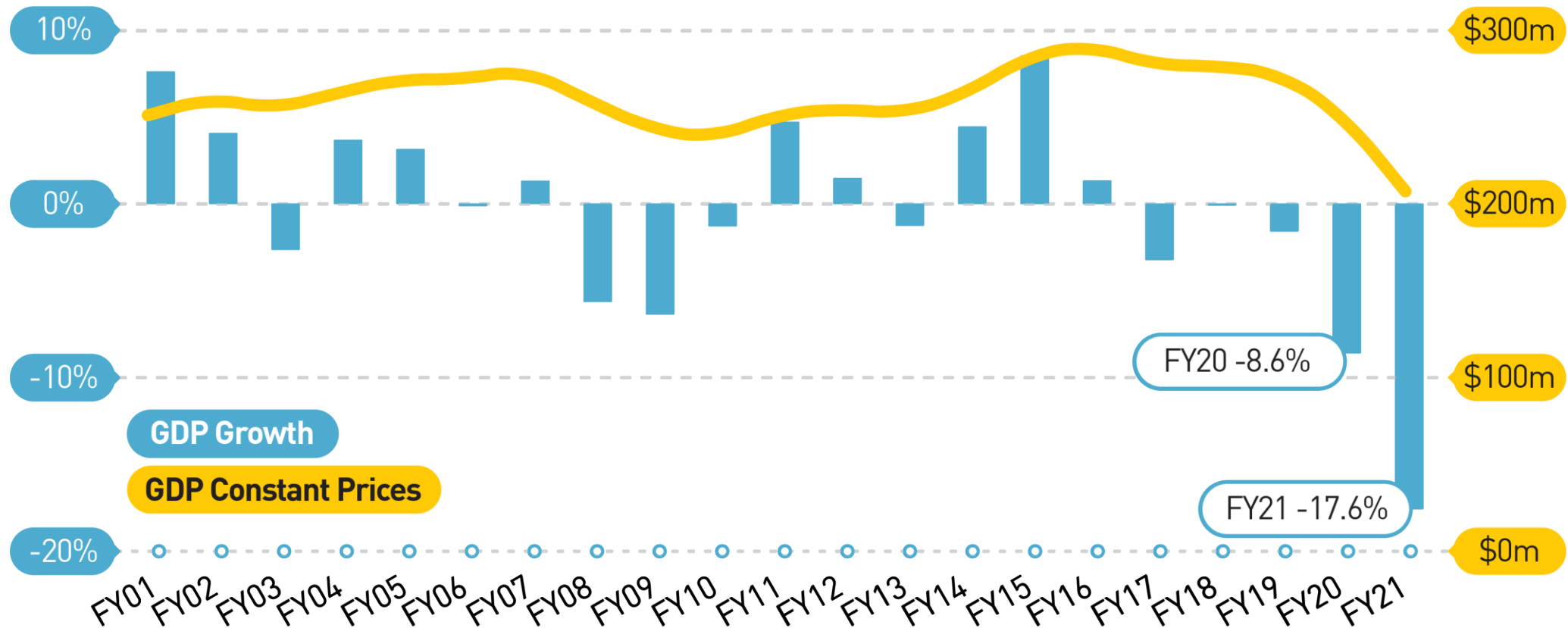
- *Palau's economic growth has been modest in aggregate and volatile on a year-by-year basis from FY2000 – FY2019*
 - Average growth over the period = 0.6% annually
 - Halfway between RMI (1.2%) and FSM (0.1%)
 - Main drivers of growth have been tourism and construction
- *During the COVID-19 pandemic period FY2000 – FY2021 (+?) the economy declined by 25%*
 - FY2020 decline of 8.6%
 - FY2021 decline of a further 17.6%



Real GDP Annual Growth



Palau Economy Fell by 8.6% in FY20, and a further 17.6% in FY21



Private Sector GDP Shock

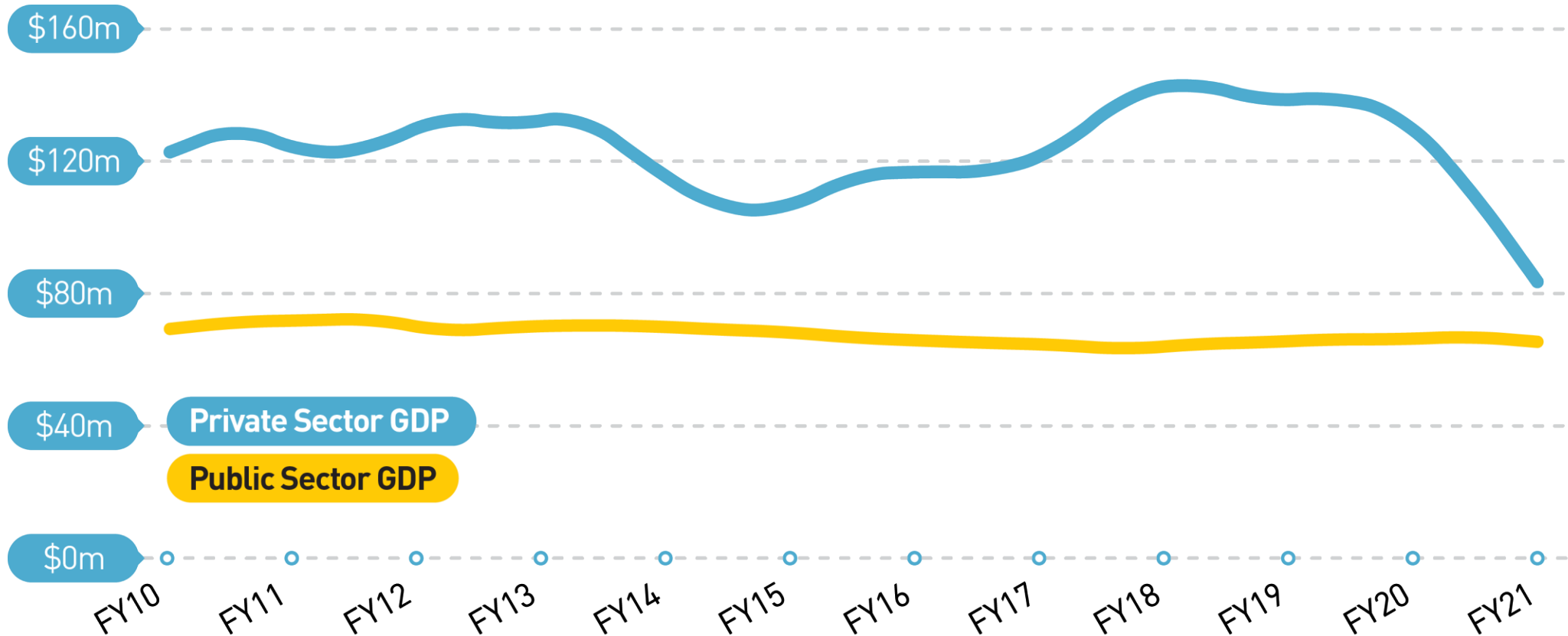
- The private sector has absorbed the largest share of the negative impact of COVID-19
 - Decline of 17% in FY2020
 - Decline of a further 26% in FY2021
 - Total decline of 38%
- Public Sector contribution to GDP steady even through COVID-19



Private and Public Sector GDP



Private sector performance has been volatile and bore the burnt of COVID



COVID-19 Pandemic Impact on Employment

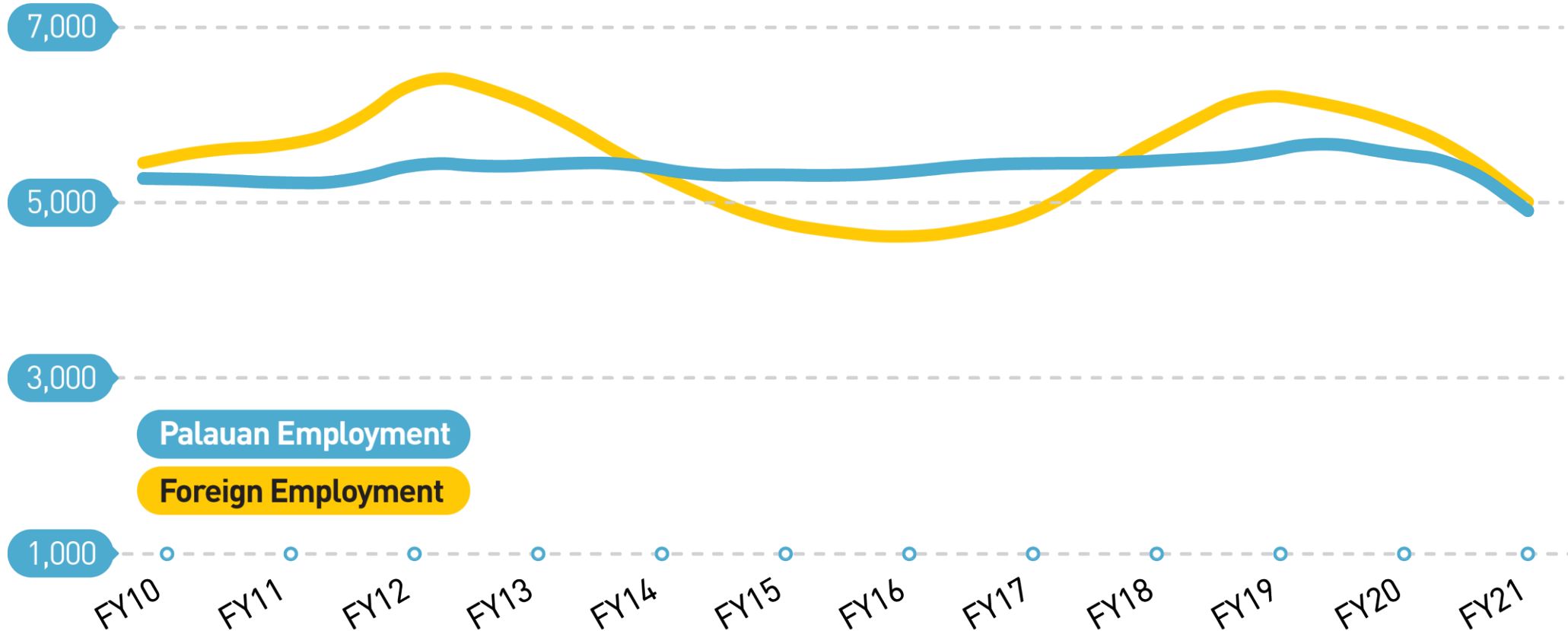
- Early projections of job loss exceeded 3,100
 - Decline of 27% of labor force
- Recent projections of job loss now under 1,500
 - Decline of 12.9%
- Actual Social Security and Gov't payroll indicate job loss of under 800
 - Decline of 7% -- needs further data analysis
- Bulk of the impact on foreign workers



Employment (Palauan and Foreign)



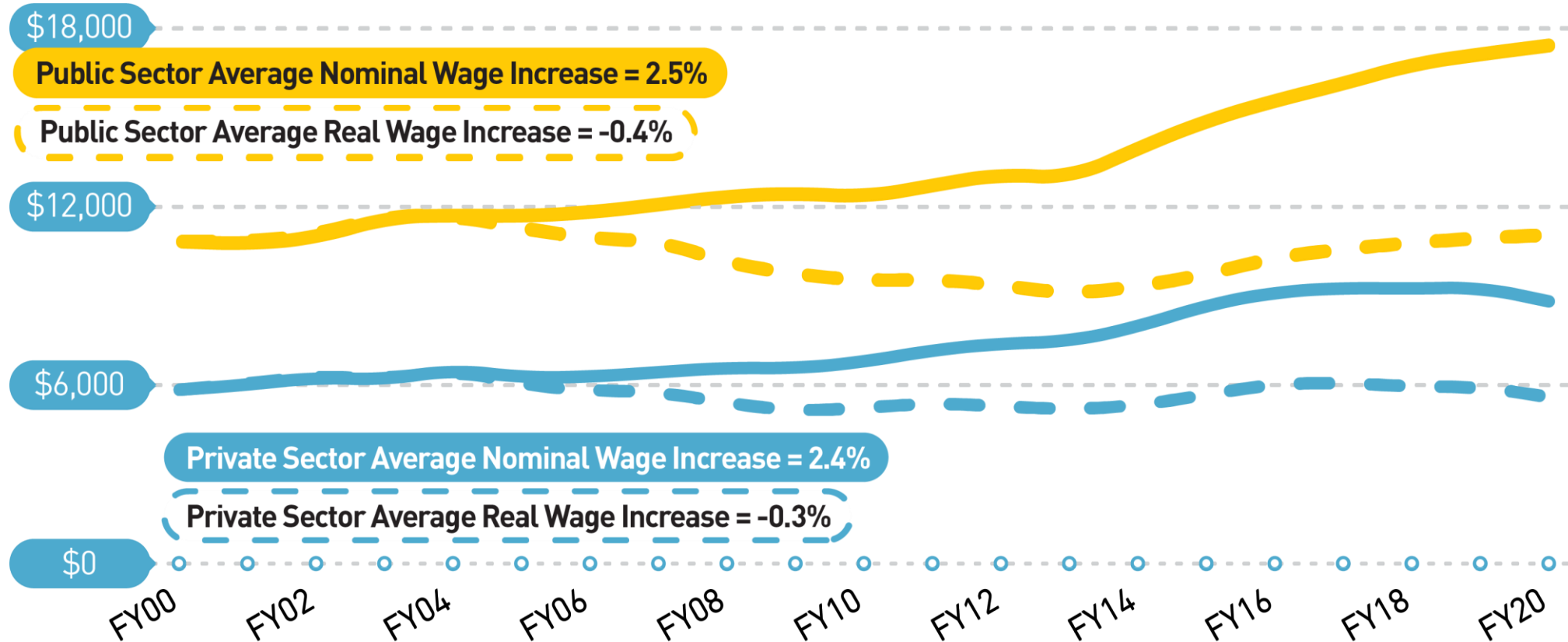
Palauan employment stable until FY20 with collapse in tourism sector.



Nominal and Real Wages



Real wages improve with tourism boom and low inflation.



Inflation (CPI)

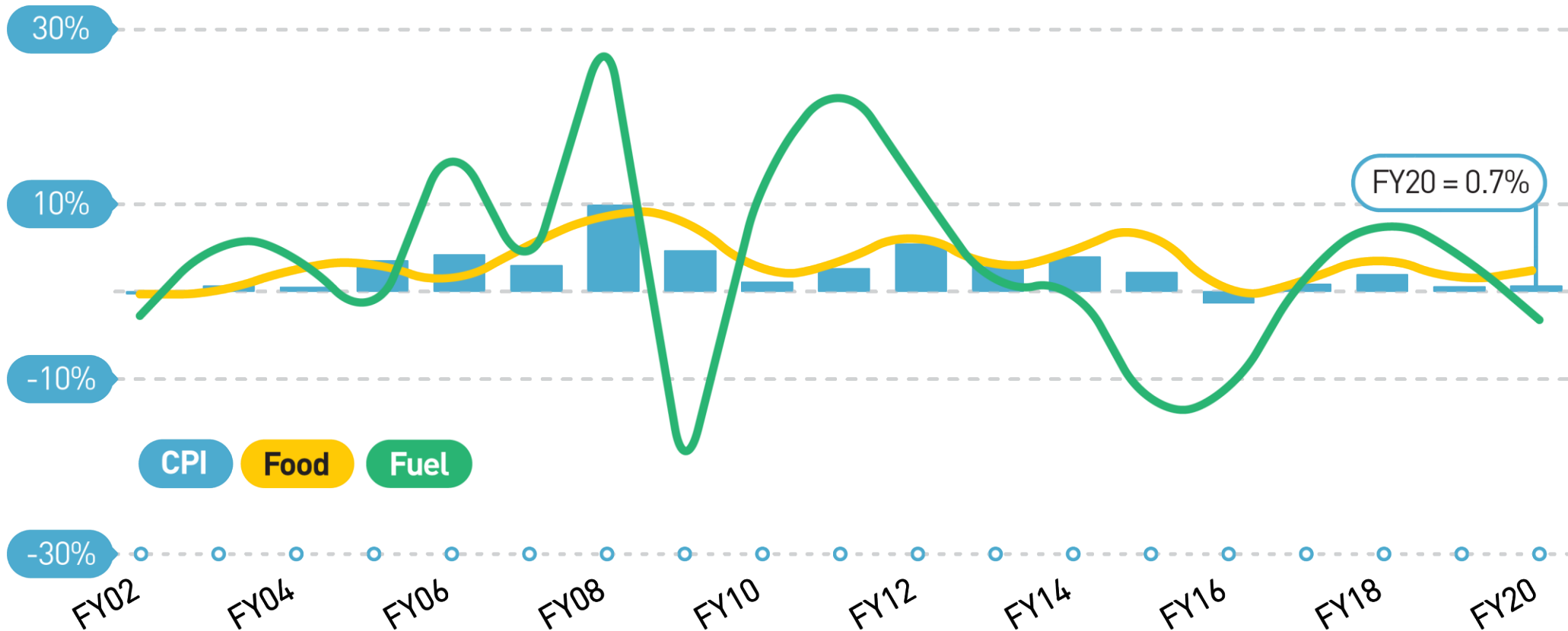
- *Inflation in Palau is strongly affected by food and fuel prices*
 - FY2000 – FY2020 CPI inflation averaged 2.9% annually
- *FY2021 looks set to show a spike in the Consumer Price Index; it is too early to tell if this will be:*
 - Persistent (true inflation), or
 - Transitory (a temporary price shock)



Consumer Price Index



Inflation remains modest, dropping to 0.7% in FY20 with low fuel prices.



Mitigation Programs Successful

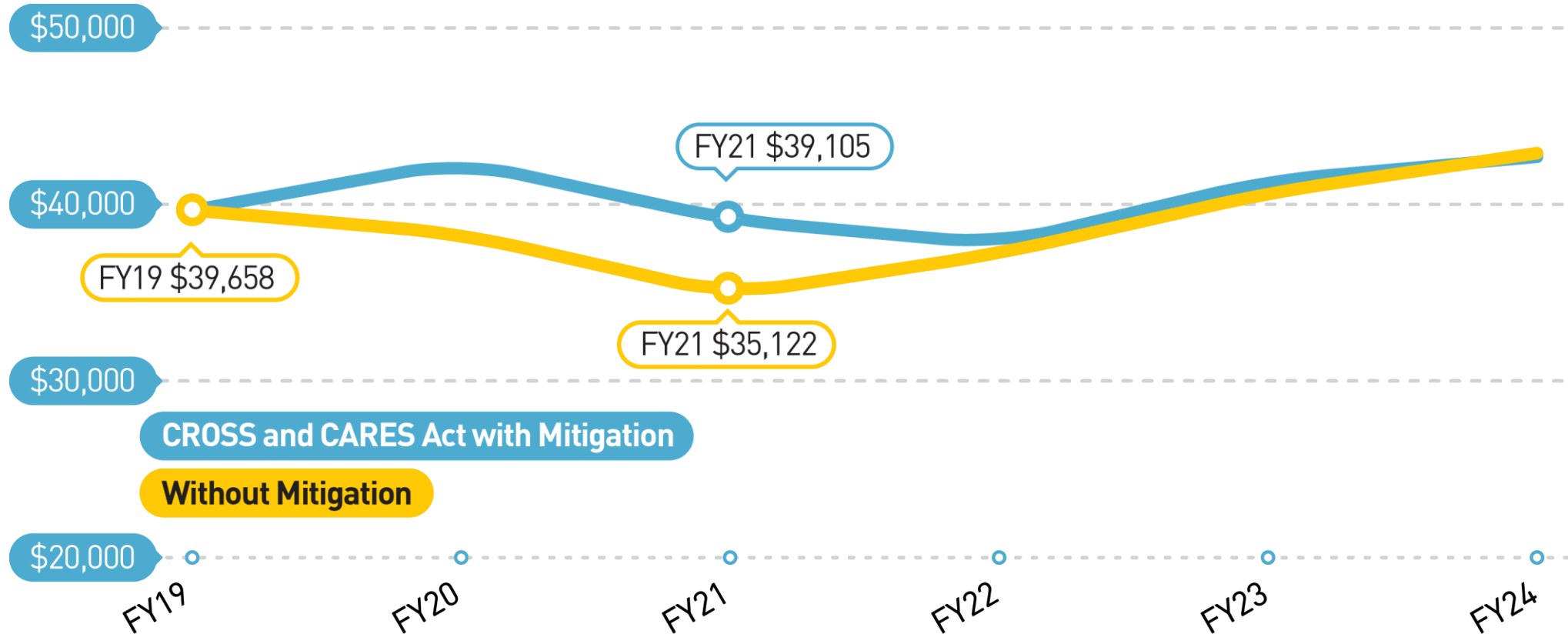
- ***Mitigation programs have had a large beneficial impact on household incomes***
 - Household incomes declined 6% from FY2019 – FY2021
 - Absent mitigation the decline would have been nearly double at 11%



Impact of Mitigation on Households



FY19-FY22 | Household incomes fall: -6% with mitigation; -11% without



Tourism Sector: Decline and Implications for Recovery

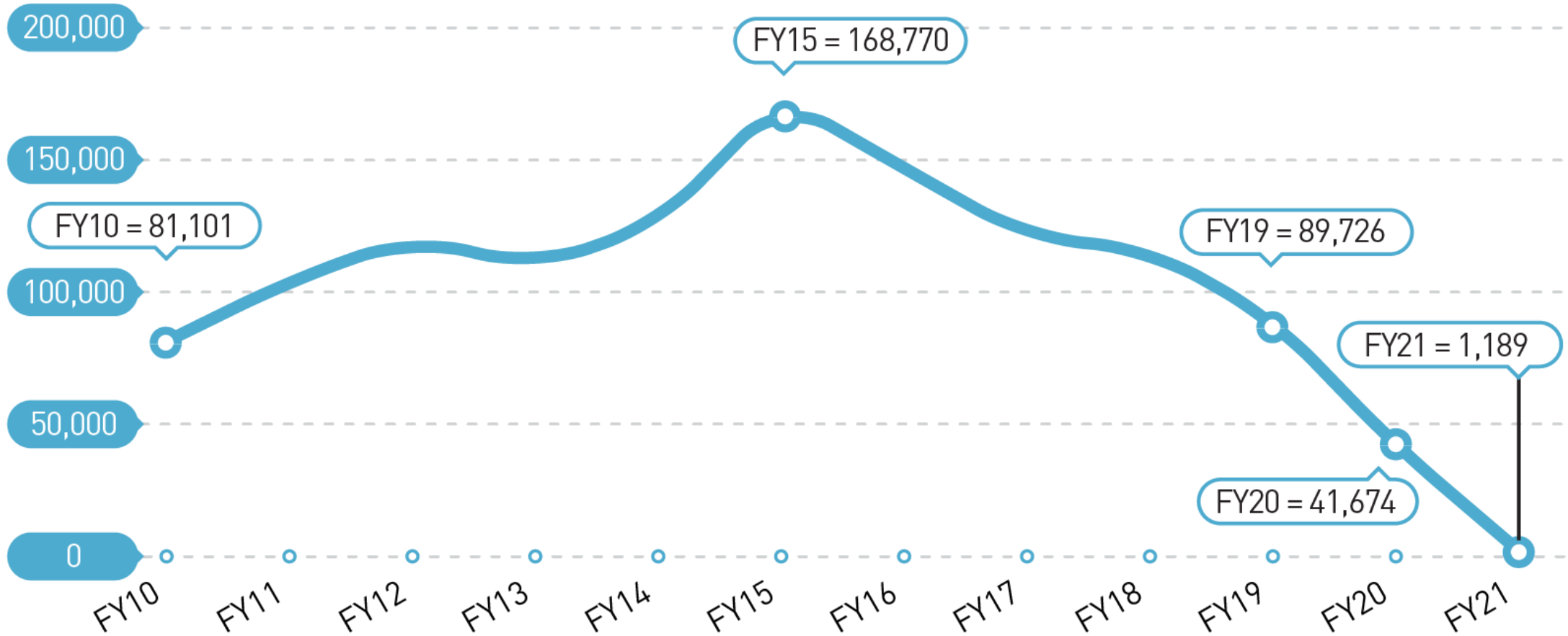
- Tourism sector has been an illustrative journey
- Preparing for tourism sector recovery... important implications for public policy if the “high-value” desired outcome is to be achieved
- A Tourism Master Plan or Tourism Strategy would be timely to implement the high-value concept



Visitor Arrivals



After peaking in FY15, arrivals decline to 0 in FY21 with impact of COVID.



Tax Reform: Fit for Purpose and Timing

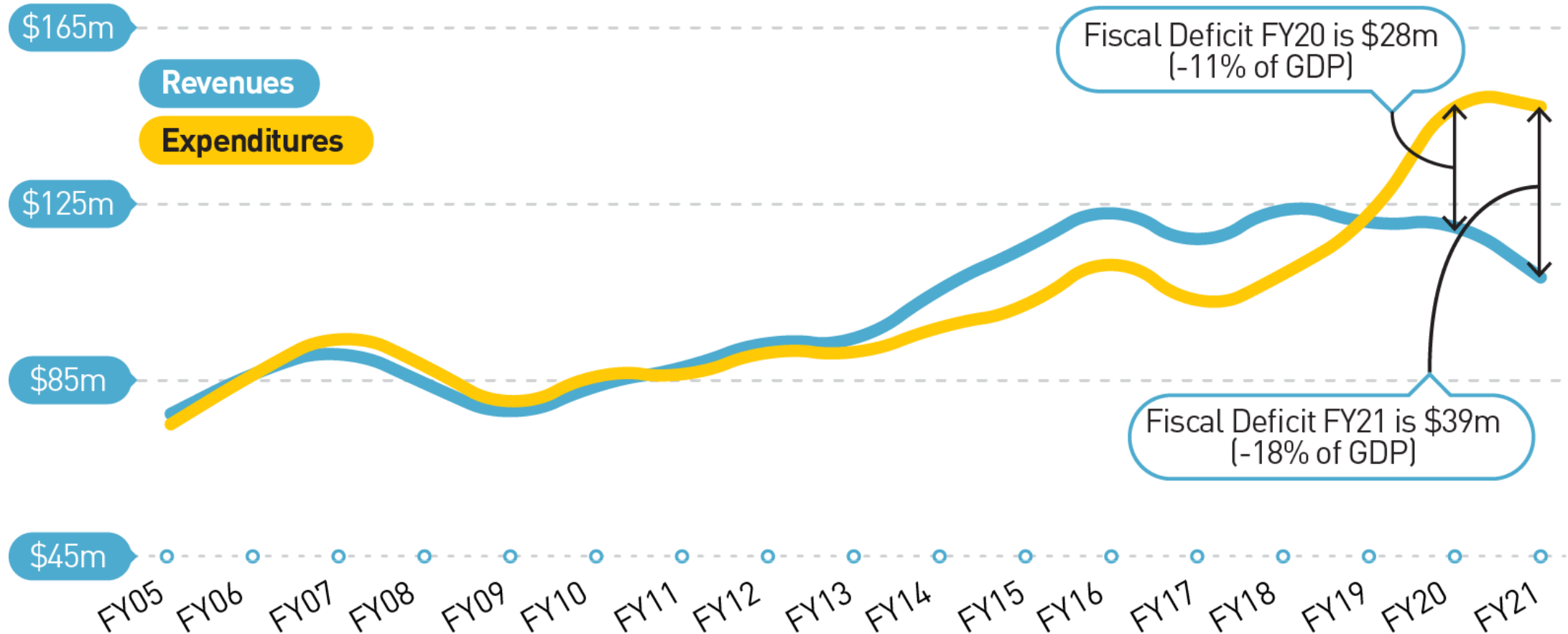
- Tax reform in Palau has been long overdue with its economy ideally suited to a goods and services tax or VAT.
- Preparing for tourism sector recovery... the tax reform under consideration will ensure tourists contribute more... allowing Palauans to pay less at any given level of tax effort
- Ideally, Palau will be the first in the North Pacific to replace an outdated and distortionary tax system... with an efficient and buoyant tax system with minimal distortions



Government Revenues and Expenses



Palau generated large fiscal surpluses, but ran large deficits with COVID.



Palau's Income Status

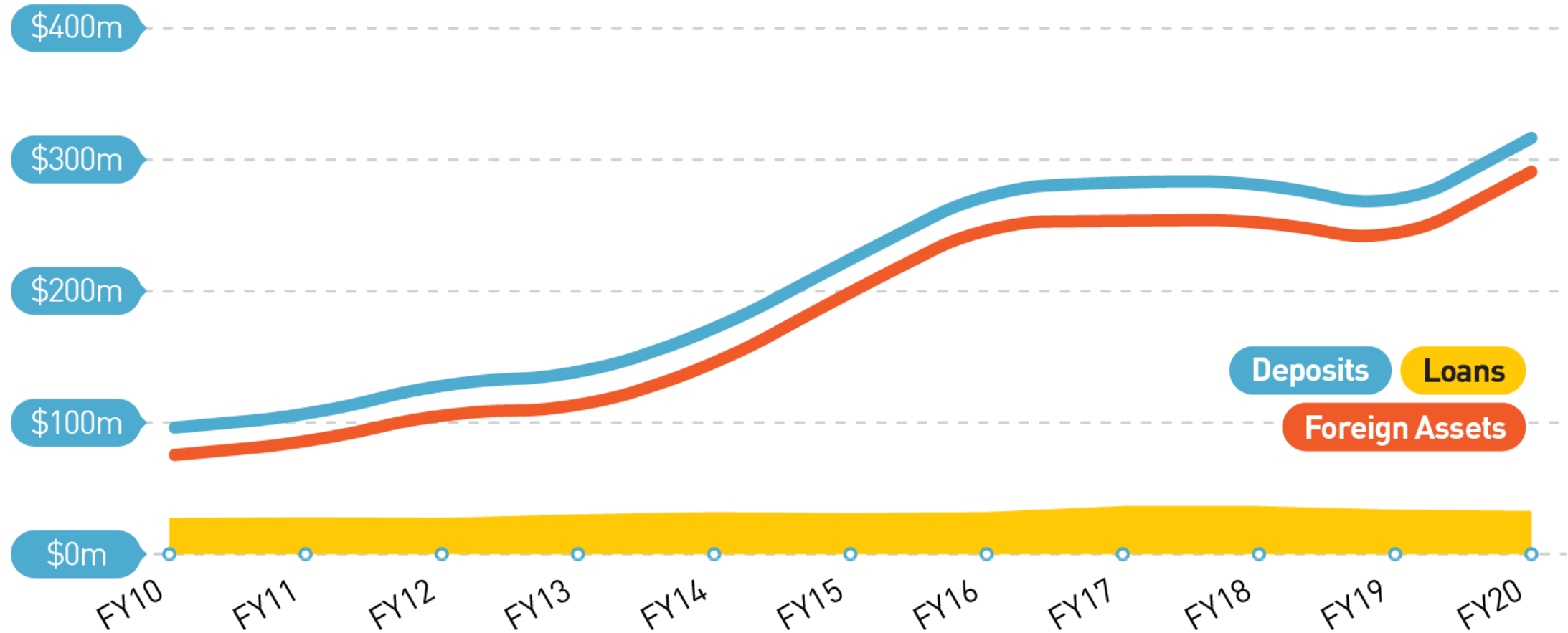
- *Palau's Gross National Income per capita is projected to decline from \$16,745 to \$13,265 in FY2021*
 - Decline from a peak in FY2019 by 20.8%
- *The World Bank's high-income group has a lower threshold of \$12,696*
 - Palau therefore remains categorized as “high-income” among developing countries
 - Implications for Palau's needs for public investment
 - Implications for the need—eventually—for domestic resource mobilization



Commercial Bank Deposits & Lending



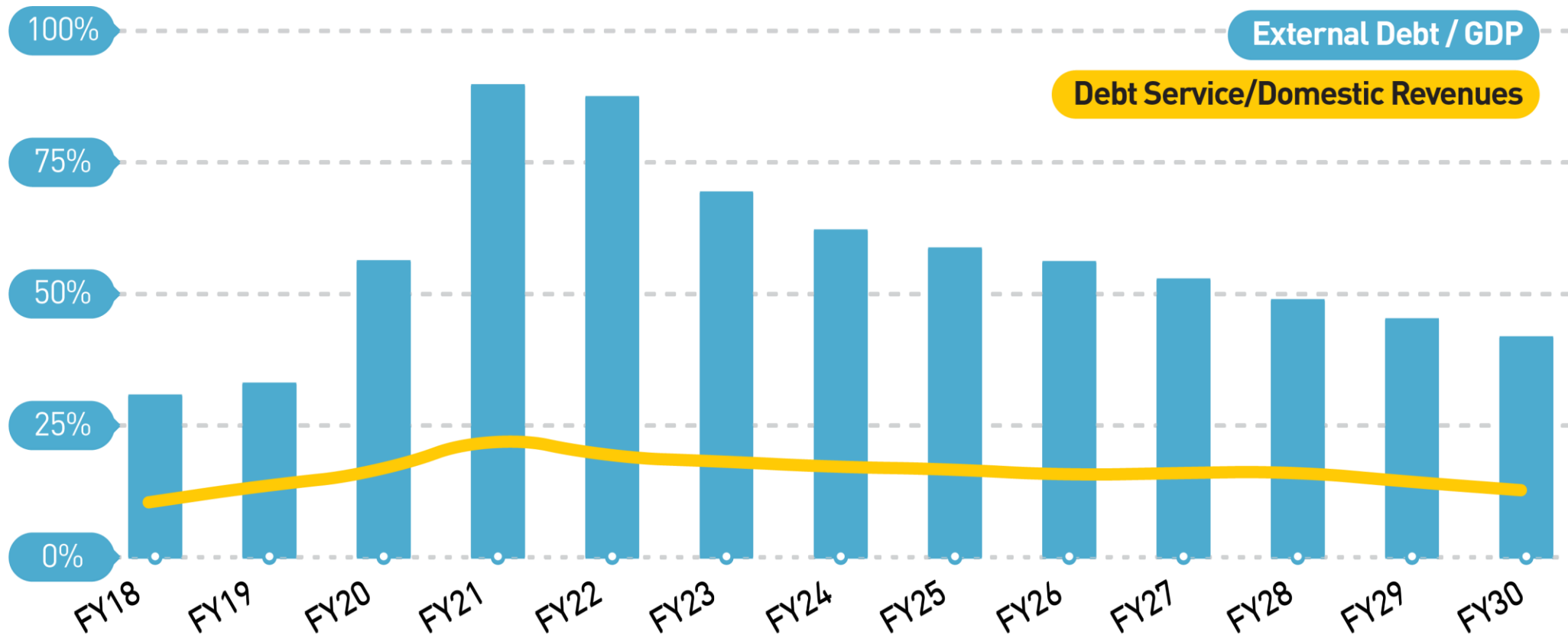
Commercial lending remains weak with funds invested offshore.



External Debt and Service (% GDP)



External debt rises to alarming heights due to COVID financing.



Fiscal Responsibility & Debt Management

- Manage operating expenditures over the medium-term within operating revenues and in relation to the rate of growth of the economy;
- Manage net capital and financial assets, to achieve rising real national net worth over time;
- Manage debt prudently;
- Manage the revenue regime to best fit the structure of the economy, to provide for an equitable allocation of tax burdens, and to allow for predictability over time;



Fiscal Responsibility & Debt Management, cont'd

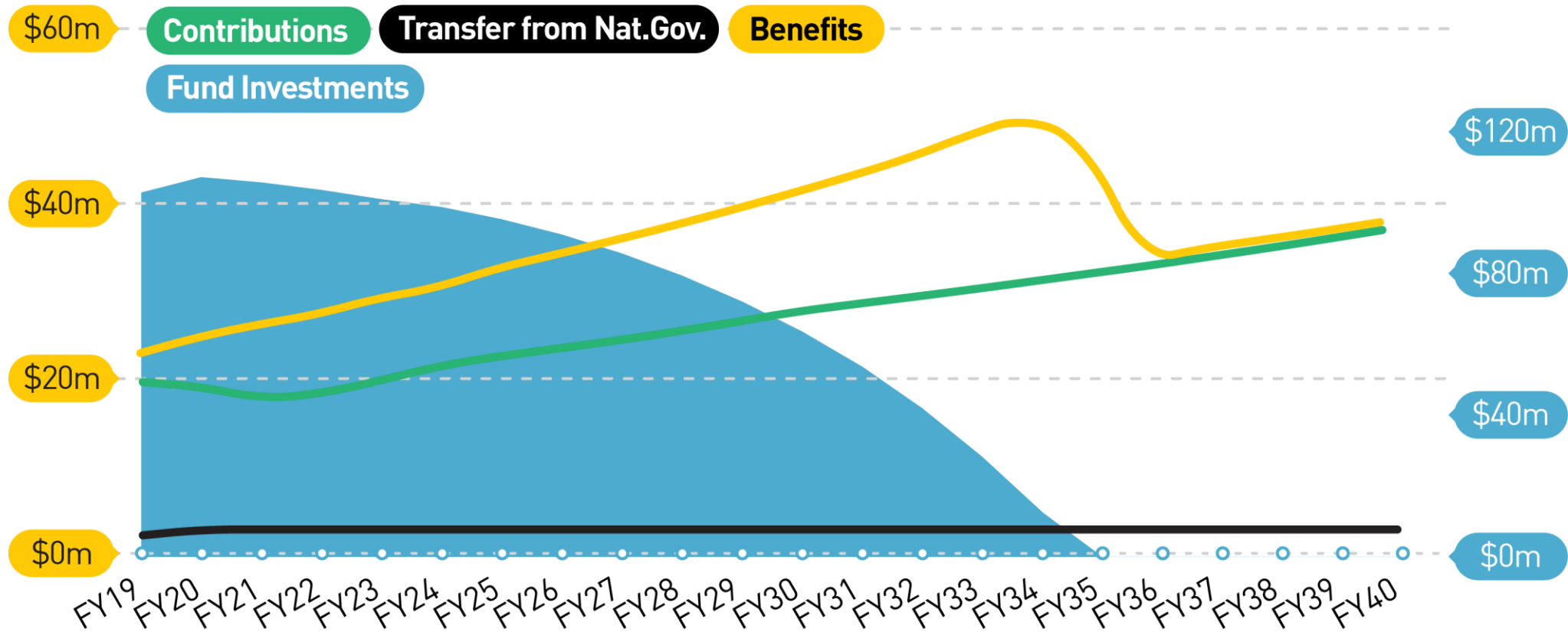
- Manage reserves and insurance coverage to offset cyclical volatility, the costs of natural disasters, and the impact of climate change;
- Manage the non-primary government public sector prudently including ensuring State Owned Enterprises and Public Financial Institutions are managed to deliver services on an effective and financially sustainable basis; and
- Manage fiscal risks and contingent liabilities prudently.



Social Security



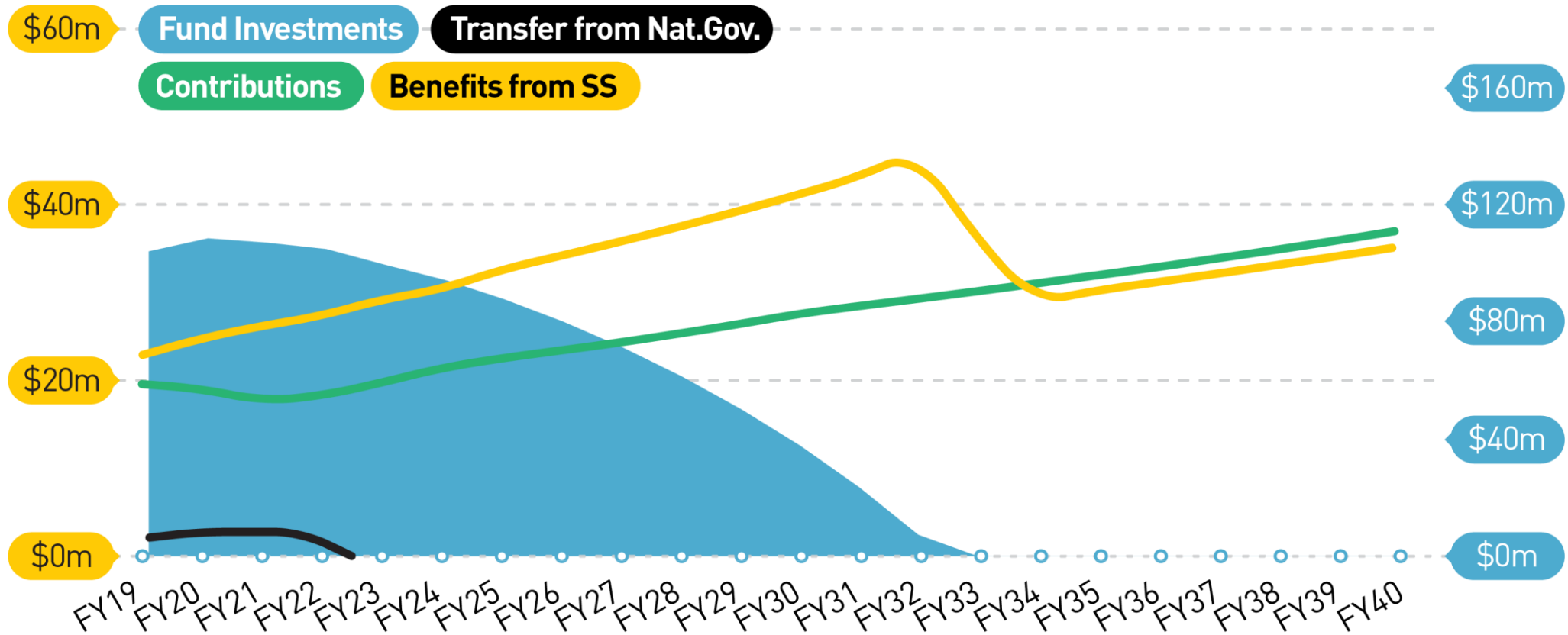
Social Security, including unfunded supplemental benefits, is now under threat of collapse.



Social Security



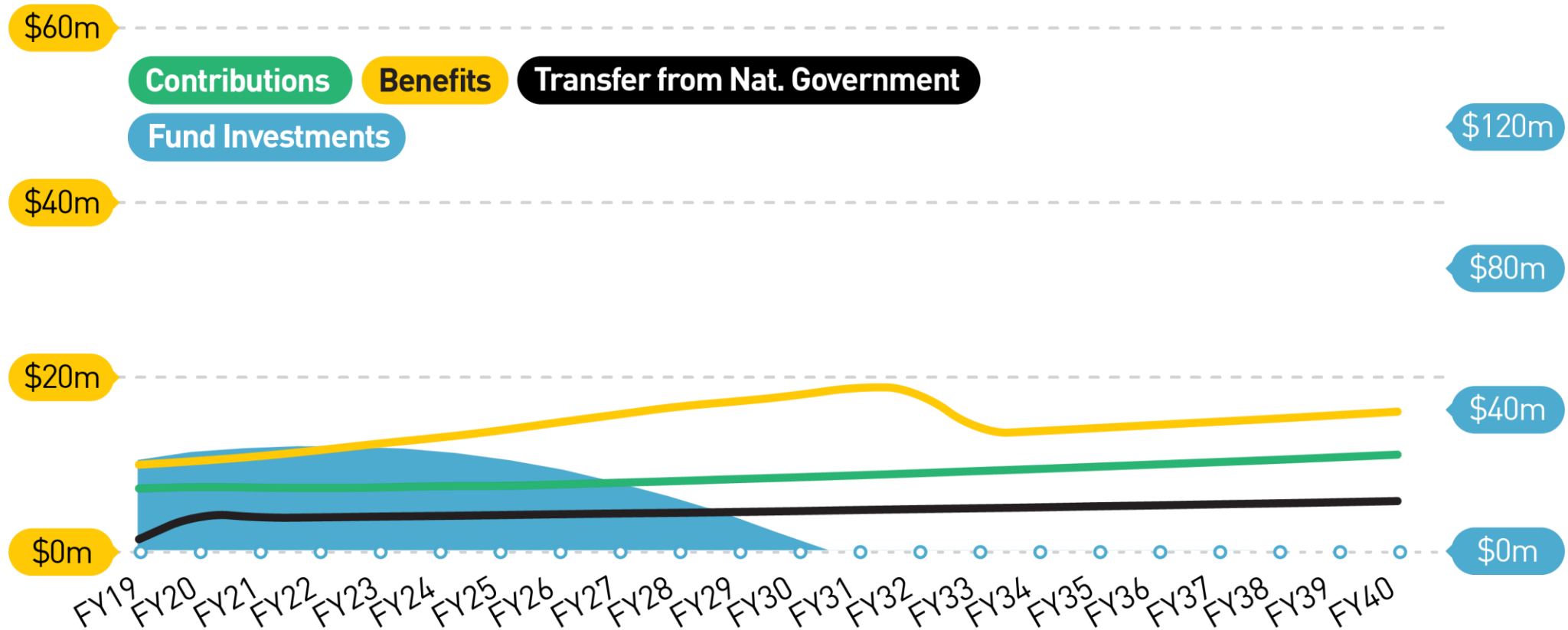
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Civil Service Pension Plan



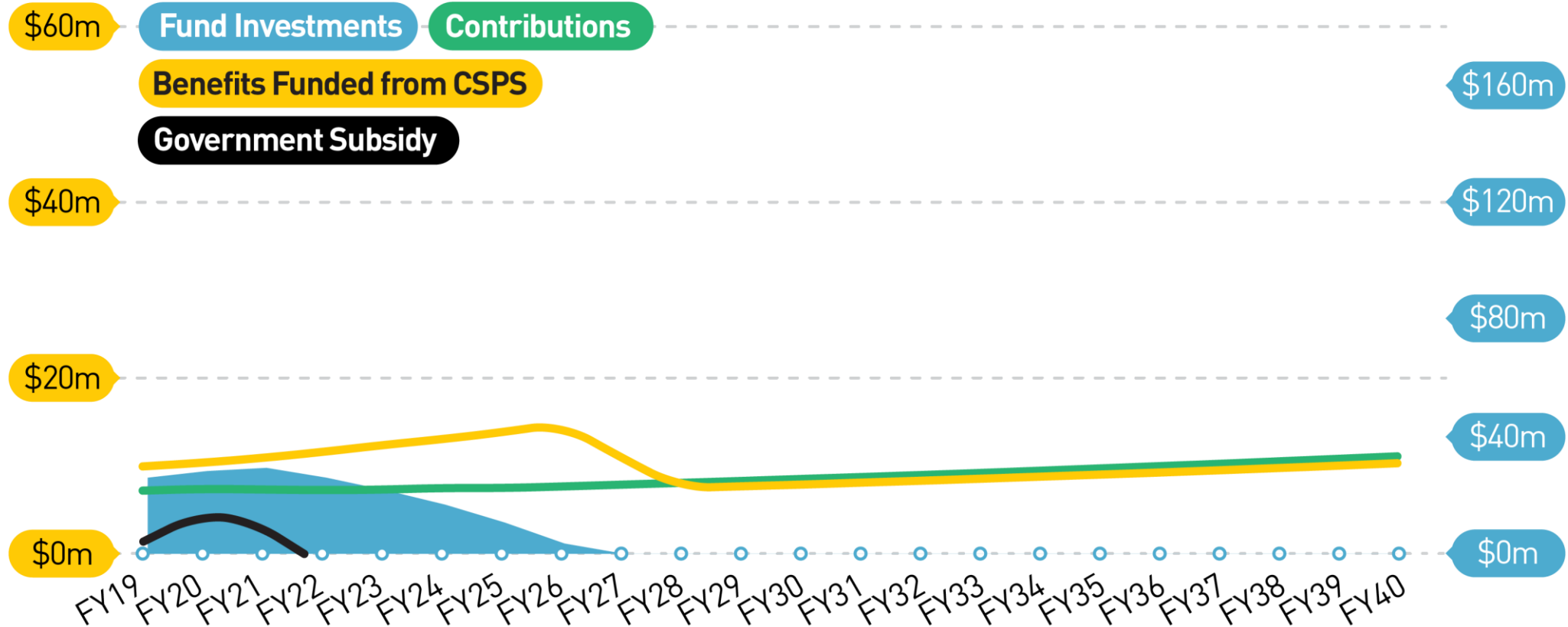
CSPP will collapse in the near term without reform.



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QUESTIONS?